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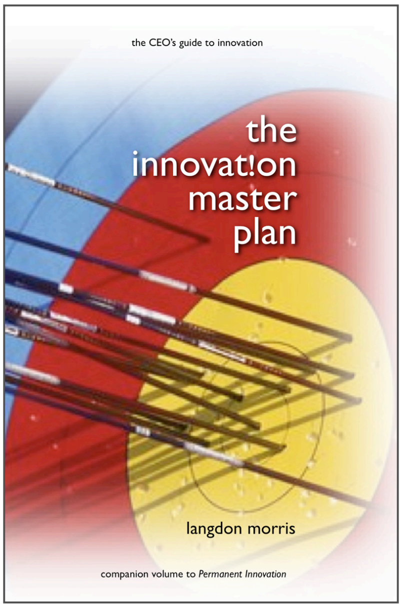
the innovation master plan

the CEO's guide to innovation

by langdon morris



this excerpt includes

chapter 1

Langdon Morris is recognized worldwide as one of the leading authors and consultants in the innovation field. A new chapter of his latest book, *The Innovation Master Plan*, will be presented exclusively at InnovationManagement.se every two weeks throughout the summer.
It will soon also be available at Amazon.com (but not quite yet).

The Innovation Master Plan

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ISBN #: Forthcoming
www.innovationlabs.com

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chapter 1

why innovate

the link between strategy and innovation

"Trying to define what will happen three to five years out, in specific, quantitative terms, is a futile exercise. The world is moving too fast for that. What should a company do instead? First of all, define its vision and its destiny in broad but clear terms. Second, maximize its own productivity. Finally, be organizationally and culturally flexible enough to meet massive change."[1]

Jack Welch

The "why" of innovation is simple: change is accelerating, which means that we don't know what's coming in the future, which means more uncertainty than ever, which means we'd better innovate to both prepare for change, and to make change.

If I am wrong about change, if things really did stay the same, then your company could indeed keep on doing what it's always done, and there would be no need for innovation. If markets were stable, if customers were predictable, if competitors didn't come up with new products and services, and if technology stayed constant, then we could all just keep doing what we did yesterday.

Good luck with that idea.

Because all the evidence shows that change is racing at you faster and faster, which means many new types of vulnerabilities. Technology advances relentlessly, altering the rules of business in all the markets that it touches, which is of course every market. Markets are not stable, customers are completely fickle, and competitors are aggressively targeting *your* share of the pie. So please ask yourself, "Are we managing with the realities of change in mind? And are we handing uncertainty?"

Since the alternatives are either to "make change" or to "be changed," and making change brings considerable advantages while being changed carries a huge load of negative consequences, then the choice isn't really much of a choice at all. You've got to pursue innovation, and you've got to do it to obtain long lasting benefits.

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1 Noel M Tichy and Stratford Sherman, *Control Your Destiny or Someone Else Will*. New York, Currency Doubleday, 1993. p. 245.

So what we're talking about here is the practice of innovation as a vital aspect of corporate or organizational strategy; the rest of this chapter explores how strategy and innovation are intimately linked and should be mutually reinforcing. The chapters that follow will then address the best practical approaches to achieving superior innovation results.

A tight linkage between innovation and strategy will certainly be part of your master plan, and to give you a better idea of how this works in practice, let's take a look at Apple, Cisco, Blockbuster, IBM, and Coca Cola to see how their strategies have shaped their pursuit of innovation.

apple: innovating to achieve the strategy

Innovation by your competitors and by your own firm causes existing products, services, and business models, and indeed entire businesses, to become obsolete. Since innovation is the driver of change, and change is the most fundamentally important driver of business strategy, then it's not an exaggeration to say that innovation is the means of achieving strategy, as we find in the story of Apple's turnaround from the abyss.

When Steve Jobs was asked to return to Apple as CEO in 1997 after an absence of more than ten years, the company was, to put it bluntly, a mess. If you thought that the PC market was a war between Apple and Microsoft, it was clear that Microsoft had won big.

Apple's market share was about 5% and shrinking, and to many observers it seemed that the company was fading away. Its product line was an incoherent collection of 11 different computers, and there didn't seem to be a clear vision guiding the company forward. The board of directors was desperate.

But did Jobs have a vision for the 21st century, as he had had in the 1970s? Did he still have the magic?

We know today that he did, but imagine that it's 1997 and you're Steve Jobs, and you have to figure out how to turn Apple Computer around. What do you do?

The company's current product mix is a *fait accompli*, but defining the future path for product development requires you to make strategic choices. More than anything else, you need to anticipate what people will want when they buy new computers to make sure that Apple's future products will meet their needs. If you can figure that out, then you can devise a strategy to return Apple to relevance in the PC industry, restore the company's credibility as a meaningful competitor, and earn profits.

Given his reputation, it's easy to suppose that Jobs, the lone genius, figured it all out himself, but that's certainly not true. The Apple executive team must have studied the driving forces in the PC market, and in doing so they realized that the driving force in the industry was the fact that customers were using more and more different media devices with their computers.

MP3 digital music players, digital cameras, and digital video cameras were replacing old analog devices, and the transition was accelerating so fast that the computer makers weren't keeping up. Companies were writing new device drivers, but many of them worked poorly and were difficult to install, so the annoyance factor was already large and growing. It could take hours to get a digital camera connected to a PC.

Remember the timing, because it's important to the story. This was many years before the iPod, and about a year before Napster, the pioneering digital music sharing site that inspired the digital music revolution. So the fact that the Apple team understood the growing significance of digital devices for customers was certainly an insightful act of strategic thinking. Describing this insight later, at the 2001 Macworld conference, Jobs commented, "This age is spawned by the proliferation of digital devices everywhere: CD players, MP3 players, cell phones, handheld organizers, digital cameras, digital camcorders, and more. We're confident that the Mac can be the hub of this new digital lifestyle by adding value to these other devices."[2]

Jobs decision to position the Macintosh as the customer's "digital hub," the computer that could connect to *any* digital device, input or output, would indeed make the Mac an indispensible tool, and while the concept became central to Apple's strategy, implementation required the company to develop innovative hardware and software tools to make it real. Innovation, in other words, became the means through which the company's strategy would be realized; for Apple to survive, innovation and strategy were inextricably connected.

