

By Jorge Aguilar and Kevin O'Donnell

Classic financial theory has it that all else being equal, the greater the risk, the greater the return. And when it comes to innovation, those businesses that are the most successful embrace that notion. Procter and Gamble's A.G. Lafley, for one, has been known to say that he starts sweating if more than 60 percent of the consumer goods giant's new ideas succeed—since it means it has been playing it too safe.

The issue, of course, is finding a way to manage or at least mitigate risks. Going back to classic thinking again, diversification is usually seen as a best bet for accomplishing this, and the most common practice among businesses is to categorize growth projects as incremental (one year), breakthrough (two-to-three years), and transformational (three-to-five years).

But to spur better innovation and achieve optimal rewards requires a more expansive view of innovation risk and how to manage it, a view that is grounded in more than merely the financial resources being put at stake to achieve success.

It should balance ongoing business activities and growth initiatives, and provide the attention and resources each requires. It should incorporate cultural issues—how well is failure tolerated or even celebrated, or does it put careers at stake? And it should reflect management expectations, for those businesses that explicitly commit to innovation are also committing a reputation for continuous change and revitalization.

Leading businesses are exploring different areas to mitigate innovation risk, including: customer-driven innovation, systematic funding and resource allocation, creative thinking at every stage of the innovation cycle, and risk sharing with strategic partners.

The notion of customer-based innovation is increasingly driving many of the most exciting new entries to the marketplace, from hotels (Starwood's new Aloft was based on guests' input, via virtual modeling techniques, on what the ideal customer experience would look like) to airplanes (Boeing's new Dreamliner was fine-tuned with the input of a 120,000-person World Design Team). It presents a win-

win situation for all involved when customers are invested in the success of offerings that they've actually helped to shape, and businesses can avoid the disconnect potential of products developed in a vacuum.

It's also imperative that senior management consistently monitors the adequacy of the investment, resources, and processes that are supporting the innovation thrust.

Underfunding, for instance, is a common killer of promising innovations. Smart businesses, however, offset that risk by creating a systematic approach for funding that ensures ideas are receiving the money they need to prove out. We know one consumer goods company, for example, that takes a page from the venture capitalist book. Each planning cycle, an operating group sets up an innovation budget. Employees with ideas write a synopsis and request seed money, with a definitive spending timeframe, to fund market research or product or service prototyping. Under this approach, ideas can either "fail fast" and be eliminated without a huge investment or, if they pan out, can be pursued without further budget struggles since innovation funding has already been committed under the planning process.

Another issue is the strategic allocation of resources. For all the creative people with great ideas in any given organization, business structures and, often, cultures themselves can inhibit innovation. In these more traditional environments, the accepted approach is to manage (whether marketing or operations) by segment; the resulting silos are difficult to surmount, whether with capital or human investment. The solution is to cultivate a more macro-orientation toward innovation that encourages resource allocation across silos. The Mr. Clean AutoDry Car Wash system revolutionized home car washing when it took the best knowledge and product attributes across product segments for a new line offering spot-free cleaning power.

There's also the need for systematic processes that strike the right balance between divergent thinking at innovation's initial stages, and convergent thinking at the

final. Software company Rite-Solutions' online tool borrows from the stock market to address this issue. Anyone in the company can populate the "market" with ideas, which are put in three classes: The SPAZDAQ (for the riskiest ideas focusing on new businesses and capabilities); Bow Jones (ideas aligned with current offerings); and savings bonds (short-term operational improvements). Employees get \$10,000 in "play money" to invest in ideas and buy or sell at will, and can volunteer their time to any. Meanwhile, a market maker revalues ideas weekly based on investments, tasks completed, and discussion board opinions. Ideas that break into the top 20 receive real money for development; investors get bonuses or real stock options once ideas go live and start contributing to the business.

Innovation risk can also be mitigated when it's shared. Partners should be involved in the development process, but that involvement should be based on a clear understanding of aligned objectives and rewards. The novel One Laptop Per Child (OLPC) organization—designed to foster learning among school-aged children in developing countries by providing a connected laptop to each—lost Intel as a partner due to this failure. OLPC's idea of rewards

was education. Intel's? Reportedly, market development. The relationship became contentious—and the disconnect bared—when Intel tried to sell its own Classmate PC to governments that already had made provisional commitments to OLPC.

And of course, caution remains the byword when sharing risk. In developing the Dreamliner, Boeing was aggressive in sharing the risk among several suppliers, and, despite overall innovation success, this approach resulted in some delays and cost overruns. Now, Boeing is rethinking this part of its strategy, and is acquiring one of its main suppliers.

Profitable growth is the ultimate reason for being for any organization. Innovation can be a leading path to achieve this, but it is one that many find difficult to navigate—largely because of its inherent risks. What businesses must grapple with is the fact that while innovation is risky, not innovating can be even riskier. Through forward thinking, inclusionary practices, and systematic processes, businesses embarking on this path will be best positioned to come out ahead.

Jorge Aguilar is an Engagement Manager, and Kevin O'Donnell, a Senior Partner, with Prophet (www.prophet.com), a leading global consultancy specializing in helping Fortune 500 clients and their senior executives more effectively use brand, marketing, and innovation to drive profitable growth. Jorge can be reached at jaguilar@prophet.com; Kevin, at kodonnell@prophet.com.