

# TEN TOOLS FOR INNOVATION

By Gerald Nanninga

Excerpts on Innovation from the blog

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# Innovation Tool #1: Pick Your Nodes

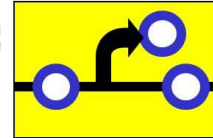
## **THE STORY**

Back when I was getting my MBA, one time, for no apparent reason, in the middle of a class, a fellow student blurted out the following:

“There are two kinds of people in the world: creative people and those who exploit creative people for profit. I plan on being one of the second kind.”

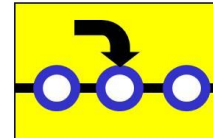
- **Taking Away a Node:**

- **Disintermediation**



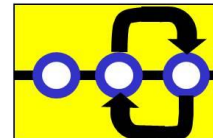
- **Adding a Node:**

- **Reintermediation**



- **Rearranging Nodes:**

- **Transposition**



At first, I thought this guy was a little bit odd for blurting that out in the middle of class. But then I started thinking...I consider myself to be somewhat creative. Hey, this guy just blurted out that he wants to exploit me!

## **THE ANALOGY**

A lot of wealth can be created by exploiting the innovation that comes from creativity. It's easy to understand why someone would want to be on the receiving end of that wealth. The problem is that there first needs to be some sort of innovation to exploit.

Although there is no sure-fire tool to instantly create innovation, there are some ways you can direct your thinking to help find innovative solutions. There is not enough room in this blog to discuss them all. Therefore, for the rest of this week, we will be looking at these ways of thinking one at a time.

The way I came up with these thinking processes was by examining all of the major innovations over the last couple of decades and then looking for common threads. I looked at everything from bottled water to ipods. I found about a half-dozen common threads. In today's blog, we will be looking at nodes.

## **THE PRINCIPLE**

In every business system, there are various steps which get accomplished in order for a product or service to get from the original source to the final consumer. Each of these steps can be thought of as a “node” along a string. For example, in one type of business model, someone extracts raw materials which are then sent to a manufacturer who turns them into a product, which is then shipped to a warehouse, which sends the products to a store, that sells the product to the final consumer. In this example, each of these steps is a node (the extractor, the manufacturer, the wholesaler, the retailer, the consumer).

Most of the time, we tend to take these nodes for granted and assume that this is the natural order of things. In reality, there is nothing “natural” about this. It is just how a process evolved over time. It could have evolved differently. And more importantly, you can often change the process for your benefit.

So, thinking process #1 for innovation is thinking about ways to re-arrange the nodes. This can take three forms:

- 1) Taking away nodes
- 2) Adding nodes
- 3) Changing the order of nodes

We will look at each of these separately.

### **1) Taking Away Nodes**

Another term for taking away nodes is the idea of being a disintermediary. In other words, in the current business model, there is a function of an intermediary who connects two nodes in the model together. Innovation would be finding a way to bring those two nodes together without the need for a third party in the middle.

The internet has provided a great many opportunities to eliminate a number of these intermediaries. For example, sites like Expedia and Travelocity have brought vacation providers and vacationers together directly without the need for a travel agent. The travel agent node is eliminated, as well as the cost of that node. The providers and the vacationers split the savings, making both better off.

A similar situation occurred with the elimination of the traditional stock broker node by trading on-line with companies like Etrade. Firms like Geico eliminated the traditional insurance agent node. Michael Dell eliminated the retail node in the selling of computers. Ashley furniture stores went direct to low cost countries to purchase their furniture, thereby eliminating the branded manufacturer and the independent importer nodes, giving them a cost advantage in the marketplace. TurboTax allows tax preparers direct access to knowledge without the need for the independent tax preparer node.

A U-Pick-It farm eliminates the node of hiring produce pickers and lets the consumer pick the produce directly off the plants. The farm in this example also eliminates the trucker node which gets the food to market, the grocery wholesaler node and the grocery retailer node.

Rock bands have found ways via the internet to create a following for their music and a way to distribute it without the need for the traditional recording label node (eliminating the need for the label's manufacturing node, distribution node, and publicity node). The band may not sell as many CDs as a label could, but instead of only getting a dollar or two per CD, the band can get \$5 or \$6 per CD and still sell the CD for less than what a traditional label charges. Hence, they may end up with more money, because they don't have to share the proceeds with the label.

Therefore, when trying to think of creative innovations to exploit, think about ways to eliminate a node.

## **2) Adding a Node**

Just as taking away a node can revolutionize an industry, one can revolutionize an industry by adding a node that did not exist before. This is the process of adding an intermediary.

Buying cooperatives would be an example of adding a node. The idea is that instead of each buyer trying to negotiate separately with their vendors, a buying cooperative node would be added, which aggregates the needs of many buyers and negotiates a better deal with the vendors than the buyers could make on their own. The Worldwide Retail Exchange is one such cooperative, designed to help retailers purchase business supplies and technology less expensively.

EBAY is another example of the power in adding a node. Before Ebay, it was very difficult for sellers of unique items to find the people who wanted to buy these items. By adding the Ebay aggregation node, buyers and sellers find each other more efficiently. It is worth paying Ebay a cut of the proceeds, because the added efficiency is worth more than the fee. An now a second node is being added, the independent firms that help a person sell an item on Ebay and help package it to ship to the buyer, firms like Quick Drop or eAuction Depot.

Another example of adding a node is the ticket scalper. Rather than go directly to the ticket office to get a ticket, you go to the scalper. You may end up paying more, but the scalper does all the hard work of securing the ticket, something you may not be able to do.

Dating services like eharmony or match.com are additional nodes providing a service which makes finding your mate more efficient.

People talk about the “long tail” phenomenon, where media growth will occur in the fringes rather than in mainstream titles for the masses. The problem is in finding which part of the log tale of niche genres are right for you. This is an opportunity for adding a node that helps you more efficiently search the long tale to find the music and movies that fit your particular tastes.

So innovation can also occur by adding nodes to a business system.

### **3) Rearranging the order of Nodes**

A third way to innovate with nodes is to rearrange the order in which the nodes occur. For example, traditionally, consumers have been brought in at the tale end of the process. Recently, however, consumers are starting to get influence into the process earlier than before. In other words, the consumer node is getting pushed further back into the system. Examples include sites that give consumers more input into the design of a product. For example, M&Ms has a site where you can design the words that are placed on the candies. Various news sources let the consumer in on helping to decide which news is presented. Sometimes, like with YouTube, the consumers produce the products themselves.

Rather than warehouse a lot of inventory, the manufacturing of a product can now be moved to a point after which it has been sold. Thanks to digital technology, there are services that will print a book on site or download content on site to a disk or other device after it has been purchased. Dell would sell a computer before it was manufactured.

There are companies that will sell consumers long-term multi-year contracts on natural gas for their homes, placing the purchasing contract for utilities well before the use of the utility.

## ***SUMMARY***

Don’t assume that just because something has always been done in a particular way, in a particular order with particular types of people, that it must always be done that way. Sometimes, a process can be made more efficient if you take away current nodes, or add additional nodes, or rearrange the order in which the nodes occur.

Sometimes, the most revolutionary innovations are not about creating an entirely new business system. Instead it is just tweaking the nodes in a current system to make it more efficient. And in the end, you get to pocket some of the efficiency savings.

## ***FINAL THOUGHTS***

If only I could figure out a way to eliminate the tax node...

# Innovation Tool #2: Bundles of Joy

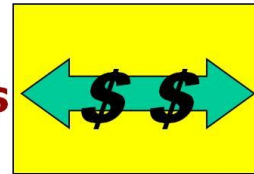
## **THE STORY**

At the end of the TV show *The Price is Right*, two contestants get to guess the price on what is called a “showcase.” The showcase is a large bundle of products which are described very quickly by the announcer and shown in rapid succession, one at a time (with a pretty woman in front to distract your attention).

- **Bundling**

- **Complete Solutions**

- **Cross Subsidies**



- **Unbundling**

- **Eliminate Subsidies**



Often times, when you look into the eyes of the contestant, they appear to have absolutely no clue as to what the bundle of items is worth. It was too many items shown too quickly. Later, when you hear their bid and then find out what the actual retail price is, you find out that your suspicions were true. They really did have no idea of what the entire bundle of items cost.

## **THE ANALOGY**

When a number of products are bundled together, it is often more difficult to decipher the true value of the entire package. It is difficult on *The Price is Right* and difficult in real life.

We are currently doing a series of blogs on ways to focus your thinking to create innovative new business ideas. One way to discover new ideas is to look at the concept of bundling. By changing the way products and services are bundled, you can create new and different business opportunities.

## **THE PRINCIPLE**

Often times, one can create new business opportunities without creating new products or services. Instead, all one needs to do is rearrange how everything is bundled together. Creativity in bundling can come in three forms:

- 1) Bundling things that were previously sold separately
- 2) Separating things that were previously sold together
- 3) Changing the Cross-Subsidies in the Bundle

We will look at each of these separately.

### **1) Bundling things that were previously sold separately**

The best examples for bundling things that were previously sold separately are in the fast food industry. The first step in bundling was the voluntary bundle, where the cashier would try to get the customer to create their own bundle. It used the five powerful words that have created a fortune in added revenue: “You want fries with that?” It takes quite a pile of burgers to create the same amount of profit as found in a single order of fries. By bundling fries with a burger, the profitability of the entire transaction goes up significantly.

Not content with voluntary bundling, the industry created “combo meals” where the burger, fries and drink (another big profit-maker) were pre-packaged together at a “value” price. Sure, the combo meal was a better value than buying the items separately, but it caused people to still buy more than they otherwise would have, and caused them to skew their purchase more towards the items with the highest profit margins. So the customer gets a better price and the restaurant gets a better profit. It’s a win-win situation. Are you missing out on the “combo meal” equivalent in your industry?

Combos work on larger-priced items as well. You can sell a computer for virtually free if you can attach enough profit-makers to the bundle: items like cables, printers & ink, software, extended warranties, services to transfer your old files to the new computer, etc.

There is a trend to bundle luxury housing with exclusive high-end golf courses. Buy a house and get access to the golf course as part of the bundle.

Supercenters bundle food shopping with general merchandise shopping. Buy a music CD and get a video of the band bundled with it. Not only is this added value to the consumer, it helps cut down on some of the piracy of music since the video can be more difficult to stream. There are companies that are bundling all the services associated with getting married (like banquet halls, clothing, photographer, invitations, etc.) and bundling it all together. And on and on the list goes.



