

## Interview Rowan Gibson for ‘O Publico’, Portugal – March 2008

### What do you think is the most important challenge for companies today?

Many companies believe that their greatest challenge is how to grow the top line – quarter to quarter, year to year – and increase the value of the share price. This is understandable, given that we live in a world where shareholders rule, and where companies are under intense pressure to grow earnings faster than the industry average. This explains why so many companies are now turning to innovation. They recognize that it’s literally the only way to drive dramatic increases in revenue growth.

However, I would argue that the true challenge facing companies today is not growth; it’s *perpetual* growth. It’s “How do we ensure that we can *continually* prosper in a world where change has become hyper-critical?” It’s about developing the capacity to dynamically reinvent business models and strategies as market conditions and other industry circumstances rapidly change. It’s about continuously anticipating and adjusting to deep, secular trends that can permanently impair the earning power of the business. And it’s about having the capacity to change before the necessity for change becomes desperately obvious. There’s only one alternative to reinvention and renewal; and that’s inevitably a traumatic crisis at some point down the line.

What I’m saying is this: the thing that kills companies today is not whether they are growing by 5% instead of 8%, or 7% instead of 10%; the thing that kills them is when they miss some turn in the road – some fundamental change in the external environment – that axes the share price by 50% and sends the firm into the toilet. This is what has wrecked so many companies in so many industries.

Perpetual growth requires perpetual renewal. It’s the only way to maintain continuity in a discontinuous world. And the fuel for renewal is innovation – not merely innovation at the margins but deep, strategic innovation at the level of the core business model. In essence, this comes down to the ability of an organization to continually reinvent both itself and the industry in which it competes. It’s about either transforming the core business model in some profound way, or it’s about creating new, “white space” businesses that directly leverage the company’s core competencies and strategic assets. Or it’s about both.

So whether we look at it from the point of view of growth, or we look at it from the point of view of strategic renewal, we find that all roads lead inescapably to innovation. Therefore, the question becomes, “How exactly do we build a sustainable capability for innovation across the entire enterprise – one that consistently drives profitable revenue growth, and that enables the company to maintain a competitive advantage over the longer term?” Organizations have been struggling with this question for decades.

The good news is that we now have a list of major companies – including GE, Procter & Gamble, Royal Dutch/Shell, IBM, Whirlpool and many more – that are working methodically to build this kind of innovation capability. These leading-edge players are demonstrating that large industrial organizations really can make innovation happen in a broad-based and highly systemic way.

Despite the gargantuan nature of the task, building a deep, systemic capability for innovation is now the inescapable imperative for every company; as important to an organization’s success and survival as the quality movement was in its day. Granted, in the

short run, there may be some substitutes for innovation – some quick ways to prop up a company’s share price and earnings over the next few quarters. But in the medium to long term there are absolutely *none*. In today’s innovation-based economy, where organic growth and strategic renewal are the new business mantras, companies either learn to drive innovation to the core or they risk becoming footnotes in the history books.

### **How can companies be 100% (and 24 hours a day) innovative?**

The only way to make that happen is by making innovation an “all-the-time, everywhere” capability, rather than the exclusive province of one or two specialized departments in the company, like R&D, New Product Development, a corporate venture group or an incubator.

As an analogy, think back to the quality movement of the 1970s. Before the Japanese introduced us to the processes and methods for making quality everyone’s job, it was actually the responsibility of a very small group of people in most organizations. We called those people “inspectors”, and quality was *their* job. Indeed, back then, the notion that quality could be an “all-the-time, everywhere” capability – the responsibility of ordinary employees all across the organization rather than a small group specialists – would have struck most corporate executives as absurd.

Then, in a radical departure from that paradigm, Deming and others came along and taught us that quality could become an intrinsic and ubiquitous capability rather than a specialized function – that it could actually be embedded and institutionalized in an organization’s core DNA. Thus, the quality movement was born, initially heralding Japan’s rapid economic rise, and later revolutionizing the relationship between manufacturers and consumers around the world.

