Strategy and Innovation:
Making the Right Strategic Decision and Developing the Right Innovative Capabilities

Lawrence John Loughnane
Centro Para Estudios Desarrollo Regional
CETYS Universidad
Av. CETYS Universidad S/N Fracc. El Lago
Apdo. Postal 4012, Zona Centro
Tijuana, BC 22550
(664) 625 3942
lloughnane@allium.org

Tijuana, México, los días 13, 14 y 15 & 16 de mayo de 2008
Abstract: All organizations must be innovative. Is this statement true or is innovation only another management practice that a company can employ in a search for superior performance? This paper suggests that innovation is a management practice and it is critical for an organization to decide if it is going to pursue innovation as a management practice. Despite the call for companies to be innovative, research indicates that it is not necessary for an organization to be innovative to be highly successful. Worse, it is problematic that few companies are capable of excelling at innovation. This is because it is a very difficult management practice and few senior leaders have a clear, well-developed model of what innovation looks like as an organizational capability within a company’s specific context.

To examine the need for innovation and a company’s capability to excel at innovation perhaps one starting point is to define innovation differently. There are two types of innovation: upstream and downstream innovation. Upstream innovation is development of new inventions and technologies. Downstream innovation is the process of turning the inventions and processes into economic value.

A company’s vision drives the process of deciding to pursue innovation. Company leaders should be aware innovation exists in a context approaching chaos. It exists in a context where complexity is high and the unpredictable occurs far more frequently than predictable results.

Determining what management practices will lead a company to superior performance is the first step to becoming a leader in an industry. Companies that out-perform their industry peers excel at what are called primary management practices—strategy, execution, culture, and structure. Companies that out-perform their industry peers supplement their skill in primary areas with a mastery of any two out of four secondary management practices—talent, innovation, leadership, and mergers and partnerships.

A company that chooses to pursue innovation, as a management practice, must first recognize that being innovative is not a strategy. Strategy is also a management practice. Being innovative is a capability that is the result of a successful strategy. A company must choose to be very good at strategy and other management practices and the practices must be aligned and performed at the same time.

Keywords: Innovation, strategic management, strategy, entrepreneurship, creativity, business practice, process

1. Introduction
There is a constant theme in the business press and respected business publications that all organizations must be creative and/or innovative. The definitions of creation and innovation are very close; close enough that many people consider them synonyms. They are not. Creativity is about idea generation. Innovation is about idea
implementation. Innovation is typically understood as the introduction of something new and useful, for example introducing new methods, techniques, or practices or new or altered products and services.

It is critical for an organization to decide if it is going to pursue innovation as a management practice. To be considered innovative an organization needs to change its industry in some way (Joyce, Nitin and Roberson, 2003). Innovators are focused on finding altogether new product ideas or technological breakthroughs that have the potential to transform industries.

It is not necessary for an organization to be innovative to be highly successful (Joyce, et al, 2003). Once an organization decides that innovation will be a management practice, it must decide if it is going to pursue upstream innovation or downstream innovation. Upstream innovation is the implementation of one’s own ideas. Downstream innovation is implementing the ideas of others. Both upstream and downstream innovations have the same goal - make investments and manage those investments so the return on the investment contributes to superior performance. Superior performance is defined as the sustained creation of value for which a customer will pay.

It is problematic that few companies are capable of excelling at innovation – it is a very difficult management practice (Hamel, 2003). Without other complimentary management practice skills innovation rarely, if ever, results in the creation of value. Determining what management practices will lead to superior performance is the first step to becoming a leader in an industry.

Traditionally companies have been told that industry forces (Porter, 1980) and how an organization reacts to those forces determine performance. Industry leaders, rather than focusing on external forces focus on developing internal capabilities (Hawawini, Subramanian, Verdin, 2002). It is important to note that it is the industry leaders or those that want to be industry leaders that focus on internal capabilities. Average or middle of the road companies focus on the external forces and how their strengths and weakness match those forces. To be innovative and thus be in a position to change its industry in some way requires that an organization develop the capability to be innovative as a management practice.

Joyce et al (2003) document the results of research that indicates:

- Companies that out-perform their industry peers excel at what are called primary management practices—strategy, execution, culture, and structure.

- Companies that out-perform their industry peers supplement their skill in primary areas with a mastery of any two out of four secondary management practices—talent, innovation, leadership, and mergers and partnerships.

