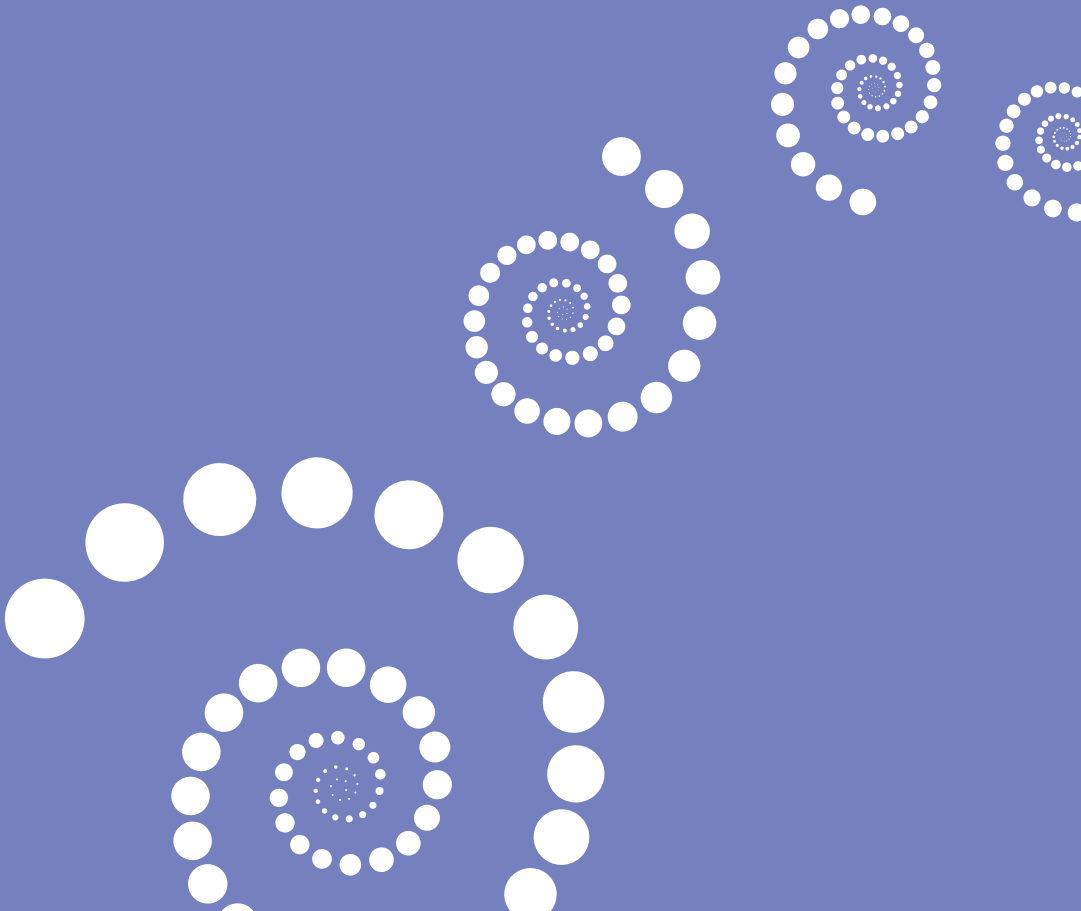


December 2010

NESTA Making
Innovation
Flourish

Organising for Innovation

Ian Davis



Contents

Introduction	3
Context	4
Organisational characteristics of innovative organisations	6

NESTA is the UK's foremost independent expert on how innovation can solve some of the country's major economic and social challenges. Its work is enabled by an endowment, funded by the National Lottery, and it continues to operate at no cost to the taxpayer.

NESTA is a world leader in its field and carries out its work through a blend of experimental programmes, analytical research and investment in early-stage companies.

Introduction

What are the characteristics of enduringly innovative organisations?

Organisational economists and business people have long debated this question, because they know that innovation is a key factor in driving productivity and growth.

In this lecture I would like to offer some personal perspectives on the defining features of innovative organisations. These perspectives are based primarily on 30 years of working with companies in the private, public and social sectors across the world. I will emphasise the importance of leaders having a clear innovation purpose; the vital role of incentives and performance management in stimulating innovation; the importance of involving young people in decision-making; and the importance of an open culture that embraces enquiry and ideas beyond the narrow boundaries of its own organisation and industry.

Context

Before I develop each of these points I would like to make a few contextual assertions about the importance and prioritisation of innovation.

Innovation has a glamorous and worthy ring to it. We all know that organisations and societies that don't innovate or change will die. Few politicians or business leaders neglect to trumpet the importance of innovation. But innovation can also be dangerous. An emphasis on innovation in any particular organisation requires justification and challenge, as well as appropriate management and identification of the consequences. Until three years ago, for example, many observers were citing the wholesale financial services industry as an exemplar of productive and transformational innovation. In other sectors the risks of innovation are even more obvious. You would not automatically encourage a culture of innovation in a nuclear power plant, for example, or in an operating theatre where surgery is being carried out on a two day-old baby.