## **2) Separating things that were previously sold together**

Lately, a more dramatic trend has been to do the opposite—break apart things that were previously sold together in a bundle and sell them separately. Typically, a bundle has a mixture of goods and services with different levels of profitability. The high profit items tend to subsidize the low profit items. However, what if you were able to sell just the most profitable item without the subsidies? That could become quite profitable.

The most profitable part of a newspaper is the classified section. It provides most of a newspaper's profits. The gathering and reporting of news is a money loser. What if you could unbundle the sections of a newspaper and just sell the profitable parts? People are doing that. Monster.com just does the profitable want ads section of the newspaper. There are also a large number of dotcoms that provide just the automobile section of the classifieds. Even if these services do not have as large a volume of business as the newspaper, they can do well, because they do not have to subsidize the unprofitable aspects of news gathering.

Many of the functions provided by a bank are unprofitable. One of the most profitable services provided by a bank is giving loans. What if you could unbundle a bank and just do the loans without having to provide those unprofitable services? Thus spring up businesses like E-loan.

In order to save money on benefits, many employers are unbundling their benefit packages, allowing the employee to pick and choose which benefits they want. This way, the employer doesn't have to pay for benefits that the employee does not want.

Selling movie theater popcorn is more profitable than selling movie theater tickets. What if you could find a way to sell movie theater popcorn to people watching movies on their home theater systems? Some high end home theater system retailers also sell institutional popcorn poppers just like the ones in the theater.

Let's go back to the fast food example. If french fries are so much more profitable than burgers, then why not stop selling burgers and only sell fries? I have seen restaurants in mall food courts that have done this very thing, selling only french fries.

## **3) Changing the Cross-Subsidies in the Bundle**

Often times a bundle will consist of a situation where you pay a full price for something and something else gets thrown into the bundle for free or at a large discount. What if you were to switch around the subsidy? For example, in computer printers, the general policy has been to sell the printer very cheaply, but force high prices on the ink. Kodak is introducing a business model which works in the other direction. You will pay a higher price for the printer, but the ink will be sold cheaply. Kodak hopes to capture the people who are fed up with paying too much for ink.

In the cellular world, some companies try to bribe you into subscribing to their service by subsidizing the price of the phone. Other companies get exclusive rights to sell really

cool phones which people are willing to pay “full price” for and the phone service is just thrown into the bundle. There are many other creative ways cell phones are being bundled with a wide variety of services, as well as a wide variety of ways to pay for them.

Once you open your mind to the possibility that other pricing models are possible, one can come up with all sorts of creative solutions.

## ***SUMMARY***

Just because products and services are sold in one fashion does not mean that it is the only way to sell them. Sometimes you can open up new pockets of profits by just rearranging the bundling. You can bundle things that were previously unbundled. You can unbundle things that were previously bundled. You can change the way the bundles are priced or paid for by rearranging the cross-subsidies.

As mentioned in yesterday’s blog, sometimes the most revolutionary innovations are not about creating a entirely new product. Instead it may just be about tweaking the bundling of the same old products and services in the industry.

## ***FINAL THOUGHTS***

If only I could figure out a way to sell just the extended warranty without having to sell the product.... Hey, wait a minute. When I bought my house, I was getting letters from independent companies wanting to insure my mortgage in case I lost my job and was unable to work. Maybe this extended warranty store could work after all.

# Innovation Tool #3:

## Access Denied

### ***THE STORY***

When I was in High School, I wanted to join the GAA (Girls' Athletic Association). I read the by-laws of the club and it said that the GAA was for girls. Well, as it turns out, I'm for girls too, so a few of us guys got together to figure out how to join the GAA.

The problem was that in order to join the GAA you had to have participated in girls' athletics (I guess that's how it got its name). So a girl we knew got us the paperwork so our group of guys could form a team in the girls' field hockey program. Things were working fine until the girls' gym teachers figured out that we were boys. Then the plan started to fall apart.



We were sent to the principle's office. The principle was actually very nice about it. He said that if we really wanted to play field hockey that badly, he would see what he could do about setting up a boys' field hockey program. But the principle missed the point. The only reason why we wanted to play field hockey was so that we could get access to the GAA.

Needless to say, we never were able to join the GAA.

### ***THE ANALOGY***

One of the main reasons why I wanted to join the GAA was because access was denied to me. The more exclusive the membership, the more I wanted to join. Business models can work this way as well. Depending on how one sets up access into the business model, one will get different results. I was trying to redefine how access was granted into the GAA. You can try to redefine access in your industry.

We are in the middle of a series of blogs on how to think about ways to create new business innovations. One of the ways to innovate is by changing the way access is defined in an industry. By changing the access rules, you can also often end up rewriting the rules for how the profits are divvied up—presumably in your favor.

## ***THE PRINCIPLE***

There are three ways in which one can alter the rules of access:

- 1) Open Vs. Closed Platforms
- 2) Limited Vs. Unlimited Supply
- 3) Democratic (customer determined) Vs. Hierarchical (seller determined) Inclusion

We will now look at each of these individually.

### **1) Open Vs. Closed Platforms**

These days, technology is often an integral component in a business model. The technology platform for the business model can be defined in two ways, either open or closed. In a closed system, one company tends to own the proprietary technology and they do not share it. This denial of access creates profits when the technology becomes popular and you are the only one that can supply it. By not sharing it, the company will create a monopoly and reap all of the benefits of any success.

This has been the primary strategy of Sony for years. In the video tape wars, they built a monopoly around the beta format and lost. They built a monopoly around playstation technology and won. They are now trying to create a semi-monopoly with Pioneer around blu-ray DVDs. Apple has had only limited success with a similar strategy for its computers, but great success using this strategy for ipod. This monopolistic closed access strategy is higher risk, but it is also higher reward.

Sometimes an open system has greater success. By sharing access to a technology, one can get more companies onto that technology bandwagon. The more firms behind a product technology, the more likely it will create enough critical mass to get customers to prefer it. After all, people want to be associated with winners, and if that many firms are supporting the technology, it must be the winner technology that is going to survive. That is how VHS won over Beta in video tape.

Usually, there is room for both open and closed systems: Microsoft Windows (closed) vs. Linux (open); Playstation (closed) vs. PC games (open). The key tends to be how many profit streams are produced by the technology. The more there are, the better it is to be open. The fewer there are, the better it is to be closed.

### **2) Limited Vs. Unlimited Supply**

Sometimes access can be controlled by how much of a resource you are willing to supply. An offering supply can be limited by a number of factors: the number produced (limited amount versus unlimited amount), the amount of time allowed (limited time to purchase versus always available), and the amount of variety offered (limited variety versus carrying it all). One can be successful at either end of these spectrums.

Take, for example television home shopping channels. Usually the variety is limited to one item at a time, the quantity is limited to only a small number available, and there is a small limited time in which to call in and order the product. All of these limits create excitement. They also cause one to act quickly to purchase before the quantities and the time run out (and before you realize how foolish some of the purchases are).

On the other hand, supercenters carry just about everything, they are open 24 hours a day, and they try to always have items in stock all the time. This creates the assurance that if you shop there, you will be able to find what you need and not have wasted a trip. Limited assortment stores, like Aldi and Save-A-Lot, provide access to fewer items and are open fewer hours, but this allows them to charge lower prices. As Bill Moran, the founder of Save-A-Lot explained it to me, it's amazing how much more profitable you can be if you can convince the customer to accept access to a more limited selection, allowing you to sell only the profitable items.

Limited availability can create a greater cache around a brand. High fashion items often lose their appeal once they become too available to the masses. On the other hand, the more access, the more opportunities to sell. Coke talks about their WAR strategy...the goal of no matter where you are, there is an opportunity to purchase Coke Within Arm's Reach.

Fast Fashion retailers like Zara and H&M cycle through their clothing styles so quickly that they sell out the limited quantities a full price, before there is a need for heavy markdowns and clearances. Yet others find success sticking to one product and pushing it year after year, like WD-40.

### **3) Democratic (customer determined) Vs. Hierarchical (seller determined) Inclusion**

Sometimes access is determined by the customer and sometimes it is determined by the seller. Take, for instance, restaurants. McDonald's has a very democratic, customer-driven approach to access. Anyone who wants to come in is allowed to come in and they are served in the order in which they arrive. Contrast this with a snooty trendy restaurant, where only people on the "A" list determined by management are allowed to make reservations. If someone higher up on the list wants to get in, the owner may cancel the reservation of someone else, allowing the more prestigious guest preferential treatment. "Commoners" have no access and are kept out by a bouncer. This would be a seller-determined access, using a hierarchy to make access different depending on the customer's status.

The same thing can occur with airlines. Some airlines treat everyone the same and it is first come, first served. Others have complex frequent flyer memberships with various levels of platinum, gold and silver, and different preferential access based on the type of membership.

In many industries, about 80% of the profits come from about 20% of the customers, and about 50% of the customers are unprofitable to serve. This is especially true in high service businesses, like banking. Some banks are acting on this knowledge by trying to discourage low profit customers from banking with them by giving them less access to banking services (and giving more service access to the profitable customers). This is called an “intelligent loss of business,” discouraging access to customers that are unprofitable to serve (or limiting your offering to them so that they become less unprofitable).

In an unusual reverse twist, Progressive Insurance uses increased access to get rid of potentially unprofitable customers. Progressive believes that their insurance quotes are as low as one can be and still be profitable. If another insurance company can offer a lower rate, Progressive believes the other firm is taking on an unprofitable customer. By offering people access not only their own quotes, but access to competitive quotes, Progressive is encouraging the loading up of unprofitable customers onto their competition.

## ***SUMMARY***

Although we were able to just scratch the surface, one can see that there are a variety of ways in which one can alter the access to goods and services in a business model. There is no single best approach. People can make a profit rearranging the access elements in a variety of ways. If you feel that the marketplace is stacked against you under the current rules of access, perhaps you can create a greater piece of the action by operating under a different set of access rules.

Again, as mentioned in the last two blogs, sometimes the most revolutionary innovations are not about creating an entirely new product. Instead it may just be about tweaking the rules of access in an industry.

