Ashridge Strategic Management Centre

Members Meeting

26th September 2019

Minutes of Meeting

In attendance

Paul Barrett	Babcock International
David Bowerin	Independent consultant, formerly Citigroup
Glen Browse	Talbot Underwriting
Chiara Covone	D S Smith
Hari Mann	Ashridge
Philip Meyers	ABF
Christoph Naumann	Siemens
Stein Rasmussen	SBM Offshore
Julian Ross	Talbot Underwriting
Nick Saunders	National Grid

From Ashridge Strategic Management Centre

Stephen Bungay
Rebecca Homkes
Jo Whitehead

Rebecca Homkes: Enterprise Innovation – Prepare to Innovate, Learn from Entrepreneurs, Grow in the Market

Rebecca's material was designed to provide a quick overview of three interrelated topics on enterprise innovation, which is her main focus currently:

1. Preparing to innovate;
2. Learning the right lessons from start-ups;
3. Speeding growth and scaling of the commercialization of innovation.

She started by asking people what challenges they experience in innovating.

- For one member is was time to market. The R&D people like to play in their sandbox and by the time something comes out it is too late for the business to use. The 'not invented here' syndrome within the technology function is also a big barrier;

- For another member, legacy systems are a big constraint. The systems are too slow for the current pace of things and have given rise to processes designed for them which are also constraining us. Replacing the systems would cost £1bn, so to some extent we are trapped.

Rebecca then described a typical corporate experience:

- We get scared;
- We visit Silicon Valley and join a tour bus;
- We change the office furniture and environs;
- We try and change the culture;
- We buy some startups.

Unfortunately, this leads to very poor returns on investment in innovation. The average return on investment is 0.0037%.
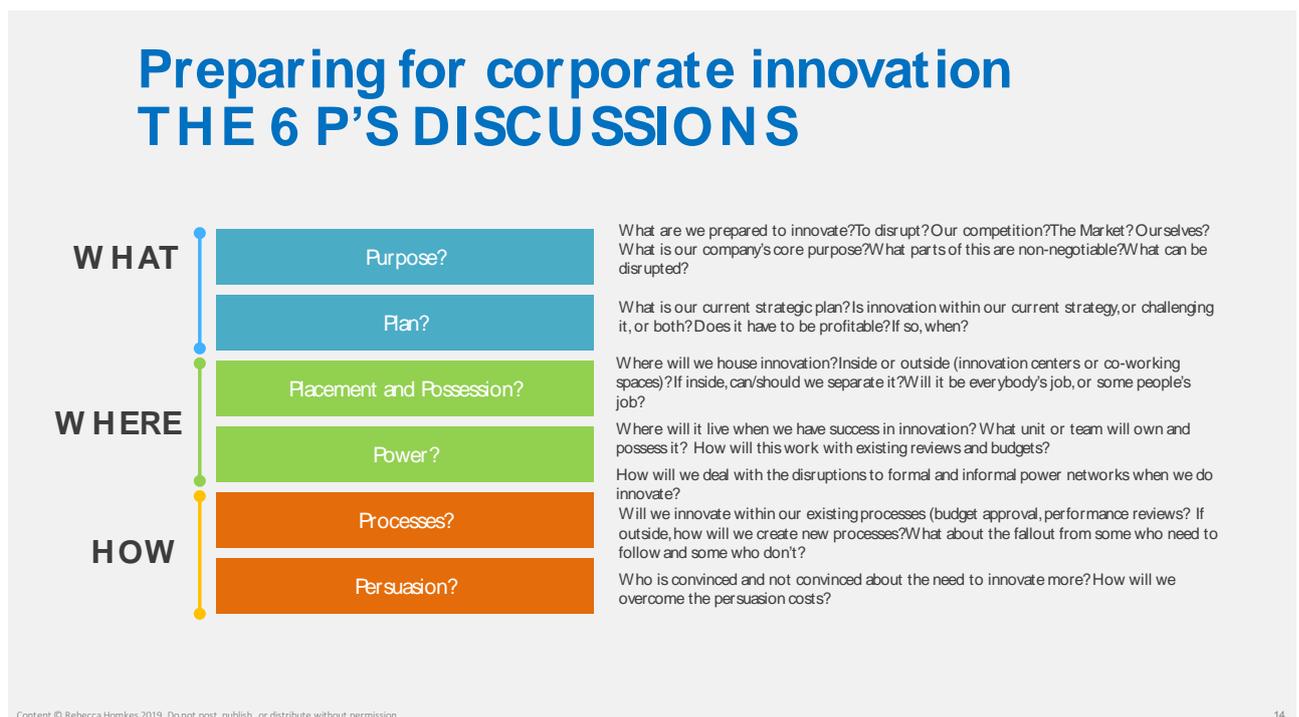
The biggest problems are not motivation, lack of ideas, creativity or money, or CEO commitment or consultants.

