Improving Returns from Investment in Innovation

In our discussions with clients, we are often asked to identify the characteristics of a successful innovation programme that will deliver good returns on the investment made. The short answer is 'one which leads to a stream of profit generating launches' – something one can only be sure of with hindsight. For innovation teams in the trenches, the question that preoccupies them reflects a different, no less relevant, perspective: - why do ideas in which the team believes wholeheartedly not get the backing the team feel the ideas deserve?

Our experience of working with businesses throughout the financial services markets – banking, insurance and wealth management – has led us to identify three types of reason why ideas fail. These provide a framework for the diagnosis of an innovation effort that, if understood, can help the team improve their performance in generating new, more relevant, ideas and taking them through to successful, high ROI initiatives.

In summary there are three broad areas for attention:

- Clarify the strategic brief, then generate new ideas that are relevant to the firms strategic objectives, in terms of its needs for scale, profitability, competitive position and the timescales in which new revenues will be required
- Present ideas to the organisation in a consistent way that reflects the realities of how the organisation makes decisions and that matches its need for information at each the stage of the development process
- Ensure that the unspoken governing values in action support the fundamental change that some ideas will require to be implemented successfully and, if they don't, tackle these as part of the innovation process itself.

I Ideas are not good enough to meet the organisation's strategic needs

Frequently, ideas will simply not be good enough to create the confidence in senior management that further, perhaps major, investment is warranted. There is no truly objective standard here – it is a matter of commercial judgement. The appropriate action is to kill the poor ideas and support the good ones – or, alternatively, to go back to the start and generate new ones. This can be very discouraging for the team concerned, but disappointment is a small price to pay compared to the alternative of investing millions in an idea that will not work.

A profusion of poor ideas can lead to what is perhaps a more insidious outcome – a pipeline full of poor ideas that are neither killed off nor progressed. This can come about when there is not enough honesty in the process – senior management, keen to encourage the innovation process but disappointed by the poor crop of ideas hope that better will follow and do not wish to discourage the team in the meantime. The result

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is incremental improvement of poor ideas, with insufficient resources given to a fresh approach.

Ideas may be poor because they have been framed too narrowly. This often occurs in situations where the role of the channel is an important part of the overall customer proposition. If the innovation effort is overly focussed on the financial instrument the result is often that the product does not fit with the ingrained practices of the channel and fails. The best outcome in these cases is that the product fails before it is launched, thus allowing the firm to rethink and broaden the remit. If it fails after launch the position is more difficult to recover from, because damage will have been done to the product's positioning.

Another common example is the extent to which customer perspectives are excluded from consideration, based on out-dated preconceptions or on confusion between customer inertia and loyalty.

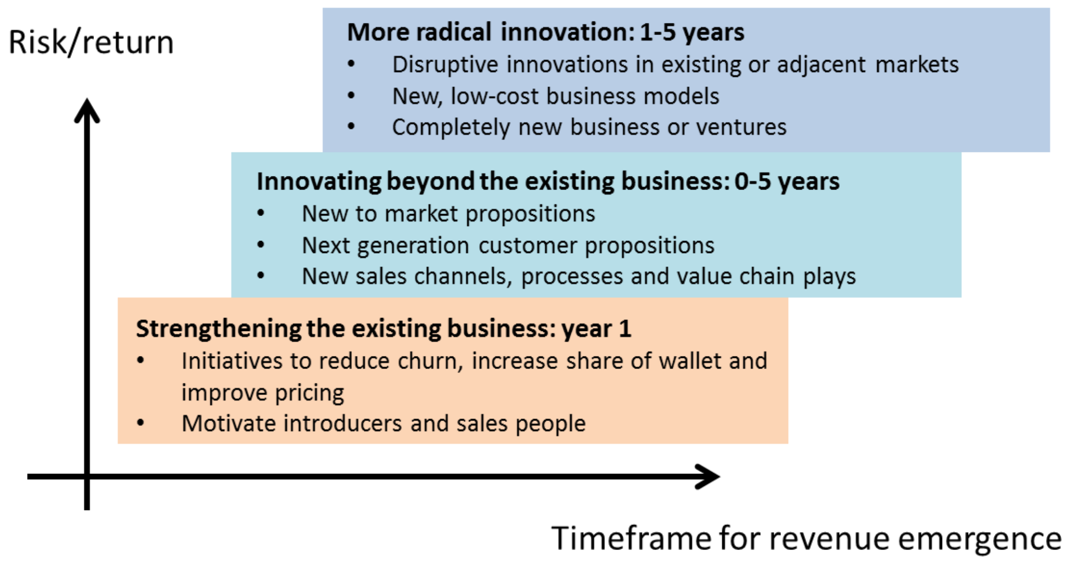
More broadly, it may be that the ideas put forward for consideration are good inherently, but not fit for the strategic purpose. That is, the ideas are not seen to meet the strategic objectives of the business or perhaps do not fulfil the original reasons for establishing an innovation process. Often, what drives innovation is the need for new sources of revenue. In financial services business, where revenues can be locked-in through some forms of annuity-like products, senior management are able to be very specific about the timeframes in which they are seeking new revenues. In good innovation these timescales should be used to drive the type of initiatives to be considered.