Innovation can, on occasion, be harmful if it crowds out more important or more urgent priorities. In many industries the need for financial stability, cost competitiveness and efficiency can be far greater than for innovation. Efficiency is not always a word that finds favour or raises the spirits (particularly, perhaps, in the UK), but it is vital. Innovation without efficiency is usually a losing game and organisations seeking to become more innovative should not overlook this. I have seen more organisations (companies, NGOs, even countries) founder because they are not cost competitive or operationally sound, than because they are not innovative.

The above observation notwithstanding, I believe that the pressure to innovate will intensify in the next decade. Globalisation, and the attendant

increase in opportunity and competitive intensity, is transforming whole sectors and industries and increasing the pressure to innovate. We have in all probability only seen the start of this trend, at least in the private sector. Assuming that there is no protectionist backlash, we will surely see more Chinese and Indian products and brands on Western shelves, as well as increased opportunities for export trade with the rapidly developing economies in emerging markets.

Technology is another underlying force that will drive innovation, as it has done for the last three hundred years. The difference now is that, with the establishment of the internet and low-cost computing, technological know-how is broadly accessible and often capable of rapid replication. It is creating huge opportunities in product development and process improvement, as well as encouraging new approaches to marketing. Again, this will intensify competition and enhance the importance of innovation.

Environmental challenges and resource scarcity are other forces that will add to the pressure to innovate. The one potential opposing force (and it is a big one) is that politicians and regulators will adopt protectionist or restrictive measures to slow down competitive intensity or to reduce the perceived consequences. But, overall, I think that the need to compete, aligned with increased transparency of absolute and relative performance, will increase demands not just for greater efficiency but for greater innovativeness. Over time this will apply as much to the public and social sectors as to the private sector.

Organisational characteristics of innovative organisations

What, then, are the characteristics of enduringly innovative companies – companies that can sustain a pattern of innovation? I would single out four:

1. Clarity of purpose

First is clarity of purpose. Clarity of purpose always sounds obvious but it is a critical feature of successful innovation. Clarity of innovation purpose requires a clear articulation of whether a company is intent on innovating and, if so, what its innovation priorities will be. As I have said before, a meaningful focus on innovation requires explanation and justification. There will be times and circumstances when the focus will be primarily on, say, acquisitions or survival or consolidation. Enduringly innovative companies are clear about this and also about the risks (and the consequences of those risks) that they are prepared to take. They are not only clear about risk tolerance but consistent in its application. Too many companies talk an innovation game but will backtrack or compromise at the first whiff of grapeshot. Employees will quickly figure out the real priorities. Organisations that are unable or not prepared to live with the risks and costs of innovation (at least for a period) would be better off acknowledging that reality upfront.

Companies with a clear sense of innovation purpose know what types of innovation they will pursue and emphasise, be it product innovation, process innovation or innovation in management systems ('business model' in the current jargon). Product innovation is not the only type of innovation that matters nor is it necessarily the most productive innovation. Credit for Toyota's initial success, for example, is often attributed to its adoption of innovative manufacturing processes and techniques (lean) and to its then novel

teamwork-based organisation. Procter & Gamble, as another example, publicly talks of itself as a company prepared to market other people's innovations and indeed has reallocated its research budget towards commercial development. Of itself, this is an innovation in management system even if it means a lesser focus on basic product research. It's a big mistake to correlate or confuse R&D expenditure with innovation or innovativeness.

Very few organisations can handle more than two of the three broad types of innovation (product, process, management system) at the same time. Conceptually they are not incompatible but, for practical and risk reasons, usually focus and hence choice is required. Enduringly innovative companies are clear on this.

As important as innovation focus is transparency about the nature and style of innovation. Continuous innovation, transformational innovation and disruptive innovation have different strategic, managerial and risk consequences. And some companies will choose an adaptive, rather than innovative, approach to change. Style of innovation (and change management more broadly) is a huge topic in its own right, but suffice to say here that it is important to be absolutely clear on the style chosen.

My final point on clarity of innovation purpose relates to consistency of language. Too often leaders mix up ideas, creativity and innovation. They are distinct, if related, concepts. Ideas are a foundational part of innovation, but usually only a small part. Ideas are ten a penny. Somebody once described innovation as ideas made productive. The hard bit is not usually the idea but in making the idea productive and commercially viable. That's why the best innovative companies respect multiple disciplines in the innovation process and involve them throughout the process of making the original idea productive.

2. Signals and incentives

Incentives for innovation have to be established and aligned with innovation purpose and strategy. Incentives are more than financial rewards and include recognition and prospects for advancement, as well as consistency of communication and emphasis.

In reality, the alignment of incentives with innovation strategy often does not happen. Leaders often proclaim for example the importance of innovation but when they talk at internal management conferences the emphasis is on earnings or cost reduction. Annual reports similarly rarely convey an emphasis on innovation, even if it is a stated priority. Such messages send a mixed signal, particularly to employees. A person's sense of humour is best judged by the quality of their jokes, rather than by how funny they say they are.