Many technical innovations were developed to make it easy for customers to connect other devices to Macs, including software drivers, and new tools to manage digital libraries of photos, music, and videos. The strategy also required the company to develop a new operating system to support all of this functionality.

From a programming and design standpoint, none of these projects were simple, and Apple set high standards for functionality and usability, which of course only made the effort more demanding. In fact, the commitment to these standards had evolved in the early days of the Macintosh, and they were still considered vital to the company's mission. In 1974 Apple had published the first of what would eventually be many editions of a key reference book that expressed its underlying philosophy concerning the customer's experience and usability. It came out under the deceptively simple title *Apple Human Interface Guidelines*.

The book presents the design principles behind Apple's hardware and software, and described the user experience that the computer, its operating system, and all applications were designed to achieve. Apple started this work from a philosophical perspective, and attempted to embody its philosophy in the code that ran the computer.

The 1987 edition of the book begins by describing the "Apple Desktop Interface," the screen that you see when you turn on your computer, and then goes on to describe the philosophy and design principles behind it.

> "The Apple Desktop Interface is the result of a great deal of concern with the human part of human-computer interaction. It has been designed explicitly to enhance the effectiveness of people. … The Apple Desktop Interface is based on the assumption that people are instinctively curious: they want to learn, and they learn best by active self-directed exploration of their environment. … People are

2 Leander Kahney. *Inside Steve's Brain*. Portfolio, 2008. P. 223.

also skilled at manipulating symbolic representations: they love to communicate in verbal, visual, and gestural languages."[3]

The book went on to describe specific design principles and standards for look and feel. To a significant degree Apple was successful in embodying these characteristics in the Apple operating system and many application programs, and the devotion that Mac users felt for their computers and the company was largely due to the ease of use they experienced; Apple had anticipated their needs and designed tools to meet those needs.

But Apple was not the originator of this philosophy. Apple's successes built on ground breaking work that was being done at Xerox's Palo Alto Research Center, PARC, where a collection of brilliant scientists who were trained in many disciplines had carefully developed the principles of personal computing, and then built the first genuine PC in the early 1970s.

Decades later, the design of Apple's iPod followed the same principles, and the resulting simplicity made the iPod the world's number one MP3 player within months of its introduction to the market. Apple's subsequent successes with iPhone and iPad were also based to a significant degree on its deep commitment to producing devices that were intuitive and easy to use.

It probably wouldn't be worth mentioning Apple's user interface guidelines if the pursuit of an optimal user's experience through good design was standard procedure throughout the computer industry. But during this period there did not seem to be any specific design standards underlying Microsoft's products, and the company was widely criticized for providing its users with genuinely awful experiences, such as the infamous "blue screen of death" that appeared when the computer crashed, which happened frequently. As the design approaches described in the 1987 interface guidelines have been copied both by Microsoft in its Windows OS and by Google's Android smart phone OS, it's clear that while Apple hasn't won all the battles in the industry, its philosophy, and the philosophy that was developed at Xerox PARC, has certainly won the war

The principles of effective user interface design were later evident in another Apple undertaking, it's chain of retail stores. When the stores were first announced, many experts in retail predicted that Apple would fail. "I give them two years before they're turning out the lights on a very painful and expensive mistake," retail consultant David Goldstein told *BusinessWeek*.[4]

Apple developed the stores so that customers could experience first hand how easy the Mac was to use. Consequently, the stores had to be located in high traffic shopping areas where people could just drop in and check out Apple's products. High traffic also meant high rent, which was another source of criticism when the concept was first unveiled.

Contrary to the dire predictions, the stores have been hugely successful. Apple now has more than 300 of them open worldwide. They reportedly draw more than two million customers a week, and Apple's store on Regent Street in London is said to be the most profitable store in the city; The *London Evening Standard* reports that by

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3 *Apple Human Interface Guidelines: The Apple Desktop Interface*. Addison-Wesley, 1987. P. 2.

4 Leander Kahney. *Inside Steve's Brain*. Portfolio, 2008. P. 208.

2009 in that store alone revenue had reached £60million a year, or £2,000 per square foot, more than double the sum estimated for the nearby Harrods department store. The Apple store also became a tourist attraction in its own right.[5]

By implementing the digital hub concept in its computers, adding iPod and iPhone to its product mix, and opening its chain of stores Apple gradually gained (or regained) customers, enhanced its image, and increased its market share. Within a few years the company was no longer in danger of collapse, and it became once again a credible competitor in the PC marketplace.

Today Apple's share of the US PC market is growing, although it's still less than 10%. But the iPod is the undisputed MP3 world leader, with 70% of the market, the iPhone became the world standard design for smart phones immediately upon its launch, and the iPad may do the same in the tablet market. And 13 years after Jobs returned, Apple's total market capitalization recently achieved an insider milestone when the company's total stock value surpassed arch-rival Microsoft.

To summarize, without a focused and successful effort at innovation Apple surely would not have survived; the quality of its innovative efforts led not only to survival, but leadership. Innovation was thus essential to the company's strategy, and it was in fact how the strategy was executed, so much so that we simply can't imagine "Apple" without thinking about "innovation."

Innovation plays the same role for many firms.

Do you admire Google? Then ask yourself what role innovation plays in Google's strategy. It's obvious that we wouldn't admire Google, and in fact we wouldn't even know about Google if it weren't for innovation. The very existence of the company is based on a single strategic insight and on two critical innovations that made the strategy real. The insight was that as the number of web pages grew, the internet's potential as an information resource was surpassing all other resources for scale, speed, and convenience, but it was getting progressively more difficult for people to find the information they were looking for. People therefore came to value better search results, and Google's first innovation to address that need was its PageRank system, developed in 1995, an algorithm for internet searches that returned better results than any other search engine at the time.

