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Purpose and Innovation

by Nikos Mourkogiannis

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How to optimize corporate R&D efforts.

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An Innovation is any development that creates change. It could be as big as a jet engine or as small as a tiny improvement to production line processes. Or, as the economist of innovation Joseph Schumpeter put it, it can be a new kind of food: "It should be stressed at once that the 'new thing' need not be spectacular or of historic importance. It need not be Bessemer steel or the explosion motor. It can be the Deerfoot sausage."[1] I'm interested in innovation—in innovative strategy, technology, products and services. I'm especially interested in the two million suggestions made in a year at Toyota through the employee suggestion scheme—because 85 percent of them were adopted.[2] That could not happen without a strong, consistent Purpose. Was it a Purpose of excellence, discovery, heroism or altruism? To answer that, one would have to know the nature of most of the suggestions.

Standard strategic analysis "explains" advantage, for both countries and companies, principally in terms of innovation. As Michael Porter puts it: "Innovation has become perhaps the most important source of competitive advantage in advanced economies."[3]

Some companies can defend their existing strengths for a while without innovation, but as everyone knows, patents expire, consumer tastes change and competitors come up with new ideas. Innovation is not at the top of the agenda for all industries—many packaged grocery products, for example, are fantastically stable—but it is somewhere on the agenda for all industries. At the same time, this reliance on innovation has often led companies away from their Purpose, into a series of expensive blind allies. In 2005, Booz Allen Hamilton conducted a study of the one thousand biggest spenders on innovation—the companies with the largest research and development budgets around the world. They found no significant correlation with any measures of corporate success. None. Not profits, not revenues, not growth or shareholder returns.[4] In other words, the simple decision to invest in innovation is not enough. How you invest, and especially how innovation serves a larger Purpose, determines the value of your investment.

It's my view that Purpose helps innovators see beyond current convention—it improves the quality of innovation. And Purpose counters the natural risk aversion that large companies have to innovation. It thus increases the *quantity* of effective innovation, often without raising the price tag.

Purpose makes an innovator more aware, or sensitive, because it is *itself* a response to the environment, and one that engages the innovator strongly. We might even say that a Purposeful response, if genuinely felt, is an innately innovative response because it provides a context for paying attention to the needs in the world outside.

Think of innovation as taking place within a mental space. In a company without Purpose, this space has three dimensions—understanding of the technology, understanding of the customers, and understanding of the competition. In a company with Purpose, this three-dimensional space becomes four-dimensional, the additional dimension being understanding of the Purpose—discovery, excellence, altruism or heroism. The extra dimension makes it easier for the innovator to think outside existing conventions. In the absence of Purpose, "what the customer wants" can be interpreted

in a very conservative way—extrapolating past purchasing patterns, listening to focus-groups and consulting qualitative research data.

The innovator has every reason to identify the essence of practices in other industries and repackage them for his own use—like Ford, who adapted meat-packing techniques, or like Aristotle Onassis, who pioneered cruise ships by borrowing from the hotel industry. The innovator may reconfigure components into new products, like the engineers at Sony who developed the Walkman. The innovator may glimpse potential benefits in new technologies, like the engineers at Seiko who developed the quartz watch or those at Apple who worked on the graphic user interface. He or she may simply see economic logic in a situation masked by current convention, like Siegmund Warburg helping Reynolds Metals take over British Aluminum. Or he or she may realize how the peculiarities of his or her organization can generate new customer benefits, like Nathan Rothschild in the 1820s, who used his international network to make local payments to international bond holders.

Purpose itself is not, strictly speaking, *necessary* for this kind of innovation. I do not think that Michael O'Leary, for example, who has changed the rules in the European airline market, would insist that Purpose drove his decisions at Ryanair. What is necessary is an ability to see beyond the existing market dynamics. Entrepreneurs have no problem with this, but large successful organizations often find it more difficult—this is why companies dominated by brand marketing departments often fail to innovate effectively. Purpose's contribution is to help avoid this kind of constraint, to help innovators see beyond existing dynamics and industry conventions.

Purpose also provides a degree of emotional cer-

Seven companies that have enjoyed enduring advantage

Company	Purpose	Type of Purpose	How Company Rewrote the Rules	Financial Results
Ford	Use machines to improve the world	Heroism	Made money from cheap cars and mass production	c. 100 percent p.a. real return 1903 to 1919
IBM	Seek out the new "beyond our present conception"	Discovery	Aimed to solve customers' problems	9 percent p.a. real earnings growth 1915 to 1956
S. G. Warburg	Maximize the achievements of the elite	Heroism	Encouraged hostile takeovers and Eurobonds	23 percent p.a. real earnings growth 1948-1969
Wal-Mart	Give the customers a good deal	Altruism	Introduced very low prices to small towns	27 percent p.a. real earnings growth 1971 to 1992
Berkshire Hathaway	Invest excellently and encourage excellent managers	Excellence	Invested large stakes on fundamentals	22 percent p.a. real returns 1965 to 2003
Disney	Make people happy	Altruism	Created new product types	18 percent p.a. real returns 1923 to 1998
Sony	Innovate in a useful way	Discovery	Invented portable, convenient products	10 percent p.a. real earnings growth 1967 to 1999

All figures are adjusted for inflation. For more information on the sources used to determine these figures, please see pg. 135 of Purpose for the original table (9.1).