## ***FINAL THOUGHTS***

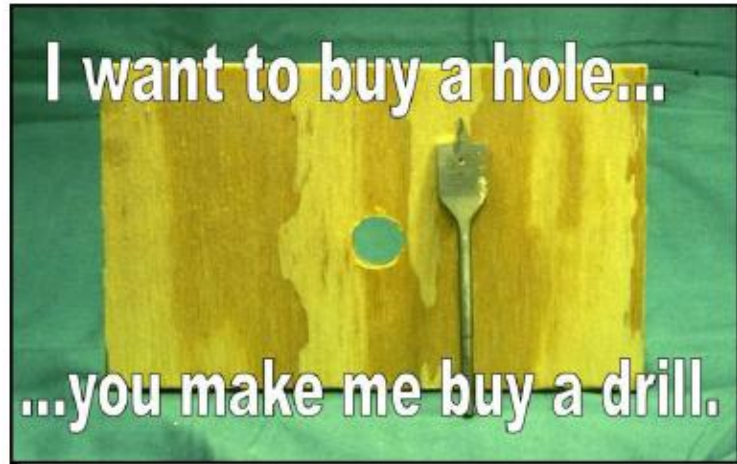
Managing access is vastly different from discriminating against people based on race, ethnicity or religion. This is not about hatred and bigotry. This is about choosing a market to serve and developing the access rules which best serve that market.

# Innovation Tool #4:

## The Solution is in the Solution

### **THE STORY**

There's an old Warner Brothers animated cartoon about someone who was selling holes. He had a suitcase full of them. He would open up his suitcase, pull out a black circle, put it on the ground, and it would instantly be a hole. You could even put it on a wall and have an instant hole in the wall.



What a wonderful invention. No need to dig, drill, or chop if you wanted a hole. Just buy one already made! If you didn't like where the hole was, you could just pick up that little black circle and put it somewhere else. If you wanted a larger hole, all you had to do was stretch the circle before you put it on the ground. It was the perfect solution.

### **THE ANALOGY**

In the cartoon, getting a hole was easy. All you had to do was buy one from the man with the suitcase full of holes. Unfortunately, in real life you can't just go out and purchase a hole. If you want a hole, you have to buy a tool to make the hole, such as a shovel, drill, or pick axe. If I want a two-inch hole, I would purchase a two-inch drill bit. I don't purchase the drill bit because I love the looks of the drill bit or admire the fine craftsmanship of the metal. I buy it because I want the hole it can make.

The point here is that consumers do not purchase products. Instead, they are purchasing the solutions that the product provides. I want a hole. This is the problem I am trying to solve. If I could buy one already made, like in the cartoon, I would. Since I can't, I do the next best thing. I purchase the solution indirectly, by getting a drill bit. If I could find a different product that could make the hole faster, better, and less expensively, I'd buy it rather than the drill bit. Hence, it is not the drill bit I want, but the solution it provides. If I find a better solution, I will buy it instead.

We are in the middle of a series of blogs on how to think about ways to create new business innovations. One of the ways to innovate is by changing the way a consumer looks at solving problems. By creating and then getting people to accept a superior solution, you can be very successful.

## ***THE PRINCIPLE***

There are two ways in which one can provide a solution that alters the way people solve their problems:

- 1) Find a new source for solving an old problem
- 2) Find a different problem for an old product to solve.

We will now look at each of these individually.

### **1) Find a new source for solving an old problem**

Sometimes, I've run into people who feel that innovation needs to come up with a new solution for a new problem. After all, all the old problems already have solutions. Therefore new solutions need to tackle new problems. The problem is that there really aren't that many new problems out there. Most everything is just a variation on a few key needs:

- a) To have your basic needs met (food, clothing, shelter)
- b) To feel loved, accepted, admired or appreciated
- c) To be amused, entertained, pampered
- d) To get the daily chores of life done efficiently, effortlessly, quickly and cheaply
- e) To feel empowered, powerful, self-sufficient, needed, having a purpose in life
- f) To eliminate barriers keeping you from living life to the fullest
- g) and so on...

Therefore, instead of trying to find a new problem to solve, take an old problem that has already proven to create a large demand for a solution and just create a better solution than the one in place today.

When I say create a new solution for an old problem, I'm not saying to take the old solution and improve it. For example, taking a detergent and just making it a little stronger or a little cheaper or a little more concentrated is not the same as creating a new solution for the problem of cleaning. That's just a better version of the old solution.

Allow me to illustrate. For years Proctor & Gamble has relied on better chemistry to create better ways to clean. Through chemistry, they could make their detergents stronger, more concentrated, and so on. But in the end, it was still basically the same solution to cleaning. Then, someone at P&G got the brilliant idea that perhaps there were ways to solve the problem of trying to make things clean that did not rely on chemistry. What if, instead of relying on chemistry, we tried to solve problems with physics?



Once P&G started looking at physics for a cleaning solution, they started coming up with brand new solutions to that age-old problem. There's the Mr. Clean Magic Eraser, the Mr. Clean Magic Reach, and the Swiffer pad. These are brand new categories for solving an age-old problem, because they looked in a new direction for the solution.

Another example would be Bausch & Lomb. They used to see themselves as in the lens business and spent their time trying to improve upon the design and manufacturing of lenses. Then, they realized that they were really in the vision correction business. The problem of improving vision can be solved in more ways than just with lenses. Therefore, Bausch & Lomb started looking for new solutions to their old problem that did not rely solely on lenses.

As a result, Bausch & Lomb came up with over-the-counter drops to put in the eye to improve vision, vitamin and mineral supplements that improve vision, prescription drugs to improve vision, medical devices and implants used in eye surgery, and a host of other things.

Recently, L'Oreal has teamed up with Coke to create a beauty beverage. The idea is that, instead of applying something to the outside of the body to make it more beautiful, why not work on the inside body chemistry to create a more beautiful complexion? The age-old problem was being attacked with an altogether different solution. In 2008 you will see these beverages sold in department stores at the beauty counter.

## **2) Find a different problem for an old product to solve**

Sometimes innovation doesn't require inventing anything new, per se. Instead, the innovation comes from finding a new solution for something that already exists. Arm & Hammer has made a fortune off continually finding new uses for plain old baking soda. People selling products with oats in them (Cheerios and Quaker Oats) now claim that their products solve another problem—fighting high cholesterol. Cheerios also claims to be a perfect starter solid food for your baby.

Back in the 1980s, when computers first started being pushed into the home market, they sold very poorly. The reason was that the problems they were claiming to solve did not seem too compelling. Salespeople would say that the computer could help you balance your checkbook, or store your recipes, or type letters. For the high price of a computer, the market did not see much of an advantage or value over current solutions for balancing the checkbook, storing recipes, or writing letters. But then a new solution appeared. The computer could help you send emails and search the internet. Now that was a solution worth buying a computer to solve. Sales suddenly started to skyrocket.

Avon has had great success selling its Skin So Soft moisturizer, once people discovered that it had a second solution as an excellent bug repellent. Pharmaceutical companies often discover that their prescription drugs can solve problems that they were not originally designed to solve, opening up new profit streams.

Mr. Carrier had a printing press that had trouble operating when the humidity got too high, so he invented a device to condition the air by taking out the moisture. He called it an air conditioner. As an interesting by-product, he noticed that it also made the press room cooler. The secondary solution of cooling air was more popular than the original solution of dehumidifying.

## ***SUMMARY***

Innovation does not necessarily require finding new products to solve new problems. Sometimes, it is about finding new solutions for old products to solve. Other times it is about finding new ways to solve old problems that have been around a long time. Sometimes, it just takes looking at a problem from a different perspective or a little tweaking of what you already have or know to create something entirely revolutionary.

## ***FINAL THOUGHTS***

Sometimes, just trying to make a current solution better can backfire. Automobile tire manufacturers found a way to virtually double the life of its tires. As a result, they ended up selling about half as many tires, which put the entire industry into a tailspin. Companies like BF Goodrich found the need to diversify by finding new solutions for the chemistry knowledge used to make tires.

# Innovation Tool #5: **Opposites Attract \$**

## **THE STORY**

There's an old trick using a 3x5 card. On one side of the card you write: "What it says on the opposite side of this card is true." On the opposite side of the card, you write, "What is says on the opposite side of this card is false." Then you give the card to a friend and ask them what the truth is.

So the friend looks at the side of the card that says "What is says on the opposite side of this card is true." Keeping that in mind, the friend flips over the card and reads, "What it says on the opposite side of this card is false." So now, you friend thinks...well, the first side said that the second side is true, so this second side must be a true statement.

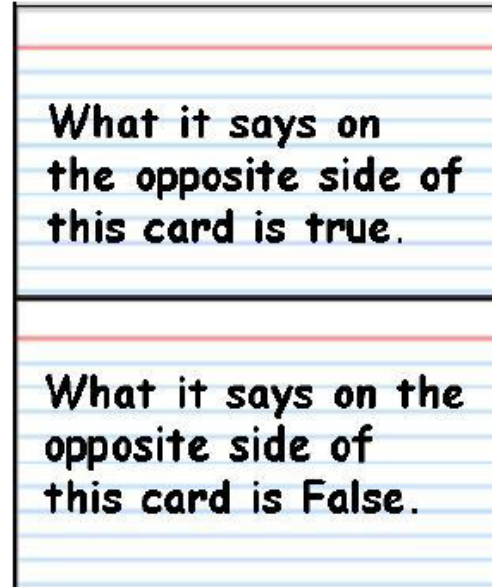
But then again, if the second side is true, then it is saying that the first side of the card is a lie. If the first side of the card is a lie, then it is no longer saying that the opposite side of the card is true, but actually that the statement on the second side is false.

But then, if the statement on the second side is false, then the second side is no longer saying that the first side is false, but rather that it is true. So that would mean that the first side really is saying what is on the second side is true after all.

But then again...

## **THE ANALOGY**

The card game mentioned above is frustrating, because it forces a person to have to deal with having opposite points of view both simultaneously being true. We are far more comfortable with the notion that if one statement is true, then the opposite statement is false. The card game does not provide that option.



In reality, business can be more like that card game than we would like. Often times, opposites in business can both be true. For example, it can be true that centralizing one's business can lead to more success, and it can also be true that decentralizing a business can lead to greater success.

We are in the middle of a series of blogs on how to think about ways to create new business innovations. One of the ways to innovate is by looking for a “truth” that is opposite to conventional wisdom. By looking in the opposite direction of conventional wisdom, one can often find another type of success. In his autobiography, Sam Walton referred to this as “swimming upstream.” By going the opposite direction as the crowd, one can often do quite well, as Sam Walton did.

