DRIVING SUSTAINABLE GROWTH AND INNOVATION:

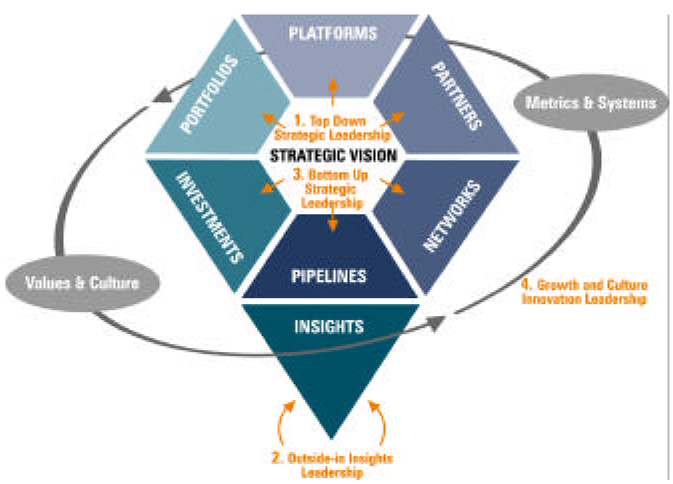
Pathways to High Performance Leadership

Adapted and updated from The Innovation Premium: How Next-Generation Companies are Achieving Peak Performance and Profitability [Perseus Press, 2000]

by Ronald S. Jonash

Re-engineering. Cost-cutting. Automation. Mergers. Acquisitions. Successful corporate strategies all – at least at one time. But what worked in the past is less likely to work in today's (and tomorrow's) fast-changing business climate. For many companies, some or all of these strategies have already reached the point of diminishing returns. When the next geographic expansion is somewhere in central Africa, when the next round of headcount reduction cuts real muscle, when the next new product is merely a new flavor or shape, and when the next acquisition dilutes earnings and retards growth, the time has come to find new pathways to growth and high performance.

PATHWAYS TO HIGH PERFORMANCE INNOVATION LEADERSHIP



The challenge for business leaders, across all industries – is to recognize and accept a new reality in which easy answers, quick fixes and magic bullets are harder to find. A reality in which pathways to success are increasingly complex and ambiguous. A reality in which organic growth and innovation emerge as the key drivers of sustainable top – and bottom-line growth.

Our ongoing research in this area [see *The Innovation Premium…By the Numbers,* page 7] clearly demonstrates that if corporate leaders want to capture significant value for their shareholders, they must create substantial value for their stakeholders, they must raise the sustainable growth expectations of their investors, and they must demonstrate the ability to deliver on these expectations.

For most companies, this means cost-cutting, M&A and operational excellence must be augmented by a sharp focus on building and driving engines for sustainable growth and innovation.

In our continued analysis of industry leaders who have been able to drive sustainable growth and innovation over the long term, four major differences have emerged:

1. They have chosen to focus their strategies around organic growth and accelerated innovation – building portfolios of compelling and differentiated offerings for well understood customer and market segments; building powerful innovation platforms supported by a rich pipeline of products and services; and building a more robust network of sources and partners who can deliver superior value across the extended enterprise.

2. They know the marketplace well and can effectively take action on their intelligence — combining a wide range of insights (customer and consumer, technology convergence and standards, value chain and competitors) a multitude of idea "sources" and "depositors," and a robust concept to customer innovation process.

3. They apply disciplined processes more flexibly to the growth and innovation arena – where pipelines need to be constantly adjusted, where fast to failure and accelerated experimentation is often as important as guaranteed success.

4. They develop new metrics and measures that shift the behavior and culture of the organization toward sustainable organic growth and innovation – including both business scorecards and individual and team performance measures.

Building a compelling and differentiated strategy for growth, driving it off of powerful market and competitive insights, delivering on the strategic promise through superb execution, and sustaining it all in the face of continually changing conditions is a daunting challenge in any industry. Yet these are the four pathways that leaders are following to drive success. Here is a closer look at each.

