# The Innovator's Solution

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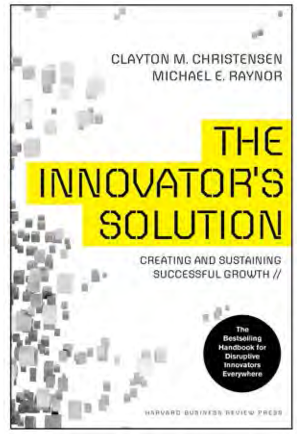


A surprising number of innovations fail not because of some fatal technological flaw or because the market isn't ready. They fail because responsibility to build these businesses is given to managers or organizations whose capabilities aren't up to the task. Corporate executives make this mistake because most often the very skills that propel an organization to succeed in sustaining circumstances systematically bungle the best ideas for disruptive growth. An organization's *capabilities* become its *disabilities* when disruption is afoot. This chapter offers a theory to guide executives as they choose a management team and build an organizational structure that together will be capable of building a successful new-growth business. It also outlines how the choices of managers and structure ought to vary by circumstance.

## Resources, Processes, and Values

What does this awfully elastic term *capability* really mean? We've found it helpful to unpack the concept of capabilities into three classes or sets of factors that define what an organization can and cannot accomplish: its resources, its processes, and its values—a triptych we refer to as the RPV framework. Although each of these terms re- quires careful definition and analysis, taken together we've found that they provide a powerful way to assess an organization's capabilities and disabilities in ways that can make disruptive innovation much more likely to succeed…..

One of the most vexing dilemmas that stable corporations face when they seek to rekindle growth by launching new businesses is that their internal schools of experience have offered precious few courses in which managers could have learned how to launch new dis- ruptive businesses. In many ways, the managers that corporate exec- utives have come to trust the most because they have consistently delivered the needed results in the core businesses cannot be trusted to shepherd the creation of new growth. Human resources executives in this situation need to shoulder a major burden. They need to monitor where in the corporation's schools of experience the needed courses might be created, and ensure that promising managers have the opportunity to be appropriately schooled before they are asked to take the helm of a new-growth business. When managers with the requisite education cannot be found internally, they need to ensure that the management team, as a balanced composite, has within it the requisite perspectives from the right schools of experience. We will return to this challenge later in this chapter.

Finding managers who have been appropriately schooled is a critical first step in assembling the capabilities required to succeed. But it is only the first step, because the capabilities of organizations are a function of resources other than people, and of elements beyond just resources, namely, processes and values. To these we now turn.

## Processes

Organizations create value as employees transform inputs of resources—the work of people, equipment, technology, product designs, brands, information, energy, and cash—into products and services of greater worth. The patterns of interaction, coordination, communication, and decision making through which they accomplish these transformations are *processes*. Processes include the ways that products are developed and made and the methods by which procurement, market research, budgeting, employee development and compensation, and resource allocation are accomplished.

Processes differ not only in their purpose, but also in their visibility. Some processes are "formal," in the sense that they are explicitly defined, visibly documented, and consciously followed. Other processes are "informal," in that they are habitual routines or ways of working that have evolved over time, which people adopt simply because they work or because ". . . that's the way we do things around here." Still other methods of working and interacting have proven so effective for so long that people unconsciously follow them—they constitute the culture of the organization. Whether they are formal, informal, or cultural, however, processes define how an organization transforms inputs into things of greater value.

Processes are defined or evolve de facto to address specific tasks. When managers use a process to execute the tasks for which it was designed, it is likely to perform efficiently. But when the same, seemingly efficient process is employed to tackle a very different task, it often seems bureaucratic and inefficient. In other words, a process that defines a *capability* in executing a certain task concurrently defines *disabilities* in executing other tasks. In contrast to the flexibility of many resources, processes by their very nature are meant not to change. They are established to help employees perform recurrent tasks in a consistent way, time after time. One reason that focused organizations perform so well is that their processes are always aligned to the tasks.

Innovating managers often try to start new-growth businesses using processes that were designed to make the mainstream business run effectively. They succumb to this temptation because the new game begins before the old game ends. Disruptive innovations typically take root at the low end of markets or in new planes of competition at a time when the core business still is performing at its peak—when it would be crazy to revolutionize everything. It seems simpler to have one-size-fits-all processes for doing things, but very often the cause of a new venture's failure is that the wrong processes were used to build it.

