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The Innovation Recipe: Surfing the Wave of Change

As history clearly demonstrates, consistent performance in the business world is a rarity—achieved by only a scant few enterprises. But the fact that even a few are able to deliver year after year begs the question, "What are they doing different?" Despite a multitude of research studies and long-winded hypotheses, the code remains to be cracked. In fact, several prominent business theorists recently suggested that performance is more luck than anything. From my perspective, such a fatalistic tone ignores those successful enterprises that consistently delight customers, seize market share, and deliver bottom-line results year after year. Someone wins the battle in every marketplace. The question is, How are they doing it? The holy grail in the business world is to discover that elusive recipe for performance.

Why is it so hard to identify the levers to pull and the buttons to push to systematize success? One theory is that the business world lacks a sufficient number of cycles to appropriately identify

an organizational model or approach that performs regardless of market and customer shifts. Change simply occurs too rapidly with too many variables—denying academics and the business community the time required to identify patterns and design models and techniques. And we know, there are only a handful of consistently successful enterprises to dissect and uncover what differentiates them from the rest of the pack.

To find the answer, perhaps our search needs to expand to investigate fields parallel to the business world with a greater track record of observations. The rationale behind identifying a comparative field is to study adaptive mechanisms—specifically those that enable organisms to thrive in threatening conditions. Fortunately, there is at least one such parallel—one that has been subjected to extensive research and analysis to arrive at conclusions that are both relevant and valuable to the business world—the natural evolution of species. The species populating our world, both today and in the past, and their tendency to flourish or to perish are analogous to market competition and the life cycle of enterprises.

Natural evolution is founded on theories developed in the mid-1800s by Charles Darwin and Alfred Wallace. Independently, but contemporaneously, they discovered that organisms evolve and adapt to changing environmental conditions through a process called *natural selection*. Depending on external stresses to a population, genetic variations allow a subset of the population to thrive under harsh environmental conditions. Other members of the population suffer or even perish under the same conditions. The surviving subset of the population eventually reproduces and passes the genetic advantages to their progeny. Over successive generations, those characteristics advantageous to the continuation of the species become increasingly prevalent in the greater population. In this way, species evolve and overcome detrimental conditions. The pace of natural evolution is modest and slow because it depends on generational adjustment.

The late Bruce Henderson, who founded the Boston Consulting Group and contributed much to the field of strategic planning, first identified this parallel between change in the business and the natural world. In his article, "Strategic and Natural Competition,"[1] Henderson states that understanding natural competition is a requisite to understanding strategic competition. Although he wrote of this linkage in 1980, when the field of strategic planning was relatively nascent, Henderson noted that evolution and strategic competition were nearly identical with one significant exception—time is compressed in competitive markets.

In contrast to the slow pace of natural evolution, strategic competition in the business world does not afford sufficient time to allow for the generational inheritance of advantageous characteristics. Competitive markets are in unending flux. Enterprise leaders are forced to respond to changing consumer preferences, aggressive competitors, and a host of other forces including societal, governmental, regulatory, and technological and scientific advances or else face the prospect of losing customers to more strategically attuned competitors.

To survive and prosper in the pressure cooker that is a competitive market, an enterprise must essentially replicate the evolutionary activities of a living organism—but at a much faster pace. For example, imagine that a new technology with far-reaching implications is released in the marketplace. The astute competitor mobilizes its resources to evaluate the implications and determines the appropriate course of action. Inside this company, a customer research team studies the technology's impacts from the customer's perspective and determines what the customer likes and dislikes. Elsewhere inside the company, a strategic planning team uses this research to plot potential market opportunities and predict how the competition might respond. The results of these assessments are passed to a leadership team that debates the merits of each opportunity and eventually selects a plan of action. The plan is implemented—and assuming

that it was well designed and that the foundational assumptions behind the solution prove to be true, the enterprise's chances of success are vastly increased. The path undertaken by the company in this example is what I call the *innovation cycle*.

But innovation is never as simple as this example suggests. If leaders were able to focus their attention exclusively on innovation, they would be far more proficient at identifying market shifts and responding appropriately. But this is rarely the case. During an innovation cycle, customers continue to buy products, and all the work to deliver those products must continue. Similar to that ringing phone in the background, there are always distractions and competing priorities that demand attention. But even if the background noise were eliminated, innovation by itself is a complicated and challenging endeavor—with many moving parts. It is easy to back burner innovation planning as it is eclipsed by the cacophony of business chatter and demands for immediacy that come with running a business. This is exactly why having an approach to innovation is a necessity. And to ensure that innovation is not limited to a singular instance, the innovation cycle needs to be stitched into the very fabric of the enterprise and become an inseparable part of business as usual—exactly as it does in a living organism. In any enterprise, continual innovation depends on the institutionalization of adaptive capabilities and the existence of an organizational and management structure that supports reinvention. Such an approach needs to be methodical and scientific and pervade every corner of the enterprise. It must live in the leadership, culture, processes, organizational structure, and indeed the very DNA of an enterprise.

The Four Facets of Innovative Enterprises

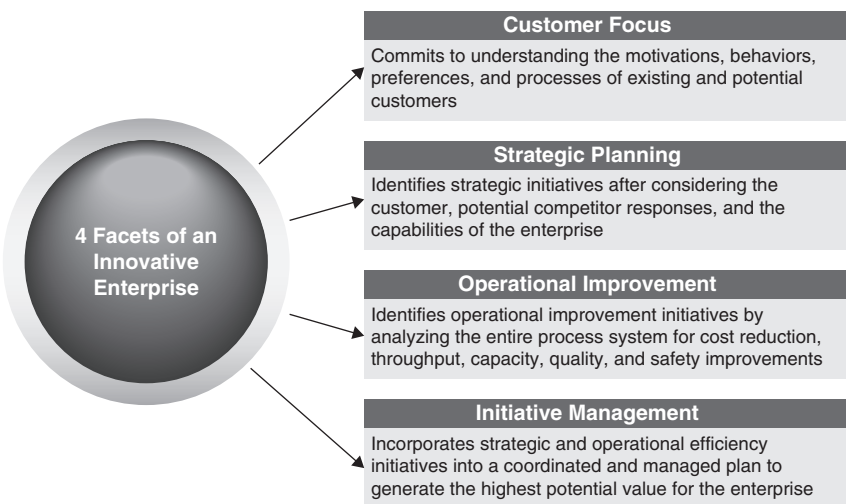
Enterprises with a demonstrated ability to harness their resources and innovate their processes, people, and structures invariably

embrace several key practices—practices that when performed collectively propel innovation. I call these practices the *four facets of an innovative enterprise* (Figure 2.1). The four facets are *customer focus*, *strategic planning*, *operational improvement*, and *initiative management*.