Even more seriously, potential innovations that threaten the existing business model will often be rejected at the outset. There is a lot of work by Clayton M Christensen[1] supporting the view that truly disruptive innovations that change the competitive order are only ever generated by new entrants and that most innovation by incumbents is incremental and defensive of the existing modus operandi.

What can be done to improve the quality, and suitability of ideas proffered?

First, it is essential to match idea generation to the strategic objectives of the business. One useful framework is the Growth Ladder illustrated above. This relates the types of initiative to be considered to the timeframe over which revenues might materialize.

The Growth Ladder



This framework helps provide a useful checklist to identify areas where more innovative thinking might be required. To illustrate: if revenues are needed in the coming year, it is better to focus on customer retention, cross-selling and up-selling, and broker production and not on a new product relying on a green-field site, new channel relationships or untried customer management software. Conversely, a business locked into a dying market such as life endowments, may need to be bolder in its search for new streams of revenue, even though some attention to retaining existing customers may extend the timescale over which the search for a rescue package can be carried out.

The framework also encourages a broader focus than merely new products, to encompass customer relationship management, communications, sales processes, broader relationships with partners and adjacent and new market development.
To actually generate the ideas, get some creative people in a room and to start thinking. At Lawrence Somerset we use a number of techniques for structuring the ideas generation process. These aim to:

- Involve a wide range of people in the process from beyond the sales and marketing team – some of whom will understand the business in great depth, some, perhaps outsiders, will have less attachment to the present and a broader vision of where a business or market might be heading

- Approach the generation of innovative ideas from a number of stand points, in order to develop fresh perspectives – in practice, this is done using structured, creative sessions (we have more than 20 ways of doing this) that are designed explicitly to generate alternative perspectives.

- Represent the customer, and indeed other third parties in the process to reflect the full extent of the customer proposition, not just the product. We often find that creativity with the relationships in the value chain produces innovations with more leverage than do narrow product ideas, which are often easily copied.

- Be honest when it comes to prioritization. It is not good policy to progress the 'best of the bunch', if the best are still not good enough, even if this means red faces and a new round of workshops.

But even when ideas seem to be powerful, they can fall foul of the selection process, and this can be especially frustrating.

II Good ideas are rejected because the innovation process does not fit the organisation

Frequently, good ideas fail to gain acceptance and backing despite having inherent strengths, and despite having been presented to the selection process more than once. This can be puzzling to an innovation team, because the process seems to be working in that all the boxes are ticked, but senior management are failing to give an idea the backing it appears to warrant.

Poor fit with the organisation's way of working

In our experience, the reason this happens is not because of a basic failure of the process itself, but because of a failure to adapt the process to the organisation's own idiosyncrasies. Often this comes down to styles of communication and ingrained ways of looking at investment opportunities that are not being sufficiently addressed in the innovation process.

A common difficulty is around the degree of financial underpinning, especially of costs in financial projections. Finance directors used to evaluating fully developed investment cases can feel exposed if they are asked to judge investments based on a revenue case or a gross margin case, without a full analysis of costs – something often too expensive and unrealistic early in the process.