The three problems are:

1. Companies are not ready because they do not have the right conversations;
2. They do not learn the right lessons from start ups;
3. They do not adapt their execution approach for innovation.

The Preparation Conversations

There are six critical conversations around 'what', 'where' and 'how'.

Preparing for corporate innovation
THE 6 P'S DISCUSSIONS

WHAT	Purpose?	What are we prepared to innovate? To disrupt? Our competition? The Market? Ourselves? What is our company's core purpose? What parts of this are non-negotiable? What can be disrupted?
	Plan?	What is our current strategic plan? Is innovation within our current strategy, or challenging it, or both? Does it have to be profitable? If so, when?
WHERE	Placement and Possession?	Where will we house innovation? Inside or outside (innovation centers or co-working spaces)? If inside, can/should we separate it? Will it be everybody's job, or some people's job?
	Power?	Where will it live when we have success in innovation? What unit or team will own and possess it? How will this work with existing reviews and budgets? How will we deal with the disruptions to formal and informal power networks when we do innovate?
HOW	Processes?	Will we innovate within our existing processes (budget approval, performance reviews? If outside, how will we create new processes? What about the fallout from some who need to follow and some who don't?
	Persuasion?	Who is convinced and not convinced about the need to innovate more? How will we overcome the persuasion costs?

The first two questions are around what you are prepared to do: the purpose and the plan.

You need to be very clear about what is non-negotiable and what is up for change. Are you prepared to make your business model redundant? These conversations can take you back to fundamentals. Faced by the challenge of Amazon, Home Depot's values allowed them to question everything. Are you prepared to contemplate open innovation or does everything have to originate inside the company?

The second question is where innovation is going to happen. Leaving it inside can impose unintended constraints, but if it is located in an innovation center, the problem is often that it leaves no pathway back into the business.

Then there is how. How will the way you currently deal with budgets, performance reviews and so on work for the people you need in innovation? If you are too tight you can stifle the new, but if you are too loose you risk losing focus.

Rebecca then invited comments and questions about the 'what', 'where' and 'how' themes of preparation:

- One member said that having the right skills of outside thinking and inside knowhow was tricky. Rebecca mentioned the idea of dual heads in innovation. Goldman Sachs have some good examples of this e.g. Fischer Black of Black Scholes and a Goldman partner working together;

- Another observed that it takes a special person to create a new business in a corporate environment;

- One member has been put in charge of innovation as well as strategy. He has found that the innovation team, which is a separate entity, is not prepared to engage with customers or the business. After a year there was some momentum because each product manager had a road map of what would happen over the next ten years. But, getting the balance between innovation people and the business is tricky;

- Some time ago Colgate took innovation away from the product managers into a separate innovation group, because the product managers focused on incremental changes within the existing business. There was a new ventures department that was to challenge the current market place and leverage the core competencies of research and development into new areas of business;

- The Bartlett and Ghoshal framework of local responsibility versus the benefits of global integration could help to frame the problem here. Apple is an example of a company in one corner (global not local). Most of the businesses in the Member company's portfolio are in the opposite corner (local not global). So, the world you are in affects how to do innovation

and there is a need to disaggregate. This suggests that there is a context within which the what, where and how are set.