The bleeding edge for companies is no longer quality; it’s innovation. But, right now, innovation is still more or less where quality was in the late 1960s. When you talk to senior executives, you find that many still think of innovation as breakthrough technology, or cool product design, or individual creativity. Or they may know it as a specialized unit or department. But, until now, they have probably never contemplated the idea of recalibrating all their core management systems and processes to make innovation an everyday “part of the system”– something that becomes reflexive and natural to everyone in the firm.

### **Spending money isn’t a guarantee of more innovation?**

No, it’s no guarantee at all. In the vast majority of cases, pouring huge money into innovation has produced remarkably little in terms of new wealth. After conducting several studies of the world’s 1000 biggest spenders on R&D, for example, consulting firm Booz Allen Hamilton has concluded again and again that there is “no discernible statistical relationship between R&D spending levels and nearly all measures of business success, including sales growth, gross profit, operating profit, enterprise profit, market capitalization or total shareholder return”. To illustrate the point, guess which U.S. firm has spent more money on R&D than any other company in the world over the last 25 years. The answer is General Motors. Looking at GM today – they actually lost a staggering \$38 billion last year! – pumping all that money into R&D obviously hasn’t left the company in very good shape. Not only has it had virtually no positive impact on GM’s bottom line; it has also had

practically zero impact on the vehicles themselves, in terms of creating any significant value for customers.

General Motors typifies what I would call the “Big Bet” approach to innovation. In the 1990s, for example, the company bet a billion dollars on EV-1, an egg-shaped, all-electric (as opposed to hybrid), zero-emissions vehicle. The car was a commercial flop. Three years after its fanfare launch in 1996, having produced only 700 vehicles, GM’s CEO decided to pull the plug. By contrast, Toyota took a patient, multiyear approach to developing eco-friendly cars – resulting in their hugely popular range of hybrid vehicles. It was managed as a stepwise migration path, with investments gradually increasing in stages as the company’s learning and experience compounded, and as its competencies in this field grew stronger. The lesson here is that it’s fine to have revolutionary goals, but the best way to achieve those goals is usually by taking consistent, evolutionary steps, not by “betting the farm”.

The fact is that, when you look at innovation, you find there is very little correlation between resource inputs and profitable outputs. Some companies spend billions of dollars and come up with nothing. Others spend peanuts and change the world. Microsoft’s annual R&D budget, for example, is somewhere in excess of \$6 billion. Yet where are all the great software innovations that have come out of the house of Microsoft? Historically, Microsoft has tended to be an aggressive follower rather than an innovator. Currently, the company is using its formidable marketing muscle to push its way into the online advertising business, which is dominated by Google. Yet when Larry Page and Sergey Brin originally came up with their search engine, they were working on a shoestring budget while studying at Stanford university. In fact, they used to make their virtual supercomputers from cheap commodity PCs strung together in racks built out of LEGO! It’s a similar story if we look at Apple. Steve Jobs once remarked that when Apple came up with the Macintosh, IBM was spending at least 100 times more money on R&D.

So it’s not really about big R&D budgets. It’s about coming up with really big ideas, and it’s especially about getting the timing right. Companies often go wrong by investing huge sums of money in ideas that are either too early for the market or too late. Take Motorola’s multi-billion dollar bet on the satellite phone venture Iridium, which ultimately went bust. The whole thing was based on a fundamentally flawed assumption about the size of the target market, because Motorola totally underestimated the speed at which rival cellular coverage would spread. In the end, the window of opportunity closed much faster than Motorola had envisaged. Webvan, the failed US online grocery business, was similarly based on a whole series of flawed and untested assumptions about the speed at which the opportunity would develop. Its founders scaled up way too quickly, eventually burning through a billion dollars and going bankrupt. Interestingly, UK retailer Tesco has since built a very successful online grocery business by taking the kind of careful, stepwise approach that I advocate. Finally, Apple had an embarrassing and costly experience with the launch of Newton, essentially the world’s first major PDA product. There was nothing fundamentally flawed with the idea – we think of it now as the prelude to the Palm Pilot – it’s just that Apple’s timing was wrong. It really didn’t matter how high the R&D budget was for the Newton – it simply wasn’t possible at that time to squeeze enough processing power onto a chip to enable good handwriting recognition. Apple could have spent all they wanted but they still couldn’t have forced the market for handheld computing to develop any faster.

