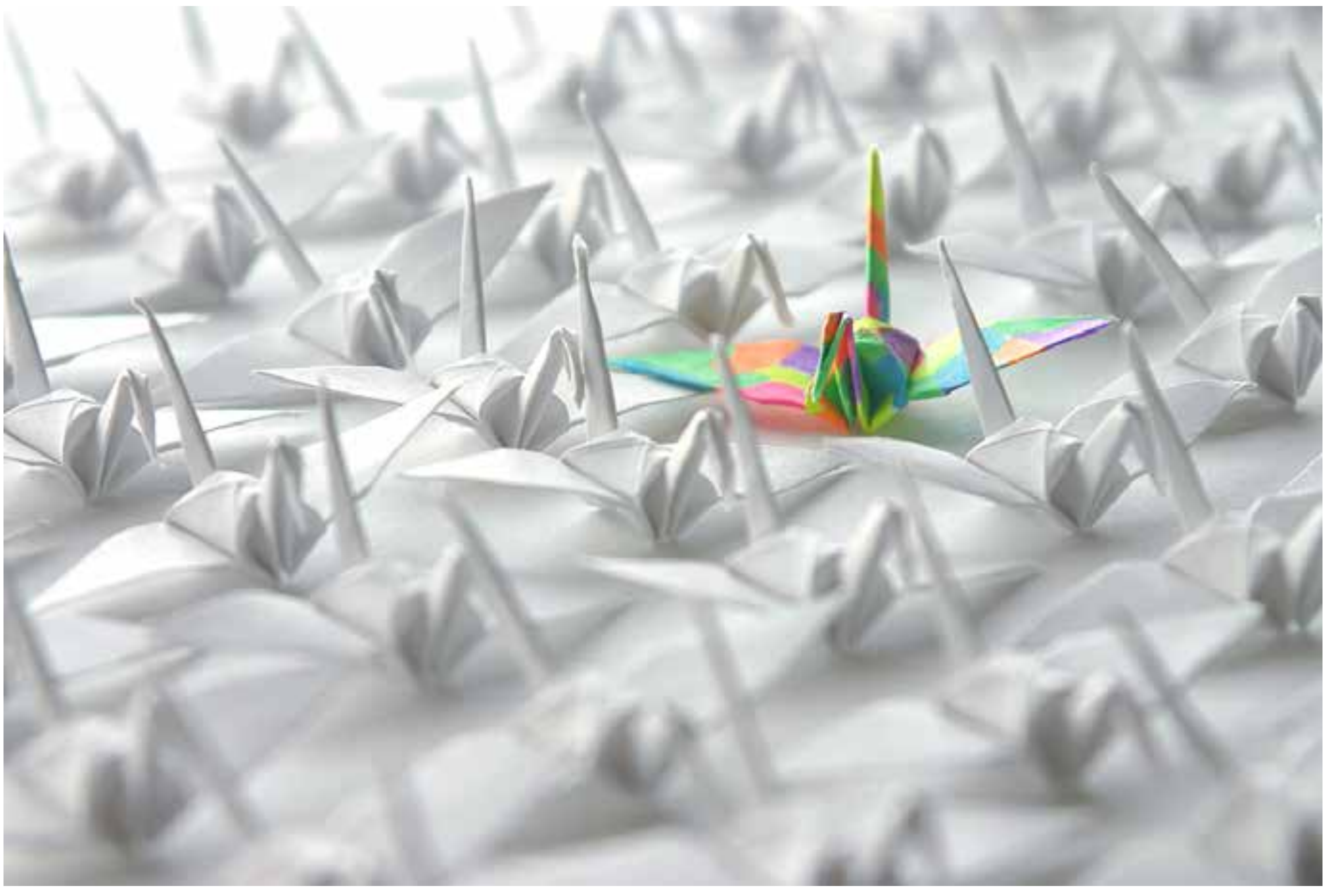
Effective Innovation Begins With Strategic Direction

Identify the forms of innovation that best support your strategy.

B. Tom Hunsaker and Jonathan Knowles

October 5, 2021



When speaking with global executives, we often ask them, "What's one thing your company needs to improve?" Their word choice varies by region, but their response is usually the same: the ability to derive more value from its investments in innovation. More often than not, the underlying problem is that innovation is assumed to be an end in itself rather than the mechanism for achieving a specific form of change. The impetus to innovate is independent from a strategic analysis of where and how innovation can improve the organization's fit to purpose, or the quality of fit with the expectations of customers and other stakeholders; and its relative advantage, or its distinctiveness relative to alternatives. But most innovation advice given to leaders lacks the context necessary to guide their actions.

