Innovation for Impact – by Understanding Why Digital Strategies Fail

Meaningfully improving outcomes from business innovation is challenging. An important reason for this is that enterprise strategies typically don't address how digital is changing economic fundamentals, industry dynamics, disruption from innovation, or what it takes to compete.

A good example of this is the processing power of today's smartphones are several thousand times greater than that of the computers that landed a man on the moon in 1969. These devices connect the majority of the human population, and they're only ten years old ! In a short period, smartphones have become integral with our lives. Few of us get around without the help of ridesharing and navigation apps such as Lyft and Waze. On vacation, marine-transport apps enable us to hitch a ride from local boat owners. While we're away, we can also do email, connect with friends, check to ensure the heat is down or to monitor things at home, make some changes to our investment portfolio, buy travel insurance, etc. As well, we can browse the Internet for personalized movie recommendations, help choose a birthday gift, create and continually update our vacation photo gallery—and make phone calls. As a User, for personal tasks, there are lots of options to quickly know what's happening and it's easy to do things - in mobile with our smartphone.

Then we go back to work — where mobile and the embrace of digital is far less prevalent ! Because of this, it raises questions –

A. Why isn't the enterprise making good on the huge opportunity in mobile ?
B. Why is change and meaningful innovation in the enterprise so challenging ?
C. What is being done to identify and pursue significant business opportunities ?
D. What are we learning from disruptors to fast track the organization moving forward ?

Because of slow uptick on expanding mobile services and capabilities and adding intelligence to processes, it is clear many enterprises underestimate what is needed to innovate for impact, the increasing momentum of digitization, the behavioral changes and technology driving it, and the scale of disruption in the making. The lack of progress to meaningfully improve business outcomes from innovation is partially explained by many companies still locked into strategy and development processes that operate annually. This despite only 8 % of companies indicating their current business model would remain economically viable if their industry keeps digitizing at its current course and speed !

How can this be when virtually every company is concerned about their digital future ? In other words, *why* are so many digital strategies failing ? The answer has to do with the need for enterprises to be much better -

1. at business innovation
2. recognizing the nature and magnitude of the disruptive economic force of digital
3. reconciling the incompatibility of new business needs and paradigms with the traditional economic, strategic, and operating models

Why Innovation and Digital Strategies Fail

For insights on successful innovation in business and winning in digital, go to –

The World's 50 Most Innovative Companies of 2019 | Fast Company

Extending on this, for enterprises to also innovate for impact and benefit in the digital economy, it's critical to proactive in getting past the following issues –

