From the What to the How: The Innovator's Solution Methodology

- A Working Paper -

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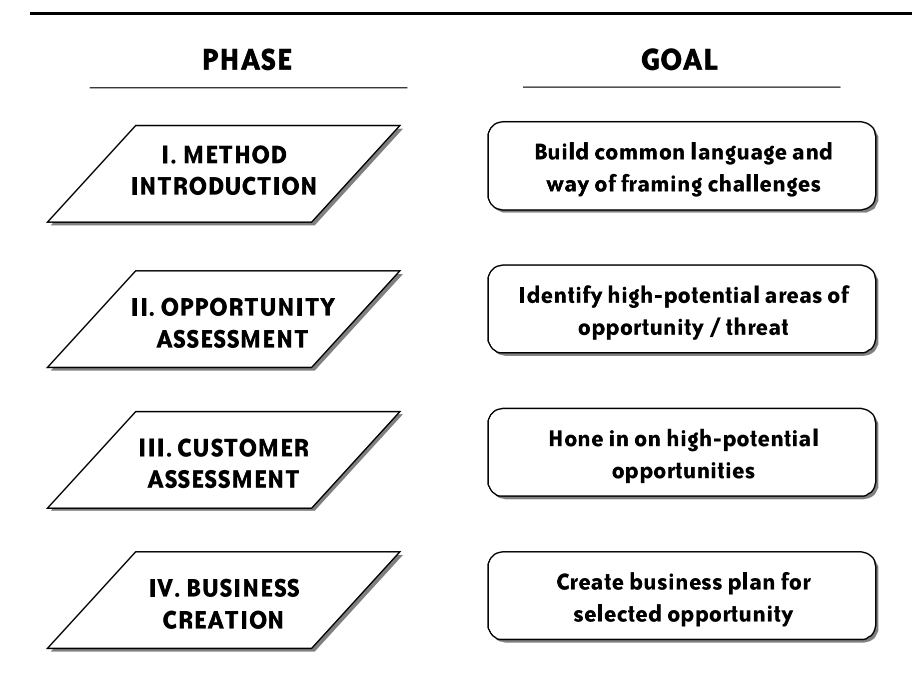
Many companies struggle to answer seemingly simple yet surprisingly frustrating questions, such as: How can we systematically identify the innovations that have the highest probability of creating disruptive growth? How can we maximize the probability of an innovation's success? How can we develop a new growth business?

We classify these as "what versus how" questions. Here's why. A few years ago, Harvard Business School Professor Clayton Christensen was in the middle of lecturing Intel's senior management about why they *had* to respond to incursions in the low end of their market. Then-CEO Andy Grove stopped Christensen and said, quite forcibly, "I know *what* I need to do. Tell me *how* to do it."

Moving from the "what" to the "how." That has always been the challenge. *The Innovator's Dilemma* explained why launching new growth businesses is so hard; *The Innovator's Solution* showed that using theory can make growth much more predictable. But how do you put these theories into action? This working paper presents a four-phase process (see **Figure 1**) companies can follow to unleash disruption and create new growth businesses.

Figure 1: Four Phases to Unleash Disruption



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Before going into the "meat" of the process, companies need to make sure they establish common understanding about the project's goals and the principles of disruptive innovation. This "**Method Introduction**," which can be done in an intense one-day offsite meeting, ensures that managers have a common language with which to communicate throughout the project. The team should also create a detailed project plan that lists out knowns and unknowns, the current thoughts on a target market, customer, innovation or "job to be done" and a collective sense of their company's strengths, weaknesses and constraints.

Phase 2: Identifying High-Potential Innovations

In phase 2, the team should use those assumptions as the basis of an "**Opportunity Assessment**." This phase conducts three separate "diagnostics" to identify opportunities that have the highest probability of creating disruptive growth and therefore merit disproportionate focus and investment.

The first diagnostic assesses **customers**, looking for signals that market segments or customer groups are "disruptable." What signals point to a disruptable market segment? Signs of "non-consumption"—such as consumers locked out of a market because they lack special training or consumption taking place in inconvenient settings—point to opportunities for new market disruptive innovations that bring new benefits around convenience or customization. Signs of "overserved customers"—such as people complaining about overly complex products or customers refusing to pay premiums for previously valued innovations—point to opportunities for low-end disruptive innovations that provide "good enough" functionality at lower prices.