The second innovation was a business model innovation, which turned the company into a financial success along with its technical search success. When Google's leaders realized in 2000 that they could sell advertising space at auction in conjunction with key words that Google users searched for, they unleashed a multi-billion dollar profit machine. The integration of these two innovations provided a multiplicative advantage, and Google's competitors are falling by the wayside as the company continues to dominate.

For example, in November 2010, Ask.com threw in the towel with only 2% of the market for internet search after trying for five years to compete with Google following its $1.85 billion acquisition by Barry Diller's IAC/InterActiveCorp. Diller wrote, "We've realized in the last few years you can't compete head on with Google."[6]

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5 http://www.thisislondon.co.uk/standard/article-23737856-apple-store-most-profitable-shop-in-london-for-its-size.do

6 *San Francisco Chronicle*, "Ask.com layoffs spell surrender." November 10, 2010

Yahoo, a much bigger company than Ask, came to the same conclusion earlier in 2010 when it decided to position itself as a media company rather than a technology company, and outsourced its search function to Microsoft's Bing.

What other companies do you like? Do you also admire Starbucks? Or Disney? Or Sony? Or Toyota? Or BMW? They're certainly innovators, and many of us appreciate them precisely because of it.

Or perhaps it's Cisco that you admire. Let's look at Cisco as we consider another important strategic question, innovation or acquisition?

cisco: innovation or acquisition?

The generally-accepted failure rate for corporate acquisitions is in the neighborhood of 70%, meaning that about 7 in 10 acquisitions fail to deliver the expected value, and the acquiring company ends up worse off than before.

Cisco's operating model, however, is based on the idea that growth-by-acquisition is a good thing. Since it was founded in 1984 Cisco has acquired more than 120 companies, and contrary to the general pattern of failure, Cisco reports that more than 70% its acquisitions have met or exceeded expectations.

The existence of some of the acquired companies is not an accident. Venture capitalists sometimes fund start-up companies that address new market opportunities in the specific hopes that Cisco will acquire them, which is also an example of how an innovation culture extends into the broader ecosystem surrounding a successful company.

Whether it's a startup or an established company that's the target, one key to making these deals work well is Cisco's precise integration methodology.

> "Acquiring other companies is an important strategy for Cisco to rapidly offer new products, reach new markets, and grow revenue. Since 1993, Cisco has acquired more than 120 companies, from small startups to large, well-established firms such as Linksys, Scientific Atlanta, and WebEx. Integrating the employees, products, services, operations, systems, and processes of acquired companies can be a daunting effort. With multiple acquisitions occurring each year, it became clear that Cisco could not approach the integration effort in an improvised manner, with different personnel and activities engaged each time. Instead, acquisition integration needed to become a standard way of doing business for Cisco employees. Cisco needed an integration approach that would be consistent across the company, repeatable for each new acquisition, and adaptable as Cisco began to acquire large companies with different operational parameters. Cisco has developed—and continues to evolve—a well-defined approach to integrating acquired companies. This approach encompasses the following elements:
>
> - Formalized and centralized integration management through a designated team in the Cisco Business Development group.
> - Cross-functional teams for each acquisition that plan, manage, and monitor integration activities across Cisco.
> - Standard principles, metrics, tools, methods, and processes that can be

repeatedly applied to new integration efforts, yet are adaptable to the unique issues and parameters of each deal. These standards are defined both at the corporate level and within the many Cisco departments involved in acquisition integration.

- Extensibility of the acquisition integration model to other major change events, such as divisional consolidations, divestitures, or acquisitions by Cisco divisions."[7]

This is a Cisco marketing document, so the glowing feeling of perfection that the quote conveys should not be taken literally. Nevertheless, the approach makes sense, and of course the companies in Cisco's markets take it very seriously, having watched the company gobble up a string of very attractive firms over the years.

A modest example of Cisco's discipline showed up in its acquisition of Pirelli's Optics business in 1999. On the day that the deal closed, Pirelli signs were removed at facilities throughout Italy and Cisco signs went up in their place. This was reported as something of a surprise in Italy, in that the Italian culture was not accustomed to seeing things come off so definitively. While replacing a bunch of signs is one thing and managing a complex business is something else entirely, this was nevertheless a message to everyone about the seriousness of Cisco's intent, and the message was indeed not lost.

As the dominant company in its industry with an attractive market cap of $110 billion and $40 billion of cash [as of November 26, 2010], Cisco is well positioned to continue its growth through acquisitions, while most of its smaller competitors simply don't have the capital strength or market dominance to be attractive acquirers.

In addition to its active pursuit of acquisitions, Cisco's internal R&D budget is more than $3 billion per year, so it maintains a good balance between internally-driven innovation and acquisition-driven innovation, and that is also a key to the company's strategic success.

While Cisco is the leading company in many of its markets, the industry as a whole is still a young one. IBM's long history, on the other hand, illustrates the dangers that can come from prolonged success followed by the arrival of a sudden downturn.

ibm & blockbuster: dangers of success

Some companies succeed by focusing on a particular aspect of business performance, only to see the market shift its interest, leaving them holding an empty bag. When a new generation of technology emerges into the market it often initiates a major upheaval in the distribution of revenues and profits. IBM was a victim of this, and so was Blockbuster.

Blockbuster dominated the market in home video rentals, but when "video

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7 "How Cisco Applies Companywide Expertise for Integrating Acquired Companies." A public white paper available at http://www.cisco.com/web/about/ciscoitatwork/business_of_it/acquistion_integration.html. Copyright © 1992–2007 Cisco Systems, Inc.

rentals" meant "going to the store to rent them" was displaced by mail delivery and then by video streaming, the company quickly tumbled into bankruptcy. Netflix captured the heart of the market, and Blockbuster kept its doors open only because video producers didn't want to lose an important distribution channel.

In a bitter piece of irony, it was recently revealed that ten years before Blockbuster's bankruptcy, the CEO of Netflix visited the CEO of Blockbuster in its Texas headquarters to propose a partnership that would bring Blockbuster's storefront retail and Netflix' internet-to-mail distribution into a single operation (this was years before video streaming was possible). According to a Netflix executive who attended the meeting, "They laughed us out of the office."

