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INNOVATION AND RISK

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Why look at innovation and risk management? Innovation has become core to corporate growth and can be a significant driver of corporate value; therefore, the need for innovation is assured. Risk is assumed as a component of achieving innovation. The key is to balance them. Risk management has become a sophisticated discipline that is fundamental to company operations and a pillar of modern board responsibility. Applying the discipline and processes of a systematic risk management program to innovation results in a partnership that allows companies to embrace greater innovation while staying within their risk profile.

Importance of innovation to corporations

Innovation has become core to corporate growth as both an offensive and defensive strategy. On the positive side, Forbes has created the Innovation Premium to measure how much investors bid up a stock price above the value of its existing business based on expectation of future innovative results from new products services and markets; this premium ranges from a high of 72.8 percent for Salesforce.com to 18.6 percent for Daikin Industries. On the downside, providing the same product or service leaves an organisation vulnerable to disruptive innovation as industries evolve, new competition arrives and technology revolutionises the way things are done. Innovation is associated with Silicon Valley but in reality impacts everything from consumer products to pharmaceuticals to digital services.

Innovation is integral to growth and financial improvements. According to Pricewaterhouse Coopers' (PwC) 'Global Report on Innovation', which is based on interviews with 1757 C-suite and executive respondents, innovation is a driver for rapid and profitable revenue growth. Responsents recognised innovation as being integral to sustaining the long-term future of their business. Forty-three percent of those executives said innovation is a competitive necessity, with that percentage increasing to 51 percent in five years. Ninety-three percent indicated that organic growth through innovation will drive the greater proportion of their revenue growth. In another PwC study, 74 percent of CEOs regarded innovation as equally important to the success of their company as operational effectiveness, if not more – a first for innovation being in parity with operations. CEOs also see a need to be more sophisticated in their approach to innovation in order to achieve these goals.

There is no question that innovation is seen as key to growth yet companies are not investing resources in the projects that are more likely to provide such returns, instead choosing line extensions that provide little risk but offer limited gains. In Accenture's 2012 innovation study of 519 companies from a cross section of industries from the US, UK and France, 64 percent were focused mainly on online extension. Only 20 percent viewed their innovation efforts as major, with the potential to be disruptive. Only 18 percent said they use innovation to achieve competitive advantage.

The role of culture in innovation

Culture is said to be not only important but perhaps the most important factor in creating and sustaining innovation. Most of the great innovative companies were founded or led by innovators; many of the enduring ones kept or brought them back. These leaders understand the importance of building a culture of innovation throughout the company. Research undertaken by Forbes of 1000 innovative companies indicated that only 10-15 percent of leaders did not encourage it in the people around them. Others, like Salesforce.com founder Marc Benioff, claimed "I can't do it all. I don't have all the ideas. That isn't my job. My job is to build a culture of innovation. That's something that we try to enforce. We encourage it. We value it. We notice it. We compensate for it. We require it." Other companies, like Google, go further, testing for creativity and installing a discipline in the hiring process that improves the odds they select individuals who have creativity and innovation in their DNA.

Innovation as a boardroom responsibility

As innovation becomes central to company growth, it is gaining recognition in the corporate boardroom. More corporations are creating innovation committees with a charter, chair and director members. Other companies work with innovation advisory boards comprised of leading experts but not board members. Both signal the importance of innovation to strategy, growth, new business initiatives and financial results. This committee is charged with identifying and developing strategies around change in the marketplace, the competitive landscape, and across products, services and processes, understanding disruptive technology or forces that can affect the company and its prospects, identifying new products, services, processes and technology that maintain or improve the company's position and secure new leadership opportunities.

The role of risk management

The relationship between innovation and risk has been debated for decades. Economists Schumpeter (1934) and Kirzner (1973) distinguish between entrepreneurs and capitalists and did not see risk as important to innovation. Knight (1971) saw innovation as risky in that such actions are geared for the future and that involves uncertainty. This uncertainty involves both tangible risks like capital, costs and corporate promotion, and less tangible ones like social standing and self-esteem. The theory is that how risk is perceived influenced what innovation is undertaken. (Brockhaus, 1980; MacCrimmon and Wehrung, 1986.)

The risks that need to be managed include: assessing the business model and assumptions; identifying, evaluating and managing suppliers; creating delivery and distribution systems and options; developing viable marketing options; and identifying and structuring agreements with strategic alliances. Even more difficult to manage unknowns are consumer reaction, global economic conditions and potential new technology introductions. Specific risk and innovation categories to be assessed and managed include: quality assurance; customer relations; data support; and customer and vendor contracts. The board of directors also plays an important role: it oversees risk management and is now doing the same for innovation.

The combination of flexible experimentation with process and tools is explained by Amazon founder Jeff Bezos: "I encourage our employees to go down blind alleys and experiment. We've tried to create tools to reduce the cost of doing experiments so that we can do more of them. If you can increase the number of experiments you try from a hundred to a thousand, you dramatically increase the number of innovations you produce. "

The process to manage risk while facilitating new product introductions

There is a need to foster innovation yet manage risk and follow regulations. For new product introductions, an approval process is often installed. A challenge is to avoid bottlenecks and unnecessary delays or cancellations as projects proceed through the process. According to Wouter Koetzier of Accenture's Innovation and Product Development Group, flexibility, speed and control are three principles required to balance risk and innovation.

Flexibility. This refers to developing a portfolio of innovation investments. Venture capitalists do this as part of their model. Monsanto, number 10 onForbes' list of the world's 100 most innovative companies, has invested in biotechnology companies as well as created the Life Science Research Center, which now has more than 1000 employees. This approach has created 'growth layers' for the company's R&D pipeline, according to Monsanto's chief technology officer, Robb Fraley. Key to flexibility is multidimensional metrics for evaluations and a commitment to creative and alternative thinking. IT also offers tools to help assess risk and return by measuring uncertainty and potential results as well as simulating results within specific frameworks and parameters

Speed. The pace of change keeps accelerating, requiring greater speed to accommodate innovation. This tendency to develop new ideas quickly needs to be paired with decisiveness. In high speed environments, risk management becomes even more important in order to stay within a company's risk profile as potential costs and risks accelerate.

Control. Controls measure and thus manage risks, allowing companies to stay within a 'safe' parameter. This often marries the finance and operations teams, bringing together two different perspectives and expertise to create effective rules and measurements. Components of an effective control system include a comprehensive monitoring system with senior management involvement. It includes tactics delegated to appropriate personnel, transparency and open communications of metrics and feedback between all team members. Finally, a flexible approach to financial forecasts, combined with an understanding that big growth often takes longer, is appropriate.

Recommendations for balancing innovation with risk management include: developing a disciplined process to manage innovation; creating an approval process the includes flexibility, speed and control; using governance to allow for intelligent mistakes; and recognising that building this balance between innovation and risk management takes time and work.

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