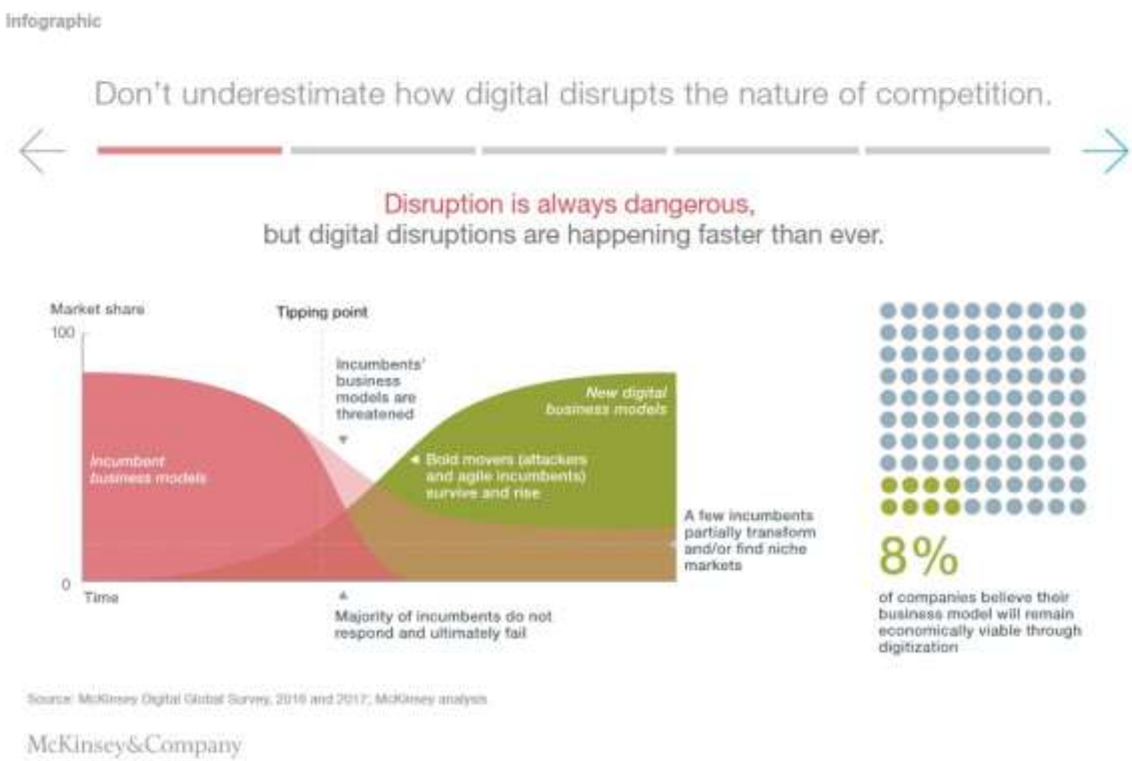
Issue 1 : Fuzzy Definitions

Business leaders typically have various meanings of innovation and digital - with some viewing it as the upgraded term for what their IT function does. Others focus on digital marketing or sales. But very few have a broad, holistic view of what digital really means. As such, it's important to get everyone on the same page by viewing digital as the instant, free, and flawless ability to connect people, devices, and physical objects anywhere, any time. By 2025, some 20 billion devices will be connected, nearly three times the world population. Over the past two years, such devices have churned out 90 % of the data ever produced. Mining this data greatly enhances the power of analytics, which leads directly to more business opportunities, dramatically higher levels of automation and operating efficiencies, more intelligent processes, greater User personalization and stickiness, as well as timely and improved decision making. All this gives birth to brand-new business models. For example, think about the opportunities that telematics has created for the insurance industry with connected cars collecting real-time information about a customer's driving behavior. The data enables insurers to better quantify and price for the risk associated with a driver, automate processes, personalize the policy, create an opportunity to offer direct, pay-as-you-go insurance, offer additional or less coverage, etc.

Lacking a clear definition of innovation and digital, companies struggle to connect strategy to their business, leaving them adrift in the fast-churning waters of digital adoption and change from innovation. What's happened with the smartphone over the past ten years should concern enterprises since no business or industry is immune to the impact of technology, rising User expectations, the need to be an entrepreneurial organization, etc. This includes enterprises who think they're okay because they're established, have lots of data, process, knowledge, etc.

Issue 2 : Not Understanding the Economics of Digital

Many professionals learned a set of core economic principles years ago and saw the power of their application early and often in their careers. This built intuition — which often clashes with the new economic realities of digital disruption and competition as follows –



A. Digital is Destroying Economic Rent

One of the first concepts learned in microeconomics is economic rent — profit earned in excess of a company's cost of capital. Digital is confounding the best-laid plans to capture surplus by creating — on average — more value for customers than for firms. This is big and scary news for companies and industries hoping to convert digital forces into economic advantage. Instead, they find digital unbundling profitable product and service offerings, freeing customers to buy only what they need. Digital also offers extensive choice and price transparency – which typically marginalizes or makes distribution intermediaries obsolete. And digital offerings can be reproduced almost freely, instantly, and perfectly, shifting value as the business scales while driving marginal costs to zero and compressing prices.

Competition of this nature already has siphoned off 40 % of incumbents' revenue growth and 25 % of their growth in earnings before interest and taxes (EBIT), as they cut prices to defend what they still have or redouble their innovation investment in a scramble to catch up. " In-the-moment " metrics, meanwhile, can be a mirage whereby a company that tracks and maintains its performance relative to its usual competitors seems to be keeping pace, even as overall economic performance deteriorates.

There are a myriad of examples where these dynamics have already played out. In the travel industry, airlines and other providers once paid travel agents to source customers. That all changed with the Internet, and consumers now get the same free services that they once received from travel agents – and have anytime, anyplace service, at the swipe of a finger — plus recommendations for hotels, activities, etc. from the " crowd " rather than reviewers. Another example is companies historically installed and maintained servers, storage, networking applications, databases, etc. in physical data centers. Now cloud service offerings from Amazon, Google, and Microsoft, etc. enable organizations to avoid those capital investments and the ongoing work to maintain those systems – so they can focus on their business operations and how to evolve the organization.