Ah, when the mighty fall, they fall hard.

Past success meant growth and profits, and as companies increase in size and scope the nature of management's challenges also change from innovating new markets to optimizing in existing ones. The farther away top managers are from the realities of change, the more difficult it is for them to face up to the need to adapt.

Most large companies invest so much to defend their existing markets that they're slow to recognize new market structures. They remain committed to old products and services too long, and fail to develop new ones quickly enough.

Leaders of small companies, in contrast, are commonly in direct contact with customers as a natural part of their roles, and this helps them recognize the need for change (although they may lack the capital to execute it). But the increasing complexities that large businesses must contend with to achieve sustained growth lead them to multiply layers of organization. As the stakes become higher, the risks that the small company took as a matter of course are now subjected to more scrutiny, and reaction times slow. The mindset problems that I mentioned in the Introduction often set in, and more committees often exacerbate the problem. Managers must rely on second-hand information or their own memories of "how it used to be," and they lose touch with the voice of the market. More levels of management have a say in major decisions, and time lags in decision making are longer. In some companies "analysis paralysis" sets in, and the demands for ongoing administration of a by-now large business requires heroic attention.

In spite of everyone's best intentions, dysfunctional and bureaucratic behaviors grow, and often result in distortions to the flow of information that senior managers depend on. Corporate politics receives increasing attention, and emphasis shifts to internal events, while external factors are obscured.

Hence, generations of GE observers noted the vital importance of the company's corporate politics this way: "Many of GE's best managers devoted far more energy to internal matters than to their customers' needs. As GEers sometimes expressed it, their company often operated, 'with its face to the CEO and its ass to the customer.'"[8]

In this situation, significant innovations from competitors may find their way into the market without a compelling response, and even large firms find themselves in decline. Blockbuster's persistent focus on designing the retail store experience, managing locations, staff, and inventory, and optimizing operations occupied

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8 Noel M. Tichy and Sherman Stratford. *Control Your Destiny or Someone Else Will*. Currency Doubleday, 1993. P. 38.

management's attention while Netflix perfected two new distribution options that Blockbuster ignored, video-by-mail and then video streaming. Having responded too slowly, Blockbuster ended up in bankruptcy.

IBM also experienced a life-threatening shift in its market when mainframe prices collapsed in 1993 due to the steady advance in the power of computer technology. Almost overnight, about $7 billion evaporated from IBM's revenue stream, and there was nothing the company could do but to collapse itself, or seek other markets. The company went through a gut-wrenching restructuring over the following decade, as CEO Louis Gerstner led the transformation of IBM from a hardware manufacturer into a services firm.

There are two aspects of the story that are particularly relevant to this conversation. First, it's quite rare for a company to transform itself to the extent that IBM did, and surely a great deal of the credit must be given to Gerstner. Most companies in this situation collapse and disappear, highlighting the "destructive" side of creative destruction. As a roadmap for transformation you'll have to look hard to find a better story than IBM's, and Gerstner himself has provided us with a compelling version of it in his book, *Who Says Elephants Can't Dance?*

The second key point is that long before Gerstner accepted the CEO's job, IBM's leaders understood that the market was changing, and they also understood what the company needed to do. They just didn't manage to actually make the necessary changes.

In a memo to IBM employees that he wrote during the summer of 1994, Gerstner noted, "We've had outstanding business strategies before. I've read them all, and they're remarkably ahead of their time. The problem was, we never fully implemented them. We sat in meetings, nodded our heads in agreement, and then went back to doing whatever it was we were doing before. So we agreed we needed to change, but we didn't change. We said we needed new strategies, and we created them, but we didn't implement them. We said we wanted IBM to remain the leader in our industry, but we didn't do what we had to do to retain leadership."[9]

This brings us back to the importance of mindset; believing that the elephant can dance, and then getting the elephant to believe that it can dance, and then actually dancing with it, are also heroic acts of management. Without a vision for innovation and a willingness to innovate, it will not happen, and in IBM's case it took a near-death experience and an outsider to bring the organization around to the necessary mindset.

And then once the mindset was in place, the actions must follow. Gerstner oversaw massive change in how the company operated: 200,000 people lost their positions at IBM, some before Gerstner arrived, and some after. The entire structure of the business was shifted to create a services capability that grew from $15 billion in revenues in 1992 to $35 billion in 2001, while net income shifted from a loss of $8 billion in 1993 to a profit of $8 billion in 2001.

Achieving this turnaround required that the entire compensation structure of the company had to change, its accounting and finance processes had to be reengineered, and its product development process transformed. Nothing was the same, except perhaps the name of the company.

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9 Louis V. Gerstner. *Who Says Elephants Can't Dance*. HarperBusiness, 2002. P. 323.

IBM isn't the only company to have encountered a challenge of this magnitude, but it is one the few to survive the experience. For most that succomb, the corporate culture acts as a barrier. Practices and mindset that work so well during the success years get deeply ingrained, leaving the company's leaders incapable of grappling with the problems that lie outside of their operational expertise.

Gerstner notes, "I suspect that many successful companies that have fallen on hard times in the past – including IBM, Sears, General Motors, Kodak, Xerox, and many others – saw perhaps quite clearly the changes in their environment. They were probably able to conceptualize and articulate the need for change and perhaps even develop strategies for it. What I think hurt the most was their inability to change highly structured, sophisticated cultures that had been born in a different world."[10]

coke: a shifting market

Like IBM, Coke was a world market leader for decades, and developed a global brand that was and remains one of the most valuable in the world. (The marketing firm Interbrand ranks Coke as the world's #1 most valuable brand, worth $70 billion. Impressive for a company that earns about $31 billion of revenue each year.)

But by the 1990s consumers were concerned with their sugar intake, and developed a taste for water, juice, and teas. As a result, by 1995 the carbonated beverage market in the US grew only 3%, while sales of non-carbonated drinks grew 18%.