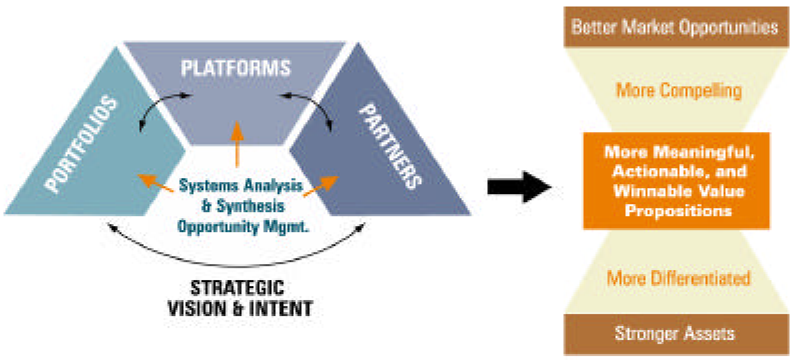
CHOOSE YOUR RACE AND SET THE PACE

Focus your strategies around organic growth and accelerated innovation

Sustainable innovation and growth start with — and cannot survive without — top-level strategic leadership:

- Leaders must move beyond buying markets and customers solely to build scale. With the growing advent of mass customization, successful industry leaders are increasingly building a diversified set of product or service components that can be customized to meet the varied needs of different customer sets. Although companies like Dell Computer have taken this practice to new heights, almost all leaders in organic growth and innovation have had some success in this arena, especially with their highest value customer segments. And though many strategies focus on building loyalty and share among the highest value customer sets, the best strategies are able to convert "lower-value" customers into high-value segments through compelling and differentiated value propositions (think Jet Blue and Southwest Airlines).
- Successful leaders also use their strategic vision to move beyond products to focus on what we call growth and innovation platforms; bundles of existing and emerging competencies, technologies, assets and partners clustered around a compelling and differentiated value proposition and directed toward a well-defined set of customers and markets. This strategic focus on a unique value proposition enables

APPLYING STRATEGIC DEVELOPMENT TOOLS IN NEW WAYS



companies to manage continuous streams of innovation across traditional business unit boundaries and focuses them around themes that will make a significant difference to the market. (e.g. miniaturization from Sony, digital display from Canon, flame broiling from Burger King, one-hand held convenience from General Mills).

- Corporate leaders must move beyond channels to focus on establishing well-aligned partnerships (both internal and external) with the potential to become strong win-win drivers of accelerated growth and innovation.

Most successful companies already have strong vision or mission statements, many of which incorporate aspects of the above dimensions, especially in the product/market portfolio arena. But few have developed the well-honed innovation-and-growth strategies that integrate across all three of these key dimensions. In the case of Millennium Pharmaceuticals, one of the industry leaders in bio-pharmaceuticals, the structure and focus of its corporate strategy is explicitly around the integration of these three elements. What sets the Cambridge Massachusetts-based biotechnology firm apart from its peers is that its leaders recognize the importance of focusing on compelling and differentiated innovation platforms that are leveraged across a strong portfolio of sources, partnerships and alliances. It is not focused single-mindedly on producing, producing, producing. Millennium's leaders faithfully adhere to a mantra that senior executives in any industry would do well to follow: We do not focus on products; we focus on creating value for all of our stakeholders.

This deep commitment to strategic innovation that both creates and captures value has yielded an undeniable payoff: Founded in 1993, Millennium achieved break-even status for three of its first six years, and despite the recent biotech slowdown, the company has set the pace for shareholder value and growth in its industry, and it has done so by means of an innovative interplay of the following:

- *highly leveraged partnerships* with the likes of SGP, Abbott, Xenova, Bayer and Genentech;
- *highly robust innovation platforms* in genomics—driven drug discovery, high throughput screening and clinical simulation; and
- *highly enabling technologies* such as leukocyte activation, kinase mediated signaling, and SNP detection.

Ask yourself this key question: How well do we articulate and drive growth strategies that make sense to all of our stakeholders; shareholders, partners, customers, and associates, and how compelling and differentiated are these strategies?

KNOW THE COURSE – AND WHEN TO BREAK

Know your marketplace well and translate intelligence into real and actionable insight.