## ***THE PRINCIPLE***

The principle here is innovation through doing the opposite of the norm. This principle works because not everyone in society wants the same thing. Some people want the opposite of what others want.

Robyn Waters talks about something similar to this in a book called “The Hummer and the Mini: Navigating the Contradictions of the New Trend Landscape.” In this book, Robyn claims that “it is hip to contradict” because “consumers pursue opposites simultaneously.” The prime example is in the title of the book where two of the fastest growing car segments are on the extremes of size—the huge Hummer and the tiny Cooper Mini.

This not only applies to products, but also business models. Sometimes, people have become so accustomed to what's normal that they haven't thought of the benefits which could come by doing things completely different. We are going to look at several types of opposite pairings to illustrate how swimming upstream can lead to profitable innovation. There is a host of others we could have tackled, but there is only so much space in a blog. The pairings we will look at are:

- 1) Pay For Vs. Free
- 2) Cherished Vs. Disposable
- 3) Government Sector Vs. Private Sector
- 4) Own Vs. Rent

### **1) Pay For Vs. Free**

There are certain things for which we have been conditioned through habit to assume as free (or virtually free). Take water, for example. A decade ago or so, most people saw water as a “free” commodity and would think it silly to pay for water. Now, the market for bottled water in the US is well over \$15 billion, and in terms of volume, the US is only about one-sixth of the global market.

It also works the other way. People used to expect to pay money for information and various forms of entertainment, such as magazines. Now, thanks to the internet, people expect to get information and entertainment for free. Payment has been substituted with an advertising sponsored approach. Now people are talking about advertising sponsored approaches to make cell phone usage virtually free.

If your business is perceived as costly, can you devise a way to create a subsidized model where someone other than the customer pays for the product (such as advertising). Or, if people expect to pay very little for what you have to offer, can you find a way to change their perceptions so that they will pay much more for it?

## **2) Cherished Vs. Disposable**

Some products are made durable, with loads of features and quality. They are meant to be prized possessions. Think of some of the high end cell phones costing close to \$1000, with tons of features. At the same time, there are people who sell disposable cell phones, which cost far less and are thrown away when the minutes are used up.

The same thing occurred in cameras. There are high-end cameras loaded with qualities and features. There is also a huge market for cheap, disposable cameras. Both are in demand.

I even read one time about a company in the paper business who was marketing disposable wedding gowns, made out of a high grade of paper. The logic was that you only wear it once, so why put a lot of money into it? If you can sell disposable wedding gowns, then you can make just about anything disposable to at least some segment of the population.

It can also work the other way. Most pens have traditionally been rather inexpensive. In fact, pens are a very popular item to give away for free as a promotional item. When finished with them, they are thrown away. Lately, there has been growth in the high end luxury writing instrument market, where pens are designed to be cherished for a long time.

## **3) Government Sector Vs. Private Sector**

It used to be that certain parts of the economy were considered to be in the private sector and other items were considered to be in the public sector. In recent years, the lines are blurring more. Interstate highway toll roads are now being run by private companies. Prisons are now being run by private companies. Heck, if you were to look at all the activity occurring outside the beltline in Washington DC, you'd begin to think that all of Homeland Security was being outsourced to the private sector.

Conversely, there are moves in the other direction, from private to public. There are people trying to push private pension programs onto the government. There is all kinds of movement in the health care industry around increasing the potential role of government. The lines are blurred in the war in Iraq. Soldiers are involved in

establishing a private business infrastructure. Private subcontractors are working alongside the soldiers doing things more traditionally thought of as being the role of the military.

#### **4) Own Vs. Rent**

There have been things that one typically owns versus things one traditionally rents. These lines are also being blurred. Retailers like Men's Wearhouse have made tuxedos so inexpensive that owning is becoming cheaper than renting.

These days, there are people who will rent you just about anything you would have traditionally purchased in the past. For example, there are companies adapting the Netflix type of rental model to high end fashion. An example is Bag, Borrow & Steal, who specializes in renting out expensive designer handbags. You pay so much a month for the privilege of having the designer bag of your choice, and when you want another, you just return the current bag. There are other companies that do the same type of Netflix model for designer dresses, jewelry and other such items.

The timeshare industry will give you the opportunity to partially own all sorts of things, from places to live, expensive boats, expensive cars—you name it.

How things get paid for, who owns the item, how long one has possession—all of these issues appear to be up for grabs and negotiable.

### ***SUMMARY***

We live in a time when conventional thoughts about how business models should work are continually being successfully challenged. Society is diverse enough that seemingly contradictory business models can all simultaneously be successful.

Therefore, when looking for a new innovation, your success may come from doing the exact opposite of what other successful people are doing. It's time to get comfortable with simultaneously opposite ideas both being true. Life is a lot like that 3x5 card we talked about.

### ***FINAL THOUGHTS***

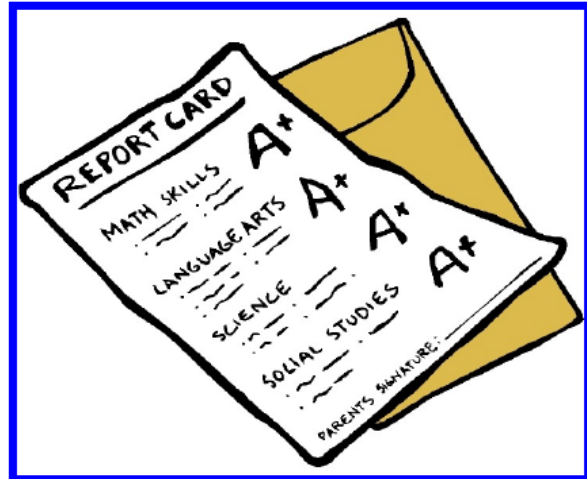
It is said that imitation is the sincerest form of flattery. It is also said that opposites attract. In this case, going the opposite direction may attract a lot of money to your business.

# Innovation Tool #6: “A” students vs. “C” Students

## **THE STORY**

I worked with a company one time that brought in some high-priced consultants to teach the employees how to innovate. We did all sorts of interesting exercises and pitched new projects to each other.

What was interesting to me was that the consultants kept saying that creativity was irrelevant in the innovation process. They said that creativity and ideas had no value. Only projects that come to life have value.



Therefore, the process being taught did not look for creativity or ideas. Instead, the process consisted of trying a large number of small experiments in a variety of directions. The ones that showed any sort of life would continue to get funded. The others would not.

Over time, I noticed that many of the employees in the process also started downgrading the value of ideas and creativity. They bought into the belief that if we just do a bunch of things, eventually a good thing will come out of it. The most interesting part was that the people who were most adamant about ideas and creativity be worthless also tended to be among the least creative people I have ever met.

Another employee who was watching this process said to me, “What the consultants are trying to do is take a bunch of “C” grade level innovators and turn them into “B-” level innovators. Unfortunately, this process will never create any “A” level innovators.”

Although a lot of busy work came out of the process, in the long run, no successful innovations were built via this process.

## **THE ANALOGY**

This is the last in a series of a series of blogs on how to think about ways to create new business innovations. There are many different theories and processes used to try to get more innovation out of a company. If you have the money, there are people who will take it in order to teach your employees how to innovate, as happened in the story above.

Yes, it is true that through learning, one can become better at innovation. However, I also believe that some people's brains are wired in a way that makes them naturally better at innovation than others. In terms of true innovation, I would rather have a small handful of "A" level innovators working on the process rather than hundreds of "B-" level employees working on innovation.

It's like the story that if you get enough monkeys typing on enough word processors, by random chance eventually you will have one of them write the great American novel. Maybe I'm old fashioned, but instead of putting thousands of monkeys on the task, I'd rather just commission a great American novelist to write the book. In many ways, I feel the same way about innovation. I'd rather put a small number creative people with lots of ideas on the task than teams of non-creative people who learned a process. In the rest of this blog, you will see why.

## **THE PRINCIPLE**

The important thing to note is the difference between innovation and business improvement. Business improvement is about improving your position in the current paradigm. I call it the "More Better" principle. It's just like the good things you did before, only you are doing more of it and you are doing it better than before.

Many of the concepts being taught in the story above work well in developing "More Better." Try lots of small experiments throughout the organization and feed the winners, starve the losers. Wal-Mart has prided itself for decades on its ability to have small experiments going on all over the company and then use its rapid communication network to get the best experiments propagated quickly across the entire chain.

These principles did not create an innovative new retail format. They just made Wal-Mart one of the best at operating these retail formats. Wal-Mart did not invent the discount store or the warehouse club or the supercenter formats. They just copied good ideas that they saw elsewhere and made them better. This is a good thing, but this is not innovation.

Innovation is creating a business opportunity in a space that did not exist before. This is something completely different from "more better." Running a current business well and creating the new businesses of the future take very different skill sets. There have been enough studies done and books written to conclude that if you try to have the same people work simultaneously on making the most of the current business model, while at



the same time work on creating the new business models of the future, they will fail at both.

In the book “Built to Last” the authors called these distinctively different tasks with distinctively different skill sets “preserving the core” versus “stimulating progress.” In the book “Creative Destruction” the authors called it “operating” versus “creating.” Because the two tasks are so different and require such a different mindset, one can not be efficient or effective switching back and forth between these mindset.

In the story above, the consultants started by having the participants from the company split their time between innovation and running current businesses. It turned out to be a failure, so they switched to full-time innovation.

I don't think most football teams would try to train an offensive lineman in how to be a better quarterback. It is a different skill, needing a different body type and a different mindset. Even if you could make him a slightly better quarterback, he will probably never be good enough to deserve to be your quarterback. Instead, the team would go out and find a naturally gifted quarterback and leave the lineman to become a better lineman. Similarly, a football team would not have every player on the team take turns at being the quarterback. It would cause too much confusion, chaos, and inconsistency of performance. Instead, only a few people with the quarterback skill-set would work at the quarterback position.

I believe the same is true in innovation. Get a skilled player for that position and leave the other people working on their different skills.

Then, there is the question of millions of small experiments versus one big bet on the future. Either extreme can get you in trouble. To optimize efficiency and effectiveness one needs to balance two issues:

- 1) Enough ideas so that there is flexibility, in case the ideas do not pan out.
- 2) Few enough ideas so that you can focus your effort and your strategy.