A note of caution, the mere existence of the four facets in an enterprise does not guarantee long-term or even short-term success. Prosperity depends on a multiplicity of factors—many outside the enterprise's sphere of control and others of sufficient complexity to thwart any accurate prediction of their impact. However, the facets are integral components of an innovative enterprise that must be understood and in existence at some level in order for leaders to appropriately respond to external change and internal challenges.

Here is how the facets connect together in the innovation cycle. Understanding what is important to the consumer (customer-focus facet) is the first part of the innovation cycle. Every enterprise intends

FIGURE 2.1 Four facets of an innovative enterprise.



to create offerings that appeal to the consumer both today and, ideally, for some time in the future. Through customer analysis and with consideration of competitors' potential reactions, the leadership team identifies strategic initiatives (strategic-planning facet) to competitively position the enterprise's offerings in the marketplace. On an ongoing basis, the enterprise adjusts its productive capabilities (operational-improvement facet) to support the enterprise's strategic goals. Depending on the existing systems, facilities, equipment, and processes, this may include increasing the quality of products/services, cutting customer response time, reducing operational costs, or increasing the enterprise's flexibility to respond to new opportunities. Whereas strategic planning is externally focused based on internal capabilities, operational improvement is focused internally with the goal of improving these same capabilities. The final facet (initiative management) is the collection, prioritization, and execution of both strategic and operational improvement initiatives. Simply knowing what needs to be done is only a part of the battle. An innovative enterprise aims to complete initiatives as quickly and efficiently as possible in order to seize the advantage before the competition knows what hit them. This is accomplished by prioritizing the full slate of initiatives based upon the value they are forecasted to deliver to the enterprise while accounting for dependencies and resource constraints. When this script is followed, the value delivered to the enterprise is maximized. Initiative management is not an annual event, like many strategic planning exercises today, but an ongoing activity that assimilates new information into the innovation cycle as it comes to light.

Taken collectively, the four facets are the innovation cycle for an enterprise. Each of the facets is much more than a simple checkbox on a planning template. To harness their potential requires a significantly deeper understanding of each of the facets and the critical activities comprising each.

Facet 1: Customer Focus

Customers are the reason for the existence of any business. As they collectively chose what products and services to buy, customers determine the winners and losers in a competitive market. This alone makes customer focus arguably the most important facet in the innovation cycle. Despite its importance, it is simply dumbfounding how few companies are attuned to their customers and invest the time and resources to understand how their customers shop, purchase, use, service, dispose of, and replace their offerings. Any enterprise that consistently ignores its customers will eventually lose their loyalty and their dollars to products more closely aligned with the customers' preferences. If deficiencies are not addressed in a timely fashion, the enterprise's continued existence may even be at risk. Unfortunately, the customer's voice is often relegated to background noise as more "pressing" matters steal leadership's attention.

In the business world, there is one definitive certainty. Customers will change over time—and not just one aspect of customers but every aspect. How they use the product, how they want it delivered, and their expectations of the product—they all change with the passage of time. This customer flux offers a major opportunity for the agile enterprise that sets the customer as its navigational beacon, but proves to be deadly to the lethargic competitor. To claim a share of the customer's wallet and remain relevant, an enterprise must reinvigorate its product and service offerings to match new customer preferences. The real challenge is to know what to change. Here is where many enterprises drop off the radar.

Across corporate America, management teams are more than happy to pay big dollars to consultants and research firms to gain insights into their customers. Why anyone would pay big bucks for information that is usually readily available and can be obtained

largely free of charge is beyond my comprehension. What every enterprise really needs to be innovative is not reams of data and analytics but rather the *voice of the customer*. In other words, an enterprise needs to understand the customer's perspective on value—what is valuable or meaningful to them. From my experience, capturing the voice of the customer can be accomplished via a three-step process.

1. Capture and consolidate information on the customer from a variety of sources.
2. Analyze the data and build the enterprise's voice of the customer for every product/service family serviced by the enterprise.
3. Disseminate and make the voice of the customer available to the greater organization.

Although the steps seem relatively straightforward, they are commonly skipped, ignored, misunderstood, or not acted on. Without solid customer information on which to predicate business decisions, leadership teams shoot blindly in the dark.

Capturing Customer Information

Getting back to the availability of customer information, where does an enterprise go to obtain good, factual customer information? The short answer is that no single source suffices. In fact, the optimal method is to use a blanket approach—using varied sources as well as techniques for collection. Aggregating the information pulled from a variety of sources minimizes most biases and results in the most accurate picture of consumers' buying patterns and preferences. Diversity and the depth of the sources are directly correlated with the information's accuracy and potential to be actionable. From my experience, most companies already subscribe to information services or possess vast amounts of customer information internally. The real work is in locating, consolidating, and analyzing that

information. Although there are many worthwhile sources of customer data, I find the following sources to be particularly valuable:

- Internal customer analytics
- Feedback loops and direct observation
- External customer research
- Trend analysis

Internal Customer Analytics

Perhaps the most commonly available source of customer information is internal customer analytics. *Analytics* is the capture and segmentation of data to learn more about the behaviors of customer subsets. This technique uses traceable data (including cash register receipts, loyalty clubs, and credit cards) to track the buying patterns of consumers. By doing so, the enterprise can analyze consumer purchases both at a singular point of time (i.e., a basket of goods) and for a set duration (e.g., annual purchases). Typical data gathered from this approach includes

- *Frequency of customer purchases or visits*. How often customers buy the product/service or visit a shopping location, such as a retail location or website.
- *Customer shopping basket*. What customers buy during individual shopping trips.
- *Product/service affinity*. The propensity of customers to buy certain products or services at the same time—for example, complementary or substitute goods.
- *Customer profile*. Identification of demographics and other characteristics to group customers with similar purchasing behaviors.

