Kellogg School of Management

LEADERSHIP, INNOVATION AND THE GLOBAL FIRM

Kellogg Innovation Network (KIN) Fall Dialogue 2007

Kellogg Innovation Network

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Summary prepared by:
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KIN Research Fellow

On Innovation as a Practice: "Innovation is really hard. It is so interdependent and integrated with so many different things: people, mindsets, company strategy, etc. As business people, we tend to want to take a lean operations or benchmarking perspective: Tell me what the great innovators do, and then I'll do it and have innovation as an outcome. But innovation is contextual and environmental, so learning it does not work that way. We've been humbled by how challenging innovation management is from a leadership perspective."

-Marla Capozzi, Associate Principal
McKinsey & Company

On Innovation Advocacy: "As a result of what I've learned at this event, I'm going to spend at least 40-50% of my time as we embark on our branded experience work, literally connecting people inside the company. If my goal is to accelerate the process of change, it's less about the coming up with innovations than implementing innovation. The key is building good relationships across functions."

-Don Fotsch, Vice President User Experience and Design
Paypal (eBay)

On Coordinating Innovation Teams: "I cannot overemphasize the importance of language, vocabulary and taxonomy inside a company….half of the change we have accomplished [at companies with whom I've consulted] is getting people on the same page, teaching them to speak each other's languages in order to create a common cognitive framework. For instance, what is the value proposition? What do you mean when you say that? What is the business model… really?"

-Mohanbir Sawhney
Kellogg School of Management

On Managing Research: "I like R&D spending to feel constrained. When there's too much, it's too easy. It's too easy to try without thinking. It's too easy to waste. It's too easy to throw things against the wall and see what sticks. Constrained resources and limitations push people to look for more creative solutions."

-Miles D. White, CEO
Abbot Labs

EXECUTIVE SUMMARY

KEY SUMMIT INSIGHTS

- Leadership must set the growth agenda and work to build a culture of trust where innovation can flourish. (If your business looks like it did ten years ago, you're probably behind!)
- Complexity kills innovation. Keep processes simple. (Yet large companies have an advantage over start-ups in their ability to manage large development projects.)
- Manage the cost of failure, not the rate of failure.
- Poverty and hunger can be good things, as they force people to question basic assumptions. More *funded* startup companies die of indigestion than starvation!
- Deliberate, diligent management of external and internal networks is the "special sauce" for innovation success.

FRAMING THE CONVERSATION: LEADERS ON LEADING INNOVATION

Marla Capozzi
McKinsey & Company

McKinsey conducted a survey of approximately three hundred (300) C-level executives and six hundred (600) professionals, the former group on innovation leadership practices and the latter on the optimal corporate climate for innovation. These results were combined with five deep dives at global client organizations.

Recommended leadership practices included the following:

- Setting a specific growth target for innovation, an *innovation aspiration*, defined as the gap between targeted overall growth and that which is estimated to come from base businesses. (However, only 32% of surveyed firms employ formal innovation performance targets and governance structures.)
- Set and re-set the emphases for innovation-led growth, tied explicitly to overall strategic planning: Incremental, strategic or breakthrough? Focused on products, technology, process, business model, value chain, etc.?
- Building trust and engagement with professionals, through active solicitation of involvement, openness to the expression of concerns, and encouragement of better ways of doing things

For professionals, the greatest motivations for innovation, beyond leadership encouragement and involvement, were quick execution, regular knowledge-sharing, and care in putting together the "right people" on innovation teams. However, leaders believe more strongly than professionals that there are not enough of the right people available, whereas professionals believe more strongly that the corporate culture is to blame for inhibiting innovation progress. Indeed, the survey found that leadership teams are not very tolerant of failure—only a third actively encourage learning from

failure—and about half acknowledge that their leadership team has not reliably followed up words with action and that they do not model the kind of innovation behaviors they wish to encourage in their organizations.

CEO PANEL

Moderator: Betsy Holden, KIN Senior Fellow; former Co-CEO, Kraft Foods, Inc.

Innovation, viewed broadly, is key to driving growth in today's environment. Innovation requires effective leadership. Top performing firms are distinguished by their leadership and their innovation climate. Our CEO's on the panel today, all members of the Kellogg Dean's Advisory, offer a variety of perspectives on leading innovation in different industries, using different approaches, with an emphasis on what'simportant for the CEO to do.

W. James Farrell, Former Chairman & CEO, Illinois Tool Works

ITW is, in effect, a collection of seven hundred and fifty (750) companies in forty-five countries. Such massive diversity demands particular management approaches. A key challenge is where to focus the entire business. For ITW, an "80-20" principle is applied throughout: i.e., focusing on the 20% of the businesses that drives 80% of the growth. Each company is kept small so as to be flexible, nimble and stay close to the customer. A central engineering resource—e.g., materials, adhesives, electronics, and the like—supports the core engineered products and systems businesses. Central engineering does not run any projects; everything is done in the business units.