A related point for operations directors is do-ability. Some will not wish to entertain new ideas until a full operational assessment has been carried out, and the impact on capacity been fully understood.

On both these points what is needed is to establish clearly upfront how decisions are going to be made. Often innovation processes are structured to evaluate and discard ideas efficiently and this means an initial screen on the basis of revenue impact - after all, if an idea does not generate revenues, why bother to cost it out fully? In practice though, because this means deferring analysis of operations and costs until later in the process, some ideas may suffer because a full business case is not available for them.

In both cases, this can be resolved by a blend of negotiation with the directors over what should constitute a reasonable basis for decision-making at each stage of the process, and designing the process itself to deliver the required information on which to base a decision.

This may involve discussion of:

- The role of revenues, vs. gross margins vs. full costings in business cases
- The use of actual cost data vs proxies from the sector, competitors or other similar businesses
- The timing of involvement of ops and finance staff in the innovation work to add their expertise
- The appropriateness of existing financial structures for evaluating new business models

It is worth remembering that in a staged innovation process, the decision required at any stage is whether or not to spend further resources on exploring the business case – what is at stake is not the full implementation cost but the spend per initiative for the next stage in the process ie it is likely to be several thousand, not a few million pounds.

IT or not IT

The second source of potential blockages is the IT function. Most financial services businesses have extensive IT development underway, often dealing with the adaptation of legacy systems to current commercial and regulatory requirements.

The implementation of new propositions frequently requires some sort of further IT development and this can be central to the innovation itself. For example:

- Better collection and use of customer information in targeting
- Pricing that is more closely matched to customer circumstances
- Tailored communications
- Information-based services e.g. alerts
- Use of new communications – e.g. mobiles
- Integration of customer management across channels

Such developments can place enormous load on IT departments and, curiously, appear to draw especially on scarce resources such as cross functional project managers or experts in particular programming languages. As a result, attractive commercial propositions can get close to the final stretch and either be turned down because of insufficient IT resources or be subject to significant delays. Perhaps worse, ideas can be implemented, but 'watered down' by the exigencies of the implementation process, emerging as just another average product, because all of the differentiating functionality has been ditched in the interests of moving the project forward.

What can be done about this? After all, the IT function is performing an essential role and resources are finite.

- Involve IT early on in the creative process. Often, IT professionals will be a lot more flexible in how resources are allocated if they have been engaged in the development work from a relatively early stage. Sometimes, IT people may not be first choice for early creative stage involvement, but they can be engaged as participants to feed back obvious constraints.

- Create a proposition development plan. Propositions need not be implemented in all their glory from day one. A proposition development plan plots the development path from an 'Entry' proposition to a more extensive version. This trajectory can be determined by IT resource availability among other things. But beware of detuning to the extent that the impact of a product is lost on launch with no chance of retrofitting the features that would have made it a winner.

- Make a bid for additional or outsourced IT resources. Occasionally, the resource issue can be a control issue, and outside resources can be used to further a new initiative rather than drawing upon scarce internal resources.

- 'No IT impact'. In extreme cases – we have experienced this with at least one client - the use of IT resource can be an early-stage decision criterion, and only propositions with little or no IT impact are progressed.

Ownership of the idea within the organisation

A third source of potential blockages to otherwise good business ideas is the question of sponsorship and perhaps also the 'not invented here' syndrome This is played out between innovation or marketing teams and those responsible for revenues or other key resources – often the heads of businesses or sales channels or even ops and IT. The root cause of the difficulty may be in the rationale for establishing the innovation initiative in the first place. A CEO or board may be either frustrated by the level of innovation coming from the business as usual teams, or feel that they have enough to do and would benefit from additional assistance on generating future revenues from a dedicated innovation team. That's all well in theory, but in practice, there can be a lot of covert hostility about ideas which come from a central team. Strong leaders running businesses or divisions will have a clear view of their own contribution, and may prefer to define their own agendas. Ideas from the outside may be seen as a threat to this and may therefore be resisted. A number of tactics may be evident. The most commonly used are:

