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## When innovation goes wrong (big time)



**by Rowan Gibson:** A global business strategist, a bestselling author and an expert on radical innovation.

**Ever since innovation became the buzzword *du Jour*, a lot of people seem to have lost their ability to tell smart ideas from stupid ones. Case in point: the financial “innovations” (read: stunningly stupid loan products) that kicked off the trillion-dollar economic meltdown mess we’re currently in.**

The simplistic notion that “new equals good” has often been a recipe for grand-scale disaster, just as it was in the dotcom debacle at the turn of the millennium. And when the doo-doo inevitably hits the fan, it’s all too easy to level the blame at innovation per se rather than admit to being a bonehead. Here’s why many ideas that are labeled “innovations” are just plain stupidity.

Simply put, innovation goes wrong (sometimes big time) when an organisation over-commits to an idea before validating the key assumptions on which it is based. Let’s take the infamous sub-prime mortgage. The assumption here was that a jobless, homeless person who is just out of jail and doesn’t even have a bank account can afford to make mortgage repayments of any description, let alone horrendously overpriced ones.

The idea of selling mortgages to poor people with bad credit was clearly “new” given that banks have traditionally offered 30-year, fixed-rate amortising home loans to people who looked like they could actually pay the money back. But going after this risky, low-end market segment with a rip-off financial product wasn’t exactly what C.K. Prahalad had in mind when he talked about “the fortune at the bottom of the pyramid”. And it turns out – duh! – that this particular “financial innovation” wasn’t a very smart one (to put it mildly), and even less smart when used as the cornerstone for a multi-trillion dollar house-of-cards based on endless derivatives of derivatives.

It’s precisely big boondoggles like this one that give innovation a bad name. In fact, columnist Paul Krugman wrote in the *New York Times* that “financial innovation” is a phrase that “should, from now on, strike fear into investors’ hearts.” Yet should the financial services industry – or any industry for that matter – now decide to “throw the baby out with the bathwater” when it comes to innovation? Absolutely not. It’s worth remembering that over the last couple of decades, innovation has given us a string of success stories in financial services: Charles Schwab’s online equity trading, Commerce Bank’s open-all-day, seven-days-a-week business model, First Direct’s branchless banking, Grameen Bank’s micro-credit lending concept, PayPal’s user-friendly, online-payment service, or Umpqua Bank’s people-centered retail environments, to name just a few. The difference with these opportunities is that they were all based on very solid assumptions about the viability and sustainability of the business model; they were not built on proverbial sand. That’s why these innovations have created significant new value and wealth, instead of destroying it.

Unfortunately, there are all too many cases where companies have overcommitted to an idea that wouldn’t even pass the sanity test. These tend to be ideas where the customer benefit is unclear or unimportant to people, or where the technology is not yet up to the task, or where the market is just not there, or where the business model is so stupid that it’s dead on arrival. Instead of first checking the validity of critical assumptions on which the idea is based, sometimes a company (or even a whole industry) decides to jump from 10,000 feet without a spare parachute, hoping against hope that the thing will somehow work.

Take Iridium, Motorola’s failed satellite telephone venture, which was built on a fundamentally flawed assumption about the size of the target market. Basically, Motorola totally underestimated the speed at which cellular coverage would spread. Their premise was that there would be huge regional gaps in the global network – parts of the world that would have no mobile phone coverage for a long time to come. That would have made Iridium the perfect answer. It turned out quite quickly that those regions would be very few and far between (you would practically have to be an Arctic explorer to need an Iridium phone!), so the target market soon shrank to insignificance. This is something Motorola should have known better.

Or take Webvan, the “oh-so-dotcom” online grocery business that burned through a billion dollars and went belly-up. There was nothing fundamentally flawed about the idea of online grocery shopping, as a host of other retailers have since proven. Rather, Webvan’s massive failure was based on a whole series of flawed and untested assumptions around the customer value proposition, the economic engine, the value of partnerships, and the product and service offering.

Business history is full of such examples: from Coca-cola’s infamous “New Coke”, to GM’s all-electric EV-1 project (which cost a billion dollars and sold only 700 vehicles), to all those other empty dot-com business models in the late 1990s – like Pets.com – that quickly disappeared. The lesson from all these disasters is to look before you leap. A company should first reduce the uncertainty surrounding critical project assumptions before committing irreversible and non-recoverable resources to an idea. The greater the uncertainty surrounding these assumptions, the greater the risk associated with any new opportunity. Therefore, the focus of an innovation project should initially be on learning rather than earning. It should be on launching experiments to test whether a business model makes sense or not, or whether a new technology will work or not, or whether customers would value the new service, or what they would be willing to pay for it, or which product configuration would work best, or which distribution channels would be most effective, and so on.

Clearly, innovation can never be risk-free. But the process of validating or invalidating these critical project assumptions should stop you from ever completely misreading the basic economics of an opportunity. It will make sure that hubris never gets the better of humility.



**Source:** Rowan Gibson is a global business strategist, a bestselling author and an expert on radical innovation. Visit our website at: <http://www.rowangibson.com/>.

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