Innovation remains key to encouraging new breakthroughs

ROWAN GIBSON

At many companies, the term "innovation strategy" refers simply to an agenda for new product development or a technology roadmap for research and development. This is like picking up a single leaf in the forest and calling it a tree.

Innovation strategy is not merely about the next product launch or patent registration. It's about exactly how your company intends to become (or remain) a world-class innovation champion.

Let's face it, not many organizations have so far managed to build a deep, enduring capability for innovation – one that consistently drives profitable revenue growth and that delivers a strong, competitive advantage over the longer term. This should be the highest goal and purpose of any innovation strategy.

The real strategic issue facing every company is this: How are we going to create growth and shareholder value in the future?

It sounds like a simple question. But organizations have had a wide variety of answers at their disposal over the last few decades. For some, the solution was "going global", or cutting costs or improving quality.

For others, it was raising productivity, or "offering the best customer service" or standing out with excellent product design.

Today, however, these traditional strategies are running out of steam. They no longer offer very much potential for driving growth and wealth creation over the longer term.

As marketing expert Steve Yastrow put it in a recent blog, they have become nothing more than basic business hygiene – the "brushing your teeth" of running a company'.

Radical change

There is a growing realization around the world that organizations have only one strategic option left for delivering growth, company value, market share and competitive advantage. And that's radical innovation – in products, services, technologies, processes, cost structures, marketing strategies and business models.

However, an honest assessment of the business landscape reveals that radical innovators are still very few and far between.

When you pick up a copy of Forbes or BusinessWeek magazines, you inevitably find yourself reading about the usual suspects – a small handful of innovation champions like Apple and Google.

It simply seems incredibly difficult for all those other companies out there to make the transition from innovation laggards to innovation leaders. And that's why there's an urgent need right now for organizations to develop a corporate innovation strategy – a blueprint for building, sustaining and managing an enterprise-wide innovation capability.

Nancy Tennant, co-author of *Strategic Innovation* and former global vice president of innovation at Whirlpool, the appliance giant, says that an innovation strategy should encompass "a wide range of actions that assimilate, incorporate, internalize and imbue the entire fabric or lifeblood of an organization with the mindset and skills of innovation".

Owning innovation

At the core of this strategy must be a broad-based vision of innovation embedment – a vision that is created and owned by the top team, that is accessible to all levels of the organization, that is both feasible and flexible, that can guide decision making and that can be clearly and easily communicated.

It must be based on a highly systemic view of the organization– a sense of connection, interaction and integration between all of the various parts of the system – where the whole is much greater than the sum of its parts. And it must enable each and every employee to understand the link between individual performance and the company's strategic innovation goal.

Once this vision is in place and widely shared across the company, the next imperative is to turn strategy into action by making the necessary changes to leadership commitment and accountability, organizational infrastructure, management policies, resource allocation, knowledge management, rewards and recognition systems and competence development programs. All of these organizational components need to be hard-wired into the company's innovation strategy.

"Can companies really make the gargantuan leap from boring to breakout, and from insipid to inspired? Consider an encouraging example.

When former Whirlpool CEO Dave Whitwam set out to define his company's global innovation strategy back in 1999, he chose to call it "Innovation from Everyone and Everywhere". This was a huge aspiration, considering that at the time Whirlpool had 68,000 employees in 170 countries, as well as 50 manufacturing and technology research centers around the globe.

The Whirlpool model

But Whirlpool rose to the challenge, and today the company has become a best-practice model for innovation as an enterprise capability across a large, global organization.

The key objective of Whirlpool's innovation strategy was to help every single employee to think outside the traditional "white box" of home appliances. Employees were asked to imagine exciting, customer-relevant solutions that create new wealth for the company.

The outcome has been a stream of breakthrough ideas for products and businesses that have come from all over the Whirlpool organization. As a result, Whirlpool has seen a steep upturn in its annual revenues from innovative new products.

In the three years between 2003 and 2006, for example, these revenues rose from $78 million to $1.6 billion (a figure over 20 times higher). And the whole strategic transition has made a massive contribution to growing Whirlpool's overall revenues and profits.

Today, the company has well over 500 projects in its innovation pipeline representing expected future revenues of $3.5 billion.

And, having witnessed the power of Whirlpool's innovation strategy firsthand, the current CEO, Jeff Fettig, is planning no change of course in the future. "If we keep innovating, we'll keep growing," he told BusinessWeek.

What Whirlpool's example amply demonstrates is that it is entirely possible to turn an "old-line" industrial organization into a catalyst for continuous, break-the-rules innovation.

But it can't be done piecemeal. Rather, a company has to be willing to recalibrate its whole organizational system around innovation.

And that is never going to happen unless it develops a wall-to-wall, top-to-bottom, "soup to nuts" innovation strategy.