The lesson from these cases - Customers are the biggest winners, and the companies that captured the value that was left were often from a completely different sector than the ones where the original value pool had resided. So Executives need to learn quickly how to stay relevant, successfully compete to attract new business and satisfy the increasing demands of current Customers, create value for Customers and monetize some for themselves in an on-line, real-time, all-the-time world with shrinking profit pools in established industries and expanding profit pools in new businesses.

B. Digital is Driving Winner – Takes - All Economics

Just as sobering as the shift of profit pools to customers is the fact that when scale and network effects dominate markets, economic value rises to the top. It's no longer distributed across the usual (large) number of participants. For insight on this, think about how Amazon's market capitalization towers above that of other retailers, or how the iPhone regularly captures over 90 % of smartphone industry profits. This means that a company whose strategic goal is to maintain share relative to peers could be doomed. See www.cail.com/BI for examples of industries and companies challenged by change, being marginalized or less relevant over time, as well as organizations that have moved off the Fortune 500 list in the last 5 or 10 years.

The changing business dynamics and economic profit distribution highlight the existence of a power curve that has been getting steeper over the past decade or so and is characterized by big winners and losers at the top and bottom. Meanwhile, digital revenue growth shows it turning sharply negative for the bottom three quartiles of companies, while increasing for the top quartile. The negative effects of digital competition on a company's growth in earnings before interest, taxes, depreciation, and amortization (EBITDA), meanwhile, are twice as large for the bottom three-quarters of companies as for those at the top.

A small number of winners — often in high tech and media — are actually doing better in the digital era than they were before. They marshal huge volumes of customer data drawn from their scale and network advantages. That triggers a virtuous cycle in which information helps identify looming threats and the best partners in defending value chains under digital pressure. In this environment, incumbents often find themselves falsely assuming their market share will remain stable, that profitable niches will remain defendable, and that it's possible to maintain leadership by outgrowing traditional rivals rather than focusing on new opportunities, companies, products, services, digital models, etc. that are winning share or changing the market.

This is what causes huge business challenge and industry shakeouts. Well before digital, we saw industry disruptions in automobiles, PC manufacturing, tires, televisions, and penicillin. The number of producers typically peaked, and then fell by 70 % to 97 %. The issue now is that digital is causing such disruptions to happen faster and more frequently – across all industries.

C. Digital Rewards First Movers and Fast Followers

In the past, when companies witnessed rising levels of uncertainty and volatility in their industry, they typically observed for a while, letting others incur the costs of experimentation and then moving as the dust settled. Such an approach represented a bet on the company's ability to "outexecute" competitors. It's different in digital where first movers and fast followers gain a huge advantage over slow moving organizations. Studies have found that the three-year revenue growth (of over 12 %) for nimble or opportunistic companies was nearly twice that of those playing it safe (with average reactions to digital competition).

Why is this ?   Because, first movers and fast followers develop a learning advantage. They relentlessly test and learn, launch early prototypes, and refine results in real time—cutting down the development time in some sectors from several months to a few days. They also scale up platforms and generate information networks powered by various technologies at a pace that far outstrips the capabilities of slow moving, processed based organizations. As a result, leaders of innovative businesses are often pushing ahead on version 3.0 or 4.0 offerings before others have launched their "me too" version 1.0 model ! Early movers and emerging industry leaders, embed information across their business model, particularly in data intensive functions (ie: internal operations, R&D, marketing and sales, etc.). They benefit, too, from word of mouth from early adopters. In short, first movers become leaders by gaining an advantage from their -

A. better look ahead …. skate to where the puck is going to be
B. agility and responsiveness in making improvements …. excellent at execution
C. are relentless in their pursuit of the business …. tenacity
D. appreciation of the need for speed …. sense of urgency

….and the high risks of not doing these things

An example of this is how Tesla captured first-mover value in electric vehicles and the issues with a wait-and-see approach. Four years ago, incumbent automakers could have purchased Tesla for about $4 billion. No one made the move, and Tesla sped ahead. Since then, companies have poured money into their own electric-vehicle efforts in a dash to compete with Tesla's lead. This has resulted in, over the past two years, competitors spending more than $20 billion on sensor technologies and R&D. As for the $16 billion difference in the transportation industry – it's the price of the established companies not being future ready ! This is good news for disruptors here and in other mature industries. And a challenging situation for enterprises – unless they meaningfully improve at business innovation and develop the competencies listed above - to have a future in the expanding digital economy.