Any jockey who wants to be first across the finish line must intimately know his horse, the course, his competitors, and, his own strengths and weaknesses. He must have a well-thought-out pre-race strategy, but be smart, nimble and gutsy enough to change it on the fly, if and when conditions warrant. And he must possess the knowledge, experience, intelligence and instinct—which collectively comprise insight—to decide when he should hang back, when he should keep pace with the leaders—and ultimately when, he should surge ahead to victory.

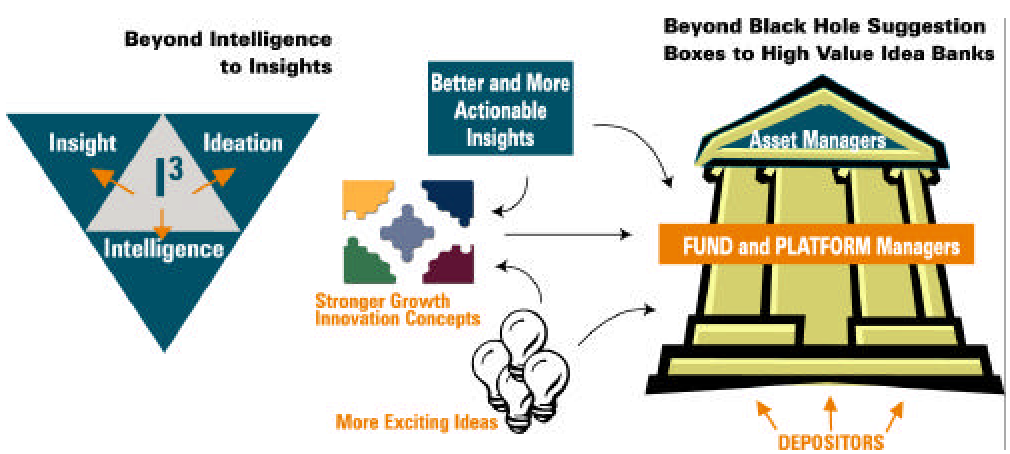
Ask yourself this key question: How deep are our insights about ourselves, our customers, our environment, our stakeholders and our partners? And how well-positioned are we to act on those insights?

So it is with companies, and the managers who wish to lead them to the winner's circle. They must transcend mere knowledge to achieve true intelligence, real insight and powerful ideation around such key drivers of business success (or failure) as customer purchase, choice and use behavior; emerging and disruptive technologies; and new performance, policy or regulatory standards. And they must use those insights to decide when to husband their resources, when to be a "fast follower," and when to break away from the pack with new products or services.

This means that, when it comes to their customers, they must replace the traditional suggestion-box or consumer-complaint mentality with "idea banking": a system that values and communicates well with a company's "depositors"; optimizes the bundling of complementary deposits; and maximizes the return on concepts that ultimately drive superior earnings growth.

One company that epitomizes the virtue and value of deep market and customer insight is Nokia. For decades, the little-known Finnish conglomerate floundered, as sales in its paper, rubber and telecommunications divisions eroded. Today, it is the world's number one mobile phone maker, and is aiming for the top of the mobile internet market, as well. How did Nokia do it? By redesigning its innovation process so that once-cloistered engineers became more integrated within the company

TRANSLATING INTELLIGENCE IN ACTIONABLE INSIGHT



and better acquainted with the needs of customers, the demands of the marketplace and the logistics of production. Today, ideas and information are shared across the enterprise, and developed via flexible, multifunctional teams and technology and innovation platforms. These teams are charged with integrating insights about customers and competitors, emerging technologies and standards, and alternative and future scenarios into a robust concept to customer innovation process. The team's metrics are aligned with this objective and the traditional boundaries between internal functional silos and business and between external partners have been largely eliminated. As a result, when market conditions demand, Nokia can launch a new product from a standing start in less than six weeks. And the company's brimming inventory of product and service ideas means that winners can be quickly pulled down from the shelf in order to establish or maintain leadership and expand the company's reach.

