

Creating a Culture for Unrelenting Innovation

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Unrelenting innovation is the most enduring source of growth, profit, and competitive advantage for firms today. Market leaders are in the best position to innovate because of their deep pockets, rich talent, and intimate knowledge of the market. Yet, throughout history major companies have stumbled, declined sharply, or gone bankrupt due to a failure to innovate. Examples in only the last few years include Sony, Kodak, Hewlett-Packard (HP), Nokia, Research in Motion (RIM), General Motors (GM). Not too long back these firms were dominant in their respective markets and some may have been symbols of innovation. At the same time, other firms seem to have strengthened their dominant positions: Samsung, Apple, Google, Amazon, Facebook. Why do some giant incumbents stumble and fail while others move from strength to strength?

My co-authored research¹ strongly suggests that the internal culture of the firm is the common theme that ties all these seemingly disparate cases. The appropriate culture can enable a firm to be relentlessly innovative. The wrong culture can push a firm into over confidence, lethargy, and failure.

While Kodak and GM had some warning of impending doom, the decline of HP, Nokia, and RIM seem swift especially given their technological prowess. However, in the current age when technological change is rapid, such declines need not surprise. Indeed, organizations are in greatest danger of failing when they are at the peak of their success. These firms suffer from a culture we have called, the Incumbents Curse – cursed by one's own success.

What causes the incumbent's curse? My co-authors and I conducted three major studies to find the answer. One study examined the evolution of 66 markets since inception spanning almost 150 years. Another study examined the history of about 93 radical innovations spanning over a hundred years. A third study surveyed over 770 firms in 17 countries of the world.²

These studies suggest that the incumbent's curse is driven by three cultural traits: a focus on the present instead of the future; a desire to protect one's most successful products against the threat of innovation; and an aversion to risk. A review of some of the cases cited above is instructive.

Since March of 2010, HP's stock has declined steeply. The company has lost 80% of its market cap since that month. What was special about that month? In April 2010, Apple introduced the iPad. The runaway success of that product rendered the personal computer partially obsolete. At the time, HP was the world leader in personal computers. As sales of tablets have soared, HP's stock price took a dive that has continued till today.

¹ Tellis Gerard (2013), *Unrelenting Innovation: How to Create a Culture of Market Dominance*, Jossey-Bass, Warren-Bennis Leadership Series

² Op cit.

The irony is that HP had a nifty e-book in the mid 1990s, at least 5 years before the iPad. E-books of the time were the precursor to today's tablets. Sadly, the company failed to commercialize the e-book. Focus was one reason. At the time, sales of even a \$1 billion innovation paled in comparison to the \$100 billion in sales for HP. Thus focus on current products rather than the future, led the company to overlook the e-book. Risk was also a factor. With the secure stream of profits from computers and printers, there seemed no reason to invest in a risky business of e-books or tablets. Ironically, as sales of computers declined, HP made a rash attempt to diversify into services by a reckless acquisition of Autonomy for \$11 billion. A fraction of that amount spent on commercializing the e-book may have enabled HP to pre-empt the iPad with a tablet of its own and retain its dominance in the computer market.

Likewise, Kodak had most of the patents of digital photography when that revolution hit analog photography. Yet Kodak was tightly focused on its current products, analog cameras and film, and failed to embrace the digital future. Despite heroic attempts by some of its CEOs, the company failed to shake off the old film culture and embrace the new digital culture. Since 1996 when digital photography took off until 2010, Kodak suffered a loss of over 90% of its value and went into bankruptcy. Similarly, RIM had a touch screen smartphone before the iPhone. At the time, RIM was riding a high with the great success of the BlackBerry, especially in the business market that loved the security of the product. It did not see the future of the mass market of consumers for touch screen smart phones. As touch screen touch phones took off, RIM lost its dominant position in smartphones and about 90% of its market cap. In these cases, a focus on the present, resistance to risky innovations, and fear of cannibalizing successful products led dominant firms to ignore innovations developed within. This is the incumbent's curse.

