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Focusing and prioritizing innovation to routinely achieve real bottom line results

Systematic Innovation

Whitepaper

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What is Innovation?

Innovation is one of those words for which there are many different meanings. This is particularly true in business environments where “creativity” and “innovation” are often used interchangeably. At The Claymore Group, we believe that creativity and innovation are absolutely not the same: While creativity is a necessary element for innovation, it does not include the equally essential elements of agreement with a company’s strategic direction, its’ capability of execution and its’ attention to return on investment.

Management gurus, including Theodore Levitt, who wrote about innovation in the August 2002 *Harvard Business Review*, even go so far as to say that creativity alone can be damaging to a business. Due in fact, Levitt states, to the disruptive effects caused of confusing the creation of ideas with their implementation.

We should also be clear that innovation is not a strategy – it is the means to achieving a strategy.

So, to avoid confusion, and for the purposes of this white paper, we will use the straightforward definition of innovation used by Peter Drucker:

“Creating a new level of performance”

This is a very freeing definition and an appealing one as innovation, which was once the domain of marketing and R&D only, now becomes an activity for the entire enterprise. But it is also a subtly demanding definition, as it implicitly requires the performance of the business unit, and not just that of a single department, to move to the higher level. While this may sound trivial, it is not. In fact, seeing the holistic enterprise is the very keystone to sustainable and profitable (or “systematic”) innovation.

Systematic Innovation

By Drucker’s definition, improvements elevating an area’s performance at the expense of the enterprise’s performance do not qualify as innovation – no matter how sexy they may seem. That type of behavior is actually anti-innovation in effect! This is a common situation and examples abound, for instance:

- Build-to-stock manufacturing operations are typically measured, and their management bonused, based upon raw throughput, *measured either in tons or parts per hour*.
- At the same time, distribution operations of the same company are often *measured on inventory turns and on-time deliveries*.
- Manufacturing becomes tempted to “innovate” in ways that support the attainment of *their performance goals* – so they find ways to run big lots of whatever will maximize their throughput measurement.
- Distribution then plays the same game, finding ways to hold off receipt of factory parts at the end of the quarter – creating small inventories of product the factory won’t usually get around to building (their busy running big lots!) until they are past due.

This was the situation in the United States steel industry until Nucor Steel introduced their now famous, but then highly innovative, build-to-order, small lot size approach. In the new system it is **dollars** and **not tons** that matter across the organization.

In this example, departments were performing according to their approved metrics. Only secondary regard was given to the bottom-line performance of the business unit as a whole. This type of performance pattern is exacerbated by the

familiar quarter-by-quarter business rhythm and always increasing goals.

The good news/bad news business practice of dividing a company into separately measured functional silos has resulted in very lean departments and business units and metrics systems which place extreme visibility on price and margins. It has also resulted in parochial problem solving and has not produced companies that enjoy the benefits of being more than the sum of their parts. To achieve this major strategic advantage, the different parts of the company must find ways to innovate collectively and execute in a seamless and synchronized manner.

It comes as no surprise that to meet our definition of innovation we must view companies holistically. From this perspective, at any point in time, the organization experiences one of three major types of limitations or constraints preventing them from “creating a new level of performance”:

1. Either the organization can't make or deliver as much as it can sell
2. It can't sell as much as it can make or deliver, or
3. It has a problem with suppliers or resources (including people)

From this 50,000 foot vantage point only improvements addressing the actual

organizational constraint qualify as true innovation.

Requirements for Systematic Innovation Systems	
Know exactly where to focus and how to prioritize innovation efforts	<ul style="list-style-type: none"> • Create new market demand • Improve internal operations • Strengthen the supply chain
Learn and use a robust innovation methodology and leverage IT/KM capabilities	<ul style="list-style-type: none"> • What to change? • What to change to? • How to make the change?
Create the needed environment and an innovation portfolio management approach in order to sustain results	<ul style="list-style-type: none"> • Governance • Enablement • Measurement

Finding and intensely focusing on the critical part of the value or supply chain which limits the overall performance of the company is the first step of Systematic Innovation.

Step two begins with the determining the new state of that part of the operation. Visualizing the desired outcome of is not trivial nor is it as straightforward as it may sound. The process requires soliciting and incorporating the input of numerous

stakeholders. The gathering of feedback can involve various up and downstream departments, as well as finance, IT suppliers, partners, and customers. During this phase, it is equally important to identify and mitigate any potential negative effects of the proposed changes.

If during the first step of the process, the constraint is determined to be insufficient product demand from the market, the innovation exercise should begin by adopting the role of the customer. Work backward from **their** desired new state to the point to where your company is today. While somewhat counterintuitive, market offers created in this way are inherently much more efficient, in both cost and speed, then crafting a new product that must be branded, packaged, sold and distributed in a “push” manner.