KEEP AND ACCELERATE THE PACE

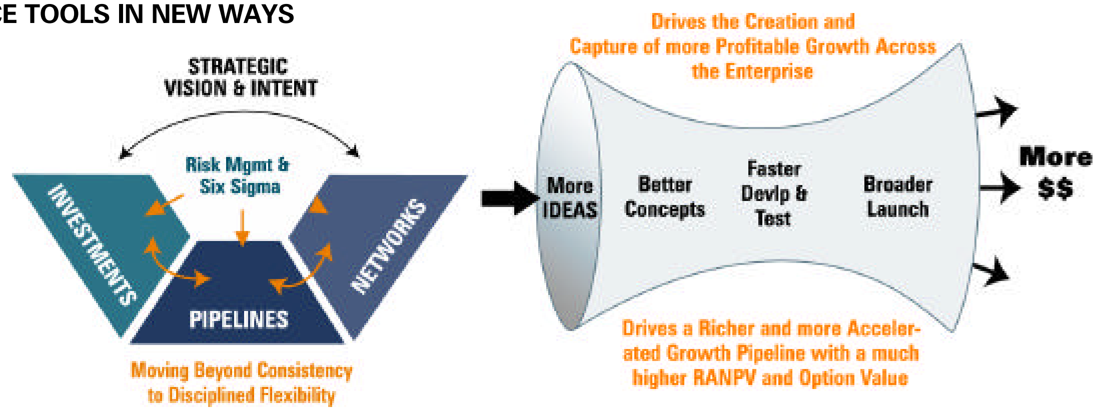
Apply disciplined execution approaches more flexibly to the growth and innovation arena

The principles of Six Sigma and other operational-excellence programs have proven their worth – and leading companies are now applying these and other disciplined approaches to organic growth and innovation. In this arena, successful leaders focus their attention on pipelines: the accelerated development and enhanced deployment of new products, services, businesses, channels, standards and delivery mechanisms. In this context, however, operational-excellence principles must be applied more flexibly than they have generally been applied. These processes, which are necessarily complex and ambiguous, cannot be held to standards of unwavering consistency and zero defects. Where innovation is concerned, "fast to failure" is often as important as "fast to success," and a batting average of .400 can lead the league. Thus, the goals are to:

- move beyond stage-gate project management to equally disciplined but more flexible and nimble pipeline management, with multiple pathways to success from R&D all the way to end users (a stream we call concept to customer);
- move beyond hierarchical command-and-control structures to more networked and collaborative organizational systems that can drive growth and innovation across business units, functional silos and the entire value chain; and
- move beyond narrow definitions of capacity utilization and efficiency to broader goals around leveraging and boosting the productivity of both tangible and intangible assets across the entire extended enterprise.

Alcoa exemplifies leadership in applying these principles to become a growth and innovation leader in an industry perceived as mature/commodity. This US based aluminum

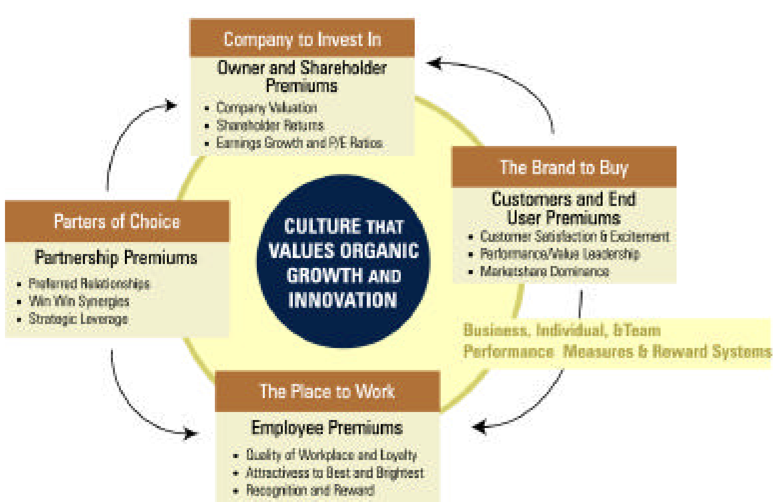
APPLYING OPERATIONAL EXCELLENCE TOOLS IN NEW WAYS