- Revenue Cannibalisation. 'The new idea is dangerous because it will erode existing revenues', or 'it capture revenues that will be captured in any case, by other initiatives which the division is planning'
- Distraction. Similar to cannibalization in terms of impact – 'we could do the new idea, but existing efforts will suffer – your choice'.
- Do-ability. 'It's a good idea in principle, but in practice not doable' – only perceived with the greater level of understanding of significant detail found in the division
- Not necessary. 'Those are good ideas, but we are covering all those bases in our next set of initiatives'

One client lost 4 years in the development of a new technology in respect of motor insurance due to organisational rivalry. Initially believed to have two markets and so the responsibility of the central innovation team, a divisional head fought to show the technology was only relevant in his division. The responsibility for the project passed to him and a year later the project was dropped. Four years later the industry is looking again at the potential, but the client is now out of the race.

How should the basic process be adapted to the organisation to improve the chances of good ideas receiving the backing they need?

The first step is to adapt the content of the process so that it communicates in a way the organisation can relate to. This may make for some inefficiencies in the process but will be more effective in the long run. In practice, this means building a consensus with senior management on the timing of work on operations, costs, and the practicalities of implementation. Bringing this work forward will slow progress but may speed decisions up in the long run. For new teams, it will mean working with finance on modelling, the use of proxies for costs, the appropriate evaluation methodologies – NPV, payback etc, and the all important discount rate.

The second step is to set up the right governance and sponsorship processes. Most organisations establish some sort of 'steering group', but it is important to be clear about roles and levels of authority and sponsorship. The approval of a committee may seem strong enough at the time, but if line directors are not involved, decisions may come unravelled. For example, in one organisation we worked with, propositions were not proceeding to the next stage unless they had the named sponsorship of a line director - even though that director would not have had an active role in the near term. It is the case in most organisations that, if no one in authority will back an idea it just won't fly.

The third step is to integrate the outputs of the innovation process with the formal planning and budgeting processes of the firm so that real objectives are there to be met which are distinct from 'Business as Usual'. This can be expressed as an aspiration of the sort:

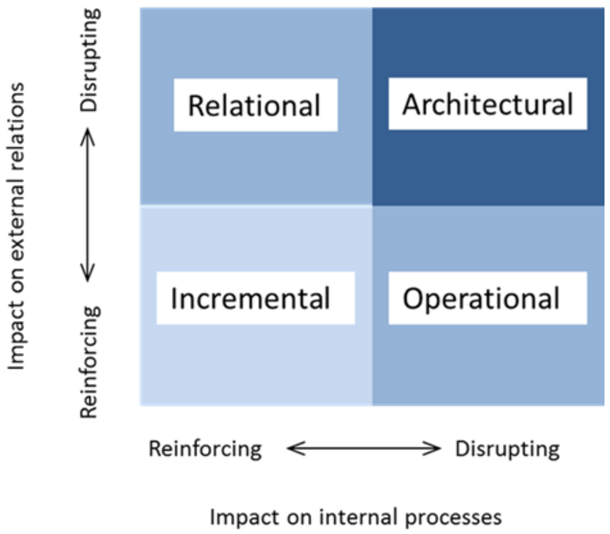
"by 2010, 20% of our revenues will come from new propositions"

or more tangibly:

"we have a £20m revenue gap in 2008, which the innovation team are down to fill"

Despite all the rational and political approaches to generating, presenting and backing great ideas, occasionally still nothing new is done.

Matching innovation to revenue objectives



III The unstated governing values don't support innovation

The third source of difficulties experienced by innovators is more of a challenge to deal with because it reveals itself in a disparity between what is said and what is done. This is very challenging.

Most organizations are reasonably successful at what they do and over time, their processes, people and mores become closely attuned to doing what is necessary to be successful in their chosen market. Often, the ability to maintain and control the existing business becomes second nature, but this also means potentially stifling a necessary new business is second nature as well! Chris Argyris[2] showed in his research that organisations 'protect' themselves from change – often leading to them continuing to do the 'wrong' thing better rather than attempting what would be the 'right' thing at all.