The author is a global business strategist and author whose books have been translated in more than 20 languages. His new book, Innovation to the Core (co-authored with Peter Skarzynski), was published in 2008 by Harvard Business School Press. The views expressed here are his own.

Chi Fulin

A blueprint for more reforms

▶ A think tank far from Beijing is producing new post-crisis ideas

By Fu Jing

A think tank professional has good reason to stay close to centers of politics such as Washington, DC, and Beijing. But some prefer to be based far from the world's political elite.

Senior political advisor Chi Fulin two decades ago left Beijing to start a think tank, the China Institute for Reform, in the island province of Hainan.

"Hainan, one of the frontlines of China's reform drive, is rich in fresh ideas," Chi recalled about his decision during an interview with China Business Weekly.

The island province was named one of several special zones, including Shenzhen, by the central government in the 1980s.

Located far from Beijing, the institute led by Chi has elevated its research and reputation in the current global financial crisis.

Just one day after President Hu Jintao attended the first G20 leaders summit in Washington, DC, last year to deal with the financial turmoil, Chi's institute published the UN-sponsored China Human Development Report.

Chi, chief author of the report, said that once a mature public service system is established, public service will become a driving force in the sustainable development of China and lessen the impact of future financial downturns.

The government invested in infrastructure nationwide with a 4 trillion yuan stimulus package last November that is building new roads, bridges and railways to stimulate the economy.

Chi and other leading economists became concerned that China could not manage the financial crisis well without deep-rooted reform measures.

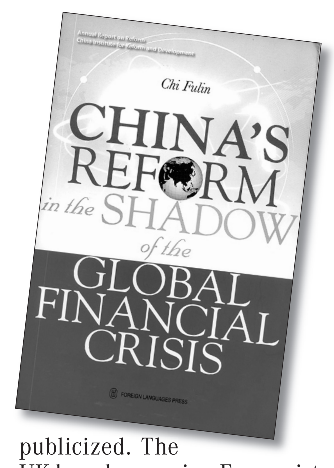
A call for more change

A five-expert panel led by Chi in March outlined a proposed reform package in the book, *Crisis Challenges Reform*, saying the reform measures should be implemented to make China's stimulus program more effective.

OPINION LEADER

The need for price deregulation of resource products and shrinking the central government's monopoly of key industries topped the 14-point reform package prepared by renowned economists such as Chi and Chang Xiuze, an economist affiliated with the National Development and Reform Commission.

Released prior to the G20 summit in London, Chi and his colleagues' insights were widely publicized. The UK-based magazine Economist declared the proposed measures fundamental to stimulating China's economy and domestic consumption.



"The suggestions in the reform package have been gradually materializing," Chi said.

In the first half of this year, China started to link its refined oil prices to the fluctuations of the global market. And the government has also speeded up reforms to the country's healthcare system in cities and rural regions.

Post-crisis ideas

Since the middle of this year, when signs of an economy recovery began appearing in China and other countries, Chi has led a panel of economists to think about the country's reform in the post-crisis era.

Their ideas were included in the book, *China's Reform in the Shadow of the Global Financial Crisis*, which was published by Beijing-based Foreign Language Press.

"I am still stressing the urgency of reform in the book," Chi said. "That's a lasting driver for China, which is on the way to a market economy."

Chi said demand for Chinese output is decreasing globally and at home. China wants to move to the upper end of the consumption chain after three decades of development, he said.

In the book, Chi said he believes that China faces tremendous challenges to transform its pattern of economic development.

Three decades of economic reform have led China to a new stage of development in terms of its society and economy. With the country advancing more rapidly, many problems and challenges have emerged, Chi said.

Chinese leaders should rethink the country's reform package amid changing global and domestic situations and take steps to move toward a market-oriented economy by 2020, the senior political advisor said.

Reform measures should speed up urbanization, break down industry monopolies by the State, deregulate energy, offer equal social welfare for rural residents and urban dwellers, and improve the government's efficiency, he said.

Radical measures

"Our top leaders should take quicker and radical measures in these endeavors within the coming two or three years. By doing so, China can do a better job in post-crisis management, as well," Chi said.

"Looking at the goal of realizing a market economy by 2020, we cannot afford to lose the time window of the next two or three years," he said.

Chi, who is also a member of the Chinese People's Political Consultative Conference, the country's highest political advisory body, praised the government's swift response to the current financial crisis.

"There is no doubt China will soon overtake Japan to become the world's biggest economy after the United States. But we should be realistic about our strengths," Chi said.

It might take about two decades for China to become an economic power "if all goes smoothly", he said.

Chi also said the government should step up efforts to encourage overseas investment and trade, which should go hand in hand with the country's efforts to internationalize its currency.

"The most important thing is that there is consensus among the leadership to reform, and they are acting now," Chi said. "What I am advocating is to carry on the momentum."

Emerging markets will attract more FDI inflows

LAZA KEKIC

The global economic and financial crisis has had a major impact on foreign direct investment (FDI) flows.