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tainty that makes the prolonged openness of mind required for innovation easier. Sometimes innovating means *not* doing something and instead waiting for the right opportunity. Warren Buffett is a good example; his commitment to excellence gave him the patience to refrain from investing when there were no real opportunities, even though the rest of the investment industry thought there were. Masaru Ibuka, the founder of Sony, had clear ideas about the reasons for its incorporation—"to establish a place of work where engineers can feel the joy of technological innovation, be aware of their mission to society and work to their heart's content." Such clear ideas, driven by the Purpose of discovery, made it tolerable that he and his colleagues "sat in conference . . . and for weeks [after the company was founded] tried to figure out what kind of business this company could enter, in order to make money to operate."[5]

A clear Purpose helps *anchor* this kind of open-mindedness as well. Buffett's investment decisions were highly calculated. Companies like Motorola and Microsoft have a very clear idea of what they are trying to achieve. The goals driving particular research and development programs are not necessarily moral, but where there is a Purpose underpinning the business of the firm, then there is an unavoidable moral discipline that engages individuals.

Having a Purpose does not guarantee greater sensitivity to market signals. It can make people more bigoted and isolated, as we saw with Henry Ford. The "right" Purpose—one in tune with the times—is more likely when developed collectively, reflecting more than one person's response to the environment. It is also more likely when it is aligned with the company's commercial strategy. An innovator's Purpose also strengthens his or her will, an important factor because the outcome of innovation is always highly uncertain. Even to embark upon the process of innovation requires an act of will, including the will to persevere no matter what may lie ahead. When Henry Ford first started tinkering with the prototype that turned into the Model T, he may have thought he knew what would happen, but it was hardly the same kind of knowledge as that produced by a cost accountant who prices all the inputs for a given output. Similarly, any successful result from a research and development lab depends on a decision to pursue a line of enquiry, the end product of which is unpredictable, to some discernable result.

Daniel Vasella, CEO of Novartis, has been explicit about using Purpose in this way: "One way we try to foster innovation . . . is to align our business objectives with our ideals. . . . I believe that people do a better job when they believe in what they do."[6]

Purpose and Radical Decisions

It has long been observed that most fields of activity have ingrained ways of doing things that all involved take for granted. Because each player takes into account the expected behavior of the other players, these habits often become unconsciously established as limits in the minds of participants. In a market of competing innovators, such habits tend to limit the scope for competition. Players tend to mistrust any innovation from outside; they become like boxers in a ring, anxiously watching each other, landing punches and going round in circles. One company may win a battle, but no company ever wins the war—and, with it, the peace.

Some companies avoid this stalemate. They innovate radically, and instead of just winning battles they achieve peace, either by so changing the rules that they come to dominate the industry, or by carving out their own niche, which they alone occupy, at least for a while. This is the achievement of enduring advantage; once this

state is reached, radical achievement breeds further radical achievement. Competitors no longer feel constrained to innovate "just enough" to beat the competition. They are free to discover new forms of competition.

Each of our entrepreneurs refused to play by the rules—they were driven by Purpose to innovate in a radical way. Tom Watson was driven to search out the potential of the data processing industry, the scope of which he thought he alone recognized. But he did not want to just lead the industry, which he did anyway; he wanted to bring it to its potential. Accordingly, he took huge risks and invested heavily in research in the 1930s, helping to make IBM impregnable. In doing so he created a tradition of innovation that helped keep the firm dominant and at the edge of development, even when technological competition became tougher in the 1950s.

Sam Walton's management system was driven by his single-minded commitment to offer the best possible prices to his customers. Built up over many years, it was nonetheless a radical innovation for his industry, and other companies, such as K-Mart, were forced to imitate him. But they lacked his Purpose, and it was he and his successors who made the system work and came to dominate the industry.

Henry Ford wanted to use machinery to improve things, and that meant democratizing the automobile. Accordingly, he invested hugely in capacity, installed the moving assembly line, slashed prices and attempted to control the entire value chain from raw materials to showrooms.[7] He created new forms of advantage—scale, automation—that for a time, at least, allowed him to dominate the industry.

Siegmund Warburg knew that he had to be one of the elite. He did not mind running a small bank, but he could not tolerate simply doing routine work for routine clients. Accordingly he innovated and pushed his clients to innovate, inventing the hostile takeover industry and the Eurobond industry, both of which he came to dominate.