- The "Purpose" idea is very important. You have to know what you are and what you want to be. We created innovations that were not part of the strategy – so they were wasted.

Better Learning from Startups: Six Myths and Six Lessons

A mythology has grown up around entrepreneurs that has led to some ideas about how to work with startups which are either misleading or downright wrong. They need to be replaced with quite different ones.

Three of these myths relate to getting to the idea and creating a *value hypothesis*:

1. You should act like an entrepreneur – instead you should question fundamental assumptions and look for exponential changes in costs and capabilities.
2. Startups are sexy, so get sexier – instead you should be structured and methodical.
3. You must innovate or die – rather you should encourage exploration.

Three further ones relate to growing the idea and developing a *growth hypothesis:*

4. You should celebrate failure – instead, invest in ways of discovering the truth cheaply and efficiently.
5. You should focus on getting the best returns – instead you should focus on reducing the unknowns.
6. Process makes you slow – in fact the right processes to create efficient learning allow you to experiment and innovate.

Rebecca explained each point in turn and invited discussion.

1. <u>Instead of trying to build an entrepreneurial culture, question fundamental assumptions</u>

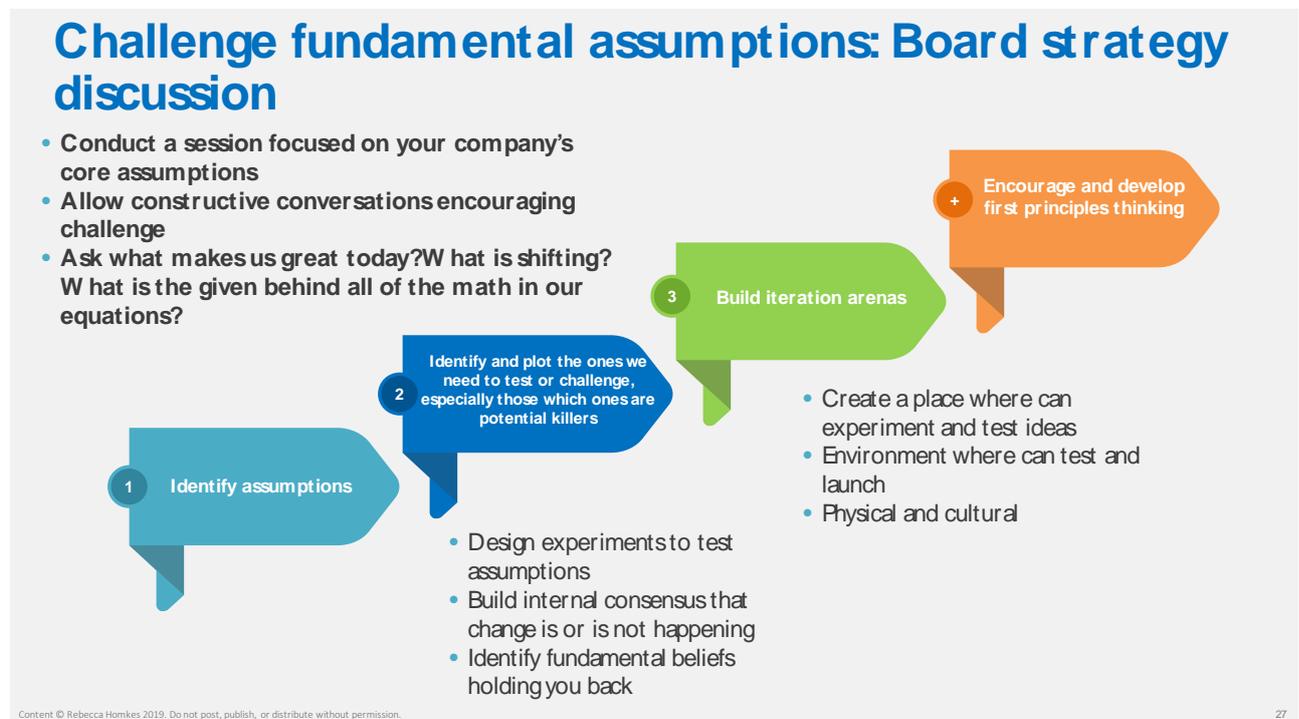Despite the claim commonly made by corporates that they are trying to make people behave like entrepreneurs, that is in fact not what they want. Entrepreneurs behave chaotically and take risks that it would be irresponsible to take in a shareholder-owned company. The claim arises from the perceived need to change. Most companies are quite good at incremental change, but innovation comes from disruptive change, which is a 10x or 20x change in a core variable the business is built on.