With its focus on defending the traditional soda market, Coke recognized change much later than arch-rival Pepsi. In fact, the two companies looked at the market quite differently. While Coke saw itself as a beverage company, Pepsi expanded it's outlook and began to focus on growing what it called "share of stomach," meaning the totality of the snack food products that consumers purchased.

To expand its reach, Pepsi acquired Gatorade, Quaker Oats, Frito-Lay, and Tropicana, and smaller brands including Lipton, Naked Juice, and Mother's Cookies. Together these brands achieved net revenue growth of 17% between 1996 and 2004, and Pepsi's share price grew by 46%.

Coke, meanwhile, saw its net revenue increase by only 4.2% between 1996 and 2004, and its share price plummeted by 26%.

At which point Coke's board brought in a new CEO, Neville Isdell. Restating the painfully obvious in one of his first public occasions, Isdell remarked that, "We were too slow to change," and he set about to move the company beyond its strategic obsession with red cans of soda, and to change the company's culture by overcoming the widespread fear of failure, and thereby accelerate the development of the necessary innovations that would return the company to a growth trajectory.

The stories of Apple, Cisco, Blockbuster, IBM, and Coke demonstrate the close relationship between strategy and innovation, and the important role that innovation plays in transforming the concepts of strategy into realities in the marketplace: none

10 Louis V. Gerstner. *Who Says Elephants Can't Dance*. HarperBusiness, 2002. P. 185.

of these companies could have succeeded without innovation.

Apple's strategy of focusing on the user experience led to innovations in its product portfolio. Cisco's strategy of growth through acquisition led to innovations in organizational structure and process. IBM's strategy of becoming a systems integrator led to innovations in its business model, as well as the structures and processes that delivered that business model to the market. Blockbuster and Coke, on the other hand, did not see innovation as strategic necessities, and paid a heavy price.

The themes we've explored here also give us a foundation upon which we can now explore the meaning of "strategy" in a bit more detail.

defining "strategy"

According to the handy online dictionary (which, by the way, is itself an innovation, and one that has been quite disruptive to the traditional business of printed dictionary publishing), "strategy" is:

"The plan of action that is designed to achieve future goals."

That definition is not quite sufficient for our purposes, but it gives us a start. With the operative words *plan*, *action*, *future*, and *goals*, we see that effective strategists must anticipate and envision the future to define the best position to occupy in a competitive landscape.

What we add to concept of the "plan" is the need for an organizing principle, or a way to understand the broader patterns of change, and to locate our own goals in conjunction with the broader view.

Having a strategy that is coherent with the evolving external market then enables business leaders to make good decisions in the present that will likely lead toward achieving their goals.

As the focus of strategy is on grasping the essence of a constantly changing situation, and on *anticipating* the future, and the goal of innovation is to *create* the future, innovation is clearly an *instrument* of strategy. And as a key driver of adaptive change from within, innovation is an essential creator of future value for every organization.

From the strategic viewpoint, then, innovation is the means of gaining advantage, while from the operational viewpoint it is often the means of survival, the means of generating new efficiencies that lead to new profits, as I mentioned above. The most effective approaches to innovation will continually strive to address both the strategic and operational benefits, neither to the exclusion of the other.

Now let's translate these ideas into action, and explore a framework we can use to link strategy and innovation from the implementation perspective.

taking action:
designing and implementing your strategic model

The first element in your master plan describes the connection between strategy and innovation in a way that will constitute an implementable and manageable process. Because this part of your plan relates to strategy, you have to focus first on understanding the outside environment in which your organization is competing, because what happens outside defines the context in which your strategy must necessarily play out.

If your organization already has a well-defined strategy then it may address the points that are explained below, and it merely needs to be adapted to the needs of the master plan.

However, if you lack a compelling strategic framework or you'd like to consider it again, my colleague Bryan Coffman and I have been developing an approach to help you think through these strategic questions, which we call Strategic Modeling.

the strategic modeling framework

Have you ever heard an executive say, "Our strategy is to double in size in the next 5 years"?

The problem with statements like this is that doubling in 5 years isn't actually a strategy, it's a goal. And while there's no question that setting good and ambitious goals is important in business, determining how you're going to achieve them in the real and very complex world is where strategic thinking really adds value. We have found that following the steps described below can be very helpful when you need to think through the design of strategy:

1. Define a point of view about the external environment.
2. Identify your current position.
3. Define your goals.
4. Design the strategic hypothesis.

define a point of view

Defining goals and executing the strategies that achieve them will occur in a world that you do not control. The uncertainty and unpredictability of the environment requires that you understand not only the market environment in which you're competing today, but also the way things are likely to unfold in the future. Therefore, the first element of the strategic model is a "point of view" about the world, and the market, and how they're changing.

Your "point of view" is a statement that articulates what's happening throughout the world that your organization inhabits, and describes why that matters. (To help you think this though, the next chapter provides an overview of some key driving forces that are impacting the world economy.) It explains the key characteristics of today's world, and anticipates what you believe that world will be like tomorrow.

And why bother with this?

Because defining your point of view about the environment in which you're competing is essential to developing an understanding of how it's evolving. When you think through the important things that you know about the environment, and then make predictions about how it's going to be, you enhance your capacity to learn, because the comparison between what you expect to happen and what actually does occur will help you identify which of your assumptions are correct and which are not. This, in turn, will help you to continually refine your views and improve your ability to make valid assumptions, predictions, and decisions.

Of course every manager has ideas and beliefs about the future, as these are the bases upon which all decisions are made. In fact, every decision is itself a prediction, as Dr. Deming points out, because the choice between one or the other alternative can only be based on an expectation about which will turn out better in the long run. The expectation is itself a prediction.

So making your point of view explicit merely brings these assumptions to conscious awareness, where they may be examined, tested, validated (or not), and improved upon.

Without a point of view, if such a thing were even possible, change could not be anticipated at all, and events would just come at you in a rush with no discernable pattern and no underlying meanings. Under these circumstances the function of management would be nearly impossible. But that situation is not acceptable.

Your stated point of view therefore describes how your organization will meet these challenges by defining your goals and plans for the future.

