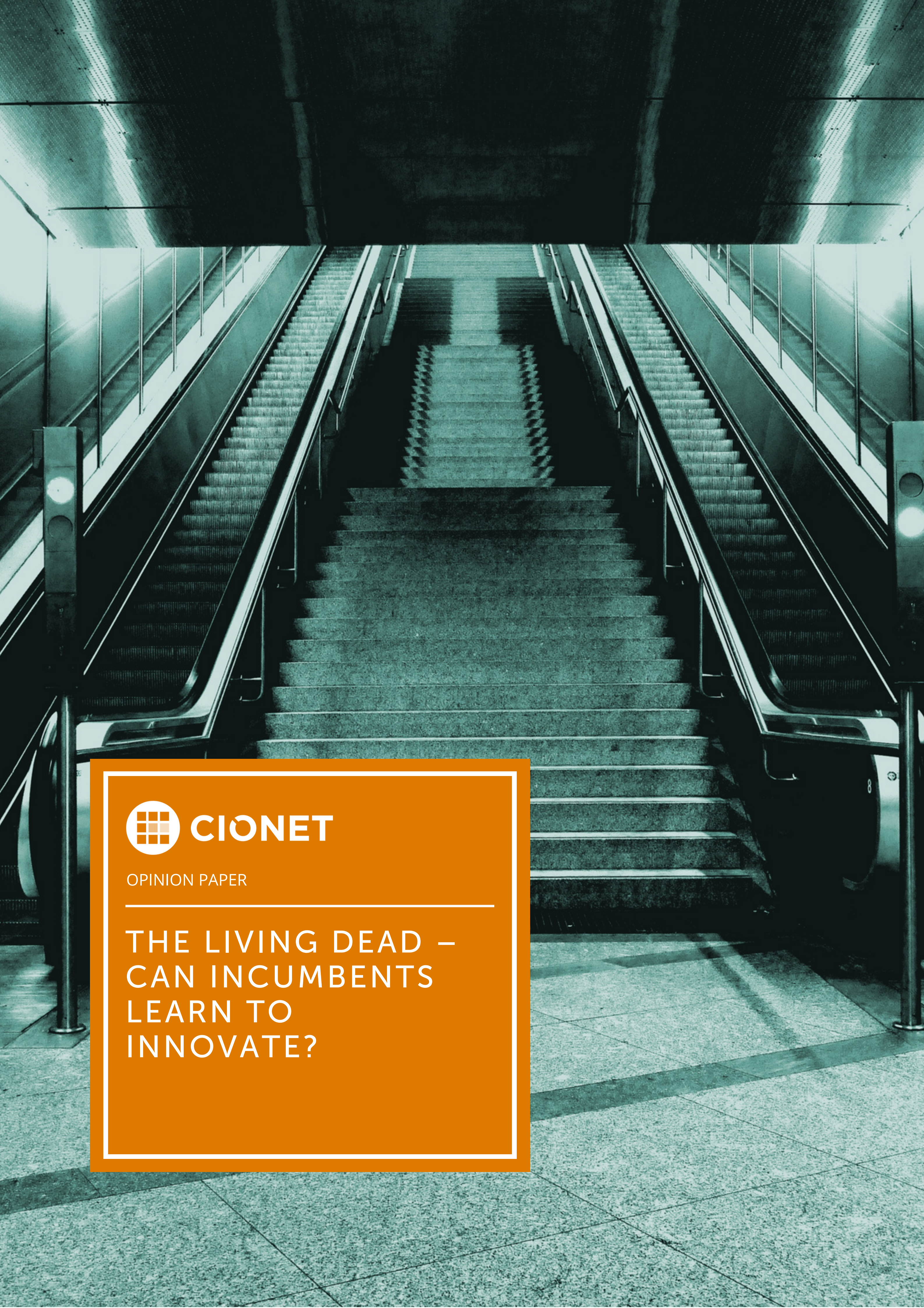

CIONET

OPINION PAPER

THE LIVING DEAD – CAN INCUMBENTS LEARN TO INNOVATE?

This article was written by Roger Camrass, director of CIONET UK and a visiting professor of the University of Surrey.

Speaking to over fifty companies both in Europe and in the USA, the conclusions of our most recent research have made for sobering reading. Over the last decade the large majority of S&P500 and FTSE100 companies have averaged less than 5% annual growth in revenues. Much of the current growth is being achieved by large scale consolidation rather than new revenue generation. At the same time, digital natives such as Google, Amazon, Alibaba and Tencent have achieved impressive double-digit figures, often as high as 50%.

In this context we set up a research group in 2019 on either side of the Atlantic to meet with CEOs, CIO and other business leaders to discover if and where genuine innovation was taking place. We asked some simple questions such as what is meant by innovation, where should it take place and what are the barriers that would impede double digital revenue growth. In return we received frank and often troubling responses. Here is a summary of our findings.

What is meant by innovation?

In the words of James Dyson, CEO of Dyson Group, "innovation is about solving problems that others ignore". Dyson is designing an electric car from scratch and plans to manufacture the vehicle in Singapore. This is a step-out for a UK based company – what we call 'working at the edge'.