Note that companies that exhibit superior performance excel at all of the primary management practices. But, it is not necessary for a superior performer to be innovative. Innovation is not a primary management practice. Innovation is a secondary management practice. (Secondary in this sense means that there is a decision about
which two of the four secondary practices a company will use). An organization must make a decision to invest in the development of a capability to be innovative. Based on the amount of literature on innovation, it might be expected that all companies should invest in the creation of an innovative culture. The truth is few companies really make this investment. Those companies that do make the investment often fail to achieve intended objectives because it is a very difficult management practice. And, it is not always the best investment an organization can make.

2. Management Practice
Management practice can be viewed as the sides of a triangle. Each side supports the other two. The sides of the triangle are content, context and process (See Figure 1). Content is limited by an organization’s capability and capacity. The competitive environment (industry forces) defines context. Process is characterized by the patterns of organizational behaviour an organization exhibits as it gets things done.

![Figure 1: Management Practice](Loughnane 2007)

Management practice is contextual simply because what works in one situation (context) can easily fail in another. When trying to determine what kind of management practice will work in a particular context a good place to start is to think about context existing on a continuum (See figure 2).
Predictability requires stability. Stability is achieved through policies and procedures coupled with flawless execution and with very few decisions. As chaos is approached, the number of decisions made increases dramatically. The complexity of the context increases. Flawless execution becomes more difficult. The power (knowledge, support and resources) required to make good decisions increases. Decisions are subject to chance rather than predictability.

Innovation exists in a context approaching chaos. It is a context where complexity is high and the unpredictable occurs far more frequently than predictable results.

An organization is not innovative because it has ideas, even great ideas. An organization is innovative when it converts the idea into a completely new product or a technological breakthrough that has the potential to change an industry. Joyce et al (2003) tell us that “innovative companies lead the way with industry changing innovations and a willingness to cannibalize offerings, resisting the temptation to wring every last cent out of a product before introducing another to take its place.”

3. The Problem
Deciding that innovation is an essential management practice is not a decision to be taken without a great deal of reflection. Few senior leaders have a clear, well-developed model of what innovation looks like as an organizational capability. And since they don't know what it looks like, they don't know how to build it (Hamel, 2003).

Hamel (2003) found two core challenges must be overcome if innovation is to be developed into a deep capability in any organization. The first challenge is that most companies have a very narrow idea of innovation, usually focusing just on products and services. Second, most companies devote much more energy to optimizing what is there (current products, services capabilities) than to imagining what could be.
There is not a shortage of creative people in most modern business organizations. The problem is the shortage of management skills necessary to follow-through. By its very nature the creative process often is not structured nor are the creative people. Many creative people do not know how an organization gets things done. Many creative people do not know how the organization makes money. Theodore Levit (2002) informs us that creativity is not enough:

“All too often there is a peculiar underlying assumption that creativity automatically leads to actual innovation.”

Creativity and innovation that follow often require organizational change. Most organizational-change programs do not achieve their intended results. Why? Consider a simple example. The creative person has lots of ideas but no implementation skills. The next in command person has a high degree of capability to manage the status quo but has a low acceptance of new ideas, a low capability to consider change and a low level of skill to manage change. Perhaps creativity will occur, but not innovation. Few companies with a history of stability can change to innovative companies simply because of the good ideas of creative people and the good intentions of top management.

Organizations, creativity and innovation do not make for a happy marriage. Creativity requires ‘permissiveness’. Organizations require order and conformity to get things done. Creativity and innovation can wreak havoc on the organization.

4. The Solution
Suppose that an organization decides that it needs to be creative and innovative. How can the circle created by the problems between the organization and the need to creative and innovative be squared, i.e., what is the solution?

Perhaps one starting point is to define innovation differently. Amar Bhide (2006) discusses two types of innovation: upstream as the development of new inventions and technologies; and downstream as a system of turning inventions and processes into economic value. Upstream and downstream innovations require different knowledge skills and resources and thus different strategies.

At this point it is important to remember that formulating and implementing strategy is a management practice. Innovation is also a management practice. The ability to practice innovation is the result of the successful implementation of a strategy. Innovation results from innovation process execution. Figure 3 illustrates innovation as a system that lies on a continuum. Innovation is a complex and usually gradual process that involves many players (companies) making incremental advances over time – the continuities. Scientists and engineers work at ideas and creativity at the upstream point. At the downstream point, big ideas are adapted to create economic value at a local level. Along the continuum there are proliferations of species (different firms responding to different customer needs). The species exist in different local competitive environments with different business systems (dimensions).
First, it is important for an organization to decide where it exists along the Innovation System continuum and how it creates value within the system. The organization must determine which secondary management practices—talent, innovation, leadership, mergers and acquisitions—best supports its primary management practices—strategy, execution, culture and structure. Second, it must choose to practice innovation. Third, the organization must assess its competitive environment to determine what level of creativity and innovation is needed as a management practice.