Carol Bernick, Executive Chairman, Alberto-Culver Company

As a small company relative to competitors such as P&G and Unilever, we must innovate to survive. (Cannot compete with them effectively on supply chain, distribution, branding and such.) They are the game makers; we are the game breakers! Everyone in the company is focused on innovation. We share our failures. We work closely with our suppliers. We measure people against it. This creates a culture of innovation throughout the company, from the top to the production lines. We "light up people's brains" and push them to focus on big wins.

Miles D. White, Chairman & CEO, Abbot Laboratories

Abbot Labs is 120 years old. Many people, especially young people, think that means the company must be stodgy and bureaucratic, a place where not much happens. But a company could not be 120 years old in our business without growing and innovating. At our headquarters, we built a replica of the founder's home, which includes a display of every product the company has made from the beginning to today. It's a living example for our employees of how the company has had to adapt

and change numerous times. (Indeed, products that I launched are already obsolete and gone!) If your business looks like it did ten years ago, you're probably behind!

To manage an atmosphere of innovation, you have to expect it everywhere. It has to be OK to fail (and that takes work). And you have to ask for the impossible. When you demand a truly unique and difficult question, it's amazing what people devise. Asking such questions while constraining resources pushes people toward more creative solutions. However, in the restrictive regulatory environment of pharmaceuticals, one must be selective: Which things must go through a defined and controlled process, and which things do not have to?

Key innovation management insights from the Q&A

- Recognition of innovation by peers and management is a big thing, typically more important than financial compensation. (By the same token, moving non-innovative people out is also important.) Celebrate victories, so that the whole company knows when there's an innovative win. Related to this, it is important to turn fear of punishment for failure into a culture of learning from failure; e.g., through talking about problems publicly, sharing stories in internal websites, and screening potential recruits on their risk attitude.

- Innovation is enhanced when every person understands how what they do drives sales and profitability. This can be reinforced by keeping people aware of the people whose lives they touch, through letters, rotations in customer-facing jobs, etc. At Abbot, for instance, in every building lobby around the world, you'll see pictures of people who benefit from their products. Abbott routinely forwards calls from customers directly to the laboratory, so that the people there stay connected to the end user.

- Development of and training in innovation processes— particularly approaches that lead to faster decisions and implementation—can foster success. Manage the complexity of your processes, not the size of your organizations. P&G is huge, but its processes are not complex.

- Partnerships are difficult. Someone almost always ends up unhappy. If successful, someone feels like they did not get their fair share. If unsuccessful, then fingers start pointing. Hence, effective conflict resolution and value alignment procedures are critical.

EXECUTIVE PERSPECTIVE
Phiroz P. Darukhanavala, Ph.D.
Vice President & Chief Technology Officer
Digital & Communications Technology
BP, plc

The BP Office of the Chief Technology Officer (CTO) was formed in 2001 with the mission to exploit emerging information technologies (IT) in BP's various businesses. After a string of mergers, BP in 2001 consisted of 130 business units with more than one hundred thousand (100,000) employees operating in over 100 countries. BP's CEO at the time, Lord Browne, saw IT "not just as a service function but as an activity which could change the nature of the business itself." The world was going to continue to become increasingly digital, with IT infusing itself more and more into BP's traditional technology areas.

In BP's culture, large, internal organizations often breed bureaucratic resistance. Hence, Daru decided early on that the Office of the CTO should start small, with little budget and no formal authority, and build itself up its reputation on successful implementations with business units. Rather than attempting to engage most complex business unit challenges, his team focused initially on "where the energy was;" i.e., business unit problems for which IT solutions were most compelling, and where the business unit saw the possibilities.

After many meetings with IT companies, Daru modeled the CTO office on venture capital firms. These were small organizations, though nevertheless well-informed and nimble. The basic principle for the CTO office would be to bring in new digital technology from the outside to improve the company's operations and performance in areas beyond the traditional IT domains of transaction processing and enterprise resource planning. The ideal CTO team member has the following traits:

- Networking skills
- Solid and relatively broad technical background
- Fast learning
- Ability to work in an unstructured environment
- A team player
- Someone who is not discouraged easily

To build up the CTO office's network of IT providers, and to help BP business units understand the possibilities offered by emerging IT, the CTO office held a series of events, known as BlueChalks. Each Blue Chalk event focuses on a specific theme. Over time, the issues raised in BlueChalk events often became the basis for Game Changer Initiatives: A major program organized around a related group of technologies that promises to confer at least fifty million dollars ($50M) in business value. The CTO office also developed formal Technology Transition procedures to match emerging technologies with potential BP business unit needs. Over time, this seeding of internal BP networks has helped solutions spread. Daru characterized the process as setting small fires that coalesce into large wildfires.

After about four years of "pushing" IT solutions out to business units, and racking up a lot of wins, the CTO office began a Business Unit Partnering initiative aimed at bringing in more "pull," based on the most compelling business unit problems as seen by top business unit leaders. Based on their experience in several projects, the CTO team has become very adept at making the connection between small IT companies and large BP business units. (Fostering productive partnerships between large and small companies is a pervasive business problem.) They have found that IT companies are usually very happy to work with BP at their own expense, as BP offers them a "living laboratory" in which to prove out their technology solutions in a complex and often harsh industrial environment. (BP negotiates a variety of different IP sharing or price reduction agreements with technology providers.)