And this is only the tip of the iceberg. With expanding technology capabilities including the ability to track customers through

loyalty programs and credit/debit-card purchases, customer data is easier than ever to obtain. In fact, the ease of gathering information creates a new challenge—consolidating and mining the information to pick out meaningful and actionable insights.

Feedback Loops

Although internal customer analytics provide useful insights into the past buying habits of customers, it is always beneficial to use additional techniques to corroborate knowledge gained from the cash register and enrich it with more predictive information. Arguably one of the best sources (although unfortunately one of the least used) is the capture of consumer information via feedback loops. No other technique provides such crisp qualitative information than reaching out directly to frontline associates and business partners and gathering their insights. As Sam Walton, founder of Walmart, once said, "The folks on the front lines—the ones who actually talk to the customer—are the only ones who actually know what's going on out there." Employees who interact with customers on a daily basis understand customer needs and desires at a greater level and with greater clarity than insights harvested by any research group. And the best part is that aside from the time to survey these employees, this information is absolutely free.

That said, there is a minor complication with this approach. Frontline employees may not be as easy to identify as in years past. In modern enterprises, quite a few positions may regularly interact with customers. For example, consider the historic role of research and development (R&D), where employees worked primarily with internal partners, such as the sales department, to develop new-product concepts. Today's R&D laboratory is radically different. Laboratory workers routinely partner with external customers and in some instances even collaborate with them (e.g., business to business) to build or redesign products. This complicates capturing

feedback but in no way diminishes the number and quality of sources. To identify customer touch points, conduct a top to bottom review of the enterprise. Ask managers if their teams interact with customers on a routine basis, and if so, ask which individuals specifically. The identified names are the initial set of frontline associates to mine for feedback. However, time and collective mechanism limitations usually whittle down the list to the roles with the strongest customer connections. With these roles identified, put a communication mechanism in place to harvest feedback and customer insights from these employees on a regular basis. The options are nearly limitless, but the collection mechanism not only should be convenient to the employee but it should also support the free flow of information to a consolidation point. Mechanisms to capture feedback include surveys, information entry points on standard processes (e.g., entering competitive bids or the reason why a deal was lost), e-mail addresses to submit feedback, websites, periodic informational interviews, and focus groups. When gathered in a timely and methodical fashion, information collected from the front line is arguably the richest and most detailed customer information available. Whereas internal customer analytic provides raw data on purchasing behavior, feedback loops provide insight into the actual customer behind those numbers.

External Customer Research

External research is a good source of data to refute or confirm information gathered via internal mechanisms. The tools for capturing market and customer data include customer surveys, consumer research studies, market or industry research, focus groups, vendor/supplier studies, and a host of others. A significant reason to use external research when assessing customers is to counterbalance internally collected data with data from outside the walls (and the influence) of the enterprise. Whereas customer analytics and

feedback loops focus on current customers, external research often spans both current and prospective customers, and this includes customers currently buying from the competition. External research can be bought for a specific topic or trend—and in many instances is available free from industry or government sources.

One caveat for external research: it is always appropriate to question the applicability and validity of the data. Resist collecting information simply because it is conveniently available. Gather information that is accurate and applicable to the marketplace. Remember that in most cases the information was not collected, cleansed, and interpreted solely for your enterprise. It is generalized and often simplified information.

Trend Analysis

A final source of customer information is trend analysis. While not calibrated directly to a current or prospective customer, this information focuses on larger trends that influence overall customer preferences and buying behaviors. Trend analysis casts a wide net and considers not only the trends that potentially affect the immediate market (micro trends) but also larger, more universal (macro) trends. Macro trends include the impact of change from various angles, including technological, societal, environmental, political, regulatory, demographic, attitudinal, and behavioral. Although such a wide swath may not generate opportunities that are immediately actionable, it only makes sense to plan customer solutions with consideration of the macro and micro trends.

Analyzing Customer Information and Predicting the Future Customer Profile

Although many enterprises collect information about their customers, the benefit they glean from that information is only partially realized because they fail to complete the critical step of making

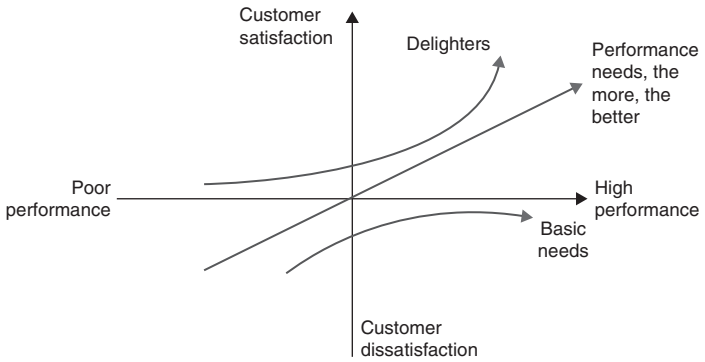
the information actionable. What they are missing is the activity to aggregate the information and pass it to strategy and planning teams. Without this step, the information is just a bunch of data hidden away in the corporate data warehouse, sitting around on computer drives, or left on paper reports scattered about the office.