To prepare this point of view you'll explore the rate and types of change that are occurring in your marketplace, and the role and impact of new technologies, to help you anticipate the way the future is therefore unfolding. You'll examine how this is likely to impact your organization, and define how the organization will need to change to meet these challenges. You'll describe the capabilities you have now and the ones you're likely to need.

history

Because your point of view is a tool to help you create your preferred future, success requires that you understand both the present and how it came to be. Thus, to understand the current situation, anticipate the future, and define plausible strategic hypotheses it's essential that you understand history.

Stated from the other side, if you don't understand history you're probably doomed to failure. Karl Marx may have expressed this best when he wrote that, "Men make their own history, but they do not make it just as they please; they do not make it under circumstances chosen by themselves, but under circumstances directly found, given and transmitted from the past."

It's not a coincidence that many innovators are also thoughtful students of history, and a strong grasp of history will help you to become one.

Here are some history questions to consider:

- How did our industry first develop, and what have the major changes been over the years?
- What were the major crossroads or crucial decision points in our industry's history? And how might things have turned out differently if those decisions had been different?

- What have the successful business models been, and how have they changed?
- What has caused the companies in our industry to change positions in the market?
- What stories from the past do we still tell today?
- What aspects of those stories are also reflected in our experiences of today's environment?

And as it is a tool for learning, please do not expect the predictions embedded in your point of view to be 100% correct. Actually, of course, there's no way that they can be. Things are always changing, and our understanding of the vast, external reality can never be perfect or complete, so there will be plenty of opportunities to improve. Nevertheless, stating your models explicitly is essential to improving them, and to managing in a complex environment.

identify your current position in the terrain

Having defined your point of view about what "reality" is, you can now locate yourself somewhere inside it. Hence, your point of view can be understood as a map of the terrain of reality, and your location is a particular spot on that terrain.

Perhaps the terrain is a matrix, and since it defines a competitive environment, the key performance criteria in your market are likely to become the axes. Is your market price sensitive (what market isn't?); then price may be one axis. What's the other?

It may be product or service quality, differentiation, or perhaps fit with market need.

Once the terrain or the matrix is defined, what are the favorable and unfavorable positions on it?

What's your position relative to your competitors?

Now that you see where you are, it becomes possible to consider where you'd like to be. This is your goal, which is probably somewhere other than where you are now. Hence, while your current location has specific attributes, including your operational performance level, your competitive situation, and the way you're coping with external events and pressures, your preferred location will be different in some specific ways.

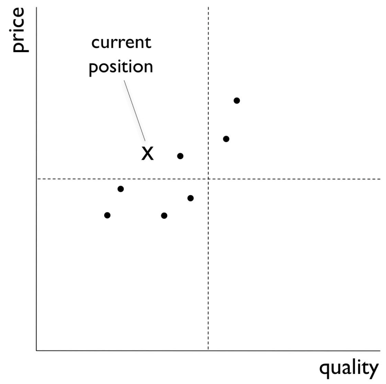

Figure 2
The Current Position
Dots represent competitors.

define the strategic goal

Many companies express their goals as a function of the competitive market. They want to be bigger, stronger, or better than they are today, and perhaps more successful than their competition. They also may express their goals in terms of capital markets, as they want to earn a better than average return on capital.

Some define their goals as an expression of their intent to serve their customers, or to serve their communities.

If you're in a period of hard times, such as IBM in 1992, or Apple in 1997, or Blockbuster in 2010, your goal may simply be to survive. If you do, and you regain a better position in the market, your goals will change and become more outwardly directed.

If you're Coke in 2004, your goal relates to regaining leadership in your market. And if you're Cisco, it may mean retaining and extending your position of strength by continuing to grow your firm, and continuing to lead your industry.

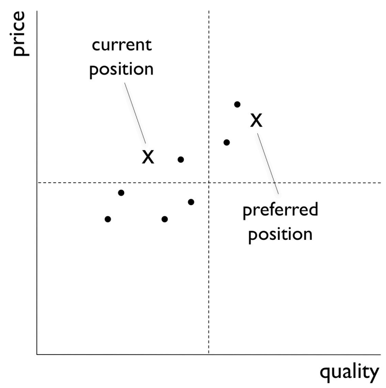

Figure 3
Strategic Goal: The Preferred Position

define the strategic hypothesis

It's one thing to have a goal, but something else to attain it, and something else again to remain there. To get from your current location to your preferred one will require a journey of some sort, and the nature and character of that journey describes much of the work you need to accomplish. And then retaining your desired position usually requires an enduring strategy to prolong your success, and thus the strategic hypothesis describes not only how you mean to get where you want to be, but also how you will create a self-reinforcing (virtuous) cycle whereby success leads to further success (we saw this graphic previously).

It's often helpful to express this work in the form of a hypothesis: If we do 'this,' then the result will be 'that.' Hence, we call this the "strategic hypothesis."

This will be a central theme of your innovation master plan, the driving thrust that shapes your choices as it informs the types of innovations you need to develop, as well as other strategic initiatives you may need to accomplish that lie outside of the scope of innovation.

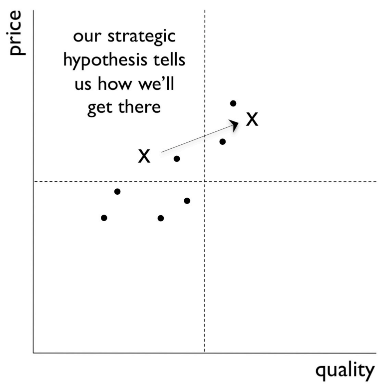

Figure 4
The Strategic Hypothesis: How We'll Get There

Because you mean to create a sustainable proposition, your hypothesis will be more than just an action item or a list of actions. It will be effective as an element of strategy when it leads to the attainment of objectives that are self-reinforcing, that close the loop. For example, if developing higher quality products leads to more profits, then those profits can be plowed back into still further quality improvements, and so it becomes a self-sustaining cycle (which, by the way, is the strategy that both Toyota and Honda followed to attain world automotive leadership).