What we conclude is that business success, in most cases, is based not on the magnitude of a company's innovation spending, but on the quality of its innovation *process*. This is the area that I focus on.

**In your new book “Innovation to the Core: A Blueprint for Transforming the Way your Company Innovates” you mention GE as one of the companies that drive innovation to the core of the organization. Is it the perfect company?**

I don't really believe in the idea of the perfect company. I believe in companies that seem to be perfectly suited to particular moments in business history. The big question is always whether these companies are able to adapt to emerging opportunities, incipient trends, and a competitive environment that is changing at breakneck speed. This is what I referred to earlier as “strategic renewal”.

GE's former chairman and CEO, Jack Welch, once put it this way: “If the rate of change inside the organization is not equal to the rate of change outside, then eventually that organization will be in deep trouble.” Welch realized that during his tenure the company needed fanatical cost-cutting, relentless efficiency drives and deal-making to keep up with the external environment. That helped to make GE perfect in many ways for that particular period.

However, Jeff Immelt, GE's new CEO, recognizes that we now have a very different era. It's an era where growth will come from new strategies that grow the boundaries of the company, this time organically rather than through acquisitions – strategies that take GE into new lines of business, new geographic areas and new customer segments. So Immelt is changing the whole strategic focus of the company in an effort to make it perfect for this new stage in economic development. Immelt says, “the only answer for us today is innovation”. That's why he has launched a culture revolution at GE; a serious break with the past that shifts attention away from continuous improvement and bottom-line results, toward the creation of bold, imaginative ideas. He really is trying to drive innovation to the core of the organization, and the company has already made great progress with this.

For example, Immelt has engineered a company-wide process for generating and commercializing breakthrough ideas. It starts at the top with the senior business leaders, whose mandate it is to find no less than three “Imagination Breakthroughs” per year, each of which must have the potential to generate incremental sales of at least \$100 million in five years. Immelt currently has hundreds of innovation projects underway and has set aside billions of dollars to fund them. Right across the company, he is working hard to set up an infrastructure that encourages and supports innovation. It includes new research centers all over the world, a “global brain trust” to generate blockbuster ideas, and a “virtual idea box” on the web for GE's 307,000 workers, all of whom are being urged to “reconceptualize” themselves as innovators. To help fuel the fires of innovation throughout the ranks, GE has introduced ideation courses, “dreaming sessions”, “idea jams”, and “Excellerator awards” for the best new ideas. It's all part of an ambitious initiative to turn innovation into a deep, systemic capability – an “engine” that will drive and sustain new revenue growth.

I'm not sure I'm ready to call GE the perfect innovator yet – or the “Tiger Woods of Innovation” – but the company is certainly setting an impressive precedent for making the strategic shift from efficient engineering to bold imagineering.

## **Why do you say that we must rethink leadership?**

Because I believe it takes a certain style of leadership to cut costs, restructure, re-engineer and downsize, and quite another style of leadership to create growth through new ideas and initiatives. In other words, the perfect leader – like the perfect company – is the leader who is perfectly suited to a particular period of business history.

Again, Jack Welch was in many ways perfect for GE during his own era, as the company's financial performance testifies. In the last five years of Welch's tenure, which ended in the year 2000, GE's market value grew from around \$50 billion to somewhere between \$350 and \$400 billion. What Jack Welch achieved at GE was undoubtedly remarkable. By doing so many things right – his corporate strategy, his efficiency programs, his value-creating deals – he was able to produce an ever-growing revenue per employee. But it couldn't go on forever. At some point it had to flatten out because, for one reason, Welch had already cut most of the costs and inefficiencies out of the system.

