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Up or down, it's a value-based economy



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

A couple of years back, when the economic barometer was pointing upward, all the talk in company boardrooms was about growth, innovation and value creation. Today, with the global economy lingering in the doldrums, corporate strategy is shifting inexorably back to the safe haven of operational efficiency.

Now you might argue that this reaction is both inevitable and understandable, and I would accept that at some level. But remember this: something far deeper and more significant than these episodic upswings and downswings is the fact that we've entered a new kind of economic era – an era where cost-cutting is no longer enough. Whether it's currently an "up" economy or a "down" economy, we now do business in a *value-based* economy. And innovation is the only sustainable source of value-creation we have left.

What organisations need to understand is that, at the macro level, productivity – which of course is central to profitable economic growth – has always been determined by two elements. On one side, it is determined by the efficiency with which companies use their inputs – how much labour and capital it takes to produce their goods and services. On the other side, productivity is determined by the value that customers place on the outputs.

For most of the industrial era, the predominant focus was on efficiency as opposed to value. Yet when we look at the companies that are creating most of the new wealth today, we find that they are not doing it by eeking out the last few percentage points of efficiency from their business processes. They are doing it by creating things that bring incredible new value to customers.

Think about Apple, or BMW or Porsche. What we find is that, while these companies are highly efficient in their operations, they do not necessarily enjoy the largest economies of scale. It's their ability to deliver value – to create things that are compelling, exciting and wonderful – that has made them enormously effective engines of wealth creation. BMW and Porsche, for example, command the highest margins per vehicle in the world. Contrast this with the meager performances of GM and Ford and we find that huge economies of scale do not *per se* deliver an advantage. If a company is not capable of combining low operating costs on the one side with high value-creation on the other, it simply becomes incredibly efficient at making the kind of products customers don't want.

On the whole, large companies have spent about a hundred years building a "hyper-efficiency" mindset into their organisations. But, until recent years, they have given very little thought to the other side of the productivity coin – how to build a mindset around creating "hyper-value" for the customer. That's why innovation goes so much against the grain in most companies. It has to fight against a whole set of management principles, processes and systems that are basically set up to deliver something else.

Creating value requires a deep understanding of unarticulated customer needs. It requires enormous creativity. It requires a degree of messiness – i.e. recursive cycles of experimentation and learning. It requires radical thinking in terms of product configuration or value proposition. But the industrial age has given us organisations that are not very good at doing any of that. It has given us organisations that treat variety as the enemy – that believe variance from a quality standard, or from a budget, or from a production schedule is a fundamentally bad thing. Yet creating value for the customer often entails challenging and deviating from these norms.

To use the language of complexity theory, most companies have been operating predominantly at one end of the spectrum – "the ordered regime" – and hardly at all at the other end, which scientists refer to as "the edge of chaos". It is this "other" end – the messy, creative, experimental end – that is so vital for value creation, wealth generation and long-term growth. Indeed, in his book, "The Hacker Ethic", Pekka Himanen wrote that, in today's economy, the "most important source of productivity is

creativity." This is the sort of mantra that becomes popular when the economy is growing; when companies find themselves drawn naturally toward the innovation end of the spectrum. But the big challenge comes when things take a downturn and there's pressure to cut costs again – which is exactly the situation we're in now. Organisations must ensure that the pursuit of radical, value-creating innovation does not get neglected as they pull back reflexively toward the "ordered regime".

As Charles Simeon, a pastor at Cambridge University in the 18th century, profoundly observed, "The truth is not in the middle, and not in one extreme, but in both extremes". The same could be said of operational efficiency and innovation. Now more than ever, organisations need to learn how to operate equally well at both extremes – they need to be both highly innovative and highly efficient at the same time. In a value-based economy, companies must be able to continually dream up products and services their customers wouldn't want to live without, yet they must simultaneously have the capacity to deliver those things with brutal efficiency.



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