Improving returns from your innovation efforts requires knowing the type of change you want to achieve. Context matters. Is the strategic objective of your innovation primarily to strengthen the trajectory of your existing path? Or is the imperative to reimagine the tactics used to achieve your strategy because of the declining effectiveness of your current activities? Or is the objective of your innovation to fundamentally reinvent your business?

In this article we identify the forms of innovation well suited for each of the three primary types of strategic change. A change of magnitude amplifies an existing strategy; a change of activity reconceives the tactics used to pursue a strategy; and a change of direction fundamentally reorients the strategy of the business.

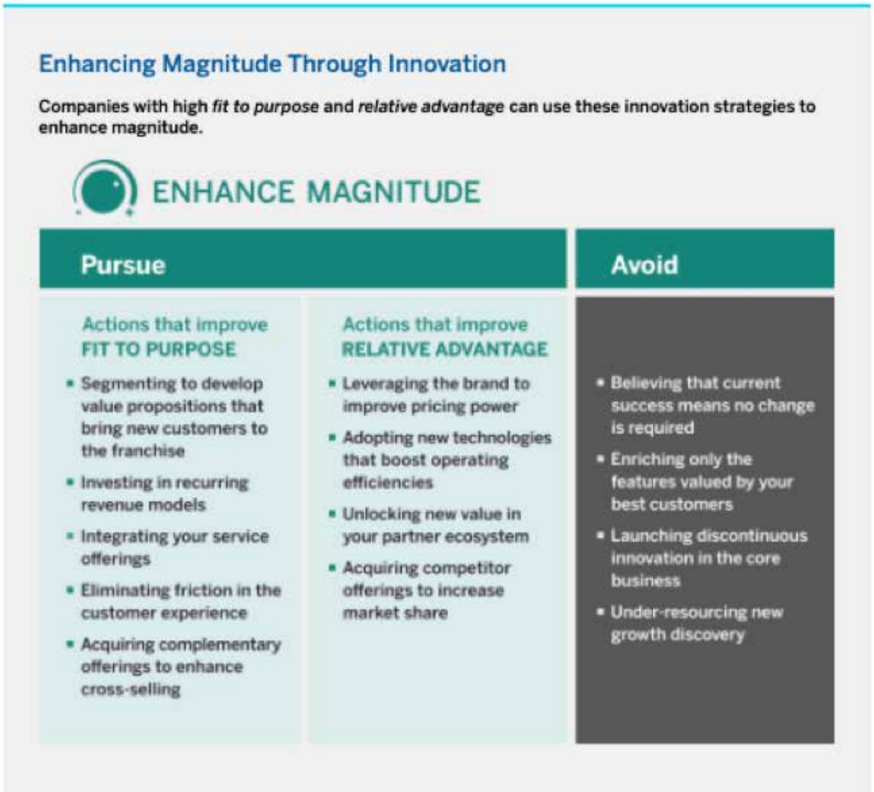
Innovate to Enhance Magnitude

When you enjoy high fit to purpose and relative advantage, the primary goal of innovation is to develop ways to enhance your existing trajectory and perceptions. This does not equate to complacency or a lack of boldness; change is required, but it should align with the existing momentum of the business so as to further strengthen what makes it relevant and distinctive to existing customers and what is attractive to new customers.

In previous years, Walmart committed to innovation that reduced friction in the consumer purchase experience and improved recurring revenue — an investment that prepared it to provide next-day delivery to 75% of the U.S. population during the COVID-19 pandemic. Danish global shipping company Maersk embraced blockchain to accelerate the previously time-intensive tasks involved in locating shipping containers. Sweden's BoMill brought new value to its partner ecosystem — and deepened its relative advantage in the process — by engaging with grain farmers to introduce AI-powered automated harvesting that reliably separated good grain from bad at the point of the pick, resulting in a nearly 50% yield spike.

Consider how Roche, the world's largest pharmaceutical company, has allowed the strategic objective embodied in its purpose statement "doing now what patients need next" to guide its approach to innovation. Having achieved a leading position in the market, the company's innovation efforts have centered on ensuring a continuous pipeline of related pharmaceuticals and diagnostics. In-depth analysis of how to better serve existing customers and attract new ones — to enhance their fit to purpose — informs Roche's R&D efforts and its integrated pharmaceuticals and diagnostics capabilities. Harnessing an agile network of over 200 external partners leverages its internal resources and provides broader, faster research output to deepen Roche's relative advantage.