The immediate effect of this phenomenon can be that ingrained ways of doing things can be simply wrong, and may lead to poor judgements. This was the case, for example, with an insurance firm considering the creation of a new business to offer guaranteed capital bonds to its customers, following an approach by a systems company offering to source the necessary systems and customer call centre. After evaluation the management team decided not to proceed because of financial analysis conducted by an actuary on a 25 year embedded value basis. However what the team had failed to see was that this new proposition had a financial structure quite unlike that of their existing businesses. As it involved committing to tranches of derivatives and selling them to customers over a 6 week period, with each subsequent deal negotiated afresh, the financial structure was in fact more like consignment-based retailing than the annuity-based life assurance they were used to evaluating. New approaches in financial evaluation led to a different and successful decision.

A further and common example found in financial services companies is the attempt to become more customer-oriented after years of fixation with product mathematics, or with serving brokers. Customer-orientation initiatives are started, but often fall at the first sign of difficulty, in favour of other more familiar activities.

This problem is a difficult one to tackle head on because is seems to require challenging what appears to be duplicity on the part of senior management, although this is not really the case - it is more a matter of their finding it difficult to adapt their thinking to the new situations catalysed by the innovation process.

It can help if the innovation team can identify where new thinking might be required in advance. This is illustrated in the chart below. New initiatives can be assessed in terms of whether they reinforce or disrupt internal competencies or external relationships. Early use of this framework can help to identify where extra attention might be required.

One manifestation of the disparity between expressed values and values in action is the existence of unspoken preconceptions or 'sacred cows' which determine how the firm acts without ever being explicitly stated. The following is a list made by one innovation team of the sacred cows they thought needed 'slaughtering' before their senior management would proceed with a truly innovative initiative.

Innovation Team's View on the 'Sacred Cows' in one firm

- New services must be fitted into existing capabilities
- A high insurance risk means low profits
- Brand equity must be protected even if it means inhibiting new ideas
- This firm can't build brands,
- We won't get an agreement to spend money on marketing
- Our success depends on underwriting
- Cross-selling is too difficult
- The insurance cycle will always bail us out
- Other companies are prepared to lose money to win
- The mass of brokers will continue to exist and are important
- The company landscape in 20 years to come will be the same as it is now
- The way we've always done things is the right way
- Budget and planning systems are the appropriate tools to manage change

This list emerged from a firm which had just implemented a company-wide innovation programme to encourage staff to put forward ideas. Remember, that this is the view from 'below' – senior management might have been appalled to read this list. Significantly, none of these ideas was discussed when the central innovation team was set up.

The solution to this problem must be in two stages:

First, the senior team becomes aware that there is a disparity between their expressed values and their values in action and that this disparity is hindering development and confusing staff.

Second, the disparity must be understood and addressed – whether it be embedded in information systems, methodologies, 'sacred cows' or in any other aspect of the firm. Only then can the firm move positively on new initiatives with confidence.

This two-stage process was very evident with a recent client. Our internal research for this client - wishing to understand how to encourage sales staff to improve customer satisfaction - revealed a significant disparity between what senior management said they valued and what they appeared to value in practice.

Customer satisfaction data was reported in approximate form on a monthly basis and reviewed in sales teams. Sales data was reported weekly, but because of the lack of pipeline information, sales managers had daily conference calls with sales people to discuss their pipelines. Even on this basis, sales received 20+ times the attention of customer satisfaction. Calls to improve customer satisfaction were effectively ignored and initiatives failed to make the desired impact, and new initiatives were viewed with scepticism. Redressing the information imbalance between sales and satisfaction reporting was identified as an essential precursor to developing any innovative approaches to improving customer satisfaction. Once the problem was understood, new initiatives stood a much better chance of being successful.

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Institutions are right to demand returns from their investments in innovation, but the answer is not to impose high hurdle rates on any ideas considered – that is a recipe for expensive and over engineered business cases too early in the process. The key is to seek out ideas that have a chance of meeting the firm's strategic objectives and subjecting them to scrutiny appropriate to their stage of development. The ideas presented here will help to address the three most common causes of why investment in innovation is wasted.

[1] Christiensen: The Innovator's Dilemma. Harvard Business School Press (1997)
[2] Chris Argyris: Overcoming Organisational Defenses. Prentice Hall (1990)