Warren Buffett wanted to be an excellent investor—which meant being a rational investor. He knew that the best way to achieve this was by staying as far away as possible from Wall Street. Unlike our other entrepreneurs, he has not dominated or changed his industry, but he has achieved a kind of peace. Instead of winning an empire he has established autarchy, his own island where he is supreme and left alone. He is spared the endless battles for relative position faced by other investment managers. He does not choose to be like Napoleon, to set out to conquer the world. He is content to stay in his hometown of Omaha.

In their book *Built to Last*, Jim Collins and Jerry Porras have presented some other examples of entrepreneurs and corporations that have been driven by Purpose to innovate in a radical way, and that ended up changing their industries. These include Walt Disney, who, they tell us, wanted to make people happy. When he made *Snow White*, the first full-length animated feature film, people thought he was mad; he came to dominate this part of the industry. In the fifties he set up Disneyland—without any market data to indicate there was demand for this new product. Again, he was driven by Purpose to take a risk, he innovated and he changed the industry.

Masaru Ibuka set up Sony in the aftermath of World War II, and he set out the "purposes of incorporation," which included feeling "the joy of technological innovation." In the fifties he decided to work on a transistor radio. "People are saying that transistors won't be commercially viable," he said. "This will make the business all the more interesting."[8]

Bill Allen, chief executive of Boeing from 1945 to

1968, said that the company he led was "always reaching out to tomorrow" and that it employed people who "eat, breathe and sleep the world of aeronautics." A stream of radical decisions led to the development of new airliners—the 707 in the 1950s (the first commercial jet), the 727 in the early 1960s and then in 1965 the 747 (the first wide-bodied jet). Discounted cash flow just did not come into it. "We will build it even if it takes the resources of the entire company," Allen told a doubtful non-executive in 1965. It nearly did require all of those resources—but of course Boeing retained its enormous lead over its rivals, such as McDonnell-Douglas. Allen was driven by Purpose to take a risk; he innovated and Boeing changed—and continued to dominate the industry.[9]

And then there is Bill Gates. His Purpose—to get Windows onto every desktop in the world—was a modern version of Henry Ford's plan to democratize the automobile, and Gates' company grew at the same heady speed, making him, like Ford, the richest man in the world. But like Ford, now that Gates has come close to achieving his Purpose, there is a dilemma. He continues to win his battles, but he has not established a peace. His software near-monopoly is eroded daily by new developments on the Internet, in open-source software, and in the nature of computer-based devices, to say nothing of challenges from regulators. Should Microsoft keep its old Purpose, honed across three decades? Or should it adapt and change the industry rules again? Perhaps consideration of this question prompted Bill Gates' announcement, in June 2006, that he would retire as chief executive of Microsoft.

These examples do not mean to imply that changing the rules is only for big businesses. It is worth remembering that Walton's approach brought him success as a small businessman before he became a big businessman. He changed retailing in Bentonville before he changed it in the Midwest or in the United States as a whole.

The key to changing the rules and winning dominance is to make decisions. This applies as much in a village market as in a global market. Henry Ford's competitors reckoned they could make a surer stream of profits from the mid-size and luxury markets. Walton's competitors allowed him to grow to critical mass in the semirural Midwest while they were milking more lucrative urban markets. Buffett's fund management rivals all preferred to estimate how other fund managers would respond to new information rather than to judge purely on fundamentals.

If you doubt Purpose can generate enduring advantage through innovation, I invite you to compare the performance of the companies in the following table with those of their rivals. ✚

Notes

1. Schumpeter, "The Creative Response in Economic History," in Richard Clemence (ed.), *Essays on Entrepreneurs, Innovations, Business Cycles and the Evolution of Capitalism* (1951).

2. Tony Eccles, *Succeeding with Change: Implementing Action-Driven Strategies* (1994).

3. Michael Porter and Scott Stern, "National Innovative Capacity," in *The World Economic Forum Global Competitiveness Report* (2002).

4. Barry Jaruzelski, Kevin Dehoff and Rakesh Bordia, "Money Isn't Everything," *strategy+business* (Winter 2005).

5. Akio Morita, quoted in James Collins and Jerry Porras, *Built to Last* (1994).

6. Daniel Vasella, "Make It Meaningful," *Harvard Business Review* (August 2002).

7. The limits to competition in established markets can become particularly rigid where there is a complex or long value chain: New entrants have to grapple with well-established patterns of supply and distribution, while existing players can become quite comfortable with relationships that were probably fashioned around their strengths. As we saw, Walton as well as Ford had to struggle with this. This, of course, is why the Internet was so liberating in industries as diverse as travel, personal computers and personal finance.

8. Masaru Ibuka, quoted in Collins and Porras (1994).

9. "When Boeing [non-executive] director Crawford Greenwalt asked a member of senior management about the projected return on investment of the proposed 747, the manager told him they had run some studies, but couldn't recall the results. Greenwalt buried his head in his hands in response." Collins and Porras (1994).

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