The aim of customer analysis is to open a window into the mind of the consumer. However, before a vivid view of the customer can be created, the information needs to be consolidated into a single repository and sliced and diced to derive meaningful insights. For example, rarely does an enterprise offer only one product. Therefore, one of the first actions is to segment the data by product family or other market differentiator. Here a bit of common sense must be infused into the process. Product/services families are a distinct offering sold to a group of customers. In many instances, there are synergies between product/service families. In fact, identifying synergistic products and bundling them as an offering is a strategic option. In a similar manner, the information may be sliced to identify the products/services sold to specific types of customers, such as distributors. Initially, segment the data consistent with the enterprise's go-to-market approach. After that, a good analyst will search for other meaningful segmentations. If the segmentation does not prove meaningful and actionable, discard it and keep going.

After segmentation, the data is ready for further analysis. Kano analysis is one of my favorite tools for mapping customer preferences. This model (Figure 2.2) summarizes the customer's preferences by identifying attributes of a product/service offering and the market's perception of that attribute.

The product/service attributes are charted based on customer satisfaction (or dissatisfaction) and whether the attribute performs well or not. In the Kano model, the categories include delighters, performance needs, basic needs, and dissatisfiers.

FIGURE 2.2 Kano analysis.



- *Delighters*. Delighters are attributes that are unexpected but appreciated by customers. They provide the "Wow!" factor that motivates customers to tell their friends about their experience. Delighters are not always immediately apparent to customers—often they surface during continued use of the product/service.
- *Performance needs*. Performance attributes are characteristics of the product/service that are the prime determinant of whether the product provides value. In general, more is better because the product exceeds what was anticipated or communicated during the shopping and purchasing processes.
- *Basic needs*. These are the attributes of the output that are expected by the customer. When basic needs are not a part of the output, customers will shop elsewhere. If they are included but do not perform, customers become dissatisfied and will, at a minimum, shop more broadly in the future.
- *Dissatisfiers*. These are attributes of the output that are unwanted by consumers. If they are known before purchase, customers will likely pass up the purchase.

An equally important aspect of this analysis is the *latent attribute*. Latent attributes are unknown by the customer. They are similar to delighters in that their discovery may drive satisfaction, but they differ in that they meet a need or want that the customer was not aware of during the purchasing process. The end goal of Kano analysis is to understand what the enterprise needs to deliver to increase sales and customer satisfaction. In Kano terms, this is accomplished by meeting the basic needs of the customer, performing to the customer's expectations, eliminating dissatisfiers, and delivering a healthy dose of delighters.

Kano analysis is far from the only method to aggregate customer requirements. An increasingly popular approach is to use personas to model customer behavior. *Personas* or *virtual customers* are profiles built to represent the differing perspectives and characteristics of a specific customer segment. By modeling a set of customers via a persona, an enterprise can predict how different groups of customers might react to product enhancements and marketing programs.

Once the customer information is aggregated, segmented, and digested, many leaders want more predictive insight—especially with regard to the direction and momentum of customer change. What will the customer want in the future? Obviously, awareness of the trends affecting consumers and the overall market improves the quality of the prediction. However, at the end of the day, the best answers are derived from intuitive guesses based on available information. Making the customer data widely available fosters additional debate and discussions and helps to forge a collective mind-set on the evolving customer and what might be critical to satisfying future customers.

Distributing the Customer Profile

The output of the customer information-gathering process is a multidimensional view of the customer—a view that can be widely distributed to support more intelligent strategic and operational planning.

Although this information aids good decision making, leaders should remember that the customer is always evolving and that every idea requires a level of testing prior to release. Research only guides the discussion—it does not provide the answer. Even if perfect information were available, the charted strategic course is only a best guess. It almost always takes a number of iterations to accurately pinpoint a promising market position. The process that takes informational inputs and develops this plan of action is the *strategic planning process*—the next facet of an innovative enterprise.

Facet 2: Strategic Planning

Strategy and *strategic planning* are two of the more overused and least understood terms in today's business vernacular. The word *strategy* pervades business conversations and has come to refer to any planning activity. Today you hear managers talk about having an information technology (IT) strategy, a strategy for completing a project, and even a strategy for improving the efficiency of a process. Unfortunately, the term's overuse has led to a widespread misunderstanding of critical activities for plotting an enterprise's future. For the sake of clarity, strategy and strategic planning are externally focused and refer to activities that competitively position a company in a marketplace. The intent of a strategy is to grow market share and ideally to do so in profitable markets. Strategy encompasses game theory—where a company positions its offerings to gain advantage against competing offerings. It predicts how a competitor will react and therefore allows a company to understand the true financial potential of strategies. In a market without competitors, strategic planning is unnecessary. In the for-profit world such a situation only exists in the most managed and regulated markets. Once a company decides on its strategic intentions, the collection of activities to position the company in alignment

with these intentions is a *business plan*. The litmus test to determine if an action is strategic is to ask, "Is this activity directly aimed at increasing market share?"

Today, strategic planning is perceived as high profile—an esoteric practice in which only the elite and most influential leaders are given a seat at the table. And here begins the trouble with contemporary strategic exercises. The reality is that large personalities dominate the process—often promoting goals to enlarge their sphere of influence. Not uncommonly, employees with valuable insights or ground-level knowledge are excluded from participating in the strategy-formulation process. And in the absence of strategic expertise, strategies are conveniently copied from the competition. After all, it is easier to mimic the actions of others than to generate new, risky ideas. Although imitation may be the sincerest form of flattery, it is a horrible way to innovate. Unfortunately, this is the path many leaders chose to follow.