My experience has been that if you get a small handful of “A” level natural innovators, they will provide more than enough innovative ideas for the company to tackle. However, if you open it up to big innovation all over the company, the company will choke on all of the activity and never be able to get enough focus to get the right ideas implemented.

Great innovation is often more successful when it leverages off the strategic strengths of an organization. By having a few people focusing on innovation, they can ensure that it stays on course for optimizing your strategic intent. When it becomes random and diffused throughout the organization, the ideas can deviate wildly from plan and even be contradictory to what someone else is doing.

It is difficult enough to bring a successful innovative idea to reality when it is carefully nurtured and focused on. In a land of chaos, the likelihood of getting through the entire process successfully is near nil.

Finally, there is the “power of veto” in an organization. If innovation is thrust into the main organization, there are too many people with vested interests in the status quo who can veto the innovation. There’s a reason why some of the greatest innovations from large companies were hidden away in remote locations outside the normal business process. It was the only way to keep them alive and out of site from the veto-ers.

## ***SUMMARY***

There are many reasons why I believe that true innovation should be put in the hands of a few who are naturally gifted in the area:

- 1) It takes a different skill set (go with people who have it)
- 2) It takes dedicated focus (away from normal business responsibilities)
- 3) You will get fewer, but better ideas—plenty enough to work with
- 4) There is greater likelihood of getting ideas consistent with your strategic intent.
- 5) Separation is needed to avoid being vetoed by the status quo

Therefore, when looking for a new innovation, bring in the “A” team.

## ***FINAL THOUGHTS***

Some people may argue that there aren’t enough “A” players to go around. Well, there are companies out there like IDEO with a reputation of nurturing great innovation. Great innovators know about these companies and flood them with resumes—more than they can possibly absorb. I don’t care if everyone can get an “A” player, only whether I can get an “A” player. If you get the right reputation, you will get these people.

# Innovation Tool #7: Ownership

## **THE STORY**

Back when I was getting my MBA, one of the things I was taught was how to do the classic “Rent versus Buy” analysis. The idea is to track the costs over the lifetime of an asset to see if it is cheaper to rent the asset or buy it.



I was so excited about learning this new tool that I immediately

wanted to apply this knowledge to the company I was working for part-time while getting my MBA. I did a quick analysis of whether this company should rent or buy its trucks. I was eager to share my results with company management.

Unfortunately, company management was not as excited about by the analysis as I was. Apparently, they had already been doing an analysis of their own, called “Reinvest versus Liquidate.” They had come to the conclusion that they were going to wind down the business instead of reinvesting in it. Thus, an analysis about renting versus buying future trucks was worthless, since they were not going to be needing any additional trucks in a wind down.

This taught me an important lesson: If you don’t have a great long-term strategy, a lot of the day to day decisions lose their importance. Maybe that’s why I’ve spent most of my career trying to help firms find that long-term strategy instead of helping them with “Rent versus Buy” decisions.

## **THE ANALOGY**

Most of the time, we see the “Rent versus Buy” decision as a minor tactic. It is usually not the key to our core business model. Instead, it is just a tool to find the cheapest way

accomplish our business model. If the business model is failing, like in my story, “Rent versus Buy” is not seen as powerful enough to stop the failing business model.

However, what if we elevated “Rent versus Buy” to become the core differentiation in our business model? Would it be possible to create a new, more powerful business model based upon assumptions around ownership? Could a creative new approach to ownership create a business model so innovative that a whole new industry is born? Could this help save companies from liquidation?

I think so.

## ***THE PRINCIPLE***

This is another blog in my occasional series on innovative business models. In the past, we’ve looked at innovation by adding or taking out intermediaries, in bundling/unbundling, changing access, and in changing how a problem gets solved. In this blog, we will look at innovation by changing ownership.

Everything has to be owned by somebody (or somebodies). For many items, ownership transfers to the buyer at the point of the transaction. For example, if I go to a car dealership and purchase a car, the ownership of that car transfers to me.

For other items, ownership does not transfer at the point of the transaction. Instead, the “purchaser” is only leasing use of the property. For example, an owner of an apartment building maintains ownership of the property and makes money by renting out the apartments.

Other times, a third party takes ownership. For example, a manufacturer may sell an item to a third party finance company who then leases the property to a user.

The point here is that you get a different business model depending on whether ownership is located with the product/service provider, the product/service user, or a third party. If you want to create a new business model innovation, consider shifting from a traditional ownership model to a different one.

### **1) Shifting From Traditionally Rented to Owned**

Let’s look at a few industries that have traditionally used a lease business (provider-owner) model to see what happens when you shift to a user-owner model. For example, apartment buildings were traditionally a provider-owner business. The owner of the building remained the owner. The users of the building rented their space from the owner (never took ownership). But what if the users did take ownership? When this happened, a whole new exciting industry was created, called “condominiums.”

And how about vacations? Traditionally, when you went to a vacation spot, you rented your accommodations from a Hotel, Inn, Bed & Breakfast, or other such facility. But

what if you could own that accommodation? Some entrepreneurs tried that and created a new business model, the “timeshare” vacation, where you own a week’s worth of a vacation property, which can be traded for vacation spots all over the world.

This timeshare model has spread to other industries where other business models had previously been dominant, such as commercial jets (NetJets) and boats. Either you went from renting to partial owning, or from full owning to partial owning.

Before the breakup of the telephone utility in the United States, every telephone in the country was owned by the telephone utilities. Customers rented them as part of their monthly utility bill. Now, customers own their own phones. This revolutionized the telephone manufacturing business.

When movie studios first started allowing customers to view video tapes of their movies in people’s homes, a rental model was chosen, spawning firms like Blockbuster. Then the studios lowered the price, so that consumers started buying and owning the movies, benefitting firms like Wal-Mart. Now, in the age of digital streaming of movies, we’re moving back to a rental model.

The point is that you may be able to revolutionize an industry by finding something which is traditionally rented and find a way to transfer ownership to the user.

## **2) Shifting From Traditionally Owned to Rented**

This same principle also works in reverse, where something typically owned by the user is shifted to a rental model. For example, instead of owning your furniture and appliances, you can rent them. Firms like Cort will gladly rent you whatever furniture you need, for home or office. Other firms, like Aarons or Rent-A-Center, use a hybrid rent-to-own model for furniture and appliances.

What about clothing? There are a number of firms specializing in renting out designer clothing and accessories via the internet, including firms such as Wear Today Gone Tomorrow, Rent Me a Handbag, and From Bags to Riches. In New York City, there are designer clothing rental shops, such as Albright and Ilus.

People may have been comfortable renting cars for a short period when away from home, but tended to want long-term ownership or a long-term lease on a car for home-town use. Now, however, there are firms such as ZipCar which will rent you a car for a few hours or a day right in your own home town in a very convenient manner. This is causing many urbanites to abandon car ownership, just renting cars for those occasions when mass transit is inappropriate. Customers claim to save money and help the environment. A new industry is born!

Again, look at industries where users traditionally own the product and consider how you could reinvent the industry by converting to a rental model. You may create the next ZipCar.

### **3) Other Interesting Ownership Changes**

Governments have traditionally been responsible for providing its citizens with a number of services, such as prisons and highways. However, even though the government is responsible for providing the service does not mean they have to own the service. Lots of government services, like toll roads and prisons are now owned or operated by non-government third parties. There may be many other government responsibilities that can be done by independent third parties.

Outsourcing can be applied to a lot of areas. This shifts ownership to others, rather than to yourself. Are there new frontiers in outsourcing yet to be developed?

And what about cooperatives? Group ownership of property may be better than owning it all by yourself.

And maybe you can split a single transaction into two. For example, one business model being considered in the electric car industry is one where you would buy the car, but rent the very expensive battery inside the car.

### ***SUMMARY***

One component of a business model is who retains ownership. It could be the provider (who rents), the user (who buys), or a third party (who facilitates). One can invent exciting new business innovations by merely changing the traditional ownership pattern in an industry business model. Maybe such an opportunity exists in your business.

### ***FINAL THOUGHTS***

My initial excitement about “Rent versus Buy” was quickly deflated in the story. However, if you look at ownership issues as the opportunity to potentially reinvent an industry, there is plenty of reason to get excited again.

# Innovation Tool #8:

## Where It's At

### **THE STORY**

Shortly after the fall of the USSR, the company I worked for started working with Russian partners to bring western-style supermarkets to Russia. It was a very difficult project, in part due to the Russian infrastructure.

In general, it is easier to transport processed food than un-processed food, since processed food is already packaged in a way that reduces spoilage. That is why, in most

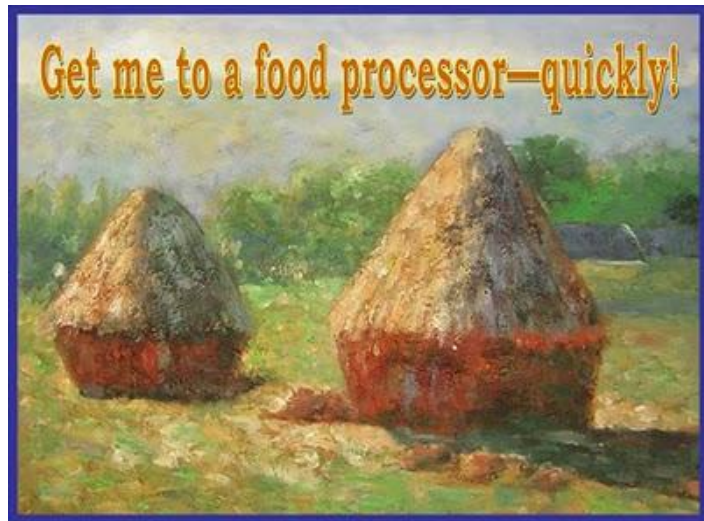
western countries, the food processing factories are located near where the food is grown. That way, the food can be processed shortly after being picked—reducing wastage and rot.

In Russia, however, we found that the food processing factories tended to be located closer to the big cities. The problem was that due to the poor transportation network in Russia, a lot of the food became spoiled and damaged before it reached the factories. The quality of the processed food suffered as well.

As a result, most of the food in our Russian supermarkets had to be imported from outside Russia. It made the products more expensive, but the customers appreciated the higher quality.