Will the BP model work at your company? To do so, there must be a large ecosystem of providers with which to network, and something that the company has to offer them in return. The CTO office has transferred aspects of its model to BP's alternative energy group, for instance.

EXECUTIVE PERSPECTIVE
Brian Ralphs
Director, Executive Awareness and External Relations
Digital & Communications Technology
BP plc

Brian expanded on how the CTO office conducts BlueChalk events. BlueChalks are aimed at building executive awareness of emerging technologies and how they might be applied to BP's business unit problems, in a non-threatening way. BlueChalks are powerful, interactive, strategic enquiries. The strategic element is central: It's not about solving a particular problem. It's about asking questions about the art of the possible. We do it by engaging the world's thought leaders in a given area, as well as practitioners who can tell compelling stories about their experiences.

There is much attention given to the layout of the room and seating plan. Internal groups are broken up, for instance, so that people don't spend time visiting with their colleagues rather than engaging with the vendors, academics and thought leaders in the room. (BlueChalk attendance is strictly by invitation.) The first day of a BlueChalk event focuses on "inputs:" Describing the technology and problem landscape, presenting illustrative case studies, and engaging in conversations in which the participants can make linkages to their own experiences and business unit priorities. The second day focuses on internalizing the lessons, through case study discussions and focused breakout groups. A skilled facilitator is used to bring coherence to the learnings.

LEADERSHIP AND THE EMEGING INNOVATION TOOLSET

Robert C. Wolcott
Adjunct Assistant Professor, Kellogg School of Management
Co-Founder & Director, Kellogg Innovation Network (KIN)

Save for a few companies, such as 3M during the 1970s and 1980s, new business creation by large, established firms has been an exceptional, episodic occurrence. Recurrent innovation was seen as anathema to what was thought of as a random, opportunistic process driven by itinerant individual maverick champions. Even where a corporate laboratory was successful in inventing numerous innovative things—such as Xerox's Palo Alto Research Center or Motorola Laboratories—the parent corporation more often than not failed to realize their potential. This was typically due to not fully appreciating or being able to implement a business strategy based on new customers, new channels, and the like, requiring consistent top leadership support to overcome organizational barriers to such changes.

During the past two years, our Kellogg study team examined emerging solutions to the "corporate entrepreneurship" problem. We characterized programs at about two dozen firms, identifying two key dimensions (out of many) under the direct control of management that are critical to successful new business development: Organizational Ownership (who is charged with accomplishing corporate entrepreneurship?) and Resource Authority (who controls money and personnel?). This leads to the four approaches described in our Sloan Management Review article, which was part of the pre-read for this event. That article highlights the different leadership challenges associated with each approach.

One of the key things to keep in mind is that each phase of the innovative new business development process requires different skills and metrics. In the early stages, where uncertainty is high but costs are low, the focus should be on exploration, using options management thinking to manage the *cost* of failure, not the probability of failure. As a proven new business concept begins to ramp up, uncertainty decreases but costs increase dramatically. This makes this stage the highest risk portion of the development process, and requires very flexible and rapid management adaptation, keyed to market feedback. Finding "business builders" who are capable of coping with this turbulent period in new business development is typically a challenge for large companies. Once the new business is viable, one moves into execution phase, where the ordinary competencies of the established firm come into play. At this stage, the new concept can begin to be managed as an ordinary part of the business.

WRAP UP

Mohanbir Sawhney
Professor, Kellogg School of Management
Director, Center for Research in Technology and Innovation (CRTI)

A major theme of our discussions was the cultivation and exploitation of internal and external networks; i.e., relationships built in a culture of trust and under the stewardship of committed leadership. The BP model was a wonderful example of how external networks can be the primary source of innovation. It can support internal experts regardless of what business you are in. Indeed, as the BP case made clear, internal business needs must be what drive the search for external solutions.

The need for external networks will increase as more companies take on an open innovation approach. At that point, companies will begin competing for thought leadership, to attract the attention of the top innovators in their field. For instance, there are about fifty cardiologists that all of the medical device companies try to woo.

How to marry the internal ecosystem with external network is a big problem. Trust is the key issue. In order to build a reputation and a relationship, you need to think about how to help others first; i.e., what is value you can bring in to your partner, rather than other way around. Also, the IBM experience showed that it is critical to become open internally before going outside. (That's a lot of what their Innovation Jam processes are about. They in fact use the same network-building and communication tools internally as externally.) The level of internal openness is a limiting factor on what can be absorbed externally. Finally, one needs translators between the language of the product manager and that of the technology provider.

Retention of entrepreneurs can be a key benefit to internal networking. Sometimes, the CEO is the only person who can stop the HR department for inhibiting innovation! Another technique has been employed at Cisco. They will sometimes spin out a company so that the innovation team can better attract talent and accelerate development. Then, if successful, the company may be given the option to spin back in to Cisco for scaling into the mainstream market.