The second diagnostic assesses the **innovation portfolio**, identifying whether any current or potential innovations (new ideas, acquisition targets, etc.) can be deployed in a way that successfully meets the needs of a disruptable customer group. This step asks three questions about each innovation:

1) Does it target **customers** identified in the customer diagnostic as either non-consumers or overserved?

2) Does it have **technology** that introduces new dimensions of performance compared to existing innovations, typically focused on simplicity, convenience, customization or low prices?

3) Does it rest within a **business model** that makes money in ways that seem unattractive or uninteresting to incumbents, because (for example) the initial target market is small, the margins are lower or there is a different mix of sales and service revenues?

Figure 2 explains how different types of innovation stack up against these three characteristics. It shows how disruptive innovations differ sharply from sustaining innovations that bring better products to existing customers in existing markets.

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Figure 2: Differences Between Types of Innovations

	Sustaining Innovation	Low-End Disruption	New Market Disruption
CUSTOMERS	Most profitable customers in existing markets	Overserved customers in low-end of existing market	New customers or new contexts of use
TECHNOLOGY	Improvements along dimensions valued by current customers	"Good enough" on traditional metrics but lower prices	Improved performance on new attributes (e.g., simplicity, convenience)
BUSINESS MODEL	Similar to existing model, improves or maintains margins	New financial or operational model that earns attractive returns at low prices	New business model, often lower price points, new sales model & distribution channels

The goal of this diagnostic is to make sure high-potential innovations are being run in ways that match identified opportunities. For example, an electronics company was convinced an innovation it was developing was a new market disruptive innovation. There were two problems with this assessment. First, the innovation offered similar benefits to the company's existing product at a lower price. As **Figure 2** notes, new market disruptive innovations typically offer new benefits, like convenience or customization. Second, the company planned to offer the innovation to its most demanding customers who still were unsatisfied with the performance of the product they were purchasing.

This was a mismatch between the innovation and its deployment. That did not mean the innovation should be scrapped, however. By iterating back to the customer diagnostic, the company identified "overserved" customers in an adjacent market who were looking for "good enough" performance at lower prices. The company shaped the innovation into a low-end disruptive innovation targeted at these customers. This route provided a better match between the innovation, the target market and the organization's abilities.

The third diagnostic assesses **competitors,** making sure the selected opportunity takes unique advantage of competitor's weaknesses and blind spots.

Analyzing existing and potential competitors' resources (what they have), processes (how they do their work) and values (what they want to do) provides insight into their strengths. What a competitor is good at determines by default what it is bad at; what a competitor wants to do determines by default what it does not want to do.

As discussed in *The Innovator's Solution*, disruptive innovations typically take advantage of "asymmetries of motivation" by entering markets that incumbents are motivated to exit or ignore. Looking at a competitor's income statement, processes, customers, balance sheet and history of investment decisions can zero in on strategies that maximize the chances of creating such asymmetries.

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Following these three diagnostics led one chemical company to realize that finding a way to reach non-consumers in developing countries was its ticket to disruptive growth. Its core market was not yet fully satisfied with current products, making it far from being overserved, and a poor place to introduce a de-featured disruptive innovation. It had an in-process innovation that would allow it to dramatically lower the cost of its output chemical. It could use that innovation to try to reach the non-consumers in developing countries. Asymmetries of motivation would be on its side—its competitors were not interested in pursuing what seemed to them to be fringe opportunities. Also, the company would have to build unique skills to reach the new market, meaning it could race up the experience curve and lock in a sustainable advantage vis-à-vis its competitors. That approach could be the underpinning of a big new growth business.

Conducting a systematic Opportunity Assessment can greatly aid companies that are evaluating multiple acquisition targets. Companies generally find that large acquisitions tend to provide disappointingly low returns because, by the time a target gets big enough to be noticed, the market puts a pretty accurate price tag on it. Small acquisitions can occasionally produce blockbuster returns but lead to highly variable outcomes. Screening for small targets that match identified disruptive opportunities can in essence "cut the tail" off of the returns distribution curve, allowing companies to capture disruptive growth before it becomes fully understood by the marketplace.