Issue 3 : Overlooking Ecosystems

Understanding the new business environment, User expectations and economics will move you ahead, but only so far. Being good at Business Innovation and realizing success with Digital Transformation means that strategies developed solely in the context of a company's industry are likely to face severe challenges. Traditional approaches such as tracking rivals' moves closely and using that knowledge to determine corporate strategy, fine-tune overall direction, or optimize value chains - are becoming less relevant than understanding where things are going and being part of an emerging ecosystem. Further, with 54 % of business leaders acknowledging they don't know who their competition will be in 5 years, it's time to rethink how you think about the future as follows –

A. Industries will Become Ecosystems or be Supplanted by New Ecosystems

Digital Platforms that enable an organization to move easily across markets or sector borders are destroying traditional industry models. An example of the familiar line of sight approach is changing grocery store strategies pertaining to Amazon as well as stores nearby. This now includes how to compete with Amazon as a platform plus the impact for its acquisition of Whole foods. Because of this, there is a need for a digital strategy, a traditional physical store competitive strategy, and a strategy to create synergies with new services by leveraging technology and enterprise competencies, presence, brand, etc.

Another example is in financial services where the availability of Apple Pay and other platform-cum-banks are emerging competitors. Further, in China, Tencent and Alibaba are expanding their ecosystems whereby they are now platform enterprises that link traditional and digital companies (and their suppliers) in the insurance, healthcare, real-estate, and other industries. A big benefit from this is they can also aggregate millions of customers to further expand business opportunities, relevance, and revenue.

B. How Ecosystems Increase the Rewards from Innovation

…. that facilitate creating synergies and new services

Can you imagine a competitor that offers the largest level of inventory, fastest delivery time, greatest customer experience, and lower cost, all at once ? Further, established companies are seeing digital platforms and ecosystem economics are changing business, including the fundamentals of supply and demand. In this terrain, the best companies have the scale to reach a potentially huge User base, utilize artificial intelligence, sophisticated analytics and other tools to engineer User personalization with a great experience and deliver an impressive service – with frictionless supply lines. New business models become possible as witnessed by Facebook now being a major media player while (until recently) producing no content, Uber and Airbnb sell global mobility and lodging without owning cars or hotels respectively. Others include Apple in music, Netflix in video, etc.

This is accelerating as an emerging set of digital ecosystems are expected to account for more than $60 trillion in revenues by 2025, or more than 30% of global corporate revenues. In a world of ecosystems, as industry boundaries blur, strategy needs a much broader frame of reference. CEOs need a wider lens when assessing would-be competitors, opportunities, go-to-market strategies, partnerships, etc. Further, in an ecosystem environment, co-opetition is more prevalent since today's competitor may become a partner, or vice versa – depending what is needed to have a highly appealing service, get to market quickly, competencies to be leveraged to increase credibility and reduce risk, etc. Failure to grasp this means that enterprises will miss opportunities and underplay threats – thereby increasing risk. And when every enterprise needs to be good at managing risk, understanding digital and innovating for impact need to be core leadership competencies.

In the way of further insight, while not all businesses are able to operate in nearly frictionless digital form, platforms are fast rewiring even physical markets, thus redefining how traditional companies need to respond. Look around and you will see the new digital structures collapsing industry barriers, opening avenues for cross-functional products and services, and mashing up previously segregated markets and value pools. With vast scale from placing customers at the center of their digital activity, ecosystem leaders have captured value that was difficult to imagine a decade ago. Seven of the top 12 largest companies by market capitalization—Alibaba, Alphabet (Google), Amazon, Apple, Facebook, Microsoft, and Tencent—are ecosystem players. This contrasts with incumbents or established enterprises where only 3 % of them have adopted an offensive platform strategy !

Issue 4 : Not Changing the Mindset

Every enterprise is concerned about the threats posed by digital companies - because of their disruptive nature and innovative business models. Further, there is concern from known competitors who are digitizing and changing things. And then there is the challenge of satisfying the growing expectations of Users / Consumers in an on-line, real-time, all-the-time world – who can easily click in or out (to quickly engage with you or go elsewhere – depending on your relevance and appeal).