In the most recent decade, business theorists and thought leaders pushed metric-based goals to the forefront of strategic planning. From a managerial perspective, the prevailing opinion on metrics is that what gets tracked gets done. Although there is some credence to this theory, metrics are limited in their capability to link strategic intent with ground-level execution. However, once the metric drug took hold, enterprises began tracking all sorts of stuff and generating reams of reports. It soon followed that leaders expected that the numbers could be analyzed and used to predict the optimal course of action for an enterprise to follow. Such an approach conveniently ignores the often-quoted statement on glossy investment dossiers: "Past results are not indicative of future results." Because of the dearth of strategic planning know-how in the leadership ranks of corporate America, analytics are receiving a tremendous amount of attention from executives today. Rather than making a decision on the strategic direction of the enterprise, executives want the numbers to make the decision for them. But it does not work that way.

Analytics, in my opinion, are misapplied when leaders look for forecasts to guide their actions. The future cannot be predicted—even using the most comprehensive knowledge available and the latest technology. Were it possible, business and investment analysts of all stripes and sizes would immediately lose their jobs because their opinions would be supplanted by predictive facts. However, although analytics cannot provide *the* answer, they are useful as the background on which to predicate strategic exploration.

Strategic planning—indeed, any future planning—requires intuitive decision making. Intuition is not the use of divining rods. It starts with a healthy collection of unbiased information on the existing market environment, understanding the momentum of the forces at play, and then generating solid intuitive hunches on the most promising opportunities. It is this "sense" that drives entrepreneurs to take a second mortgage and to start a new company. It is generating this intuition—a hypothesis based on an abundance of information culminating in a gut feeling—that is the aim of the strategist.

This leads us to one of the greatest struggles with strategic planning—assessing its effectiveness. The lag between strategic actions and market results makes correlating the action with the result essentially guesswork. Although a strategy might be spot on, the benefits may not manifest for years. In a period when investors clamor for results, leaders do not have the luxury of waiting. And further complicating the analysis of strategies is the question of whether a specific strategy failed because it was misdirected or because of poor execution. But these difficulties should not dissuade leaders from advocating for a robust strategic planning function. Strategic planning vastly increases the odds that an enterprise responds correctly to shifting market conditions and is an infinitely more effective approach than letting the chips fall where they may.

But what makes a strategic planning process good? What are the key activities in a good strategic planning process? To start, let us

review a list of activities included in a best-in-class strategic planning process. Rarely today does an enterprise have the knowledge, structure, or processes to execute all the activities I have listed. From my experience, customer analysis, competitor analysis, and game theory are the steps most frequently neglected or skipped.

Activities in a World-Class Strategic Planning Function

- Identification of market and customer segments in which the enterprise competes
- Detailed view of customer wants and needs
- Identification of competitors and their market positions
- Analytical and intuitive identification of potential market offerings (i.e., product, fit, positioning, etc.)
- Understanding of the enterprise's capabilities relative to the strategic alternatives
- Development of initial strategic hypotheses
- Use of game theory to predict the market reaction to strategic options
- Selection of optimal results based on competitive market models
- Development of objectives to accomplish the desired strategic result
- Creation of strategic initiatives to accomplish those objectives

To be effective, these steps need to be more than just formalized checkboxes. Building a good strategic plan requires diligence in gathering solid, unbiased information and processing that information to identify opportunities. Thus any good strategic planning cycle begins with an all-out effort to collect a solid book of information on both customers and competitors for a specific product/service market.

In addition to customer information, strategic planning requires details on competitors in each product/service market. This includes information from historical and current perspectives on how competitors position their products/services. In other words, what is the value proposition that the competition communicates to customers? Fortunately, much of this information is readily available.

Using the information gathered about customers, the strategists identify opportunities to expand the sales of existing products/services or to develop new products/services. That is, they find places in the market where they can exploit their relative advantages to steal market share. In a world of imperfect information, strategy and market positioning come down to intuition—a hypothesis as to what customers value and how the company can uniquely provide it. With the identification of a strategic hypothesis, game theory then comes into play. A strategic planning team studies the competition to predict the reaction to the company's strategic hypothesis and the possible financial outcomes of the strategy's implementation. The aim is to identify strategies to maximize sales and profitability while preserving the overall profitability in the market.

Preserving the profitability of a market is an important yet often overlooked aspect of strategic planning. When companies ignore the competition's reactions, they make themselves and their market vulnerable to a major upheaval. For example, a company that opts to pursue a cost-reduction strategy by dramatically reducing its retail prices may well gain market share initially. However, if the competition chooses to respond by also cutting prices, the overall profitability of the industry declines. Commodity products are particularly susceptible to price wars. After a protracted price war, raising prices and the return of the industry to a more natural level of profitability may be extremely difficult, if not impossible. Astute leaders avoid price wars and other destructive strategies because of their potential negative ramifications.

To understand a market, I find it helpful to graphically depict the customer/provider information into a user-friendly format. One useful tool to depict markets is a *market map*. A market map (Figure 2.3) is a two-dimensional diagram that identifies the customers on the vertical axis and the suppliers on the horizontal axis. Where a specific customer intersects with a specific supplier, the dollar amount of the sales for the product/service is noted. To see patterns, it helps to represent the sales graphically through the use of shading (denoting the size of the relationship) or via icons (with each individual icon equating to a set amount of sales). Along the borders opposite the customer and supplier listings, the specific attributes of the supplier or customer are listed. At a glance, the market map quickly identifies rough market share and the product/service attributes desired by

FIGURE 2.3 Market map.

		Suppliers				
		Strategy Firm	**Supply Chain Consulting Firm**	**Specialized Consulting Firm**	**General Consulting Firm**	**Customer Summary**
Customers (Buyers)	**Project Resources**					• Projects support corporate initiatives • Few Buyers
	Staff Augmentation					• Staff Augmentation roles to support IT PMO • Other staff aug roles Eliminated
	Supply Chain					• Network Integration started with two assessments
	Strategy					• Internal resources believed to be experts • Lingering bad taste from Strategy Firm Failure
	Provider Summary	Revenue = $1050K IT PMO, Shrink Initiative, Lean Assessment, Cost Reduction Initiative	Revenue = $250K Supply Chain Assessment	Revenue = $500K Distribution Network Assessment	Revenue = $200K Category organizational Assessment	 = $50K

the different customer segments. A market map may be segmented by other dimensions (e.g., geographic, temporal, or specific customer segment) for a deeper investigation of opportunities. Building the most useful market map may take several iterations. The aim is to define customers by what they buy, how they use the product, and what they value in a product.