This particular innovation stage can require a great deal of structured creativity (see, we do like creativity but in its place!) to construct a solution that, with the minimal expenditure and required change frees the organization to move forward.

The final step of Systematic Innovation requires the detailed analysis and planning to make the changes required by the final version of phase two. Once again, working backward from the desired new state is very advantageous. The output from this stage will be an agreed to and sequenced plan of action populated with tasks, responsibilities, completion dates and realistic cost projections and benefits.

This three-step innovation process can be described as determining what to change, what to change to and how to make the change. Even then, the changes must cost less than the margin improvement they deliver or opportunity they present.

The Innovation Portfolio

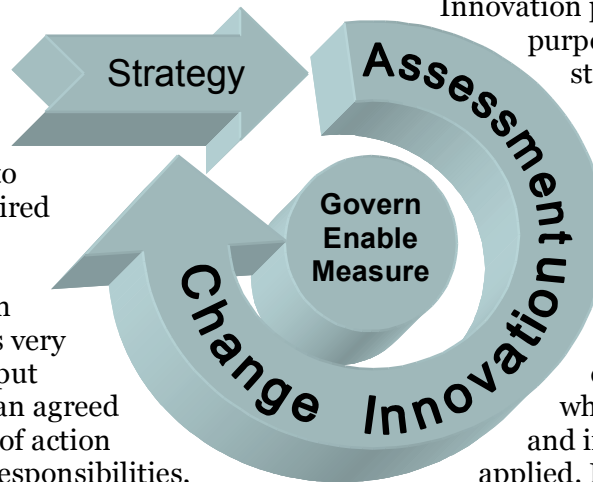
Some sources claim that up to 70% of change or improvement initiatives fail to reach their objectives. From our experience, the root cause of the majority of these failures is that the change efforts are disconnected from the strategy of the company and thus the priorities of its management.

At the same time, most strategic planning sessions do not result in real change in the company's performance. There's even an acronym, SPOTS, for Strategic Plans On The Shelf, to describe the futility of many of those efforts. Much work is done, few results are realized. SPOTS occur because most strategic plans are much more detailed in "where" exactly the

company should be going then in how it should get there.

The missing ingredient is innovation – the creation of that new level of performance. A structured Systematic

Innovation program serves the purpose of connecting the strategy to action by eliminating the barriers to implementing the strategy. The discipline of the Systematic Innovation approach determines exactly what change is required and in what way it is to be applied. It also ensures that ROI for innovation remains center stage.



From this discussion it is easy to extrapolate to the following four levels of innovation (we won't bother giving them cool names as only two are desirable):

Level One: Change (for the sake of change) efforts labeled as innovation that often hurt like hell, achieve zilch and achieve negative ROI's

Level Two: Innovation that feels good but has no impact or ROI

Level Three: Innovation that impacts organizational performance and might have an ROI

Level Four: Innovation that eliminates a major constraint and delivers a positive ROI

The obvious, but not-so-simple, task of management is to optimize their Systematic Innovation system to support and encourage as much Level Four innovation as possible. Successful Level Four innovation will drive the desire for further innovation of the same type,

because companies become addicted to positive innovation ROI. As Systematic Innovation becomes institutionalized it will drive a process of on-going improvement, as well as support an environment of realized potential (making a difference) for employees.

Level Three innovation has its place in the improvement portfolio – improving organizational performance (holistically – without causing damage to the output of the whole) is always a good thing. But since it is not breaking an organizational constraint, it cannot demand the same high level of support or focus as a Level Four effort. In some cases the ROI cannot be forecasted – this does not mean that the project shouldn't qualify for support, just that to do so must be viewed as a calculated risk. As part of a portfolio, some risk is acceptable. How much depends upon the company's fiscal circumstances, strategy, risk tolerance level, culture, and leadership style.

The first two levels of innovation should be avoided at all cost. The first for obvious reasons, the second because it causes organization fatigue analogous to the metal fatigue seen when bending a wire back and forth until it breaks. Doing things differently can sometimes, by itself, improve performance – a famous case study showed that changing the lighting or turning up the background music increased throughput in factories and offices. But those improvements were found not to stem from the specific change, but from the perception by the workforce that management actually cared. Change must drive visible results or it is viewed as a nuisance.

Creating Systematic Innovation Systems

Many popular and academic business books recommend that every company should immediately launch a program to foster constant innovation everywhere

within the organization. Few of those authors, however, have managed a P & L in today's business environment. The reality of having to achieve more with less prohibits or hamstring the creation or the ongoing operation of such programs.

To be a little less cynical, what hasn't or isn't working with current innovation efforts in many companies? Large formal innovation programs are often characterized by their upfront cost, hype and enthusiasm. Their nebulous ROI potential coupled with the demands of actually implementing their outputs causes a type of organizational weariness and intolerance.