Contrast Roche's innovation approach with that of Shire, another pharma company. A specialist in rare diseases, Shire largely relied on acquisitions as its vehicle for innovation. It moved its tax domicile from the U.K. to Ireland in 2008 and allowed tax considerations to cloud its evaluation of the complementarity of certain acquisition targets. This culminated in Shire's ambitious $32 billion acquisition of Baxalta in 2016, driven in large part by the favorable tax benefits of paying cash for a company that had only recently been spun out of a larger company (Baxter). Underestimating the complexity of integrating an entirely new therapeutic area resulted in a financial underperformance that left Shire itself vulnerable to acquisition. It was taken over by Takeda in 2019.



Innovate to Reimagine Activity

Companies with moderate combined fit to purpose and relative advantage have a valid strategy in place, but they have a pressing need to innovate around how they will achieve their goals. The priority for companies in the Reimagine Activity zone is to identify ways to reconceive their fit to purpose — that is, how their products, services, and delivered value align with customer and other stakeholder expectations — and to boost their relative advantage to reduce vulnerability to substitution.

U.S. bank holding company Capital One needed to reimagine the activity of its car oan business in order to grow its customer base and improve its distinctiveness. This led to the launch of Auto Navigator, an app that integrated the car-buying and -financing experience into a single platform. The company focused on eliminating aspects of the previous experience that customers disliked, such as credit-score reductions when loan shopping, limited down payment and term-length options offered by the car dealership, and a selection that was restricted to the vehicles in a single dealer's portfolio. By combining breadth of car choice with financing options and loan qualification, Capital One enabled customers to select and finance their new vehicles within a single app.

Recognizing that competitors' improved quality was eroding its perceived distinctiveness, paint manufacturer Sherwin-Williams focused its innovation efforts on factors that were important to customers and partners when researching, buying, and using paint. It redesigned interaction points for consumers and launched complementary offerings for contractors, including paint color selection, proposal development support, onsite product replenishing, and no-hassle returns.

A helpful way to begin this process of reimagination is to focus on building a bigger box. Rather than ignoring the current frames of reference of your business, this technique involves deliberately expanding them so as to encourage lateral thinking, but without the random idea generation that often plagues exercises based on thinking outside the box. One key technique is to unbundle the customer experience into its pre-purchase, purchase, and post-purchase components in order to identify the elements most enjoyed by customers and other stakeholders and, as importantly, those aspects that evoke ambivalence or dislike. This allows the reimagination efforts to be focused on targeted improvements to the customer experience.

When Target noticed that it was missing out on a significant portion of consumer spending and risked losing further ground to Walmart, it used this approach to identify grocery expansion as the priority. Building on its existing reputation for competitive prices, Target's expanded grocery offerings attracted customers who prioritized access to fresh products. The process also identified which aspects of Target stores added significant operating cost without improving the customer experience. By eliminating these costs, the company freed up capital for other investments — such as positioning stores as fulfillment hubs, which drove down digital transaction costs to nearly level with in-store transactions.

Innovate to Shift Direction

A fundamental shift of direction is the correct form of change for incumbent companies whose current strategies will not deliver their desired outcomes, and for new entrants who are looking to upend the dynamics of an existing industry.

This is the form of change that receives the bulk of business press attention and is popularized in concepts such as blue ocean and disruptive innovation. As described by creators Chan Kim and Renée Mauborgne, a blue ocean is the successful creation of a new space that customers value, whether by an incumbent company seeking to exit its current "red ocean" or a new entrant seeking to establish an uncontested market space. Clayton Christensen's Theory of Disruptive Innovation describes a specific type of innovation used under a specific set of conditions. According to Christensen, disruptive innovation refers to "a process by which a product or service powered by a technology enabler initially takes root in simple applications at the low end of a market — typically by being less expensive and more accessible — and then relentlessly moves upmarket, eventually displacing established competitors."

However, it is important to recognize that disruption is a specific form of innovation, not a synonym for innovation in general. The misapplication of his concept so troubled Christensen that he appealed to researchers, writers, and consultants to restrict their use of the term disruptive innovation to the particular context to which it applies.