In their groundbreaking study of 200 management techniques Joyce, et al, (2003) found surprising results: most techniques themselves have no direct impact on superior business performance. What does? Mastery of business basics is the key to superior performance.

To sustain superior performance, an organization has to excel at four primary management practices—strategy, execution, culture, and structure—and any two of four secondary practices—talent, leadership, innovation, and mergers and partnerships.

The key to this “4 + 2” formula is not which technique you choose within each practice, but how well and consistently an organization sticks with it. There’s no recipe to follow. But the most enduringly successful companies in the study (those delivering a 10-fold return to investors over a 10-year period) clearly demonstrated hallmarks that any organization can follow.

What one learns about strategy from Joyce, et al (2003), is how market competition is shaping up for the future. Innovation is a practice that requires a constant research effort on customer knowledge, market analysis, pricing, the competition, and much more. The authors also reveal their assumptions of how strategy is developed in the organization. Strategy is, they argue, emergent. Henry Mintzberg (1994) would agree that strategies emerge but when looking at results Mintzberg argues that strategies are realized. Joyce, et al (2003) persuade us that there is a synthesis between the vision prescribed by the corporation’s executives and those actions, investment decisions, and
prioritizations that bubble up from the bottom of the organization from among middle managers, engineers, the sales force, and financial staff. Mintzberg (1994) informs us that realized strategies are the result of patterns of decisions over time.

What is important is there is no choice about the primary management practices; however, there is a decision to be made in choosing to pursue innovation as a secondary management practice.

Vision drives the process of deciding to pursue innovation. Vision is the result of competent strategic analysis (a process). Vision results from an examination of the environment (the context) in which an organization exists. A true vision reflects the direction that is desirable and possible. Choosing to be an innovative organization is a risky decision – it has to be possible.

7. Aligning the Primary and Secondary Management Practices
A continual program to deepen the capability to perform both the primary and secondary management processes is essential. Accomplished athletes make competing look easy, but their skill is not just the result of being born with certain attributes. Their skill comes from practice and discipline over time. Athletic superior performance is the result of a balance of the physical, mental and emotional system. Organizations are systems and the parts of the systems interact. In organizations the alignment of the primary and secondary management practices requires a systems approach. None of the practices are stand-alone. The practices must be aligned and accomplished at the same time.

8. The Practice of Innovation
To be successful at innovation an organization must have a “well developed model of what innovation looks like as an organizational capability” (Hamel, 2003). According to Hamel, few senior managers can describe their corporate innovation system. In fact, few companies practice innovation. A review of the literature supports this view. The same companies, Dell, Starbucks, Wal-Mart and Google are examples that are cited as being innovative by multiple authors in multiple articles.

To develop an organizational capability in innovation requires a strategic decision. One must remember at this point innovation is one way an organization will create competitive advantage (value for which a customer will pay). For a strategic decision to be implemented requires a significant investment for which there must be a significant return. Investment in creating innovation capability is about making a trade-off regarding how a company will compete. A company must evaluate trade-offs to determine the greatest return on investment.

(Joyce, et al, 2003) advise that it is not important what technique is used to perform the primary or secondary practices. For example, Sawhney, Wolcott and Arroniz (2006) describe 12 dimensions of the business system in which an organization can look for opportunities to innovate. They identify four key dimensions as anchors: offerings (what), customers served (who), processes employed (how) and points of presence it uses to take its offerings to market (where). Hax and Wilde (1999) developed the Delta
model. According to Hax and Wilde, the Delta model defines strategic positions that reflect fundamentally new sources of profitability, aligns the strategic positions with a firm's activities, introduces adaptive processes and shows granular metrics that are drivers of performance. What is important is that an organization excels at the technique chosen. Jim Collins reported in *Good to Great* (2001) that what existed in companies that went from good to great was a down-to-earth, pragmatic, commitment to *excellence of process* - a framework - that kept the company, its leaders and its people on track for the long haul.

