

## Innovation and Profitability

The profitability equation is quite simple: when a firm's revenue from selling its product or service is greater than the cost of offering it, then it is concluded that the firm is profitable on that given offering.  $\text{Profits} = \text{Revenues} - \text{Cost}$

If we further analyze this simple equation, then we recognize that the revenues are a function of the quantity of a product or service sold at a price that the customer is willing to pay. This price is chosen based on the attractiveness of that product or service to the customer, i.e. its attributes. On the other hand, the cost is also a function of product's attributes and the quantity it is produced at. For profitability, the ultimate goal of a firm is to offer products with differentiated attributes that customers are willing to pay high prices for, while keeping costs low and competitors out.

What does that mean for your innovation? Innovation is about implementation of a new idea for the purpose of creating value: value for the firm, and value for the consumer. Innovations come in many forms, and the research on innovation and innovation types can be quite confusing, as each author has his/her perspective and terminology. Unfortunately, this is further exacerbated by the fact that innovation has become the latest buzzword or Holy Grail for firms as they look for growth. Innovation Types

Lets take a look at some of the ways your innovations can contribute to the bottom line of your firm.

- Create cost advantage &ndash; If you can produce the same product cheaper, you will improve your profitability. If you can become the low cost producer in your industry, then you achieve cost leadership. Economies of scale and experience curve clearly play into becoming a low cost producer. Examining your value chain and value network is a good start for determining the specific costs associated with each activity, as well as how your competitor is performing that activity differently.
- Process innovation &ndash; when we think about improving efficiencies and increasing productivities, as well as reducing costs, we think about process innovations. The overall goal is to remove or reduce non-value added activities from the delivery of the product or service, such as FedEx's use of scanning technology to provide shipping status of packages to inquiring customers. Six Sigma and Total Quality Management (TQM) are process management programs that are focused on increasing efficiencies or taking out wasted steps. However, don't just limit your process innovation to obvious examples; improving the efficiencies and effectiveness of your software development processes can enable you to better your time to market for competitive advantage.
- Technology innovation &ndash; research and technology related developments are included in this category of innovations. While the incremental innovations are small improvements, usually derived as a result of the learning curve, radical innovations can completely displace the incumbent technology, such as transistors replacing vacuum tubes. Utilizing technology roadmaps and linking them to product roadmaps is an effective way to synchronize the two activities, and focus your innovation investments.
- Go for price premium &ndash; what differentiated product functionality or service will convince your customers to pay extra? As I highlighted in my blog "Innovate with Quality"; establishing a competitive differentiation should not be limited to just technology, but you should also focus on your brand for building and growing a loyal customer base.
- Product innovation &ndash; this type of innovation encompasses differentiation through features and functionality that the current offers do not have. Firms tend to mainly focus on improving existing products or services, and creating line-extensions, as this is a less risky type of innovation. Some examples would include cameras in cell phones, wireless connectivity, Crayola's special crayon that only writes on Crayola's special paper.
- Value-delivery innovation &ndash; this type of innovation includes differentiation stemming from improved customer experience through branding, marketing, customer service and other networks and alliances. Examples would include Apple's iPod, with its popularity is driven by the Apple brand, ease of use through iTunes end-to-end integration, as well as its incredible style.
- Increase the size of your overall market share &ndash; increasing the number of buyers in your market will positively impact the revenues. Innovation types discussed here, such as product and technology innovations, would contribute to increasing your overall market share. In addition, you should also investigate ways to reach customers you didn't serve before.
- Business model innovation &ndash; these innovations are about developing new ways of doing business. Generating revenue by hosting online advertising, and Amazon's plan for leasing computing power and digital storage over the web are examples of how companies are extending their reach to serve customers they weren't serving before.
- New venture &ndash; this type of innovation is about taking the product or technology that exists to new markets. Hummer's retargeting of their military personnel carrier to soccer moms is an example of a new venture. Firms' extension into China, Latin America and other emerging/developing countries are all methods to gain more customers.
- Look for growth - firms are pursuing innovation for growth. This pursuit further requires them to invest in disruptive innovations, organic innovations, and innovations through an acquisition strategy.

- Disruptive innovation &ndash; this is the creation of new markets based on disruptive technologies or new business models. These types of innovations are often difficult to recognize, and can take time to develop and grab a hold in the market. Growth of digital cameras and their impact to traditional film, or PCs vs. mainframes are examples of disruptive innovations.
- Organic innovation &ndash; a method through which firms reposition themselves for growth by tapping into their most important assets: their core competencies and valued customers. IBM as an e-commerce-enabling company, and UPS moving beyond package delivery to a global provider of specialized transportation and logistics services are examples of organic innovations.
- Acquisition-based innovations &ndash; mergers and acquisitions (M&A) are a way to gain access to new innovations and markets. Although this strategy can certainly enable growth, such as in Cisco&rsquo;s case, expected results can be difficult to achieve due to the many challenges and complexities that are involved in M&A. Nevertheless, acquisitions are a popular strategy for growth. Innovation Strategy

Recognizing your innovation type, and its role within your innovation strategy helps you ensure it is aligned with your firm&rsquo;s current and future objectives and goals. In addition, managing your innovation programs as a portfolio not only provides better visibility of your efforts and management of those efforts, but also presents opportunities for new discoveries and synergies.

Analysis of your innovation portfolio will help determine if you are focusing on the right types of innovations. If your innovation strategy, which is aligned to your business strategy, is highlighting the importance of growth for your firm, yet you find yourself mainly focusing on product and process innovations, you know you have too narrow a focus on innovation.

In your innovation portfolio, you should also analyze the differences of success rates between your innovation projects. The results of the analysis will be illuminating about what works and doesn&rsquo;t work within your firm, and where you need to focus in order to improve the return on investment of your innovations.

Your innovation strategy and your portfolio will also help determine how to build and manage your innovation network: internal and external partnerships. Successful collaboration can bring out more creative ideas, improve knowledge sharing among groups, facilitate shorter innovation cycle times, and result in improved productivity and quality. Sources of Innovation

Where does innovations, or ideas for innovations come from? Although not the focus of this article, it is worth considering a few departing thoughts.

- Deep customer understanding &ndash; study your customers, their workflow and pain points, but go above and beyond and deliver to their unspoken needs.
- Blend design with technology &ndash; examine all potential dimensions of your product or service and determine how you can extend its value, such as in the example of Apple&rsquo;s iPod and iTunes.
- Continuous improvement &ndash; study your value-delivery chain, and look at each step and determine how the value is added; then determine if it can be done better.
- Networks and alliances &ndash; knowledge of other advancements, trends and shifts can highlight innovation opportunities.
- Look for trends &ndash; change is constant, so look for changes in demographics, behaviors, attitudes, and beliefs.
- Be observant &ndash; innovations come from unexpected sources, including unexpected usage of your products; be observant and be open.