### **THE ANALOGY**

A simple little concept—where to put the food processing factory—made a big difference in the Russian food chain. Russians needed to import food—not because they couldn't grow it, but because so much of it spoiled before it could get consumed. Had they only located the factories closer to the growing fields, there would have been fewer food shortages.



Every product or service needs to be located somewhere, be it food processing or business consulting or whatever. Just as poor location choices had a detrimental impact on the Russian food chain, poor strategic choices of location in your business could have disastrous results. Conversely, if you are clever in your locational decisions, you may create exciting new business opportunities.

Therefore, when creating your business strategy, it may be wise to ponder new locational alternatives. It might revolutionize your industry.

## ***THE PRINCIPLE***

This is another in a series of blogs on innovative business models. In the last blog, we looked at innovation via changing who owns the product/service. In this blog, we will look at innovation base on where the product/service is created/sold.

Although we can often think of location as a given, there actually is quite a bit of variability in where one can provide a good or service, if you think creatively. If you decide to make location decisions differently from conventional wisdom, you may create an exciting new growth opportunity.

### **1) Locate Where the Customer Is**

Often, people must travel to the store or service shop in order to get a good or service. But what if you brought the store or service shop to the customer? Take cars, for example. There are firms that will drive their service operations to the location of your car rather than you having to drive your car to the service shop. This includes a variety of services, such as windshield replacement, cleaning, and even mobile oil change trucks.

Enterprise rent a car came up with an ingenious locational idea. Their great insight? If you need to rent a car, then there is a good chance that you do not have transportation to drive to the car rental location. Therefore, Enterprise will drive the rental car to where you are located.

And how about shopping? Firms like Tupperware, Avon, Amway and Mary Kay do the selling right at your house...no need to go to the store. And of course there are all the eetail options where you can buy from your laptop.

Firms like SnapOn Tools and Mac Tools drive their inventory of tools to the worksite to sell right where the work gets done. Lunch Wagons will drive the restaurant right to the work site as well. Consultants or other contract workers can be located at their place or your place...whatever works best.

You can get grooming services (for you or your pet) to come to where you are. And if your computer isn't working right, the Geek Squad will drive to your home or work



location and fix it right there...or they might do it remotely through the internet. No need to lug your computer to a shop.

Perhaps you can think of a business typically done remotely which can be revolutionized by moving it closer to the customer.

## **2) Locate Away From The Customer**

The opposite can work as well—taking jobs usually done on customer’s site and move it somewhere else. For example, homes are traditionally built at the site where the home will be lived in. However, that is not the only way it can be done. Pre-manufactured homes can be built in a factory and merely assembled on site.

“Home-Cooked” meals are traditionally made at home—hence the term “home-cooked.” However, there are a number of firms like Dream Dinners which provide an off-site kitchen, where groups of customers come in and cook a week’s worth of meals at the same time—then take them home to freeze for later.

Modern technology and internet connections are making remote diagnostics possible, so that problems can be repaired without visiting the home. We already talked about this with computers. But now there are home devices which can monitor health (and are remotely connected to medical providers). Similarly, if some business equipment (like copiers) fail, they can sometimes be repaired remotely through the internet. You can check up on your home remotely, to see if there are any burglars, or to change the lighting or heat settings.

There are people looking to do the same thing for home appliances. Why have a repairman drive out to the home if you can fix it with a software patch sent to the appliance over the internet? In fact, if the appliance starts feeling “sick,” it may remotely contact the repairman on its own.

Perhaps you can think of a business typically done near the customer which can be revolutionized by moving it somewhere remote.

## **3) Upstream Considerations**

Not only can you make innovative changes by changing the locational orientation with the customer. You can also change the locational orientation with suppliers. We saw in the story how building food processing factories closer to the farms can be beneficial. This same principle can apply to other supplier issues.

For example, breweries consume a lot of water. It makes sense to locate breweries near cheap, high quality water. Otherwise, you would go broke trying to import water to the brewery

Sometimes the economies of scale are such that it makes sense to centralize production. Other times, distribution costs may be for of a factor than production, so it could be better to spread production closer to your customers.

Labor costs vary by area. If you have a high labor process, perhaps it makes more sense to locate closer to cheaper labor. Then again, if you get creative, you might be able to reinvent an industry by bucking that conventional wisdom.

Take, for example Zara, the fast fashion retailer owned by Inditex. Where most clothing retailers source their apparel from cheap labor markets in Asia, Zara gets much of its inventory from higher-cost nearby Italy. Zara found that by avoiding Asia and using nearby Italy, they increased their flexibility and speed to market tremendously. Then, they designed a business model for Zara which exploited this speed and flexibility. It has been fabulously successful. The higher labor costs are more than compensated for by the competitive advantage in speed and flexibility due to the different location choice.

## ***SUMMARY***

Location decisions do not have to be “automatic.” Although conventional wisdom may cause everyone to locate their business or service in the same way, it doesn’t mean that it is the only way it can be done. By creatively changing the traditional location where goods and services are produced or sold, you may create an innovative new industry with plenty of growth potential.

## ***FINAL THOUGHTS***

In retailing, they say that the three most important factors for success are “location, location, and location.” If you get clever, perhaps location can be the key to your success.

# Innovation Tool #9: Free Lunch?

## **THE STORY**

Back when I was getting my college degree, the economy was bad and jobs were practically non-existent. I needed to find a job to help pay for my education and was not having much luck finding one. I was desperate.

Eventually, I found a job working at a telephone call center. My job was to call people up on the telephone and tell them they had won some “free” magazine subscriptions. After they had accepted the “free” gift, I was to tell them about a small handling charge for setting up the subscriptions. As it turns out, that “small handling charge” was equivalent to paying for a magazine subscription.



Once people heard how much those “free” magazines would cost them, they cancelled the subscriptions.

After doing this job for two days, my conscience told me that selling “free” subscriptions to unsuspecting people is wrong. The lies and deceptions were more than I could take. So after two days, I quit. As it turns out, I was not that desperate for a job.

## **THE ANALOGY**

If you want your business to survive long-term, eventually you have to generate income. And the income needs to exceed costs. Giving everything away for free forever to everyone is usually not a path to long-term prosperity. Somebody, somewhere has got to put money in your pocket.

At the call center, I was telling people they were getting the magazines for free. In reality, that was a lie. These people were really paying for these magazines. All we had done was change the name of what they were paying for, from “subscription fee” to “handling fee.” Call it what you want, but they were still paying for the magazines. I’m

sure the call center was also getting money from the magazine publishers who wanted to increase their subscriber base in order to charge more to the magazine advertisers.

So in the end, those magazines weren't free. The subscribers were paying for them in "handling fees" and the advertisers were paying for them in "advertising fees." And that was how this call center put money in its pocket even though it was supposedly giving away magazines for free.

There are lots of creative ways to put money in your pocket. There can be sources for your income that have nothing to do with the user of the product (like the magazine advertisers). Because there are lots of ways fund an income stream (from a variety of potential sources), creative revenue sourcing can become a key strategic differentiator and a source of innovation.

## ***THE PRINCIPLE***

This is another in a series of blogs on innovative business models. In the last two blogs, we looked at innovation via changing who owns the product/service and where the product/service is offered. In this blog, we will look at innovation based on how a product/service is funded.

One's initial thought may be that the person who uses the product/service should be the one that pays for it. After all, they are the one getting the benefit. However, as we will see below, that is only one option. There are many other ways to fund a business' revenues. If you are creative enough in sourcing your revenues, you may open up a whole new business model that creates new growth opportunities. Listed below are a few ways to derive income from people other than by just charging everyone who uses a product/service.

### **1) Only Special Users Pay Model**

Instead of having everyone who uses a product or service pay for it, you can have only certain class of people pay for it—the rest getting it for free. This is often referred to in the online space as the "Freemium Model." Most people get the basic version of the software/internet service for free, but if you want extra features, you pay for the premium model. A perfect example is LinkedIn. The vast majority of the people using this job-related social networking site are using the free version. However, because free pricing created a large pool of people in the LinkedIn database, the data became extremely valuable to people like job recruiters, who pay money to get a premium version with extra features to access this data.

A similar example is Adobe PDF. They give away the Adobe Reader files for free to establish PDF as the standard way to read protected documents. Then, Adobe charges money for the premium version which allows people to not just read the files, but also write files in PDF. Without the large base of free readers, there wouldn't be much incentive to write files in the format (where the real money is).

This is not just a digital model. Think about night clubs that have a “Ladies Night,” where women get in free. The reason is similar to Adobe PDF or LinkedIn. If you have a lot of women at the night club, you make the night club more valuable to single men who are willing to pay a premium to be at a place with a greater abundance of single women.

Perhaps there is a way you can segregate your customers, whereby if you give some a free ride, you will create more value for others who will pay a premium for a version of that product/service.

## **2) The Advertising Subsidy Model**

Anyone who has watched a NASCAR race understands the advertising subsidy model. The cars and the drivers are completely covered with advertising logos. Advertisers pay a bundle of money to get those logos on the cars and drivers. Why? They know that a lot of eyeballs are watching the race and they want to take advantage of those eyeballs to get them to like their product.

A large proportion of internet sites use this model. The sites are free to users, but they are covered with advertising. A lot of the traditional media also rely on advertising as a primary source of income (as we saw with the magazines in the story). They are all trying to exploit the eyeballs looking at the media and make a pitch to them to purchase something else unrelated to the media.

When you purchase a new computer, the initial screen can be full of free trial versions of software (from which they eventually want you to buy full versions). This is referred to as “Spamware.” Software companies are so willing to spend money to be on that initial computer screen that both the manufacturers and retailers of computers are fighting to get that money. Some retailers will wipe off the spamware installed by the manufacturer and put their own spamware on the computer before selling it.

Perhaps there are ways to put advertising into your business model in ways that have not been done before.

## **3) The Bundling Subsidy Model**

When you bundle items together, you can sell one piece of the bundle for virtually free, because you are making sufficient profit on the rest of the bundle. For example, some stores sell computers at a loss, because they know that if they can bundle enough other goodies with the computer (like extended warranties, printers, ink, cables, software, etc.) the net bundle is profitable.

Mobile phone carriers often bundle in a free cell phone, provided you sign up for a long contract (long enough to pay off that cell phone in the monthly fees). Movie theaters keep ticket prices low by charging a small fortune for popcorn and soda (and make a profit on the whole bundle).