9. Investing in Innovation: Making the Right Strategic Decision and Developing the Right Innovative Capabilities

Investing in innovation is a strategic decision. Determining what innovative capabilities a particular company needs is the result of analysis of the company and its environment. Selecting the capabilities to be developed is a strategic decision. Innovation is a management practice requiring company specific knowledge, skills and resources. Innovation is hard, real work that can and should be managed like any other practice.

Two businesses that deal in the same goods and services, in the same territory and with the same clientele, cannot coexist equally (Henderson 1989). Every business is different - a business exists in a unique context. As context changes – internal and external – companies must adapt. They must adapt by changing the *content* of innovation. For example, content may shift from product innovation to process innovation. However, the process of innovation (identifying opportunities and applying these ideas to the creation of customer value) is a constant.

10. Innovation and Entrepreneurship

Entrepreneurship is not innovation and innovation is not entrepreneurship. Entrepreneurship is about creating wealth. Corporate Entrepreneurship is the discovery and pursuit of new opportunities through innovation and venturing (Hayton, James C., Donna J. Kelley (2006). Innovation is about creating customer value. Each requires a different set of knowledge, skills and resources. Entrepreneurship is not a small or large business activity nor is innovation. Companies of all sizes practice entrepreneurship and innovation. To implement either, companies use a variety of management tools. For example, scanning for opportunities in entrepreneurship and brainstorming in innovation. Both entrepreneurship and innovation to be successful require an investment in the development of capabilities to use specific management tools.

What is important, an organization must choose to develop the capabilities that best reflect those required by the context in which it operates. And, an organization must define what the terms innovation and entrepreneurship mean in its particular context. The terms entrepreneurship and innovation when not defined in context can negatively influence other practices such as strategy. How innovation and entrepreneurship are defined can have a major impact on the culture of an organization. It is important to remember a previous point about innovation. Stability is the enemy of innovation. The same can be said about stability and entrepreneurship.
11. Academic Impact
Examining the extent literature reveals two serious questions about management and the practice of innovation. One: Do managers have a clear well-developed model of what innovation and two: Do managers have the requisite skills to manage innovation? Innovation is a management practice and recent literature (Pfeffer and Fong, 2002, Mintzberg, 2004), indicates that there is little evidence that business school research is influential on the practice of management. Management and managerial skill is considered a core competence for sustainable superior performance. For those responsible for research and curricula must examine and evaluate programs to insure they prepare students to manage in organizations that choose to pursue innovation.

12. In Conclusion
Even though there is a constant theme in the business press and respected business publications for companies to be innovative, it is not necessary for an organization to be innovative to be highly successful. In fact it is problematic that few companies are capable of excelling at innovation – it is a very difficult management practice. Management practice has content, context and process. It is contextual simply because what works in one situation (context) can easily fail in another.

There is not a shortage of creative people in most modern business organizations. The problem is the shortage of management skills necessary to follow-through. Companies must invest in the development of management skills to take ideas through to value creation. It is important that a company, first decide where it exists within the Innovation System and how it creates value within the system.

There is no choice about primary management practices; however, there is a decision to be made in choosing to pursue innovation as a secondary management practice. Vision drives the process of deciding to pursue innovation. Innovation is a capability and a company that pursues innovation must have a continual program to deepen the capability to perform both the primary and secondary management practices. To be successful at innovation an organization must have a “well developed model of what innovation looks like as an organizational capability”. Investing in innovation is a strategic decision.

Every business is different - a business exists in a unique context. Context in a dynamic world is constantly changing. Context changes the requirement for content and process must continually be improved. Because of commoditization and global competition, many companies believe innovation is critical to their future success. These companies must determine what exactly is innovation. Although the subject may be at the top of the agenda, many companies have a mistakenly narrow view of it. Many see innovation as synonymous with new product development or traditional research and development. Companies that do not see that innovation is a capability that must be developed and being innovative as a strategic decision that includes trade-offs do so at their peril.
References


Hamel, Gary (2003), Innovation as a Deep Capability, Leader to Leader, No. 27 Winter


Levit, Theodore (2002), Creativity is Not Enough, Harvard Business Review, August


Mohanbir Sawhney, Robert C. Wolcott and Inigo Arroniz (2006), The 12 Different Ways for Companies to Innovate Sloan management Review No. 3, pp. 75-81

Pfeffer, Jeffery, Christina T. Fong (2002) The End of Business Schools? Less Success Than Meets the Eye, Academy of Management Learning & Education, Volum1, Number 1