

## Interview Rowan Gibson for Turkishtime – March 2008

### **What should a company do to make its innovation facilities more effective? What is the way to make innovation a profitable activity?**

Innovation is perhaps the only area of business where we see such an unbalanced correlation between inputs and outputs. Some companies spend billions of dollars and come up with nothing. For example, General Motors has spent more money on R&D over the last 25 years than any other U.S. company, yet last year GM lost an incredible \$38 billion! Conversely, other companies spend peanuts in relative terms, and change the world. Apple, for example, spends just a fraction of the annual R&D budget of firms like Microsoft or IBM, yet Apple has repeatedly reinvented whole product categories and markets.

So what is it that makes Apple's "innovation engine" so much more effective than those of other companies? Well, for one thing, Apple knows how to come up with radical, game-changing ideas. The hard reality is that incremental innovations – "new and improved" versions of the same old thing – can only take a company's revenues so far. A different flavor of Coke, an additional blade for Gillette, or the next version of the BMW 3 Series – these are not going to deliver huge chunks of revenue growth. The only way to boost revenues in a *dramatic* way is by bringing exciting, value-packed new products and services to customers.

Sure, incremental innovation has value: Apple is constantly upgrading its products with exciting new features to keep them several steps ahead of the competition. But the really exciting growth at Apple has not come from incrementalism; it has come from launching radical innovations like iMac, iTunes, iPod, iPhone, and the company's ultra-cool retail stores. That's why Apple is worth so much more today than it was ten years ago.

In other words, one way to make a company's innovation efforts more effective and profitable is to generate and then successfully commercialize ideas that have *radical* potential. By "radical" I mean ideas that they have the power to fundamentally alter customer expectations and behaviors, or to reinvent the cost structure in a particular industry, or to redefine the basis for competition. What I'm focused on, therefore, is how to help companies generate those radical, rule-breaking ideas and growth opportunities, and thereby get a better return on their innovation efforts.

This is not to say, by the way, that all radical ideas are necessarily good ones. If an idea is based on a set of very faulty assumptions, then it's more likely to lose the company money rather than create any new wealth. Take GM's venture into hydrogen, or Motorola's failed satellite telephone, Iridium. These were clearly radical ideas. But sometimes an opportunity can be fundamentally flawed: for example, the customer benefit is completely unclear or unimportant to people; the technology is not yet up to the task; the market is simply not there yet; or the business model is so stupid that it's dead on arrival. Obviously, a company should test the critical hypotheses behind any radical idea before committing serious resources to it. However, the point I am making here is that if you want to generate

really big returns in terms of revenues and profits, as well as increased market share and stock market value, then you need to come up with a few really big ideas.

**2- There is some disappointment about the innovation in some sectors -especially in pharmaceutical sector- The companies develops new products, but they do not make money from that new product as they expect? So what do they do wrong? In order to what do they determine the limits of their expectation.**

There are some industries where companies have to make big bets on innovation, and those bets may or may not pay off. The airplane manufacturing industry is one of them. If you're Boeing or Airbus, for example, every new aircraft is a "bet-the-farm" decision. But, again, to reiterate my last point, the bet that has recently been paying off big-time for Boeing is the one they made on a radical, game-changing new kind of airplane: the 787 Dreamliner. The whole plane is actually made of plastic composites rather than aluminum, which makes it lighter and therefore 20% more fuel efficient than conventional passenger aircraft (at a time when oil prices have reached \$100 a barrel). No wonder it's the bestselling aircraft Boeing has ever produced. Not only has it pushed the company's revenues into a steep growth curve, but it has also helped Boeing regain the top slot from Airbus. Now, that's the power of radical innovation!

The pharmaceutical industry is likewise a field that tends to require a "big science, big dollar" view of innovation, particularly when we consider how much it costs to pursue a new drug discovery and to subsequently commercialize it, not to mention the ever-higher regulatory hurdles. Then there's the problem of patent protection, which is rapidly running out for a lot of blockbuster drugs. This opens the door to low-cost generic drug manufacturers. And even when you have a big success with a radical product innovation like Viagra, it's not long before there are competitive products on the market – in this case Levitra and Cialis. So the major pharmaceutical companies are facing some very difficult challenges in these regards.