With these being major challenges is why there is a need to change the mindset about the business and know how to position the organization for success going forward - especially with the increasing pervasive of technology in society and the impact of digitization in business. For enterprises this means recognizing –

A. Digitizing a Business and building ecosystems is hard

Any enterprise has the potential to change, self-cannibalize and disrupt the status quo. However, as more and more changes occur, it can be difficult to manage since it can get to the point where it's very difficult to control, or where the wheels come off – even when the company has significant market share, brand recognition, Customer base, etc. – especially when they move on a digital offensive and innovative strategy across the organization. This is because digitization and innovation typically go from being an incremental initiative to disrupting multiple aspects of the organization and the value chain. In contrast, technology based companies, especially young ventures, can focus on one segment by design, it's a smaller operation, don't have the need to support a previous business, etc. Regardless, the need is to identify your core competencies and Partner for complementing capabilities to fast track progress, reduce risk and cost, be responsive to new needs and opportunities, etc.

B. The B2B opportunity

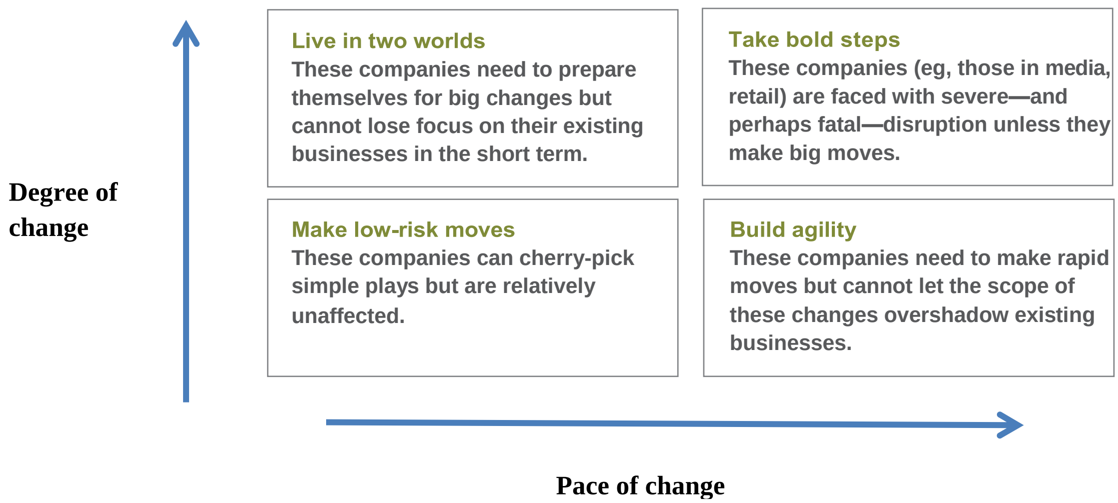
The importance of B2B digitization and its competitive implications is easy to overlook because the digital shifts under way are less immediately obvious than those in B2C sectors and value chains. However, B2B companies can be just as disruptive. When they have digitized their core offerings and operations to lower costs and improving the reach and quality of their offerings. The Internet of Things, combined with advanced analytics, enables leading-edge manufacturers to predict the maintenance needs of capital goods, extending their life and creating a new runway for industrial productivity. Robotic process automation (RPA) has quietly digitized 50 % to 80% of back-office operations in some industries. Artificial intelligence and augmented reality are beginning to raise manufacturing yields and quality. Meanwhile, blockchain's digitized verification of transactions promises to revolutionize complex and paper- intensive processes, with successful applications already appearing in smart grids and financial trading. Should the opportunities associated with shifts like these be inspirational for incumbents? Threatening? The answer is both.

Issue 5 : Missing the Duality of Digital

The most common response to a digital threat is " If I'm going to be disrupted, then I need to create something new ". Understandably, that becomes the driving impetus for strategy. Yet for enterprises who can't ignore or walk away from an existing business, the nature of disruption is challenging - with the need to digitize the current business and innovate with new products, services, business models etc. As a result, the organization needs to learn how to walk and talk at the same time to innovate for impact to meaningfully improve outcomes and prudently manage the risks associated with change.

The nature, magnitude and increasing pace of innovation and digital transformation have enterprises in the following matrix to determine their response. For those facing massive and rapid disruption, bold moves across the board are imperative to stay alive. Retail and media industries find themselves in this quadrant. Others are experiencing variations in the speed and scale of disruption; to respond to the ebbs and flows, those companies need to develop a better field of vision for threats and a capacity for more agile action. Keep in mind that successfully transforming the core business leads to much lower costs and greater customer satisfaction for existing products and services (ie: digitization reduces mortgage approval time from weeks to days or hours). This magnifies the impact of incumbents' strategic advantages in people, brand, and existing customers and their scale over competitors.