The first step in methodically searching for better ideas is therefore to look for *exponential capability increases matching exponential decreases in cost.* If they

occur in one of the variables underlying your business, you are facing potential disruption, but you have also discovered a source of innovation. The systematic way to discover such sources is to challenge your key assumptions.

Incumbents often fail to recognize when disruption is a threat because they fail to challenge assumptions which prove to be wrong. Kodak believed that people cared about the quality of a photo and dismissed early digital photography because the quality was poor. They failed to recognize that convenience was highly valued and that as digital technology developed quality would rapidly improve. Blockbuster believed that location mattered most. Dell assumed that because people's data is sensitive, they would always want to have servers in-house - until the cloud proved them wrong. Unchallenged assumptions are dangerous.

The first genuine lesson to learn from entrepreneurs is to challenge key assumptions, and there is a structured way of doing so:

Challenge fundamental assumptions: Board strategy discussion

- Conduct a session focused on your company's core assumptions
- Allow constructive conversations encouraging challenge
- Ask what makes us great today? What is shifting? What is the given behind all of the math in our equations?

1 Identify assumptions

2 Identify and plot the ones we need to test or challenge, especially those which ones are potential killers

- Design experiments to test assumptions
- Build internal consensus that change is or is not happening
- Identify fundamental beliefs holding you back

3 Build iteration arenas

- Create a place where can experiment and test ideas
- Environment where can test and launch
- Physical and cultural

+ Encourage and develop first principles thinking

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Rebecca then invited members to consider some examples of assumptions underlying their businesses:

- Do we actually need a national grid, or can electricity be distributed without one?

- We assume that packaged good have two barriers to entry: brand and shelf-space. But online brands are being set up on Instagram and go direct to the consumer. When they get to 10 million the supermarkets want them;

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- We assume that you need insurance companies to connect people with risks to people with capital.

One member observed that sometimes the problem is that although you need to move early in trying to do something, you get the response 'don't waste my time' because there is no obvious threat. Another commented that the deepest assumptions are implicit and difficult to even recognise as assumptions. Rebecca suggests that it takes multiple iterations to get to the list of core assumptions (and has a few methods for getting to these), but you also need the right group to carry out the process.

2. Don't try to be sexy and creative: be structured and methodical

Although there is often an element of serendipity in innovation, generating random ideas in an innovation offsite does not work. Nor does trying to imitate the culture of a start-up by creating a cool, sexy environment. This confuses a superficial manifestation with the underlying cause.

Entrepreneurs think in a structured way. They imagine what would happen if exponential changes in cost or capability were to take place. Therefore, as an incumbent you can systematically go through your cost structure and do the same thing.

One exercise is to go through the P&L, and for each line item ask: 'what would happen if this went 10x? 100x? to 0?' Which of these would make a fundamental difference? For the ones that are, what technological or societal change could be driving that change? The key is to unpick the underlying equation behind that number. This is also a lens into what startups to look for regarding partnering.

For example, FedEx' biggest cost is drivers. If each driver were able to deliver 20x more parcels in a day the business would be transformed. Drones could enable this to happen.