Other companies such as the Walgreen Boots Alliance describe innovation as making critical changes at the 'core' of today's business such as offering online delivery of pharmaceutical products (where only 1% fall into this category today in the UK). Such innovations are all about improving customer convenience.

Most companies included in our survey are implementing digital transformation programmes within the existing business. These are designed to increase efficiency and improve quality. Our view is that such programmes, although entirely worthy, are little more than an attempt to sustain the living dead. In the face of competition from the digital natives, we suspect that most will continue to experience a slow decline in revenue leading to a predictable long-term demise. Just look at IBM.

Genuine innovation is about creating the 'New' rather than refining or even transforming the 'Old'.

Where should innovation take place?

Well run incumbent organisations have grown up during a century of stable, predictable market growth. By adopting linear five-year strategies and employing a philosophy of 'operational excellence', such companies have enjoyed strong profitability and dividend growth. Their leaders have focused on exploiting globalisation and IT to operate at scale. Rich rewards have been earned by minimising risks and avoiding failure.

This is in sharp contrast to conditions in the twenty first century where we compete now in a VUCA (volatile, unpredictable, complex and ambiguous) world. Strategy is no longer about formulating a predictable 'five-year plan'. It is more about creating a vision that can flex as conditions change rapidly. With the advent of digital natives who adopt business models that suits the VUCA environment, many incumbents see an inevitable decline in their core businesses. If they are to sustain earnings and market value, they need to start emulating the newcomers. This is about building new businesses that can exploit a torrent of emerging technologies such as IoT, AI, 5G, 3D printing and Blockchain.

How should a genuine innovation be enacted?

Our main learning during the survey was that genuine innovation needs to be separated from the 'core' business. It is about taking big, long term risks that would never be accepted by today's business unit managers. This implies activity at Group level to build tomorrow's Unicorns. Such activities may be characterised by:

- New business models based on software and data assets rather than plant and machinery – as practiced by the digital natives such as Amazon and Google
- A dedicated team of entrepreneurial managers who are incentivised to take risks and operate as venture capitalists – producing returns in 2-5 years rather than 90 days
- Adopting emerging technologies that can solve customer problems in a new fashion as illustrated by OCADO in the UK who is revolutionising distribution

- Organised around 'two-pizza' teams that control profit and loss and exploit an ever-growing range of micro-services and platforms to deliver agility at speed

Although such approaches appear radical, several organisations are now ready to back this approach such as Philip Morris International (PMI) who is exiting tobacco products; Dyson and a new product line of Electric Cars; Philips and its entry into digital healthcare; AXA NEXT and concerted defensive of its financial services business. In every case, these firms have appointed CEOs to lead 'edge' initiatives, and organised governance to accept multiple failures as well as big wins (as per a venture fund).

What could impede innovation?

There is a long list of impediments that will lead to the decline of incumbents. At the top of the list is the shareholder (mostly institutions) who concentrate on near term/90-day performance. There is little appetite amongst this group for 2-5-year returns. The public failure of Jeff Immelt of GE is a case in point, where share values have plummeted due to shareholder disbelief in his digital strategy.
Other impediments include:

- Limitations in current planning methods that do not incorporate a VUCA world view
- Lack of suitable resources to deploy in innovative projects and new business ventures
- Organisational friction between 'core' and 'edge' activities – especially around finances
- Legacy debt that includes systems and processes as well as traditional trade partnerships

Perhaps the biggest impediment is the 'C' suite itself who continue to enjoy excessive returns from mature businesses with inflated exit packages. It will take a new generation of management to confront the digital natives many of whom are run by founders that thrive on risk taking such as Bezos and Musk.

What are the stark choices for business leaders?

Business leaders have a stark choice between transforming the 'core' business and conducting innovation at the 'edge' i.e. outside traditional business domains or metrics. In our research we have found that most are concentrating on streamlining the core by employing costly transformation programmes. At best this will sustain such entities for a few extra years.

Genuine innovators have established teams outside the core to explore new possibilities. They have taken some of their brightest managers out of the line to run new ventures and recruited staff with venture backgrounds as is the case at Capita with the appointment of an external CDO at Board level. Partnerships with, and acquisitions of digital natives are an essential adjunct to this approach.

We believe that the next decade will decide the future of incumbents across multiple sectors. Taking a different strategic view will be vital for success in a world defined by speed and agility.

About CIONET

CIONET is the leading community of more than 10,000 digital leaders in 20+ countries across Europe, Asia, and the Americas. Through this global presence CIONET orchestrates peer-to-peer interactions focused on the most important business and technology issues of the day. CIONET members join over a thousand international and regional live and virtual events annually, ranging from roundtables, programs for peer-to-peer exchange of expertise, community networking events, to large international gatherings. Its members testify that CIONET is an impartial and value adding platform that helps them use the wisdom of the (IT) crowd, to acquire expertise, advance their professional development, analyse and solve IT issues, and accelerate beneficial outcomes within their organisation.

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