Furthermore, this analysis will also highlight opportunities for sustaining innovations. Companies should make sure they don't forget about these opportunities. Sustaining innovations—such as faster microprocessors, better televisions, smaller cellular phones and more powerful automobile engines—allow existing companies to grow within established markets. They are the means by which companies exploit their growth potential after they establish their initial foothold and are the lifeblood of most firms. What kills companies is when they try to introduce sustaining innovations into disruptive markets and vice versa.

Phase 3: Honing High-Potential Innovations

Of course, simply identifying opportunities isn't enough. Phase three takes the identified high-potential innovations and does a "**Customer Assessment**" to identify precisely what the innovation must look like for it to succeed in the marketplace.

The most robust way to conduct this phase is to use market research that segments a market by examining the job the customer is trying to accomplish—rather than employing a typical demographic scheme.

There are various ways to understand what jobs customers are seeking to accomplish. One approach, of course, involves basic market research. Companies can conduct a handful of customer interviews, design a quantitative survey based on the qualitative research and administer that survey to a statistically significant population.

This goal here is to identify what a product or service must do to help people get done what they are already trying to get done. This means going beyond understanding customer ratings of features and functionality. More than 25 years ago, Harvard Business School marketing guru Ted Levitt was famous for telling MBA students: "Customers don't buy a quarter-inch drill. They buy a quarter-inch *hole*." This is a job to be done—people are "hiring" the drill to achieve the "job" of putting a hole in the wood.

Unearthing jobs to be done requires constructing customer interviews that go beyond questions such as: "Do you like this in blue or red?" Ask questions such as: "What problem are

you trying to solve when you use this product?" "What alternatives do you consider?" "What problems were you hoping to solve but couldn't?"

Answers to these sorts of questions can identify the full complement of jobs customers are seeking to get done. Those jobs should then form the basis of a survey designed to to highlight the important jobs customers *want* to get done but cannot.

Another approach involves observing customers as they go about their daily lives. Watching customers closely through some form of anthropological or ethnographic research can unearth jobs that people are trying to get done, but can't.

Companies often discover surprising things during the customer assessment. For instance, a health care company found out that the biggest barrier to consumers using a disruptive product had nothing to do with the technology itself—it was largely market misperceptions about the product. The jobs that physicians were looking to get done but couldn't were actually addressable by the product—the physicians just didn't know it! The company made sure its sales force addressed these "pillars of misperception," thus increasing consumption.

The project team can use the findings from the customer assessment to hold an interactive strategy session that evaluates different product concepts in real-time. Armed with insight about the market, the innovation and the customer, the team can now quickly reject product designs that will have a low probability of success.

Step 4: Creating Businesses to Commercialize High-Potential Innovations

The output of phase three is a product or service concept that is optimized to meet customer needs. Phase four of the process involves "**Business Creation**," turning that concept into a business plan for commercializing the highest-potential opportunity. This phase uses the theories in the back half of *The Innovator's Solution* to develop a business that maximizes the chances of capitalizing on disruptive growth.

Correctly designing the business that will commercialize the innovation is critically important. Many high-potential innovations—such as Apple's Newton, Hewlett-Packard's Kittyhawk disk drive, Pandesic's enterprise resource planning software product and Prodigy's online service—fail not because of some fatal flaw in the innovation itself. They fail because companies end up making the wrong choices during commercialization, such as: targeting disruptive innovations at mainstream markets (Apple), building a cost structure that forces them to seek large markets (Hewlett-Packard), hiring managers who have the exact *wrong* set of skills to lead disruption (Pandesic) or rigorously following a strategy even when market signals suggest changing course (Prodigy).

The principles of Total Quality Management showed us that setting up a manufacturing process in the right way dramatically reduces error rates. Similarly, setting an organization up in the right way can dramatically *increase* the probability that the business will be successful. Creating the organization with the right capabilities means that what ultimately will be the right choices to drive long-term growth can only look attractive to that organization.