Based on the extent and speed of disruption, enterprise response options are -



McKinsey&Company

Beyond this dual mission, companies face another set of choices that seems binary at first. As indicated, the competitive cost of moving too slowly puts a high priority on setting an aggressive digital agenda. Yet Executives indicate their ability to execute their strategy — amid various agendas and cultural challenges — is what they worry about most. So they struggle over where to place their priority, resources, energies, etc. — is about making game-changing bets or remaking the org. The fact is that strategy and execution can no longer be tackled separately or compartmentalized. The pressures to meaningfully improve at business innovation and win in digital mean the enterprise needs to adapt both simultaneously and iteratively – and learn fast in the process.

Because of this, the organizational implications are profound. From a people perspective, it is estimated that half the tasks performed by today's full-time workforce may become obsolete as digital intensifies. New skills in analytics, design, and technology must be acquired to step up the speed and scale of change. Also needed are new roles such as a more diverse set of digital product owners and agile-implementation guides. From a corporate perspective, the question is – Should we separate or not the efforts to digitize core operations - from - the more creative aspects of business innovation ?

While the details of getting this balance right will vary by company, two broad principles apply:

- ***The Bold Aspiration Enterprise*** **-** The first-mover and winner-takes-all dynamics described earlier require significant knowledge and big investments in where and how to play – especially if there are to be major changes to the business model. The boldest enterprises expand their comfort zones and core competencies with major investments in technology, partnerships and digitally related acquisitions. As well, they are aggressive at investing in business-model innovation to expand relevance and revenue. Over time, this strategy is a big performance differentiator.

- ***The Highly Adaptive Enterprise*** - Opportunities to move boldly often arise as a result of changing circumstances and require a willingness to pivot. The watchwords are failing fast and often and innovating even faster — in other words, learning from mistakes and adjusting accordingly. Together they enable a better sense of market direction, rapid reaction, and a more unified approach to implementation. Adaptive players flesh out initial ideas through skilled ideation and pilots, minimum viable products trumping polished solutions, build on theoretical business cases, etc. However, many companies have trouble becoming proficient in developing these capabilities since it means freeing themselves from the mind-set of the day-to-day business and operational silos. As a result, this hinders risk taking and makes bold action difficult. It also diminishes awareness to gauge how close a market is to a paradigm shift or competitive break point and what the disruption will mean to established companies in the space.

As business innovation and digital disruption accelerate, there is often a sense of urgency among Executives. Unfortunately it rarely reaches the level of specificity needed to address the disconnects associated with the aforementioned " Issues ". Rather, people are far more likely to describe initiatives as " we have an Innovation Group ", " we're taking our business to the cloud", " we're leveraging the Internet of Things ", etc. This contrasts with the need to face the new realities of innovating for impact and being proactive at digital disruption with the need to develop a strategy to become number one and get there quickly by creating meaningful value for customers, redefining personnel responsibilities and the organization's role in an ecosystem, providing a new business-value proposition, etc. - to drive improvement in the current business, increase market share, grow in current markets, and successfully enter new markets.

Recognizing these challenges is a first step for leaders to effect change and position the enterprise to increase the rewards for innovation. The next step is to develop an innovation and digital strategy that includes –

A. expanding business opportunities
B. Increasing organization relevance and revenue / monetizing value creation
C. Better managing risk

…. with new capabilities that –

- have high value to the business and Customers, and are User centric
- are based on digital platforms that leverage current IT and newer technologies
- increase organization presence in mobile
- utilize new business model(s)

This is important to meaningfully improve business outcomes with –

1. Corporate Innovation and Strategy involving the entire Leadership team and Influencers …. not just a few people

2. New thinking to respect the pace of change is accelerating and the nature of change going forward is different than in the past. This is very relevant for better planning, setting corporate / product / service direction, etc. Along with this, there is a need to compress strategy reviews from annual to quarterly time frame, having real-time refinements and sprints to be quicker at increasing opportunities, responding to a need, etc.

3. Recognizing the changing and more complex business landscape, rising Customer expectations, new competitive considerations, the evolving stakeholder environment, etc. -- means the *what* of strategy needs updating to include role playing, scenario - planning exercises, and war games – since traditional frameworks such as Porter's Five Forces are no longer sufficient

4. The importance of performance and agility means the " soft stuff " is important in determining the *how* of strategy. This is also critical to sense strategic opportunities on a timely basis - to enable the organization to adapt and pivot as well as to fast track outcomes from exploring, testing and learning from innovation