giant is known for introducing aluminum beverage cans to the packaging industry, the aluminum space frame to the automobile industry, and a multitude of advanced alloys to the aerospace industry. Rather than rest on its laurels, however, it has pressed ahead with an ambitious, innovation-centric strategy to extend its enterprise globally and improve communications and manufacturing techniques, while also attempting to cut production costs and inventories. In order to do so, it has radically streamlined the organization to ensure that knowledge is shared, processes and people work seamlessly together, and innovation is nurtured throughout the company rather than relegated to any particular hierarchical structure or silo. Today, a complex array of formal and informal teams and networks promote close collaboration and sharing of best practices across facilities, business units and the extended enterprise. When it comes to new ideas and technologies in both the operational and product arenas, Alcoa is constantly raising the bar.

Ask yourself this key question: How effectively do we align and manage our resources and processes with our growth strategy?

BUILDING METRICS TO SHIFT BEHAVIOR TOWARD GROWTH AND INNOVATION



SUSTAIN THE PACE AND WIN THE RACE

Build a system of metrics that shift the behavior and culture of the organization toward sustainable growth and innovation

Metrics matter, but the right metrics matter even more. Our practice and recent research jointly with Stanford and Rice Universities have shown that too many companies assess what's easy to measure, rather than what's important to measure. In order to be effective, metrics must gauge team as well as individual performance, and must serve as the basis for team performance-based recognition-and-reward systems. Because in the end, the most important scorecard is that which helps a company become the brand to buy, the place to work, the partner of choice, the company to invest in.

In the same way, innovation-savvy firms will sometimes throw out the old rules about corporate behavior and culture and create new ones of their own, on the fly. Perhaps no modern-day company exemplifies this more than Southwest Airlines, a company whose now-legendary rule-breaking innovations – from cheap fares and fast equipment turnarounds to ticketless travel and proprietary reservation system to an emphasis on customer service and (literal and figurative) employee buy-in – have made it the biggest airline success story of the past three decades. Their costs that are consistently well below industry average and operating margins are consistently well above. (Testimony to its accomplishments: The raft of imitators such as JetBlue, Song, and Ted now bent on exploiting and expanding its groundbreaking approach.)

Southwest has developed bold new approaches to a tradition-bound industry. It has aggressively leveraged its assets, human and otherwise, in its pursuit of continuous innovation. It has, as another innovative company, Apple, would put it, "thought different." And by doing so, it has won.

Is there risk involved in committing to these pathways of high-performance leadership and sustainable growth and innovation? Unquestionably. But when properly conceived and managed, driving organic growth innovation yields rewards that repay the risk many times over. Conversely, in today's hyper-competitive business climate, not taking active steps to build sustainable growth and innovation may be the biggest risk of all. ♦

Ask yourself this key question: How well have we built our organizational capabilities and behavior to support sustainable growth and innovation? How clear and compelling is your strategic vision?

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The Innovation Premium...By the Numbers

Managing innovation for sustained superior results and organic growth is a difficult and complex task. But our research indicates that the impact on the bottom line usually more than repays the time and effort invested.

This research confirms that next-generation businesses that innovate consistently and effectively - not just in products or services, but also in strategy and operations - drive superior rates of profitable organic growth and are accorded a premium in the marketplace. These companies are more valuable to owners of their equity and debt, and more valuable as suppliers and customers of choice in their webs of commercial interaction.

The Innovation Premium, published in 1999, and based on extensive cross-industry research between 1992 and 1998, demonstrated a strong positive correlation between a company's effective focus on innovation and organic growth and their future shareholder returns. It showed that companies who were rated by us as innovation leaders in the industry in 1992-93, performed significantly better over the following 5 years than other firms. In mid-2003, we went back and looked once more at these companies to see whether they still (particularly after a down market) commanded an "innovation premium." One of the companies had been acquired, and thus disappeared from the sample. Of the remaining nine who had been profiled in the 1999 book, eight significantly outperformed their industry, by margins from 70 percent to a stunning 650 percent of the original investment.

While there are many factors that drive shareholder returns and value, these companies explicitly chose to strategically focus on innovation leadership. And that focus has clearly paid off. The conclusion is inescapable: In good times and bad, innovation leadership has held its own as a competitive differentiator and a driver of both performance and organic growth.