3. Instead of telling people to innovate or die, encourage exploration

The 'innovate or die' tagline is common in conference agendas. The message is to innovate now or perish and that produces a scramble to get it right.

Timing is critical, and you can be too early as well as too late.

It is difficult to think exponentially because human beings have evolved to think linearly. In a linear world you have plenty of time, but in an exponential world nothing actually changes for a long time until suddenly everything changes and there is no time left to adapt or respond. You therefore need to plot out mathematically when it is time to put in the effort to get going, which is just

before the point at which exponential decreases in cost intersect with exponential increases in capability.

To do this you need a corporate 'sandbox', which is a 'safe' place where mistakes can be tolerated, to regularly explore emerging trends. Facebook carries out many of its experiments in New Zealand, a market which provides sufficient size to learn, but limits scope so that not all of its customer base is subjected to continuous experimentation.

There were a number of comments:

- Someone does have to get in early to drive costs down. In practice, someone always does;

- In some areas like photovoltaics, timing market entry is difficult because no-one is making any money;

- It can be misleading to focus entirely on technology because sometimes the innovation is happening in another area, like the customer;

- It is hard to do this. There are trade-offs, for example, in the costs and benefits of on-shore and off-shore wind power;

- Food is rather traditional but even so there is a lot going on, so much so that it is hard to navigate. A 'client venture model' has developed whereby consultants specialise in connecting people doing R&D and corporates to whom it would be valuable. This is also happening in insurance.

4. <u>Stop asking innovation teams to focus on projects with the best returns and focus on reducing the unknowns by discovering the truth cheaply and efficiently</u>

Large corporates spend a huge amount of time selecting, preparing and debriefing experiments. They search for those with the highest RoI. This is a waste of time, as the numbers behind RoI calculations are all guesswork.

The challenge is to validate the idea and then ride the growth wave upwards at the point at which the numbers will start to matter to the company as a whole because exponential scaling is possible. The way to validate is not to argue about who is right, but to look for conversion funnels, assumptions where small variations make a big difference. Then, use your expertise to review the assumptions, come up with good estimates and then work to reduce the level of uncertainty.

One member commented that such questioning can come over as negative. Another said that on occasions they had asked customers about their reactions to new ideas and the answers came back positive. Then in practice they did not buy. Rebecca went through a few ways to unpick the conversion funnel.

5. <u>Processes do not make you slow: the right processes allow you to innovate and experiment efficiently</u>

There is a common myth that entrepreneurs eschew process, but this is a myth. It is also a bad idea to eliminate all process around innovation, but most innovation demands a different type of process. To do this, Rebecca recommends doing a process audit.

On this, organisations have processes for a few reasons, mainly to increase efficiency, avoid mistakes, and manage to the lowest common denominator. Processes designed to avoid mistakes and manage to the lowest common denominator *do* inhibit innovation. They have given processes in general a bad name amongst people who want to innovate. However, not all processes are bad, and some, which lower the cost of uncovering the truth, are necessary to enable innovation - anything that lowers the cost of reaching an insight is good.

You therefore need to carry out a process audit to remove processes that are really just about control. If a process is not difficult but just takes up time, try to speed it up.

One member company had a helpful process called 'success transfer' which was designed to speed up the dissemination of new ideas across the organisation.

Some of the biggest blockers to innovation lie in the distribution of decision-rights. The question here is not only who makes which decisions, but what constitutes a good decision. Rebecca also recommends having an explicit discussion about 'what makes a good decision for us.' This increases agility as people/teams can make decisions much faster without having to meet to discuss each individual case. While it is a useful growth hack, gew companies discuss this.

For example, in the research department of one pharma company, the scientists applied scientific levels of proof before deciding to stop work on a drug candidate, so wasting millions of dollars on compounds which they all knew would never make it. Changing this behavior was encapsulated in the phrase 'We are sifting for gold, not polishing coal'.