In these cases, the user ends up paying for everything by overpaying for one piece in order to underpay for something else. However, you may find strategic partners who want to become a part of your bundle and will put in part of the subsidy in order to get into your bundle (because they know they will sell more as part of your bundle than on their own). You can have different vendors bid against each other to get into your bundle (or pay to participate).

Of course, it can also work the other way. You can create a new model by unbundling. Some phone carriers do not subsidize the mobile phone. As a result they can charge a lower price for monthly service. Just because the industry does it one way does not mean you cannot do it the other way. We talked more about the bundling model in another blog.

#### **4) Greater Good Subsidy Model**

Sometimes you can get someone other than the user to pay because they see a greater good in subsidizing the purchase. For example, governments pay for all sorts of things used by customers because it is seen as a public good to do so (like health insurance). I see all sorts of commercials on TV selling motorized chairs for people with disabilities. The commercials brag that the chairs are free to the user, because they get the government and insurance companies to pay for them.

Charities (via the people who donate to them) also pay for a lot of items which are then given away for free (often to the poor who cannot afford them) because it is a good thing to do.

Employers will often provide on-site daycare, health care facilities, and cafeterias at a subsidized rate because they see the greater good in employee hiring, employee retention, getting employees to work longer hours, or in reducing health care costs.

Perhaps you can find a way to get money from employers, charities or the government instead of from the customer, because you can prove “a greater good” will come of it.

#### **5) The Insurance Model**

In the insurance model, people do not pay for their individual use of a product and service. Instead, they pool their money with others. When they need the service, the money is paid out of the pool. The customer hopes that they will put less into the pool than they take out in services.

Insurance is common for things like health and life and automobile accidents. But why stop there? Now you can get insurance on your pet’s health, insurance against identity theft, insurance for auto repair, and legal assistance insurance. What other things could you convert to an insurance model?

## **6) Bad Person Punishment Model**

Sometimes, you can paint someone else as “the bad guy” and force them to pay for your costs as a form of punishment. This is common in the legal profession, where lawyers will take on your case for free and get paid via the damages paid by the “bad guy” you are suing. By why stop there?

In Canada, there is a 21 cent surcharge placed on every blank recordable CD sold. Why? Because blank recordable CDs are portrayed as the bad guys since they encourage the illegal downloading of digital content. This surcharge is then distributed amongst “the victims” of illegal downloading.

Many are clamoring to do the same to food companies that sell products with too much fat or salt. They want a bad health tax put on them to help pay for the health consequences of poor eating. They’ve already done it in a way with cigarette manufacturers, getting them to pay for their unhealthy product. Some are pushing to tax news content on the internet to subsidize print media.

Maybe you can find someone to paint as the Bad Guy (and paint yourself as a victim) and get the bad guy to pay your costs for you.

## ***SUMMARY***

Don’t automatically assume that your income has to come from all the people who use your product/service. There are lots of other options, including premium customers, advertisers, bundle partners, government, employers, charities, insurance pools, and bad guys. If you think creatively about your business model, you may find a way to revolutionize your industry by funding it in a new way.

## ***FINAL THOUGHTS***

There’s an old saying that there is no such thing as a free lunch. Well, if you are creative in your funding model, you can create a free lunch for some, just so long as you find someone else to pay the bill.

# Innovation Tool #10: Divergence or Convergence

## **OOOPS!**

Back in the June 18, 2007 edition of Advertising Age magazine, marketing guru Al Ries made a prediction. Apple was about to launch the first version of the iPhone. Al Ries predicted that the iPhone would be a major disappointment.



Well, looking back, it would appear that Al Ries was wrong. By just about any measure one can think of, the iPhone has been a HUGE success. For example, the recent launch of iPhone 4 sold 1.7 million units in the first three days.

## **WHAT WENT WRONG?**

Since I think that Al Ries is one of the smartest human beings on the planet (at least when it comes to business and marketing), it shakes my confidence to see him appear to have been so wrong in his prediction. But then I realized that he was wrong for all the right reasons.

Ries predicted that iPhone would disappoint, because he saw it as a convergence device. Convergence devices try to be multi-functional by combining the functions of other single-purpose devices. Rather than creating a new solution, they merely take old solutions and cram them into a single device. In this case, he saw the iPhone as being a multi-function device combining the functions of a phone, a computer, a camera, a media player, and so on. As Ries so convincingly put it in his article, when consumers view your product as a convergence device it usually fails to catch on (think of all the failed combination computer/TVs that have been introduced over the years).

The problem is that when you are seen as combining a bunch of stuff into one device, you are not viewed as an expert at any single function. Why buy a complicated, sorta-good,



multi-function device when you can buy the best single-function products from experts in that field?

Instead, Ries says success typically goes to the divergence device. A divergence device takes a current product offering and narrows the scope by becoming more specialized or more narrowly targeted than its predecessors. It goes narrow to create a more specialized solution for a more narrowly defined problem. To quote the Advertising Age article, “The first computer was a mainframe computer, followed by the minicomputer, the desktop computer, the laptop computer, the handheld computer, the server and other specialty computers. The computer didn’t converge with another device. It diverged.”

Therefore, since he saw the iPhone as a convergence device rather than a divergence device, Ries predicted disappointing results.

The theory was right. What was wrong was Ries’ prediction of how the iPhone would be perceived in the marketplace. Apple never marketed the iPhone as a convergence device and consumers never thought of it as a convergence device.

Instead, Apple created a unique, new business ecosystem centered around “apps.” First, there were the thousands upon thousands of apps developed, doing things never done that way before. Then there was the App Store, a place to purchase all of these unique Apps. And then there was the iPhone, a device to make the apps come to life.

The iPhone was not seen as the combination phone/computer/camera/media player Ries feared it would be. Instead, the iPhone was viewed as a specialized divergence device—the first App Machine. Apple became the undisputed leader in the world of apps...they owned that space because they built an integrated system. Therefore its iPhone—the App Machine—became a huge success. Others are having trouble copying this success, not because they cannot mimic the device, but because they have an inferior offering of apps (making them inferior app machines).

## ***CHANGING FUNCTIONS***

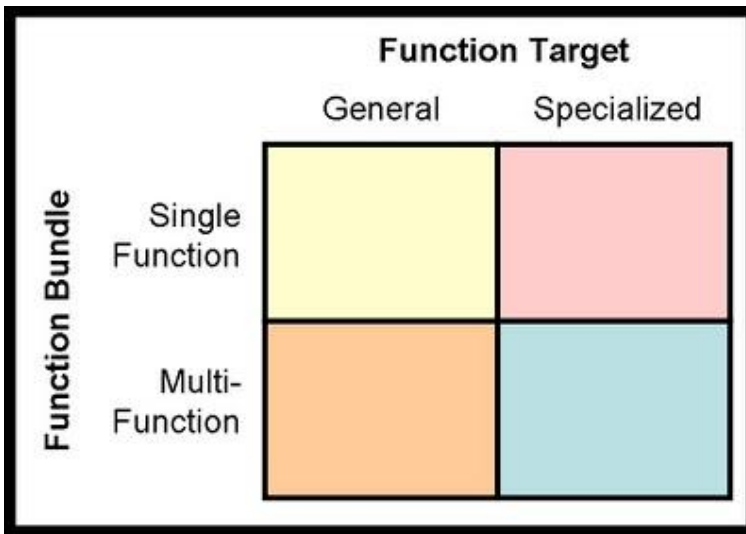
In the last few blogs, we’ve been looking at ways to create innovative new growth opportunities by tweaking elements of the business model. We’ve seen how you can innovate by changing ownership, changing location, and changing who pays. Today, we are looking at changing the amount of functionality. The iPhone was a huge success, because it created a new way to look at how a phone functions (as an Apps machine, where talking is seen as just one of many apps—and not necessarily the most important one).

When it comes to functionality, you have several options:

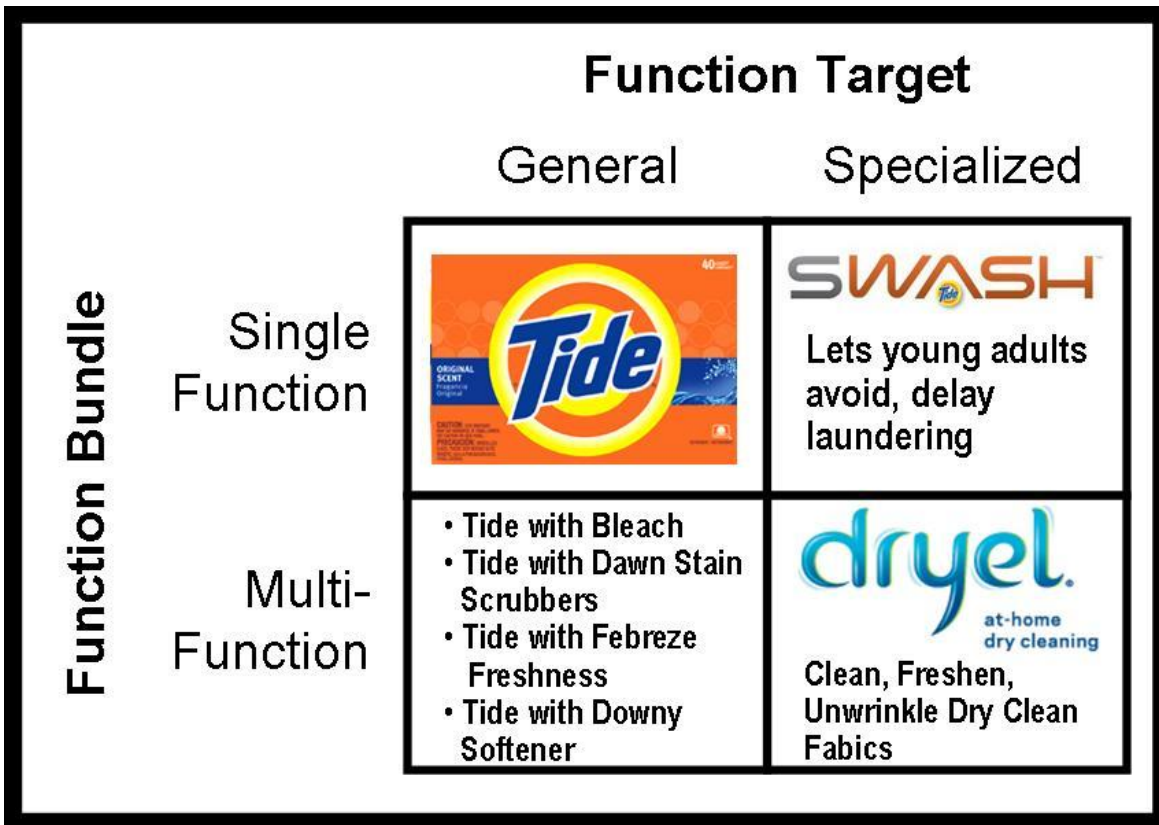
1. Function Target: General Solution (broadening the target) or Niche/Specialty Solution (narrowing the target)

2. Function Bundle: Single Function Solution (unbundled) or Multi-Function Solution (bundled).

When you put this together, you get a 2x2 grid.