German grocer Aldi disrupted the U.K. market by cutting branded products and display costs to deliver price discounts for customer essentials. The Virgin Group conglomerate has disrupted segments of the travel, entertainment, and mobile telephony industries by entering into partnerships with existing providers to secure low-cost access to an infrastructure that Virgin can then use to deliver a superior customer experience, often at a lower price than competitors.

Successful shifts do not have to occur at the low end of a market. Consider how Tesla's Elon Musk ignored the disruptive innovation playbook of entering the car market at the low end, offering instead a better product and service experience to the luxury market. Uber launched in San Francisco to serve existing taxi users rather than appealing to low-end, unserved customers. Funding platform GloRaise deliberately designed its service to more effectively connect founders with funders, reframing collaboration norms in the process. By offering a substantial improvement over the previous way of doing business, these companies were able to persuade existing users to switch their allegiances from competitors.

Incumbent companies face the need for a radical change in direction when the dynamics of their industry changes (such as the shift to renewable energy and the ensuing shift to electric vehicles) or due to underperformance of their current strategy. Such pivots are hard for large companies to execute — witness the recent failure of AT&T's effort to become an integrated media company or GE's failure to establish itself as the leading platform for the industrial internet of things.

But other organizations have succeeded in radically shifting direction. Danish energy company Ørsted has transitioned away from hydrocarbons to become the world's largest provider of offshore wind power. Market research firm Qualtrics executed a successful pivot in 2012 when it refocused the business on the enterprise experience management market despite being the leader in the academic market. This required a comprehensive overhaul of its tech stack and the reinvention of its business model. Revenues rose from less than $48 million in 2012 to over $723 million in 2020, when Qualtrics was acquired by SAP.

In a similar vein, market research provider Greenfield Online — established in 1995 as a pioneer of web-based research and panel management — recognized that, a decade later, online research was becoming a commoditized service offering. Greenfield Online changed its business model from providing research services directly to customers to offering researchers a technology platform to power their research. The success of this pivot culminated in its acquisition by Microsoft three years later.

In each successful pivot, the company correctly diagnosed the nature of its change need and employed the right form of innovation to deliver on it.

The first step in deriving more value from your innovation investments is to define the change you're trying to achieve. Each type of change — magnitude, activity, or direction — is best served by different forms of innovation. Recognizing what type of change is appropriate to your context can help you understand which forms of innovation are likely to yield the greatest impact for your business.

ABOUT THE AUTHORS

B. Tom Hunsaker is a strategy professor at Arizona State University's Thunderbird School of Global Management. Jonathan Knowles is the founder and CEO of the advisory firm Type 2 Consulting.

THE STRATEGY OF CHANGE SERIES

MIT Sloan Management Review describes the goal of the series as follows:

To develop effective strategy amid constant change, leaders must hone their ability to determine which changes will boost their organization's competitiveness. This series examines data from companies worldwide to provide practical insights for business leaders seeking advantage as they navigate complexity and change.

Article 1 – 13 August, 2020

Changing How We Think About Change

Introduces the idea that change can take three different forms – magnitude, activity or direction – and that the form of change that is appropriate for your business depends on how you are performing on the key dimensions of fit to purpose and relative advantage.

Article 2 – 17 December, 2020

The Essence of Strategy is Now How to Change

Argues that traditional approaches to strategy are based on two assumptions that are no longer valid – stable industry structures and shareholder primacy. Demonstrates how a focus on fit to purpose and relative advantage provides a reliable and timely guide for how businesses can improve their performance across multiple stakeholders.

Article 3 – May 20, 2021

Most Businesses Should Neither 'Pivot' nor 'Double Down'

Challenges the received wisdom that business leaders have to decide between doubling down on their existing strategy or pursuing some radical transformation. Shows how the change signal for two-thirds of companies is "reimagine activity" (sticking to an existing strategy but innovating the tactics used to achieve it).

Article 4 – August 5, 2021

Great Strategy Considers More Than Just Customers and Investors

Proposes that companies are social entities that exist in a multifaceted economic environment. By expanding the number of constituencies with whom exchanges of value can be undertaken, this biological mindset increases the variety of strategies available to companies.

Article 5 – October 5, 2021

Effective Innovation Begins With Strategic Direction

Argues that innovation is not an end in itself but the mechanism for achieving specific forms of change. Discusses the type of innovation that are best suited to a goal of enhancing magnitude vs. that of reimagining activity vs. that of shifting direction.