In fact, few of history's disruptive innovations were the result of great foresight on the part of managers. If the conditions—the organization design, cost structure, management team, investors, and so on—are correct, managers can see the right choices for what they are. If the conditions are wrong, the right choices look like the wrong choices. This is why most managers in existing firms look at a potential disruptive innovation and see a business that looks "insignificantly small," "cannibalistic" or "dilutive to the brand" while an entrepreneur looks at the same innovation and sees nothing but opportunity. The entrepreneur is not any smarter than

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the manager in the existing firm. They are in a circumstance where the right choices are clear to them.

How can the project team make sure they create those circumstances? A useful starting point is to look at financial metrics such as unit prices, gross margins as a percent of sales, asset turnover and fixed asset intensity to see how the new business differs from the company's current business. The results of that assessment—coupled with the results of the previous phases of the project—drive six key decisions the team faces:

1) **Whether the new business should be set up to operate autonomously.** Opportunities that require developing new skills and using new business models ought to be kept separate from the main business.

2) **The activities the company should build versus the activities it should buy.** The new business needs to control activities that allow it to improve performance along dimensions that matter most to customers.

3) **How the new business should interact with "value network" participants, such as suppliers and channel partners.** The new business must help its value network partners move up their own improvement trajectory. People don't do what doesn't make sense to them.

4) **Which managers should be appointed to run the new business.** Managers should have wrestled with challenges (attended "schools of experience") they know they will encounter.

5) **How the new business should set its strategy.** In all likelihood, the new business needs to use an "emergent" strategy process that lets it experiment and learn from the marketplace.

6) **Who should fund the new business.** The new business needs investors whose prioritization criteria match the business' needs. For truly disruptive innovations, this typically means being patient for growth but impatient for profits.

Again, going methodically through the "Business Creation" process leads to surprising outcomes. The electronics company realized that its current, highly successful sales force would be the exact *wrong* group to try to sell a low-end disruptive innovation that required lower margins and lower overhead. The only way it could succeed was to set up a separate organization that used a new sales force to commercialize its low-end disruptive innovation.

Summary

Launching a viable disruptive attack requires getting a complicated set of things right. Among other things, companies must hire the right people, use the right strategy-making process, seek the right funding, develop offerings that nail a job people care about, find the right lead customers and integrate in the right way. **Figure 3** presents a summary list of all the things companies should check to ensure they are following the disruptive path.

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Figure 3: The Final Checklist

- ❒ The target **customers** are either non-consumers or overserved customers
- ❒ The **technology** provides benefits along new attributes compared to existing technologies
- ❒ The **business model** makes money in ways that seem unattractive to competitors
- ❒ The **organization** is housed in a location that facilitates making the right choices
- ❒ The company controls all **activities** that are critical to improvement along dimensions that matter most to customers
- ❒ The **value network** has unique partners such as suppliers, partners or distribution channels to support the new business model and limit opportunities for incumbent co-option
- ❒ The **management team** has been to the right “schools of experience”
- ❒ The **investors** have values that will facilitate disruption
- ❒ The **strategy-making process** encourages emergent forces and has the flexibility to test, learn and adapt

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Sticking to this disruptive path is not easy. From day one, companies will begin to hear whispers that tell it its best chances for success involve finding a way to appear appealing to existing organizations. “Those organizations control access to customers and have deep pockets,” they’ll say. “If you make yourself more attractive to them, you too can access those customers. Maybe they will even buy you out.”

Companies seeking to create disruptive growth need to ignore such whispers. They need to focus on attracting new customers in new places in new ways. They need to develop the unique skills to deliver their unique value proposition. Efforts to make businesses look more appealing to existing organizations obviate an organization’s unique advantages. It makes an organization much more likely to run into the barriers that hamper existing organizations.

People will say, “You are smart, you can avoid the problems that snared those organizations.” A strategy that presupposes one organization’s management team is simply more insightful than another organization’s management team is doomed to fail. No matter how smart a team might be, it still has to grapple with the forces that act on every organization. Mimicking what others have done puts organizations at the mercy of the same forces that make smart people appear foolish. Following this four-phase process allows organizations to harness these forces and drive completely new forms of growth.

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