Furthermore, if innovation programs are created outside of the normal business structure they become targets for cutbacks. If they are implemented within the normal structure they languish like another fad of the month. Middle management is often tasked with making this "one more thing" happen without the resources to be successful. There are always a few individuals who sense the vitalness of innovation, but as time progresses, with no marquee breakthrough to hang their hat on, these people ultimately fall out of the decision streams. Their passion is often perceived as an irritant. Being an innovation champion hasn't always been the safest career move!

The innovation situation at some firms is entirely analogous to the efforts of many companies who implemented Total Quality Management (TQM). Total quality sounds wonderful and it would be silly to say you didn't think better quality wouldn't be good for your company. TQM organizations, gurus, training centers and such were created with much ballyhoo in company after company. But where are those organizations and gurus now? Most are gone. The problem? TQM attempted to improve quality everywhere at once.

Without prioritization, TQM costs were high and the paybacks were almost always longer than the quarterly business event horizon.

What is needed instead of the above is an effort very similar to that used in successful change management programs.

An innovation program conducted with this foundation would consist of an internal communications plan, strong executive sponsorship, knowledge management tools, and a review of departmental measurements.

Additionally, training in innovation tool sets with emphasis on systems thinking and gaining buy-in is required. Finally, continuous management effort to maintain focus on organizational constraints and a tracking system to determine and provide ROI feedback ensures the continuation of the process.

We have found the most sustained and successful Level Four Innovation efforts revolve around three core management activities: **Governance, enablement and measurement.**

Governance begins with the executive leadership actively and publicly getting behind the new innovation program. Next, management objectives and communications must be designed to foster cross-functional performance improvements and visibly align with company goals. ROI calculations and hurdles (such as internal rates of return) must be widely communicated and followed. And finally, a strong program of

intellectual capital lifecycle management provides the needed valuation, asset management, and strategic feedback.

Many of these governance requirements can be tasked to a committee composed of executive management and thought leaders across divisions and/or departments. They should meet often to review innovation projects and provide support to those that meet the needed criteria. The committee also has the equally vital task of staying constantly familiar with the company's strategy and the challenges to implementing that strategy. In other words, at any given time, they must know where to focus

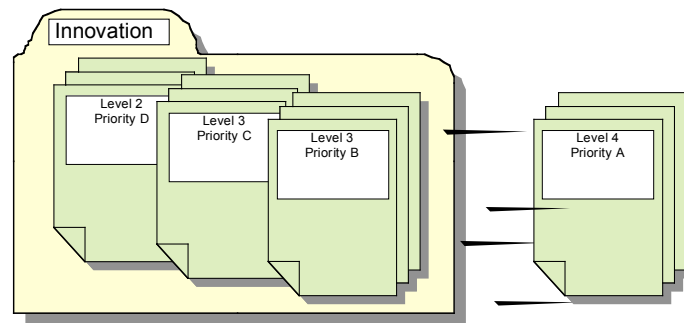
innovation resources for bottom line results. (We know you're thinking – how could I possibly fit another meeting into my schedule? The initial overlap

will quickly give way to a simplified schedule of required meetings.)

The committee should be the innovation avatars in the company – finding, freeing, and challenging the organization and its resources on how to best break organizational constraints.

The committee itself, should be measured on the results of its' innovation portfolio's ability to deliver documented bottom line results. This can be achieved in much the same way a mutual fund management team's performance is tracked and rewarded.

Enablement comprises the organization's structures, policies, and measurements. These are the elements that allow cross-functional projects to flourish and human capital management



systems, innovation skills education and knowledge management software to make their maximum contribution. Enablement is simply about ensuring that when the rubber meets the road it gets all the traction it needs.

Measurement is complex and includes several related activities: the tracking and reporting of results against the criteria used to justify the project; the ongoing communications and project team debriefs for individual, leadership and process improvement opportunities; and the internal reporting and public relations required to trumpet success and to insure a tolerance for failure.

A straightforward but rigorous audit of the governance, enablement and measurement components listed here (along with their subsystems) will readily expose opportunities and lay the planning groundwork for innovation system improvements.

Conclusion

Between the creation of strategy and the implementation of change lies the middleware of innovation. Put another way, innovation provides the means for the incarnation of strategy into the field of results.

Innovation should be treated as a rigorous discipline and a core competence. It cannot be the hoped for result of an unfocused, unstructured, and unmeasured effort.

The mission of management should be to drive and support innovation capabilities that rapidly solve real organizational constraints, with minimal risks and maximum ROI.

The Claymore Group works with clients to create strategically aligned, cost effective and sustainable innovation infrastructures and processes.

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