

UNLIMITED POTENTIAL

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Newsletter

Tough Times Call for Disruptive Innovation

"It's an environment the likes of which managers have never seen – a Great Disruption in which the old rules for success become recipes for failure, and 'doing more with less' will not be nearly enough to survive." – Scott D. Anthony, *The Silver Lining: An Innovation Playbook for Uncertain Times*, Harvard Business Press, 2009

The inevitable constraints this tough economy imposes on companies provide fertile ground for innovation because necessity truly is the mother of invention. Companies that learn to innovate more quickly, cheaply and with less risk will emerge from the downturn stronger than ever.

To succeed, smart executives will need to adopt a different mindset and effective frameworks to determine what to start doing, stop doing and do differently. Consultant and author Scott D. Anthony, who earned his MBA at Harvard Business School, prescribes a disruptive-innovation mindset.

Over the last decade, technological improvements have made starting and scaling businesses easier than ever. Brazil, Russia, China, India and other emerging markets prove U.S. leaders have more competitors at home and abroad. Industries are frantically converging and colliding.

These changes make it more difficult for great companies to maintain success – a problem that has caused leaders to lose sleep for some time (even before the 2008 financial market collapse).

Tough business environments force companies to take a hard look at innovation. While output may shrink and unemployment is sure to rise, companies that master these challenges have a chance to thrive. Those that don't are sure to struggle.

A Historical Perspective

While no one can predict with certainty how the global economic crisis will play out, many companies face serious challenges:



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- Should they cut costs and streamline innovation projects until business picks up?
- Should they play it safe until the current storm passes?

If history is a guide, the answer is a definitive “no.” We can restore hope and gain a better perspective by taking a step back and considering how past downturns were resolved.

Many successful companies have been launched during recessions. Grim economic times can highlight previously hidden problems or cause old problems to intensify. When a deep-seated customer problem emerges, search for novel ways to address it.

National Cash Register was founded in 1884, the year of “the Great Panic.” At a time when investments from coal and railroads were sharply declining, the Patterson brothers decided to commercialize the mechanical cash register. At the time, they invested \$6,500. Today, NCR has more than \$6 billion in annual revenue.

Thirteen of the 25 companies on the Dow Jones Industrial Average, as of December 2008, were formed during an economic downturn, including 3M, General Electric, Microsoft and Walt Disney.

A number of game-changing products, services and business-model innovations were developed or launched in daunting economic climates:

- In 1876, Bell developed the technology underpinning the modern telephone.
- In 1900, Eastman Kodak launched its Brownie camera, transforming the world of photography.
- In 1948, McDonald’s pioneered its fast-food service technique under the name Speedee Service System.
- In 1957, Sony introduced its transistor radio.
- In 1961, Procter & Gamble introduced the Pampers brand of disposable diapers.
- In 1981, IBM launched its first personal computer.
- In 1982, Nokia introduced its first car phone.
- In 2001, Apple launched its first version of the iPod.

Disruptive Innovations

Instead of trying to best their competitors, disruptors change the game. They typically transform existing markets or create new ones by focusing on convenience, simplicity, accessibility or affordability.

Harvard Business School Professor Clayton Christensen, author of *The Innovator’s Dilemma*, describes

disruptive innovation as a corporate effort to redefine quality, adopt new technologies and anticipate customers’ future needs.

Subsequent research has identified more than 200 disruptive developments over the last 50 years, across a range of industries. Some disruptions reshape existing markets:

- Discount retailing (Wal-Mart)
- Low-cost automobiles (Toyota)
- Steel mini-mills (Nucor)
- Digital music (Apple)

Other disruptions create entirely new markets:

- Personal computers (Apple, IBM)
- Online advertising (Google)
- Online auctions (eBay)

You would think recessionary times would be particularly hard on up-and-coming disruptive companies that haven’t yet broken into the mainstream. Logic dictates that when consumers are closing their wallets, unfamiliar newcomers pay the steepest price.

But history suggests otherwise. The innovation research company Innosight analyzed how up-and-coming disruptors (those with revenues of less than \$1 billion) performed in the face of the last three U.S. economic downturns (as dated by the National Bureau of Economic Research to cover 1980-1982, 1990 and 2001).

In 1979, 11 companies, including Intel, Home Depot, Nucor and Southwest Airlines, fit these criteria. Their revenue grew at a compound annual rate of 22 percent between 1979 and 1982.

Between 1989 and 1991, the sample of 11 up-and-coming disruptors, which included Best Buy, Cisco and Charles Schwab, grew revenues by 33 percent.

The pattern continued in the 2001 downturn. Between 2000 and 2002, 23 up-and-coming disruptors like Google, Amazon.com and Research In Motion (maker of the BlackBerry product line) grew revenues by 32 percent.