What's needed at GE today is not the kind of leadership that focuses on cutting resources and costs while the top line remains flat. It's the kind of leadership that keeps resources and costs on more or less a flat line and actually grows the revenues. This arithmetic may be embarrassingly simple but it is also profound, because the realization is that each of these routes to increased productivity requires very different leadership skills. That's why I would say that Jeff Immelt seems to be the appropriate leader for GE today.

## **You say that a leader mustn't run the company by the numbers alone. Isn't this asking too much?**

If a leader wants to truly drive innovation throughout an organization, he or she should try to create aspirations that go beyond the numbers. For example, a challenge like "How can we increase our earnings per share by 20 percent?" is certainly not going to inspire as much innovation as the kind of challenge you regularly hear in Apple's Cupertino headquarters: "How can we change the world?" In other words, innovation is also about creating well-articulated and meaningful challenges that speak to employees' hearts as well as their heads.

Warren Bennis, author of *Organizing Genius*, studied some of the greatest project teams in recent history – from Disney's animators to Lockheed's Skunk Works to the Manhattan Project – in an attempt to identify some common characteristics. His conclusion was that, without exception, the teams that really reached epiphanies truly "believed that they would make a dent in the universe." He says that their team members all felt they were enrolled in a deeply meaningful cause – something Bennis describes as "an exciting, insanely significant vision."

Creating an inspiring cause, vision or corporate challenge – whether it involves fundamentally redefining a product category or an industry, or addressing some important unmet customer need, or solving one of today's most pressing global problems such as pollution or poverty – can act as a powerful demand generator for innovation.

Ask yourself: would employees rather be part of a "status quo – let's just meet the budget" sort of company or would they rather work for a firm that inspires them to do bigger things? In my experience, once employees get the feeling that they are part of a

vibrant, innovative company that is out to make history, and not just profits; once they get hooked on the excitement and energy of innovation, they automatically begin to demand more innovation from themselves and their peers. Thus, the demand for innovation ceases to be the sole province of the CEO or other top level executives. All levels of the organization begin to drive innovation.

### **What would your main message be Executive Seminars 2008/Primavera Academy held in Portugal on 18th March?**

My main message is that it is entirely possible to boost your company's innovation performance in a dramatic and enduring way, but it can only be done if you are prepared to make innovation a systemic capability. Nobody can hope to achieve anything by throwing a light switch and saying, 'OK, from Monday morning we're all going to be a lot more innovative'. Anyone who seriously wants to influence the values and dynamics of a business organization – especially a large-scale, highly distributed one – is going to have to roll up their sleeves and get ready for some really hard work.

In other words, it can't be done piecemeal – an innovation reward program here, a corporate venture fund there, or a few days of brainstorming somewhere else isn't enough. But the message is that *it can be done*. If companies like GE, Procter & Gamble, IBM, Shell, Whirlpool and others have taken on this challenge, and are already achieving extraordinary results, any company can do the same.

Again, the quality movement sets an encouraging precedent. Look how adept today's organizations have become at systematically manufacturing world-class products. Who would have thought that what once seemed so daunting could become almost run-of-the-mill business practice? In the years to come, I see no reason why corporate *innovation* systems shouldn't become just as efficient – and just as commonplace – as corporate quality systems.

Clearly, making such a profound cultural change requires time, money and commitment. In my experience, it can take an organization three to five years to build the kinds of skills, tools, management processes, metrics, values and IT systems that are required to support ongoing, across-the-board innovation. But, as James Andrew and Harold Sirkin, senior partners at The Boston Consulting Group, argue in their book *Payback*, managing and mastering innovation as a disciplined business activity can help an organization reap dramatic financial rewards.

Already, the "innovation movement" is gathering momentum. The challenge of building a systemic innovation capability has become the focus of increasing attention in both business and academic circles around the world. Companies everywhere are asking themselves exactly what they need to do to drive innovation to the core – to make innovation an "all-the-time, everywhere" reality inside their organizations.

That's the question I am going to answer on March 18th. In fact, I'm going to talk in a fairly detailed way about how to embed innovation as a systemic enterprise capability. So, I invite every manager who is ready to take on the challenge of building a deep innovation capability inside his or her own company to join me for the day.