A strategic hypothesis describes the iterative feedback loop that leads to more success, which means it's not just a once-and-done action plan, nor a glorified to-do list, which may not be easy to define nor to accomplish.

Further, the hypothesis should not be a self-evident tautology, such as, "more sales lead to increased market share," as there's no mechanism in that statement that says how to achieve those additional sales.

Nor is a strong strategic hypothesis a motherhood statement, nor a perfectly bound little package of business babble. Instead, it may be a couple of pages of detailed reasoning that may indeed have a central theme or organizing principle, and which will also provide considerable detail as to how the goal will be attained, and especially how it will lead to a world of self-sustaining improvement, growth, and success.

To summarize, then, what we've discussed so far is a strategic model consisting of these four elements:

1. Your point of view, which describes the world as it is and how you expect it to be.
2. Your current situation, your present position in the competitive landscape.
3. Your goals, the type of organization you'd like to be, and the performance you expect to achieve.
4. And your strategic hypothesis statement, the detailed expression of if-then statements that convey how you expect to get there, and the virtuous dynamic that your success will generate to enable you remain.

Now let's look at the challenges of the 5 companies I described above to see what this tells us about the strategic modeling approach itself.

testing the framework

apple

By 1997 Apple had been developing me-too products for nearly a decade, and although the company still had customers, they were running out of reasons to remain loyal by the time Apple's board asked Steve Jobs to return as CEO. The PC industry was quickly moving on, and leaving Apple behind, so Apple's current situation could be described as "approaching total irrelevance."

Jobs' first goal was simply to make the company viable again, but this required a strong sense of purpose and direction. As the leadership team studied the evolving marketplace, the concept of the digital hub took hold as an appropriate strategic goal for the company to target. The means of getting there, the strategic hypothesis, was that if the company could develop the right combination of hardware and software tools to enable customers to use their Apple computers as the easiest-to-use digital hubs for all their digital applications and devices, and if customers could be persuaded to try them, then the company would once again be relevant and important in the industry. And over the next 5 years that's exactly what they did. Profits were retained and reinvested in a continuing stream of innovations across a broader and broader set of needs, making the company's products indispensible to a growing set of users, until the company itself became an iconic representation of the best experience that consumer electronics could provide.

cisco

Cisco was born at a propitious time, and took the lead in its market almost immediately. The market grew at a very rapid rate, and given the rate of technical advances in the industry, the current situation could therefore be stated as, "a fast moving wave of technological progress and market growth," and Cisco was riding on the front of the wave.

But with so much going on across a wide range of technical systems and subsystems, the scope of progress was far too broad for Cisco's internal R&D capabilities to keep up with. Therefore, to achieve its goal of remaining in the lead as the industry continued its explosive growth, Cisco's strategic hypothesis could be stated as, "sustain success and lead the market, create an attractive equity position, and use that as a lever to expand our technical scope by acquisition." Or more simply, get in front and stay in front through clear vision and superior execution. A few early successes created enough momentum to make the strategy achievable.

blockbuster

Blockbuster grew rapidly with the video rental market, establishing itself as the unquestioned market leader through good timing and shrewd management. However, too much focus on the existing market structure of DVD rentals at its retail stores left it vulnerable to a new business model, mail order rentals, and then to a new technology, video streaming.

Its business deteriorated so quickly that it was forced into bankruptcy to avoid failing altogether. Its goal now is simply to survive, but it's an open question as to whether the company can even pull that off.

What's the hypothesis that makes survival plausible? Can Blockbuster catch Netflix? Does it have any useful assets that constitute a strategic strength? The stock market doesn't think so – from a peak of about $30 in 2002, it's now trading at about 8 cents a share, while during the same period Netflix has risen from about $10 to $200 per share.

So the two companies are on opposite trajectories. It will take some tremendous innovation successes to save Blockbuster, but in reality the company seems to lack any strategic assets, and it's probably too late.

ibm

IBM was confronted with a life-threatening crisis, the collapse of its primary market. Therefore, at the time its current situation was simply that the bottom had fallen out, and without a new business model the company would surely die. The leaders of IBM seriously explored the idea that company should be broken up in pieces and sold off, and Gerstner was brought in to sort it all out. While the board had a strong preference for keeping the company together, it wasn't clear if that could be done, and if so, how to do it.

As Gerstner and his team studied the situation, however, they identified two strategic goals which they believed could sustain the company as global leader, albeit a quite different company than the old Big Iron mainframe company. The first was that IBM could become the leader in providing services to its clients that integrated products from many vendors, whereas it had once specialized in providing products and servicing only its own; the second was that the rise of computer networks would create a need for those services to an unprecedented degree (which the success of

Cisco, occurring at the same time, is also based on). The two hypotheses were mutually reinforcing, and in hindsight, correct.

Gerstner's managerial hypothesis was that he could get the elephant to dance quickly, that he could transform IBM's stagnant culture and its inefficient operations before the collapsing market exhausted all its cash and forced him to liquidate the company. He succeeded admirably, and returned IBM to a position of global prominence that far exceeded most people's expectations.

coca cola

Coke focused so wonderfully on its critical core product that it didn't notice the world changing around it, and it's growth slowed to a crawl. The situation could therefore be stated, simply enough, as "the world changed but we didn't." The strategic goal for CEO Neville Isdell was therefore to return the company to a growth trajectory and get its stock, which had dropped half its value in the preceding 5 years, performing at a level comparable to its main competitor, Pepsi.

Isdell diagnosed four major problems: lack of response to market change, as noted above, as well as mistakes in advertising, supply chain and partner management, and most lamentably, a lack of innovation. He specifically attributed the lack of innovation to the company's culture, which, much as Gerstner described, grew complacent as it grew sophisticated. The fear of failure set in, and as people became unwilling to risk mistakes in pursuit of innovation, innovation stopped.

Isdell set about to change Coke, his hypothesis being that fixing the four root problems would return the company to market leadership. But unlike the turnarounds at Apple and IBM, he was not so successful. When he retired in 2008, Coke's stock price was not substantially higher than it had been four years earlier when he publicly identified the 4 causes of the company's demise. It would seem, then, that the sophisticates outlasted the CEO.