Companies need three traits to counter the incumbents curse and stay relentlessly innovative. First, they need to focus on the future. Successful products get obsolete by the relentless advance of technological evolution. The future belongs to innovations. Second, they must willingly commercialize innovations even if they cannibalize their successful products. Better to cannibalize one's own products even at some loss in profits rather than go bankrupt when a competitor does so. Third, companies need to embrace risk. Risk arises from the steep loss function of innovations. That is, thousands of ideas have to go through a process of screening, development, prototyping, testing, to yield one innovation. Even then, most innovations fail. Risk means willing to stomach all those losses to reach the one success.

The three drivers of relentless innovation that I outlined above are deep cultural traits that cannot be changed overnight. My co-authored research into the psychology of organizations suggests three practices that can overcome those traits: offer incentives for enterprise, empower product champions, foster internal competition.

First, let's consider incentives for enterprise. Most firms today offer meager rewards for successful innovation but steep penalties for failure. Such penalties lead innovators to shy away from taking risks, which is essential for innovation. For unrelenting innovation, firms need asymmetric incentives that are the opposite of the above: strong rewards for innovation with weak penalties for failure. For example, 3M offers its employees 15% of time to devote to developing innovations of their own. Google offers an

even more generous 20% of time for the same. Moreover, Google repeatedly admonishes its employees to learn from failure and move on. Such an incentive structure encourages employees to experiment, embrace risk, and develop and commercialize game changing innovations.

Second, let's consider empowering innovation champions. Great innovations often emerge deep within the bowels of giant corporations. Examples include digital photography in Kodak, the MP3 player in Sony, the e-book in HP, or the touch screen smartphone in RIM. However, many large firms have bureaucratic structures in which innovations have to be approved by numerous committees and levels of the hierarchy before being implemented. This is anathema to innovation. The reason is that innovations arise from the minds of mavericks. Bureaucracies and hierarchies enforce conformity and inadvertently kill innovations. Worst still, great firms often commit the cardinal sin of ejecting innovation champions. For example, Tony Fadell, the co-champion of the iPod left Philips where his novel ideas did not receive a warm reception. Steve Jobs was at one time fired from Apple, which he co-founded and which he subsequently led to become the most innovative company of a century. Roger Newton, the father of the most profitable drug, Lipitor, left Pfizer because, which found his talent and style irksome.

To remain relentlessly innovative, firms need to create, retain and empower champions of innovation. They can do so by providing adequate resources, time, and talent to innovative, few penalties for failure, and productive critique of ideas.

Third, let's consider internal competition. Many employees choose to work for big corporations because of job security and protection from the ruthless competition of the marketplace. By the time it went bankrupt, GM highlighted this security, where employees were paid generously even when the factory closed. But the market is fecund in generating game changing innovations. For example, Silicon Valley, which has generated more wealth in a short time than any other cluster in the world, did so by ruthless competition among innovations. Large firms that did not innovate quickly declined. Entrepreneurs that had great innovations spawned and dominated new markets that brought them enormous wealth. Thus, the market will innovate, if the firm stays still. To remain relentlessly innovative, firms need to bring within the corporation, the competition that is outside in the marketplace. In that way they can generate innovations to obsolete their own products before the market does so.

Practically, internal competition means setting up system wherein teams of innovators compete with each other in idea fairs, funding contests, prototype races, market tests, and competing commercializations to bring innovations to the market. Such competitions are open to employees in the whole organization. Evaluation is by peers, senior managers, and even outsiders in the market. In this way, the organization is tapping into, encouraging, and empowering the whole pool of employees to be innovators. The firm benefits from the "wisdom of the crowd." This is a bottom up method of encouraging innovation, rather than a top down approach that depends on the highly fallible decision of a few. This is what internal competition at its best.

Thus, the culture of for unrelenting innovation consists of three traits and three practices. The three traits are a focus on the future, an embrace of risk, and a willingness to cannibalize successful products.

Traits are difficult to change overnight. But three practices can engender the traits: incentives for enterprise, empowering innovation champions, and internal competition. Success with innovation can make a firm wealthy and lead to the incumbent's curse. The above practices and traits help to overcome the incumbents curse. Figure 1 shows the dynamic causality that exists among practices, traits, innovation, and the incumbents curse. My new book provides details of the psychology of these factors and the cases that highlight good and bad culture. It argues that unrelenting innovation is not an option but essential for survival and dominance. It is not automatic but must be fostered. It flows not from luck but from enlightened management.

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