On the other hand, we see a growing demand for safer, more effective medicines all over the world. In China alone, the pharmaceutical market is growing at 11% annually. I just came back from a speaking trip to India, where the pharma sector is delivering revenue growth of around 15%. Let's also not forget that we have an ageing population in many nations, so the need for medicines is rising. Then we have the relatively new market for "lifestyle" medicines, where consumer demand is rising, too. So there are lots of exciting growth opportunities for the industry, and there is clearly a lot of money to be made.

I think my advice to the pharma industry would be this: given that the drug discovery process is quite a marathon, there is little point in running the race unless there is an enormous prize at the end of it. I would want to be sure that the market for any new drug we are developing is potentially *enormous* before committing a lot of effort and resources to it. I would also want to be sure that the product attributes and the marketing push were going to be significant enough to give us a clear and sustainable lead.

Beyond this, I would say that some of the biggest opportunities today in the pharma business are based not on product innovation but on *business model* innovation. Whereas, in many cases, product innovations are relatively easy to replicate, a breakthrough business model that differs from industry conventions along several dimensions is

typically the most difficult kind of innovation for industry incumbents to replicate. One example is the business model of generic drug manufacturers which has created incredible manufacturing efficiencies. Another example today would be the pharmacogenomics companies – like Amgen, Genentech, and Genzyme – whose business model is focused on gene-based therapy and “personalized medicine” rather than on conventional drug-making. By focusing on microbiology and genetics as opposed to chemistry, this new breed of pharma companies is fundamentally changing the game.

On the long term, it is business model innovation – not product innovation – that holds the greatest potential in any industry for creating new wealth and competitive advantage. The challenge is to come up with a business model that differentiates your company and that creates substantial value for your customers, putting you in a unique position in your industry. Good examples would be IKEA’s assemble-it-yourself furniture model,

eBay’s peer-to-peer, Web-based marketplace, Apple’s iPod/iTunes platform, or BMW’s customize-your-own MINI Cooper. These dramatically different business models break from industry norms in several radical ways, either by serving unmet or unsatisfied customer groups, or by providing new or different benefits, or by delivering and/or extracting value in an unconventional fashion.

### **3- Finally some lobbies think that innovation is nonsense. What do you say to them? What makes the innovation a strong reality in economics.**

I would say, “go and look at some of the biggest and most successful companies on earth, and ask yourself what those companies have made their No.1 strategic priority.” Consider GE, for example, the world’s largest company by market capitalization. GE’s Chairman and CEO Jeff Immelt says, “the only answer for us today is innovation”. IBM’s CEO, Sam Palmisano, says, “all roads lead to innovation”. And Alan Lafley, the CEO of Procter & Gamble, says, “I want innovation across the spectrum – in how we market, manufacture and distribute.” Why are these leaders now standing up and beating a loud drum about innovation every day at their companies? Why has each of them launched nothing less than a cultural revolution inside their organizations, to shift the emphasis from efficiency to innovation? Why are they making deep changes to their corporate values, their management processes, their training programs, their IT systems, their budgeting systems and so forth to make innovation happen?

It’s because they have understood that the only way to drive growth and wealth-creation over the longer term – literally the ONLY way – is to innovate. It’s not by cutting costs, downsizing, buying back your own shares, or taking the consolidation gains out of a merger. And if you look closely at those companies, you will find that innovation – in all its forms – has actually generated billions of dollars of organic revenue growth over the last five years.

Again, how did Apple manage to grow the value of its stock from \$20 a share to \$200 a share in less than ten years? Was it by trying to take costs out of its manufacturing system, or by merging with another computer company to create “economies of scale”? Or was it by launching exciting new products that customers didn’t know they needed but today can’t live without? Clearly, Apple did it by delivering unbeatable value in radical

new ways. And the only way you do that is through rampant and radical innovation, not just at the product and service level but at the level of the core business strategy.

As I pointed out earlier, the notion that merely throwing lots of money at R&D will lead to revenue growth really is nonsense. In fact, Booz Allen Hamilton has done numerous surveys which reveal that there is no relationship at all between R&D spending and the primary measures of economic or corporate success, such as growth, enterprise profitability, and shareholder return. Rather, the real source of revenue growth, and company value, and market share and competitive advantage is the capacity to innovate in radical, gamechanging ways. Unfortunately, many managers haven't yet understood is that "R&D" and "radical innovation" are two completely different notions.