6. <u>Don't' celebrate failure: instead focus on efficient information discovery</u>

Conventional wisdom has it that one reason for a lack of innovation is fear of failure and that start-ups celebrate failure. This is a myth. The idea that they celebrate failure confuses another superficial effect with the underlying cause.

The reality behind the myth is that rather than trying to get things right first time, start-ups carry out large numbers of cheap experiments with fast feedback loops. The winners are the fastest to find out what is wrong. The definition of an experiment is 'the testing of a business assumption, which, if true, will affect the profitability of the company'.

If you are trying to get things right, a failed experiment is one that does not work. If you are trying to find out what is wrong, a failed experiment is one that does not yield any information. The most valuable experiments are ones that surprise you by disproving a fundamental belief you hold.

Contrasting views of how to experiment are illustrated by the US pet and pet food retailer Petco, and Amazon. Petco runs 75 experiments a year (down from 100), which have to be approved to avoid duplication and 'small ideas'. Amazon focusses instead on reducing the time and cost of experiments in order to become an innovation machine. If Petco's 75 carefully planned experiments have a 50% chance of success Petco will learn 32.5 things a year. Amazon conducts 10,000 experiments a year without putting any time into trying to guess the right answer. If they each have a 5% chance of success, Amazon will learn 500 things a year, giving them a learning advantage factor of 15x.

Lowering the cost of experiments enables you to conduct the large number of them you will need to carry out in order to be successful. There is nothing new about this. Thomas Edison is said to have observed 'I never had a failure – I just discovered 10,000 ways it did not work.' Today, James Dyson works in a similar way. In the 1950's, instead of setting up a lot of real stores to test the most efficient layout, McDonalds spent a day with some students trying out alternative formats drawn in chalk on a tennis court, which could be altered within minutes and cost almost nothing to do. (The scene is re-enacted in the film '*The Founders*'.)

One member commented that the cost of experimentation seemed to depend on the industry. What if the cost of experimentation is high? Rebecca replied that there were many different ways of lowering costs, and you need to set parameters: isolate what you are testing, choose an experiment that will have a rapid feedback loop; set boundaries as to how much it will affect customers; if money and time are limited, decide what you want to try out; and ensure that it is aligned with your values and does not put your reputation at risk. For example, Facebook use New Zealand as a sandbox. At UPS, there is a rule that you should fail in a way that never touches the package. At Match.com experiments had to take less than two weeks, and have at least one KPI you were trying to influence which had to contribute 33% to monthly growth.

There is now also infrastructure to call on to reduce the cost of experimentation, such as simulation software. Some generative design software can run 10 million variants to deliver a set of real options within hours. Crowdsourcing enables companies to experiment in communities, and resources like Upwork enable them to cheaply access specific skills from anywhere on the planet. Local ecosystems are growing up to facilitate experiments, such as Techshop in Silicon Valley for manufacturing systems or Trinity Groves in Dallas for restaurant concepts.

One Member found adopting the principles of open innovation - or indeed any drawing on third parties - to be hard in practice because their technology people were very resistant to outside people being involved. Rebecca commented that that assumption needed to be challenged. Another Member also had the experience that people believed that experimentation slows things down and they just want to charge on. In fact, fast cycle experiments speed things up. What really slows things down is trying to get things right without experimenting, launching the innovation and then finding out you were wrong. You then have to start again. If you are arguing about who is right, you are wasting your time. Don't ask if this is a good idea. Instead, draw out the assumptions by asking what would have to be true for it to be a good idea, and then test them.

Executing on Innovation

Rebecca then gave a brief summary of lessons learned about executing on innovation to grow and achieve scale:

1. Instead of using a linear innovation 'funnel', which narrows things down from a wide set of opportunities to a narrow set of launch options, adopt an iterative approach with shorter milestones at which progress is validated;
2. Instead of setting a maximum budget for the whole life of a project, release money in small packets to fund each step. Do not set a deadline or people will use all the time available, even if they could have done things faster;
3. Instead of measuring progress in terms of revenue, prioritize learning. Early revenue is a poor indicator of final revenue;
4. Instead of waiting until you have worked it all out before you go to market, test early, talk to customers and work with the market to develop the product;
5. Talking to people inside and outside the company is at the heart of successful innovation.