Similar to customer profiles, building a current-state market map is only the first step to building a market map to predict a market's future. This is true strategic planning at its most fundamental level. Based on a projected future market view, strategists can identify potential product enhancements or where they can promote their existing offerings to new customer segments. A single market map rarely provides all the information critical to identifying strategic options. Large conglomerates with product portfolios spanning multiple industries require multiple maps. Strategists and market analysts often create multiple versions to examine variants of a single market. Again, a market map is not the end state of customer understanding but rather a tool to identify where to attack in a market—and what positions to defend.

Through the analysis of market maps, customer data and other market information, strategic opportunities surface. And when it comes to building strategies, no strategists need fret over a lack of advice. Bookstores sell literally troves of books offering guidance on how to build game-changing strategies. Before even getting to strategies, though, one precedent question helps to eliminate a lot of wasted effort. For each product/service family, ask if this is a market worthy of participation. If the profit is low or the risk is high, perhaps there are other more promising targets. When there is potential in a market, then proceed with the selection of a strategic course of action. From my experience, there are only four main strategies—although variants of each exist.

- *Strategy 1: Low-cost provider.* The intent is to sell the product/service at the lowest possible price to consumers.

This strategy is extremely common, is often successful, and is relatively low risk for a market leader in an established market. The enterprise with the highest market share possesses an advantage when choosing this strategy because of the benefits associated with climbing the learning curve faster and gaining economies of scale.

- *Strategy 2: Innovator*. The enterprise choosing this strategy commits to continually offering products and services with new benefits and features of interest to consumers. This strategy is extremely risky but comes with a tremendous upside. A first mover enjoys the benefit of creating customer preferences and forcing the competition to react. The key for this strategy to be beneficial is to base the innovations on the unique advantages of the enterprise. That is, make them hard to copy. Otherwise, low-cost providers may swoop in and nab market share before the innovator has recouped its investment.
- *Strategy 3: Value player.* Enterprises following this strategy seek to provide the greatest value per dollar spent by consumers. While not a low-cost provider, such enterprises provide product/service attributes exceeding those of the low-cost provider and at a price commensurate with this additional value. Differentiators frequently include an expanded suite of offerings, reputation, durability, flexibility, quality, efficacy, and others.
- *Strategy 4: Customized product/service provider.* The last strategy focuses on providing individualized products/services for consumers. This strategy is differentiated by the development of a product or service specifically tailored to specific customers. Luxury goods fall into this strategy, as do highly customizable offerings such as high-end automobiles or yachts. As advancements in manufacturing and customer communications progress, the cost of and obstacles to

customize for a larger audience are falling—making it possible for manufacturers to offer individualized products such as shoes at Nike.com.

Strategy is more than identifying market opportunities. The product or experience actually has to be delivered and accepted by the all-powerful customer. Before a strategy is rolled out, there always should be a confirmation that it aligns with the enterprise's capabilities. This includes a study of the value chain and its adaptability to manufacture the desired products/services or whether the capabilities need to be built from scratch. Equally important is whether the strategy is credible to target customers. Will they embrace it as a logical extension of the company's offerings, or is it tantamount to Burger King opening a gourmet restaurant? Smaller companies often skip this step because the ramifications of a promotional misstep are minor. They lack the brand image to damage. However, as larger enterprises extend their reach into new market segments, they often try to be all things to consumers. Such a strategic move may backfire with customers who have grown accustomed to the company's offerings and brand message—destroying any goodwill previously earned and pushing consumers to consider alternatives. Strategy is as much about deciding what a company will not do as it is determining what a company will do.

Once a strategic objective is selected and its feasibility is confirmed, the strategy is broken down into pieces called *initiatives*. Strategic initiatives are the culmination of the strategic planning process—taking high-level opportunities and separating them into manageable chunks of work. For every identified strategic objective, there will be one or more strategic initiatives. For example, a company may key on a strategic objective to expand its existing product offerings. A strategic initiative to support this objective may be to launch a new product line for a newly identified customer base.

Another initiative may be to adjust an existing product in response to changing consumer preferences. These initiatives focus on different customer segments and products and therefore require two distinct efforts, but both initiatives support the same strategic objective of expanding the company's offerings.

As a simplification, strategic initiatives provide the "What?" and the "How?" of competitive positioning. But even with a perfect strategy, market success is in doubt if the enterprise is unable to deliver. Strategic execution relies on the existence of internal capabilities to produce the desired output. This brings us to the third facet of an innovative enterprise—*operational improvement*.

Facet 3: Operational Improvement

If the intent of strategic planning is to drive to a specific destination in a car, the goal of operational improvement is to keep the engine and other systems operating efficiently so that the destination is attainable. In a nutshell, operational improvement encompass the development and ongoing enrichment of an enterprise's operational capabilities. Its scope includes internal functions, processes, and resources that sum together to make it possible for a company to design, develop, manufacture, sell, and deliver its offerings. When viewed from a strategic lens, operational improvement provides maneuverability, adaptability, and flexibility—delivering the ability for an enterprise to chase sales opportunities and to do so efficiently. Measures of operational improvement include profitability, scalability, and adaptability.

- *Profitability* measures the efficiency of operations to produce customer-desired outputs. In the accounting world, it is measured by subtracting total costs from total

sales. Operational improvement focuses on the cost side of this equation—delivering units of output at the lowest possible cost.

- *Scalability* is the ability to adjust production to support volume increases or decreases efficiently. Throughput is a measure of the amount of output produced in a given period of time.
- *Adaptability* is the ability to transition production to new products/services or geographic markets. Adaptability is a measure of strategic maneuverability of an enterprise's structures and processes.