After declining in 2008 by 17 percent to $1.73 trillion from $2.09 trillion in 2007 – the high point of a four-year long boom in cross-border mergers and acquisitions (M&As) and FDI – global FDI inflows are forecast to plunge by 44 percent to less than $1 trillion in 2009.

The big drop in 2009 is occurring despite the improvements in the global economy in recent months.

However, a notable feature of trends in 2009 is that emerging markets for the first time are set to attract more FDI inflows than the developed world.

Global FDI

Global FDI inflows are estimated to have contracted by 49 percent in the first half of 2009, compared with the same period in 2008.

The estimate is based on data for 54 countries (20 developed countries and 34 emerging markets) that accounted for just under 90 percent of total global FDI inflows in 2008.

For 47 of the countries, FDI inflows in the first half of 2009 were lower than in the first half of 2008; only seven countries recorded growth in inflows over this period. The decline in inflows to developed countries was significantly sharper than the drop for emerging markets – by 54 percent and 40 percent, respectively.

The declines were especially marked in the United States and United Kingdom, by 68 percent and 85 percent, respectively. Among emerging market regions, the sharpest decline, by 55 percent, was to Eastern Europe.

Flows to Latin America and to emerging Asia declined by one-third in each case. China, the main emerging market FDI recipient, had a decline of only 18 percent, while FDI flows to Brazil and Mexico dropped by 25 percent.

Only a modest improvement is expected in the second half of 2009. Despite improved global economic trends in recent months, a significant recovery in M&As will not happen soon.

Rising confidence and a rally in equity markets have failed to boost M&As, since corporations remain very cautious and bank financing is constrained. The nine-month 2009 data for M&As was not encouraging.

According to data provider Dealogic, the value from M&A deals globally of $1.62 trillion in the first nine months of 2009 was down by 37 percent on the same period in 2008.

FDI to emerging markets

Flows to emerging markets initially proved resilient to the impact of the global crisis.

Inflows into the developed world declined by one-third in 2008, whereas flows to emerging markets increased by 11 percent.

FDI flows to emerging markets will decline considerably in 2009, albeit by less than FDI flows to the developed world.

In 2009, for the first time ever, emerging markets are likely to attract more FDI than developed countries. The forecast is obviously subject to considerable uncertainty.

For example, a few large cross-border deals in the final quarter of 2009 could tip the balance back in favor of developed countries.

But even should the emerging market share in global FDI inflows fall short of 50 percent, the share in 2009 will almost certainly be the highest on record.

Practice and theory

The overall decline in global FDI flows is thus being accompanied by a distinct shift in the pattern of FDI.

Economic theory tells us that capital should flow from capital-abundant rich countries to capital-scarce poor countries.

In practice, that has not been the case, since developed countries have consistently attracted the bulk of global FDI flows.

High risk in many emerging markets, the benefits of advanced institutions and infrastructure, and a superior overall business environment in developed countries have tended to outweigh the attractions of greater market dynamism and lower costs in emerging markets.

This time, practice might be catching up to theory. FDI has tended to rise during recessions, as slumps in M&As have hit the developed world disproportionately. Some 80 percent of cross-border M&A sales are still in developed states.

However, other factors are also pushing up the share of emerging markets in global FDI inflows.

FDI flows to emerging markets have held up better because their overall economic performance has been much better than that of the developed world, which has experienced its worst recession since the Second World War.

Much of the superior performance of emerging markets is, of course, due to the continued fast growth of China and India.

However, even if China and India are taken out of the equation, most emerging markets will have outperformed the developed world in 2009. Emerging markets have thus to some extent "decoupled" from the developed economies.

Globalization and increasing competitive pressure on companies have increased the cost in lost opportunities of not investing in emerging markets.

Outlook for 2010

Although the global economy is still weak, conditions are now improving in many countries. Global growth resumed in the second half of this year, creating momentum that will carry into 2010.

The recovery in 2010 will, however, be sluggish and fragile. Global growth is unlikely to return any time soon to the trend rate of recent years, since it will be constrained by the after-effects of the crisis in 2008 and 2009.

As a result, although global FDI inflows are likely to grow in 2010, the recovery will be modest. The growth rates of FDI into the developed world and emerging markets are expected to be similar, so that their shares in global FDI are unlikely to change significantly from 2009.

Companies' plans for the next five years, as reflected in the recent Economist Intelligence Unit survey, "Survive and Prosper," imply that emerging markets will attract considerable FDI and probably more than developed countries.

Just under 60 percent of companies expect to derive more than 20 percent of their total revenue in emerging markets in five years' time – almost double the present proportion of 31 percent.

This would suggest that the shift in the distribution of global FDI flows in 2009 is a longer-term development and not just a transitory phenomenon.

The article is part of the Columbia FDI Perspectives series, published by the Vale Columbia Center on Sustainable International Investment. The views expressed here are his own.