Round the table comments

- Good to have challenges to myths and received wisdom. It would be good to have some B2B examples. We have a small number of large, conservative customers, and experimenting doesn't seem to work in the same way, but we could use this thinking in the way we apply technology. We do not have to be leading edge as we are often sorting out a client's legacy kit but applying innovation to that could be interesting. I would come back to the culture – if it isn't there it won't happen.

- It was good to return to this theme. There is a certain level of cognitive dissonance as we have some very traditional mature businesses such as sugar, and some interesting ingredients businesses where technology is relevant but customers, such as bakers and farmers, are very conservative. However, we also have the fashion retailer Primark, where the ethos is to get it on the shelf to try it out and scale it up if it works. You get feedback within the day. It is based on endless cycles of learning. It would be a great environment to try out some of these ideas, but elsewhere it would be more challenging.

- This was all very relevant to us at Siemens. The most important point is how to address change as an incumbent in large markets. We didn't get telecom right. We now have a challenge in central power generation – steam and gas turbines – and things are moving quickly. Our problem is that we see things coming, but we do not react. The main question for me is how to get into the discussion about assumptions. And I don't know how good we are at experiments. There is a constant battle over how close to the business innovations should be. We are moving things away but we see the gap. And a third issue is open innovation - how to get the engineers to accept that we have to be open, particularly in digital. Perhaps they are not ready.

- Very relevant and interesting. It puts the finger on some of the issues that I face every day. There are internal customers who have a huge influence. Sometimes they are the biggest barriers. An issue for me is, who to engage with and how to engage with them.

- This has a real impact on strategy for us. Our primary assumption is that we are going to change from oil to gas and renewables. That needs to be tested. We know what the disruptors could be and people are battling with how fast the transition will happen and whether we have the right innovation, the right products. It is relevant for strategy not just innovation. I am also now responsible for technology innovation. Getting the technical people to think this way is so hard. The biggest issue is working out what problem you are trying to solve. We need to get better at producing problem statements. I have also told my technology director

that 20% of the budget is allocated to open innovation. I am struggling to get that door open a little. Once they see it, I think we can build momentum. But it is tough. They say that 60-70% of the problems posted on the open innovation platform have been solved before! So, how much time and effort are we wasting?

- There is a lot of exciting substance being developed in this work. I would have liked to spend more time on the readiness framework. I think there is more for folks like us there that would be helpful. I found your focus on making assumptions explicit and challenging them was very interesting, and I think it is fundamental to strategy as such, not just innovation, and I would like to see it developed as a tool.

- I found this very interesting and the idea of experiments very appealing. We have a subscription market. We don't have our own products. The broker will ask if we want a share of a product, so it is not so easy for us to innovate. The other thing that struck me were the cultural aspects. We are a staid company in a staid market in a staid industry, and we are a bit arrogant. So, it made me think, how would I do that? This suggests a better way of moving quickly, which we need to do.

- It makes me thing about what innovation looks like in a very old fashioned, highly regulated market. In 20-30 years, it won't be here - it will be electronic. We need to go back to the customer. What is the real value proposition for them?

Future meetings

The next Members' Meeting will be held from 13.00 – 17.30 on 21st November 2019.

This time we will be trying out a different venue - the Garden Room at 11 Cavendish Square, W1G 0AN. Cavendish Square is close to Oxford Circus, behind John Lewis. After this meeting we will decide whether to book that location for 2020 or return to Horseguards.

The subject of the meeting will be 'Corporate Stumbles' and will be led by Jo Whitehead and Neil Monnery.

Members are also reminded about our final seminar of the year to be held at De Vere Venues on 4th December when the subject will be Strategy Execution, led by Rebecca Homkes.