Unfortunately, operational improvement is undoubtedly the most neglected of the four facets. The old adage "If it ain't broke, don't fix it" is alive and well. In most enterprises, significant functions fall outside the domain of strategic initiatives and lack the "sexiness" to receive the attention they deserve. This is a colossal mistake. Supporting, managerial, and administrative (SGA) functions are frequently victims of such neglect. When considering that the cost of these functions may be the lion's share of overall corporate costs in some industries, SGA areas are some of the most fertile grounds for reaping big returns on improvement endeavors. An added benefit is that the savings recouped from efficiency projects flow directly to the bottom line. And from my past experiences, I know that operational initiatives often pack as much punch as strategic initiatives in moving the financial needle. During periods of market stagnation, the redirection of improvement efforts to operational areas may be particularly effective when there is little room for strategic maneuvering. I know of several companies that rely almost exclusively on efficiency programs to fund their investments in strategic endeavors.

Given the functional silos that exist in many enterprises, department-based efforts to elevate productivity are unfortunately the norm.

The results of these efforts are all too often counterproductive—improving a section of the value chain at the expense of the overall system. To a large extent, the Reengineering movement was the culmination of a near-universal failure of enterprises to execute major improvement efforts across organizational divisions. Until the mid-1990s, business managers attended to deficiencies in their areas without consideration of the greater operational impact. In contrast, the Reengineering movement aimed to create game-changing advantages by tossing out the old way of doing business and rebuilding the value-creation engine from the ground up. In this way, a company could leapfrog competitors who plodded along using outdated improvement approaches.

Although the primary focus of operational-improvement initiatives traditionally has been to improve efficiency, a complementary and equally important aim is the expansion of strategic capabilities. Especially in hypercompetitive markets, flexibility and adaptability are critical to success. Under most market conditions, price cutting supported by internal cost reduction is the safest strategy to undertake (and therefore also the most popular). Cost reduction improves a product's profitability and may extend its life cycle. Lower prices are always appealing, but the benefit may be short term if competitors retaliate by also lowering their prices. In contrast, changing a product's attributes comes with the risk that customers may not embrace the new design. The counter to a cost-reduction strategy occurs when new innovations make the (less costly) product obsolete.

In contrast to strategic initiatives, operational-improvement initiatives are generated in a different manner. Whereas strategies are birthed through the strategic planning process, operational-improvement initiatives capture attention in multiple ways, including the evaluation of quantitative or qualitative metrics, an investigation of cost pools inside the enterprise, the uncovering

of "limiting" enterprise capabilities (e.g., systems, processes, or resource constraints that impede the enterprise from moving forward with other initiatives), and grassroots identification by employees.

With increasing frequency, enterprises dedicate teams to identify and capture operational-improvement opportunities. This may be done via a special-forces approach, where a designated team takes the mantle of a pseudo–efficiency squad and is set loose on the enterprise to find what it may. A close cousin to this approach is to conduct a health check on the enterprise through an enterprise-wide investigation to identify opportunities and bundle them into initiatives. Another more recent approach is to use a team of Lean coaches schooled in specialized efficiency tools to coach functional leaders and managers on opportunity identification. This option, while often slower, institutionalizes the capability to improve performance—and fosters a grassroots effort to exploit opportunities. When an enterprise reaches the point where managers are perpetually improving their respective areas, the advantages compound over time.

Regardless of the method of identification, the desired end state is a list of ideas to reduce cost, increase safety, expand capacity, or improve quality. From these ideas, initiatives are created to bundle the ideas into actionable pieces of work, exactly as done with strategic initiatives. These initiatives commonly take one of the following forms:

- *Process improvement.* Using tools such as Six Sigma (to improve the quality of a process), Lean (to remove waste from a process), and Reengineering (to transform the enterprise's processes and drive breakthrough results).
- *Technology enablement.* Automating processes or using information to improve how processes run (e.g., enterprise resource planning systems).

- *Organizational design.* Focusing on how people are organized to perform work, how the performers are trained for their role, and motivating them.
- *Structural improvement.* Investigating and improving the systems that are in place to support the enterprise production equation (e.g., the production system, compensation system, cultural behaviors, and leadership styles).

As stated previously, the overwhelming majority of companies in corporate America largely ignore operational improvement except when they inhibit the execution of corporate initiatives or during market downturns when costs are scrutinized. In contrast, innovative enterprises aggressively seek opportunities to improve processes, functions, and structures.

The strategic and operational facets are the ying and yang of innovation. Both are necessary for an enterprise to prosper year after year. Depending on economic or market conditions, though, one of the facets may take precedence because it promises greater rewards. It is not uncommon for the operational focus to take a back seat during a period of rapid market change as an enterprise fights for market share and operations are sufficient to the task. Correspondingly, a strategic focus may be less necessary during periods of market stagnation when operational improvements offer the greatest potential for increasing profitability. But periods of dominance for either facet are short-lived, and prosperity over an extended period of time requires that enterprises pay attention to both.

When strategic and operational initiatives are viewed collectively, the consolidated list is an *innovation portfolio*—the sum total of efforts to improve the strategic position and financial results of the enterprise. The management and execution of these initiatives are what drive continual innovation—and doing so efficiently and effectively is the goal of *initiative management*—the final facet of an innovative enterprise.

Facet 4: Initiative Management

Three of the four facets focus on the path to identifying strategic and operational opportunities. In contrast, *initiative management* is the preparation, evaluation, staging, and execution of the initiatives to actualize those opportunities. The result of initiative-management activity is an innovation game plan—a list of initiatives prioritized in the order they will receive resources and be executed. Taking it to a deeper level, initiative management includes the scoping, prioritization, allocation of resources, launch support, and ongoing management of the complete collection of initiatives. Some people will argue that this function is performed adequately in corporate America today. Here I vehemently disagree.