But that might not be correct. Coke was indeed on the rebound until the financial collapse of 2008, when the value of the company dipped again as the entire economy slumped. Since then Coke has made significant progress under its new CEO, Muhtar Kent, and has just about matched the performance of its arch-rival Pepsico. Interestingly, Coke's market cap is now about 40% higher than Pepsi's, a good portion of which is attributable to the strength of the Coke brand; through all these difficulties the brand has always been managed impeccably (with the exception of the "New Coke" disaster), and brand management remains one of the company's most successful and important competencies.

Each of these stories maps pretty well onto the strategic modeling framework, although of course these short versions don't tell us the gnarly details of how these transformations were achieved at the hidden levels deep inside each company, where policies, systems, and processes make the difference between success and failure. That stuff is usually kept secret, which is one reason why Gerstner's book on IBM is so interesting. (It's also very well written.)

Each of the stories also illustrates the connection between the four major elements of the framework, the current situation, our position, the goal, and the strategic hypothesis, that defines a set of priorities and actions for management.

They also highlight the importance of a well-considered view of the future. The winning companies are almost always clear-sighted and future oriented, while the losers often suffer from debilitating short-sightedness (so we're back again to the mindset problem).

While there's of course a massive amount of simplification here, the framework may actually be useful to you precisely if it helps you to simplify a massively complex reality into a story that you can act effectively on, and if those actions make sense as the future unfolds.

In addition to the steps I've outlined here, the strategic modeling framework also suggests that you examine the business processes that constitute the way you operate today, and then describe how these need to change to attain your strategic goals. The final element of the model is thinking through how you're going to persuade the various stakeholders that they must make the transition from the old ways to the new ways.

So while there's much to strategic modeling beyond this very concise overview, my intent has been to give you a way to think about the linkage between strategy and innovation that will allow you to formulate clear goals towards which your innovation efforts can then be directed. As I mentioned, the next chapter presents a brief overview of some of the major forces that are driving change in our world, and this may also help you to formulate a good picture of the contemporary world and define your own point of view.

the last word …

The concept of creative destruction offers a compelling description of what's constantly happening in the capitalist marketplace. It's both a warning about the prevalence of change and a reminder of the inescapable need for innovation to respond to it. It's thus an invitation to become an innovator.

"Creative destruction" also accentuates the important connection between strategy and innovation, and perhaps it also helps you see that you must align your strategic efforts with the broader patterns of innovation in your industry. This may also give you insight into the specific innovation processes that need to run inside your organization.

If you follow the model that's presented in the following chapters you'll rise to the challenge of creative destruction by developing an innovation portfolio of initiatives and projects; you'll manage those projects to completion and success with a rigorous innovation process; you'll develop a culture of innovation to evoke the highest levels of participation from everyone in your organization while also engaging an abundance of outsiders in the pursuit of innovation. You'll also design and implement the infrastructure that enables people and systems to operate at the highest levels of effectiveness.

The design for of all this will be your innovation master plan.

And as you implement it, you'll see enormous improvement in the quality of your innovation process, and more importantly in the results you achieve. You may or may not become the leader in your market, but you should expect to achieve significant improvement in your competitive positioning, in the value of your brand, and in your prospects for the future.

These are the "whys" of innovation.

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Please return to InnovationManagement.se for the subsequent chapters of *The Innovation Master Plan* by Langdon Morris.

You can learn more about his work and access additional writings and his blog at www.innovationlabs.com.

About this Book

This book is intended as a companion to my previous innovation book, *Permanent Innovation*.

During the four years since *Permanent Innovation* was completed, we've continued to refine our understanding of the innovation process through work with many organizations, and we've found that senior managers have a continuing interest in guidance in the design and management of their innovation initiatives. *The Innovation Master Plan* addresses many of those needs, and deals with aspects of the innovation process that *Permanent Innovation* didn't address.

In the course of preparing *The Innovation Master Plan*, I've also discovered some opportunities to improve *Permanent Innovation*, and as a result a revised edition is now available.

(You can download *Permanent Innovation* at
www.permanentinnovation.com)

About the Author

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Langdon Morris is a co-founder and partner of InnovationLabs LLC, one of the world's leading innovation consultancies. He works with organizations around the world to help them improve their proficiency in innovation.

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He is author, co-author, or editor of eight books on innovation and strategy, various of which have been translated into six languages, author of many articles and white papers, and a frequent speaker at workshops and conferences worldwide.

He has taught or lectured at universities in the US, France, Portugal, Taiwan, and Argentina, including Stanford University, the Ecole Nationale des Ponts et Chaussées and the Conservatoire National des Arts et Métiers, Paris, the University of Belgrano, Buenos Aires, and Chaoyang University of Technology, Taiwan.

early praise for

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"A fantastic piece of work, and a guide you must hold at hand when traveling in Innovation-Land. Use it as a reference in outlining your plan to future growth and profits. The business world has to be different, just start to build it ... with this Master Plan."

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"For anyone who is wrestling with the challenges of innovation in their organization *The Innovation Master Plan* is a must read. Langdon offers a comprehensive handbook that maps this uncertain territory by asking (and helping you answer) five key innovation questions; Why? What? How? Who? Where? Having taught "Needfinding" and design research methods at Stanford for the last 2 decades, it's clear to me that this book is a significant contribution to the field that will benefit students and experienced practitioners alike."

Michael Barry
Stanford University and Point Forward

more praise for

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"I love this book a lot.
I can be an innovation leader, because I keep providing my own industrial and educational visions to the related parties.
I can be an innovation champion, because I support all kinds of innovation activities in the industrial and academic societies.
I can be an innovation genius, because I learn, think and practice all sorts of innovation methodologies.
Most of all, I can be a master of innovation."

Justin Lin, Ph.D.
Chaoyung University of Technology

"Thought-provoking, enjoyable, and indeed inspirational! The key messages here are incisive and convincing. A very worthwhile achievement that deserves the widest readership."

John Holmes
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