The most crucial processes to examine usually aren't the obvious value-adding processes involved in logistics, development, manufacturing, and customer service. Rather, they are the enabling or back-ground processes that support investment decisions. These include how market research is habitually done, how such analysis is translated into financial projections, how plans and budgets are negotiated and how those numbers are delivered, and so on. These processes are where many organizations' most serious disabilities in creating disruptive growth businesses reside.

> **"The old paradigm held an ideal of reason freed of the pull of emotion. The new paradigm urges us to harmonize head and heart. To do that well in our lives means we must first understand more exactly what it means to use emotion intelligently."**
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> –Daniel Goleman, *Emotional Intelligence*

Some of these processes are hard to observe, and it can therefore be quite difficult to judge whether the mainstream organization's processes will facilitate or impede a new-growth business. You can make a good guess, however, by asking whether the organization has faced similar situations or tasks in the past. We would not expect an organization to have developed a process for accomplishing a particular task if it has not repeatedly addressed a task like that before. For example, if an organization has repeatedly formulated strategic plans for established businesses in existing markets, then a process that planners follow in formulating such plans likely will have coalesced, and managers will instinctively follow that process. But if that organization has not repeatedly formulated plans for competing in markets that do not yet exist, it is safe to assume that no processes for making such plans exist.

## Values

The third class of factors that affect what an organization can or cannot accomplish is its values. Some corporate values are ethical in tone, such as those that guide decisions to ensure patient well-being at Johnson & Johnson or that guide plant safety at Alcoa. But in the RPV framework, *values* have a broader meaning. An organization's values are the standards by which employees make prioritization decisions—those by which they judge whether an order is attractive or unattractive, whether a particular customer is more important or less important than another, whether an idea for a new product is attractive or marginal, and so on.

Employees at every level make prioritization decisions. At the executive tiers, these decisions often take the form of whether or not to invest in new products, services, and processes. Among salespeople, they consist of on-the-spot, day-to-day decisions about which customers they will call on, which products to push with those customers, and which products not to emphasize. When an engineer makes a design choice or a production scheduler puts one order ahead of an- other, it is a prioritization decision.

The larger and more complex a company becomes, the more important it is for senior managers to train employees at every level, acting autonomously, to make prioritization decisions that are consistent with the strategic direction and the business model of the company. That is why successful senior executives spend so much time articulating clear, consistent values that are broadly understood throughout the organization. Over time, a company's values must evolve to conform to its cost structure or its income statement, because if the company is to survive, employees must prioritize those things that help the company to make money in the way that it is structured to make money.

Whereas resources and processes are often *enablers* that define what an organization *can* do, values often represent *constraints*—they de- fine what the organization *cannot* do. If, for example, the structure of a company's overhead costs requires it to achieve gross profit margins of 40 percent, a powerful value or decision rule will have evolved that encourages employees not to propose, and senior managers to kill, ideas that promise gross margins below 40 percent. Such an organization would be *incapable* of succeeding in low-margin businesses—be- cause you can't succeed with an endeavor that cannot be prioritized. At the same time, a different organization's values, shaped around a very different cost structure, might enable it to accord high priority to the very same project. These differences create the asymmetries of motivation that exist between disruptors and disruptees.

Over time, the values of successful firms tend to evolve in a predictable fashion in at least two dimensions. The first relates to accept- able gross margins. As companies upgrade their products and services to capture more attractive customers in premium tiers of their markets, they often add overhead cost. As a result, gross margins that at one point were quite attractive will seem unattractive at a later point. Companies' values change as they migrate up-market.

The second dimension along which values can change relates to how big a business has to be in order to be interesting. Because a company's stock price represents the discounted present value of its projected earnings stream, most managers typically feel compelled not just to maintain growth but to maintain a constant rate of growth. For a $40 million company to grow 25 percent, it needs to find $10 million in new business the next year. For a $40 *billion* company to grow 25 percent, it needs to find $10 *billion* in new business the next year. An opportunity that excites a small organization simply isn't large enough to be interesting to a very large one. One of the bittersweet rewards of success is, in fact, that as companies become large, they literally lose the capability to enter small emerging markets. Their size and success put extraordinary resources at their disposal. Yet they cannot deploy those resources against the small disruptive markets of today that will be the large markets of tomorrow, because their values will not permit it.