Today, management of the portfolio of improvement activities is—with rare exceptions—vastly underdeveloped and poorly defined. Similar to support and governing processes, the initiative-management function languishes from inattention and clarity as to its purpose. Rarely, if ever, is it the target of a formal improvement effort. As a result, it hinders innovation efforts by focusing attention and resources in the wrong places.

Whereas it is by itself extremely rare that an enterprise prioritizes its initiatives, I know of only a few enterprises today that fully incorporate resource allocation into this exercise. Thus enterprises are, for the most part, investing blindly in their future. This is a mistake on many levels. The rationale for including all initiatives in the same launch process is to enable smarter investment decisions. Resources and energy should be focused on efforts predicted to deliver the greatest bang for the buck—that is, initiatives that deliver the greatest value. And when the process expedites delivery of the benefits, the value of the innovation portfolio is maximized.

Today the most typical initiative-management approach is to approve initiatives on the basis of their individual merit—in other

words, on whether they have a positive impact on the bottom line. Each initiative is evaluated from a go/no-go proposition with minimal comparison with alternative investments. When given the green light, the initiative is tossed into the chute for execution—many times leaving planning and resource procurement to a sponsor or the eventual project team. Obviously, executing initiatives in isolation omits consideration of collaboration opportunities and dependencies. Additionally, this approach blatantly ignores the scarcity of resources. If an enterprise has unlimited resources and no competition, this approach is perfectly reasonable. However, most enterprises operate in markets with numerous competitors, and they have limited capital to invest, limited technological capacity, and limited qualified personnel to toss at improvement opportunities.

Although not the blatant outright victim of neglect like operational improvement, initiative management is arguably the worst-performed facet in contemporary enterprises. Many enterprises, especially larger companies, use portfolio-management organizations (PMOs) to oversee and track the execution of major projects. Although launched with the best intentions, PMOs usually degenerate into a pseudo–status-tracking mechanism. Project and program managers pull together reams of documentation, including charters, work plans, financial workbooks, stakeholder assessments, and various other "required" project deliverables. From then on, the project's documentation and status are reviewed at delivery stages (often called *gates*) or periodic intervals (e.g., quarterly). To quickly communicate their stage of completion, projects are assigned a color correlated with stoplight colors. Green denotes a project on target based on the original estimates of budget and timeline. Yellow denotes a project at risk of falling behind the original timeline or going over budget. Red identifies a project in trouble. What I find humorous is how "red" projects are commonly handled. When a project slides off the rails, a change order is created to adjust the deadlines or budget. Once approved, the project reverts back to a

green status. The fundamentals remain unchanged. Is this really an efficient way to build an enterprise's future?

In addition, many initiative-management processes suffer from the absence of integral elements. Most prominently, they lack any true health check on the initiatives in progress. Reviews rarely extend beyond timelines and budgets and usually fail to question whether the initiative's goals are still relevant or even desirable, except in the most obvious situations. As a result, it is rare to find initiatives that are halted or canceled even when their potential for success is negligible. Along the same lines, initiatives in flight are rarely redesigned or course-corrected when the underlying assumptions change or their current path leads to nowhere. In effect, initial goals and project directives are gospel. After launch, there are no remedies for inaccurate assumptions or flawed planning.

Under these conditions, initiative management (or *portfolio management*, as it may be called) ends up being more of feel-good exercise than an actual evaluation and management process. And this is where failure takes root. The wrong initiatives are resourced and launched—and more strategically and financially beneficial initiatives are back-burnered. Although perhaps not initially visible, the enterprise gradually loses ground to more nimble and assiduous competitors. These missteps affect profitability and the strategic footing of the enterprise. This leads to an equally big issue: enterprises rarely, if ever, assess and improve their approach to managing and executing initiatives. In the absence of such an examination, initiative management remains the same checkbox activity.

Understanding the potential of good initiative management necessitates a good definition for *initiative*. In today's business world, initiatives are usually associated with strategic planning, and in this context, they are identified as a collection of activities to achieve a strategic objective. But let's broaden this definition slightly: initiatives are programs or projects, not necessarily strategic, that

when collectively executed deliver a financial benefit or expand the enterprise's capabilities. As mentioned previously, consolidating all of an enterprise's initiatives into a single list yields the innovation portfolio.

The total value projected to be delivered by the innovation portfolio is the sum of the individual benefits from each approved initiative. But the total value of the innovation portfolio is not static. Indeed, it rises and falls with the value of individual initiatives. Because of the time value of money, an initiative that is delayed for a year will, all else being equal, have a lower net present value. The aim of portfolio management is to maximize the value generated by the innovation portfolio by expediting the highest-value initiatives and stopping or delaying initiatives with minimal or no benefit. Tools and techniques for maximizing the value of the innovation portfolio will be discussed at length in Chapter 7.

Innovating an Enterprise via the Four Facets

The four facets of innovative enterprises are the primary ingredients for systematically responding to an ever-changing world. That being said, circumstances rarely require an enterprise to be hitting on all cylinders at any one time. Enterprises go through periods when the cash register sings and strategic adjustments are delayed as the company strives to keep pace with incoming customer orders. Other times sales are slow and cost savings are needed to keep the business afloat. Enterprises employing an innovation approach consistent with the four facets are armed to react appropriately and prosper in both evolutionary and revolutionary markets.

Building a continuously innovative enterprise entails institutionalizing the facets by melding them into the DNA of the

enterprise. This is where most improvement theories run into a wall—how to bake these critical practices into the everyday activities of an enterprise.

Based on my experiences, I believe that the optimal framework for innovation is to use common terminology and structures. Processes are the structure that most accurately depicts work efforts. By using processes as the basis on which to frame improvement activities, the facets can be seamlessly intertwined into the structure, people, and management of any enterprise. The first step on this path is to fully understand the concept of process.