Appointments can be another important signal for the innovative organisation. CEOs who talk about the importance of innovation but appoint people with reputations for control and bottom line orientation risk sowing confusion. Appointing people with demonstrable, innovative track records will send much more powerful messages to an organisation about the importance of innovation. Annual appraisals and reviews in innovative organisations focus as much on innovation (what you have done that is new and different?) as on results. The final signal and incentive I would pick out is performance management. The notion that innovators and innovation cannot be managed is nonsense. Certainly the style of innovation management is different from, say, that of financial management – innovation needs to be encouraged and nurtured rather than tightly controlled. But productive innovation demands challenge and boundary setting, as well as regular checks on progress. It is not true, and not acceptable, that innovators or creatives should be left alone like plants. They need and respect challenge and they need, like everyone else, performance metrics and monitoring. This is a key component of innovation leadership. Done appropriately and sensitively it reinforces rather than diminishes the notion of productive innovation.

3. Involvement of younger people

Enduringly innovative organisations in my experience involve young people meaningfully in decision-making. They recognise that experience can be a trap as well as a source of wisdom. Young people can bring a freshness of thought and of creativity, as well as an awareness of modern needs and developments. It is no accident that most of the big technical innovations recently have been driven by young academics and entrepreneurs with little prior business experience. The same is true in the social entrepreneurship world.

When I say ‘involve’ younger colleagues, I do not mean simply inviting them to meetings for the experience. They have to be full participants, involved in the decision-making, and live with the results of those decisions. Examples of this approach can be found in the best R&D labs or in academic research departments. If you talk to professors about their most memorable breakthroughs they will often say that creative insights or new methodologies came from the PhDs or post-docs. Mixing experienced people, who are often more pragmatic and more disciplined, with younger people, who are often more creative and unconstrained in their thinking, can be a powerful mechanism for driving innovation. The balance and blend of skills and experience is important. Ironically some of the most innovative companies, particularly in the technology and social sectors, underplay the importance of managerial experience to their long-term detriment.

It is crucial, also, to build effective teamwork and encourage team behaviour. Innovative organisations often spend considerable resources on team building skills, particularly where different functional backgrounds are involved. A silo mentality is rarely conducive to productive innovation. It is important to spend time to build knowledge and respect among the team members and to create the bonds that characterise high-performing innovative teams.

4. Openness to the outside world

Enduringly innovative organisations are curious organisations. They look beyond their own boundaries and look for ideas and best practices everywhere. They are aware that ‘disruptive innovations’, which bring down whole companies or industries, often come from outside that industry.

Being open to the outside requires energy and discipline, particularly for established successful companies. Successful organisations naturally tend to look in on themselves, and to protect or build on what has already made them successful. This is necessary and powerful, but it can be dangerous if it leads to complacency or lack of awareness of external forces. Ironically organisations or industries that are assumed to be innovative or creative (e.g. high-tech, media, advertising, arts) can be most prone to this inward looking tendency. This may be one reason why so few fail to evolve as enduringly successful organisations.

I recently met with a small group of CEOs of high-tech and media organisations, most of them spectacularly successful. I mused with them that the seeds of their own destruction were being sowed in the fields of their current success and explosive growth. With one exception, all said that they were spending little time really thinking about long-term developments beyond their industries and that they were consumed with the challenges of coping with their current businesses and their current industry structures. Further, most of their professional and social contacts were from within their industry. It is easy to accuse companies of being too internally focused, but leaders in innovative organisations manage to make time to explore outside and to seek different perspectives and experiences. Just as an open mind is more likely to be an innovative mind, so open organisations are more likely to be innovative organisations.



In summary, I would postulate that enduringly innovative organisations embrace a number of characteristics. They are clear about their innovation purpose and priorities but respect the importance of other factors such as efficiency, competitiveness and risk management. They spend time and thought on innovation incentives and performance management. They involve younger people meaningfully in decision-making and invest in skills such as team building to make this possible. They are open to outside ideas, thoughts and trends.

I have long been a great supporter of NESTA and of its commitment to help make the UK more innovative. It is working on a crucial set of topics for the UK. I hope that at least one or two of the points I have made this evening will resonate and create energy, and thereby contribute to NESTA's overall mission.

(This article is adapted from NESTA's annual lecture given by Ian Davis, former Worldwide Managing Director of McKinsey, on 29 October 2010.)



Ian Davis

Ian Davis is Managing Director Emeritus of McKinsey & Company. In his 30 years with the firm, Ian advised multinational organisations on a range of strategic, marketing and organisational issues. From July 2003 until July 2009, Ian was the Worldwide Managing Director of McKinsey.

Ian is a non-executive Director of BP plc, a non-executive Director of Johnson & Johnson Inc, a senior Advisor for Apax Partners LLP, and a board member of non-profit Teach For All. He also serves on the International Advisory Committee of the King Abdullah Petroleum Studies and Research Centre, and the President's Council of the University of Tokyo.

Ian was educated at Balliol College, Oxford University, where he studied Politics, Philosophy and Economics.

NESTA

1 Plough Place
London EC4A 1DE
research@nesta.org.uk

www.nesta.org.uk