Let's apply this grid to the way Procter and Gamble (P&G) approaches the laundry business. In the single function/general solution box you have Tide. Tide is positioned as the best working laundry detergent for the general public (one function for the masses—the upper left-hand box). But Tide did not stop there. They also have multi-function versions of Tide:



1. Tide with Bleach
2. Tide with Dawn Stain Scrubbers
3. Tide with Febreze Freshness
4. Tide with a Touch of Downy Softener

These multi-function products still target the masses, but do more than just regular detergent (placing them in the lower left-hand box).

And then there is Dryel, P&G's system for doing dry cleaning in your home dryer. It is specialized, in that it was designed to only provide a solution for "dry clean only" clothing. But it is multi-functional, in that it claims to clean, freshen and uncrease those specialty fabrics. This places it in the lower right hand box.

Finally, there is the new brand from P&G, called Swash. Swash is targeted at a very special niche: Young adults who are too busy or too lazy to do laundry, yet still want to look nice when they go out socializing. There are four single-function products under the Swash brand:

1. **Swash Fresh It Up** – Spray your clothes and 5 minutes later they smell like they were just laundered. You can tell this product is targeted at young, socializing adults, because one of the fragrances is called "Posse," a young adult term applied to one's inner circle of friends/companions.
2. **Swash Get It Out** – Just rub the pen over the stain and it goes away.
3. **Swash Smooth It Out** – Just spray the clothes and smooth them out with your hands while it is still wet. When it dries in a few minutes, most of the wrinkles will have gone away.
4. **Swash Steam It Out** – Just put the sheet into the dryer for a few minutes with the worn clothes and they will come up almost like newly washed.

The beauty of this approach is that P&G has created all sorts of laundering innovations without having to create all sorts of new inventions. It's multi-function versions of Tide are combining Tide with products/inventions already in the P&G portfolio—Dawn, Febreze, and Downy. Swash uses a lot of existing P&G technology, only packaged and modified a bit, such as the technology behind the Febreze freshener, the Dryel steaming sheet, and the Tide To Go stain pen.

The innovation behind Swash is not so much about inventing new technology as it is about taking old technology and reinventing the business model as it relates to functionality. They took generalized functionality and repackaged it as a solution for a niche audience/need. Suddenly you have a whole new laundry category.

## ***BUT WHAT ABOUT THE CONVERGENCE ISSUE?***

But what about Al Ries' concern over the high failure rate for convergence products? Doesn't that make adding multiple functions a bad move? The problem is not whether or not you add functionality. The problem is how you position the result.

The iPhone added a lot of new functions to the mobile phone, but it was not positioned as a mobile phone plus other functions. It was positioned as a single function device—the apps machine. Similarly, Dryel was not positioned as a freshener plus cleaner plus unwrinkler of specialty garments. It was positioned as the first system for doing dry cleaning at home (a new single function).

But what about things like Tide with Bleach? Well, the positioning there is that there is a single function to be done (cleaning your clothes). Rather than using two products during that single function (adding detergent AND adding bleach), you just add one product, giving you the benefit of one product/one step convenience plus the assurance of compatibility.

So, if you are going to change the business model to increase the number of functions, either position it as resulting in a brand new single-function category (Apps Machine or Dry Cleaning at Home), OR position it as a superior way to tackle a single problem (like doing laundry).

Don't position it as a way to multi-task, a way to do multiple functions with a single product. This is where Al Ries says you get into trouble.

## ***SUMMARY***

One way to innovate is by changing the functionality of the product. This includes the idea of either broadening or narrowing the target of the function (mass vs. niche) or broadening or narrowing the number of functions done (single vs. multi function). The trick is that if you want to broaden the number of functions, you need to position the result as a superior one-function product, even if that means inventing a new category.

## ***FINAL THOUGHTS***

In the blog, we talked about how P&G took mass oriented products and created a whole new industry when they applied them to a narrow solution with Swash. It can also work the other way. There have been lots of narrow solutions, like the coating to protect spacecraft re-entering the earth's atmosphere, which created new industries when applied to mass solutions (Teflon coating for non-stick cookware). The idea here is to look at which box on grid a technology is currently located (regardless of where it is) and see if you can create innovation by putting that technology into a different box on the grid.

# Summary of the Ten Tools of Innovation

To wrap up, here is a brief summary of each of the ten tools for innovation.

## Innovation Tool #1: Pick Your Nodes

1. **What to think about:** The nodes in the supply chain
2. **New ways to think about this:**
  - a. **Taking away nodes:** Disintermediation (like eliminating the travel agent and buying airline tickets direct).
  - b. **Adding nodes:** Reintermediation (like adding Ebay between buyer and seller)
  - c. **Rearranging the order of the nodes:** Transposition (like getting consumers involved in the design of a product)

## Innovation Tool #2: Bundles of Joy

1. **What to think about:** How goods and services are bundled.
2. **New ways to think about this:**
  - a. **Bundle what is traditionally unbundled:** Like bundling all the services associated with a wedding to a single transaction.
  - b. **Unbundle what is traditionally bundled:** Like selling a mobile phone plan without bundling a phone with the plan.
  - c. **Changing the cross-subsidies in a bundle:** Should high ink prices subsidize a low printer price or should you lower the ink prices and charge more for the printer?

## Innovation Tool #3: Access Denied

1. **What to think about:** The amount and type of access a consumer segment has to the offering
2. **New ways to think about this:**
  - a. **Open Vs. Closed Platforms:** How open should the technology platform be? Should it be open (like Android) or closed (like iPhone)?
  - b. **Limited Vs. Unlimited Supply:** Should I offer everything everywhere all the time (and win on convenience and assortment, like Coke) or should I limit the variety and availability (and win on excitement or specialization, like the Home Shopping Network)?
  - c. **Democratic Vs. Hierarchical Access:**
    - a. Democratic Access means that all customers get treated the same in their ability to deal with the company (tends to be customer driven in that the customer tends to choose how they access the company). Think of a supermarket where all customers can shop it how they like.

- b. Hierarchical Access means that the company segments the customer base and provides different levels of access to different customers. Think of a bank that has personal banking assistants for big customers, but forces small customers to only access via a web site.

### Innovation Tool #4: The Solution is in the Solution

1. **What to think about:** The type of solution my offering provides to the customer.
2. **New ways to think about this:**
  - a. **Find a new way to solve an old problem:** Like solving the problem of improving vision with laser surgery rather than lenses.
  - b. **Fining a new problem for an old product to solve:** Like having Subway sandwiches solve the problem of trying to lose weight.

### Innovation Tool #5: Opposites Attract \$

1. **What to think about:** The traditional norms of the industry (the accepted rules of thumb for how things get done). What if I went in the opposite direction from the norm?
2. **Examples of Opposites:**
  - a. **Pay For Vs. Free:** Switch from one to the other
  - b. **Cherished Vs. Disposable:** Like cheap versus investment writing pens.
  - c. **Government Sector Vs. Private Sector:** Like Toll Roads.
  - d. **Own Vs. Rent:** Apartments versus Condominiums

### Innovation Tool #6: “A” students vs. “C” Students

1. **What to think about:** Who does the innovating and how they do it.
2. **New ways to think about this:**
  - a. **Who to Use:** Use people who are already “A” innovators rather than trying to train “C” innovators to become “B” innovators.
  - b. **How to Use:** Separate those working on building a new future from those continuing the status quo.

### Innovation Tool #7: Ownership

1. **What to think about:** Who owns the product or service?
2. **New ways to think about this:**
  - a. **Shifting from Rental to Ownership:** Like from renting a hotel room to owning a timeshare.
  - b. **Shifting from Ownership to Rental:** Like renting expensive handbags from Bags to Riches.
  - c. **Non-Traditional Ownership Models:** Like reverse mortgages, where elderly people get paid the equity they have built in their homes (while still living there) through a new relationship with the company who will own their home after they pass away.

## Innovation Tool #8: Where It's At

1. **What to think about:** Where the product/service is offered/assembled.
2. **New ways to think about this:**
  - a. **Locating Where the Customer Is:** Like vans that drive to the customer's home to groom the customer's dog on-site.
  - b. **Locating Away From the Customer:** Like moving home construction from the home site to a manufacturing facility.
  - c. **Locating Based on Where Supplier Is:** Like putting food processing plants closer to the farm.

## Innovation Tool #9: Free Lunch

1. **What to think about:** Who pays for the product/service.
2. **New ways to think about who pays:**
  - a. **Only Special Users Pay:** The —Freemium model used by firms like linked-in where only premium customers pay (free for everyone else).
  - b. **Advertising Subsidy Model:** Get a non-user to pay for access to the user, like ads on a free website.
  - c. **Bundling Subsidy Model:** Get someone to pay to be a part of your bundle, which helps to subsidize the entire bundle. Like getting spamware with your new computer bundle.
  - d. **Greater Good Subsidy Model:** Get the government or charity or an employer to underwrite some or all of the cost because of a greater social benefit. Like getting an employer to pay for on-site child care for its employees.
  - e. **The Insurance Model:** Pool resources and risks among a group. Like pre-paid legal insurance.
  - f. **“Bad Person” Punishment Model:** Find a —bad person to pay for the problems they caused to you. Like having the loser in a court case pay your court costs.

## Innovation Tool #10: Divergence or Convergence

1. **What to think about:** How a product's function is positioned to the customer.
2. **New ways to think about this:**
  - a. **Single Function Vs. Multi-Function:** Is the iPhone a multi-function device (phone + computer + entertainment) or is it a single function device (an Apps Machine).
  - b. **General Purpose Function Vs. Specialized (Niche) Function:** Repurposing the general function Tide for a specialized niche (college students) and call it Swash.