Executives and Wall Street financiers who engineer mega-mergers among already huge companies in order to achieve cost savings need to account for the impact of these actions on the resultant companies' values. Although the merged corporations might have more resources to throw at new-product development, their commercial organizations tend to lose their appetites for all but the biggest blockbuster opportunities. Huge size constitutes a very real *disability* in creating new-growth businesses. But as we will show later in this chapter, when large corporations keep the flexibility to have small business units within them, they can continue to have decision makers who can become excited about emerging opportunities.

### The Migration of Capabilities

In the start-up stages of a business, much of what gets done is attributable to its *resources*—particularly its people. The addition or departure of a few key people can have a profound influence on its success. Over time, however, the organization's capabilities shift toward its processes and values. As people work together successfully to address recurrent tasks, processes become defined. And as the business modeltakes shape and it becomes clear which types of business need to be accorded highest priority, values coalesce. In fact, one reason that many soaring young hot-product companies flame out after they go public is that the key initial resource—the founding team—fails to institute the processes or the values that can help the company follow up with a sequence of hot new products.

Success is easier to sustain when the locus of the capability to innovate successfully migrates from resources to processes and values. It actually begins to matter less which people get assigned to which project teams. In large, successful management consulting firms, for example, hundreds of new MBA's join the firm every year, and almost as many leave. But they are able to crank out high-quality work year after year because their capabilities are rooted in their processes and values rather than in their resources.

As a new company's processes and values are coalescing, the actions and attitudes of the company's founder typically have a pro- found impact. The founder often has strong opinions about the way employees ought to work together to reach decisions and get things done. Founders similarly impose their views of what the organization's priorities need to be. If the founder's methods are flawed, of course, the company will likely fail. But if those methods are useful, employees will collectively experience for themselves the validity of the founder's problem-solving methodologies and criteria for decision making. As they successfully use those methods of working together to address recurrent tasks, processes become defined. Likewise, if the company becomes financially successful by prioritizing various uses of its resources according to criteria that reflect the founder's priorities, the company's values begin to coalesce.

As successful companies mature, employees gradually come to assume that the priorities they have learned to accept, and the ways of doing things and methods of making decisions that they have employed so successfully, are the right way to work. Once members of the organization begin to adopt ways of working and criteria for making decisions by assumption, rather than by conscious decision, then those processes and values come to constitute the organization's culture. As companies grow from a few employees to hundreds and thousands, the challenge of getting all employees to agree on what needs to be done and how it should be done so that the right jobs are done repeatedly and consistently can be daunting for even the best managers. Culture is a powerful management tool in these situations. Culture enables employees to act autonomously and causes them to act consistently.

Hence, the location of the most powerful factors that define the capabilities and disabilities of an organization migrates over time— from resources toward visible, conscious processes and values, and then toward culture. When the organization's capabilities reside primarily in its people, changing to address new problems is relatively simple. But when the capabilities have come to reside in processes and values and *especially* when they have become embedded in culture, change can become extraordinarily difficult.

Every organizational change entails a change in resources, processes, or values, or some combination of these. The tools required to manage each of these types of change are different. Moreover, established organizations typically face the opportunity to create new growth businesses—and the consequent requirement to utilize different re- sources, processes, and values—at a time when the mainstream business is still very healthy—when executives must not change the resources, processes, and values that enable core businesses to sustain their success. This requires a much more tailored approach to managing change than many managers have felt to be necessary…

### Creating Management Bench Strength

A company that works to develop a sequence of new-growth businesses can build a virtuous cycle in management development. Launching growth business after growth business creates a set of rigorous, demanding schools in which next-generation executives can learn how to lead disruption. Companies that only sporadically attempt to create new-growth businesses, in contrast, offer to their next-generation executives precious few of the courses they need to successfully sustain growth. ■

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