The sample is heavily biased, but the directional results are interesting. If you work for an operating company that is debating whether to postpone innovation efforts until better times arrive, be cautious. You may miss powerful growth opportunities. Furthermore, by waiting, you create space for competitors to step in with novel advantages in tomorrow’s growth markets.

The Abundance Paradox

Abundance is actually the root cause of many corporate struggles with innovation. Too much time or money often leads companies to continue following fatally flawed strategies. Their leaders create overly complicated solutions that overshoot customer needs.

In contrast, constraints often enable innovation in the retail industry. Over the last century, there have been numerous significant business-model innovations:

- Wal-Mart's discount model
- Costco's warehouse club model
- Inditex's Zara fast fashion model
- Amazon.com's collect-cash-before-you-contact-suppliers model

One explanation for the retail industry's inventive business models is scarcity. The constrained retail environment leads them to funnel creativity to where it can best be applied.

Entrepreneurs are another example of flourishing innovators. They have no choice; if they fail to rapidly adapt, they run out of money. Bad times force discipline, which allows companies to impose sharper restrictions that inspire creativity.

There's never been a better time for innovators to face tighter purse strings. A lot has changed since the last global recession in 2001. Innovation can happen more quickly and cheaply.

Tools like prediction markets, collaboration software, design tools, virtual focus groups and markets of low-cost specialists can dramatically expedite the innovation process.

Facebook was launched in a dorm room and became a community with millions of members in less than five years. Entrepreneurs and corporate innovators have never had more affordable ways to move an idea forward.

The Transformation Imperative

Survival really comes down to change or die. In the 80s and 90s, companies could grow bottom-line profits by focusing on operational excellence. Today, most well-run companies have little fat left to cut.

In the Great Disruption, companies have two choices: Live with shrinking profits and increasing chances of extinction, or follow a completely different approach.

The challenge is steeper than eking out incremental improvements or expanding into new markets.

It's about reinvention or transformation.

Improving what companies already do won't be enough. You'll have to perform in ways that are fundamentally different from your status quo. Perpetual transformation is the only way to thrive during the Great Disruption.

A 2008 Innosight and Forbes survey found that close to 80 percent of respondents recognized the fundamental need for transformation. About two-thirds reported allocating resources toward transformation, but only 12 percent said they were making excellent progress in their efforts.

Furthermore, 80 percent of respondents reported that the current economic climate increased the need for transformation, even as resource allocations remained constant.

Apple and IBM are often cited as having mastered perpetual transformation, which requires them to enter new markets and leave old ones.

Companies rarely transform themselves through cost-cutting or improved operational effectiveness. While the latter is necessary to compete, it's insufficient to drive long-term competitive advantage.

More often than not, companies fail when they try to go beyond their core business. But in the Great Disruption, they really don't have a choice.

Investing in transformational efforts in a brutal market appears difficult, but the alternative isn't stagnation – it's extinction.

Disruptive Guidelines

To develop a disruptive mindset, managers must master four areas:

1. Liberate resources for promising innovations by prudently shutting down dead-end projects and declining businesses.
2. Drive fresh growth by re-features existing products and services and reinventing outdated processes.
3. Mitigate risks by conducting strategic experiments and forging alliances with customers, competitors and suppliers.
4. Appeal to value-conscious consumers and fend off low-cost attackers by delivering "good enough" offerings at an affordable price.

The Executive Challenge

Systematizing disruptive innovation is a different beast. Senior executives must think and act in ways that run counter to everything they have done to succeed in their careers. How do you simultaneously manage two different instincts: one operational, the other entrepreneurial?

Executives who encounter tough times naturally become more conservative. It's hard for them to tolerate creative thinking when they face the prospect of downsizing. But companies that play it too safe can wind up in trouble down the road, and frustrated managers may quit, leaving their firms ill-equipped to function effectively once the downturn ends.

What can you do to harness creative talents? One approach is to give innovators freedom to dream up bold, new ideas, as long as they can use low-cost experiments to show value. You can involve creative minds in core business challenges.

Leaders, managers and employees at all levels must improve their abilities to master seemingly paradoxical demands. Innovation practitioners need to strengthen their creative muscles, which include associational thinking and discovery skills like questioning, observing, exploring, challenging assumptions and networking.

Embracing paradox and systematizing disruptive innovation have graduated from niceties to necessities. Leaders can master these requisite skills by:

- Developing an awareness of themselves and others
- Creating a personalized program of developmental leadership with an executive coach
- Striving to improve their ability to spot hidden opportunities and act in more entrepreneurial ways
- Scheduling regular excursions to observe how certain customers use a product or service
- Attending a conference in a different industry
- Learning to ask more "what if..." questions

The economy may be unhealthy, but innovation and entrepreneurship remain alive. Make sure they thrive in your company. There are ample opportunities for corporate innovators to create booming businesses that transform what exists and invent what doesn't.

Herdlinger Associates

P.O. Box 20389

St. Simons Island, Georgia 31522