A HARVARD BUSINESS REVIEW ANALYTIC SERVICES REPORT

Harvard Business Review

EMBRACING DISRUPTION WITH INNOVATION

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Innovation at Our Core

Chief executives tell us that they feel great urgency to respond to market disruption with innovation. KPMG's recent *CEO Outlook Survey* reveals that 51 percent of CEOs expect their top-line growth over the next three years to be five percent or less. So, to stay competitive and keep shareholders satisfied, even highly successful companies must consider innovation a business imperative.

First, let's clarify what we mean by *innovation*. Although many associate innovation with new technologies, forward-thinking companies put equal emphasis on social change such as demographic shifts, evolving buyer behaviors, and the communication preferences of millennials. Insights are derived from ethnographic research that analyzes human behavior. Corresponding innovations—new products, services, channels, or even business models—are brought to life through human-centered *design thinking*.

Walking the walk. At KPMG, we don't just advise clients on how to embrace disruption with innovation, we've embedded innovation into our *own* DNA. By creating a culture where it is safe to experiment and *fail fast*, the ideas we generate are inventive and bold, built by teams notable for their diversity of skills, thinking, experiences, and outlooks. One of our strategic priorities is *Innovation at Our Core*, which starts with our vision and strategy and forms the *core* of how our people think about themselves, their clients, and the firm. Most important, our innovation efforts are managed with a tangible commitment and hands-on role by senior leadership.

Some of the factors that distinguish KPMG's culture of innovation are:

- **A continuous sensory approach** to monitoring a global network of political, economic, social, and technology (PEST) sources for *weak signals* that could turn into disruptive trends. Business decisions are informed by PEST insights and our *trend indexes*, which monitor venture capital flow, startup launches, and new technology investments. Our clients also benefit from this rigorous approach of *signal tracking* leading to *insight* and then *action*.
- **A clear method of choosing whether to *build*, *buy,* or *ally* to expand our innovation ecosystem.** The linchpin of our innovation approach is to *build* capabilities by tapping our top thinkers; market-leading Strategy Practice; Data & Analytics team; and creative labs. When market speed demands, we selectively *buy* capabilities through strategic acquisitions. Additionally, we *ally* with the world's best-known innovators, exemplified by our key alliances with Oracle, Microsoft, and IBM Watson (which enabled us to have *first mover* advantage in cognitive business solutions).
- **Dedicated labs and alternative workspaces.** KPMG explores innovative ideas in three revolutionary workspaces: (1) *Innovation Labs*, where we delve deeply into market disruptors and customer trends; (2) *Ignition Centers*, cross-functional project spaces dedicated to uncovering new technologies and transformation opportunities; and (3) our *Insights Center*, which facilitates the visualization of future business uses of data and analytics. Many innovations are conceived in these creative workspaces, after which they are scaled by our business and deployed.

It is clear to us that companies must disrupt before they are disrupted. What's at risk is not just reputation but survival. By accepting the reality of a vastly transformed market environment and taking steps to elevate innovation to a core competency, businesses **can** thrive in an age of disruption.

Mike Nolan
Vice Chair, Innovation & Enterprise Solutions
KPMG

EMBRACING DISRUPTION WITH INNOVATION

Business leaders have long understood the power—and the threat—of disruptive innovation. As formally defined two decades ago by Harvard Business School professor Clayton Christensen, the theory describes how a smaller company with limited resources overtakes a larger competitor with a cheaper product or service, either by targeting the low end of the incumbent's market or by reaching out to potential customers the incumbent has been ignoring. figure 1 The upstart then moves inexorably upmarket, ultimately threatening the industry stalwart. Think Netflix overtaking Blockbuster, or Zipcar racing past traditional rental car companies to lease vehicles by the hour.

Today, as technology speeds the pace of change in industry after industry, simply understanding how disruptive innovation works isn't enough. CEOs must position their companies to take advantage of innovation before they're beaten by it. That requires creating an environment, and processes, for searching out and spotting disruptive innovation when it arises, defending their turf where it is threatened, and, just as importantly, ferreting out opportunities to employ disruptive innovation themselves, beating would-be disrupters to the punch. In short, innovation is not a nice-to-have capability, but an imperative that directly impacts brand perception and value, top-line growth, and a company's relevance—and sometimes survival—in the marketplace.

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THE CHALLENGE: WHERE TO START, AND HOW

Managing disruptive innovation isn't always complicated. In some cases, it can be as simple as acquiring the company doing the disrupting. In 2014, Spanish bank BBVA saw what fintech startups were accomplishing in the financial services industry and decided to scoop up fast-growing Simple, a Web-based virtual bank headquartered in the U.S.[1] More recently, Unilever PLC agreed to buy Dollar Shave Club for $1 billion after seeing how quickly the startup, an online seller of discount disposable razors, was eating away at the market share of Procter & Gamble's Gillette unit.[2]

At the opposite extreme, managing disruptive innovation can require a wholesale reinvention of a company's core business model, or a component thereof, perhaps after a long period of retrenchment. That's what happened at IBM in the 1990s, when CEO Lou Gerstner redefined the company as a software and services player after it had faded in the PC and disk drive businesses it had largely invented. It may be happening at IBM again today as the company further deemphasizes its history and ties its future to cognitive computing. Note that transformative transitions such as IBM's used to take 10 to 20 years to play out. Today the timeline is much shorter; some companies are transforming through disruptive innovation in as few as two to five years.

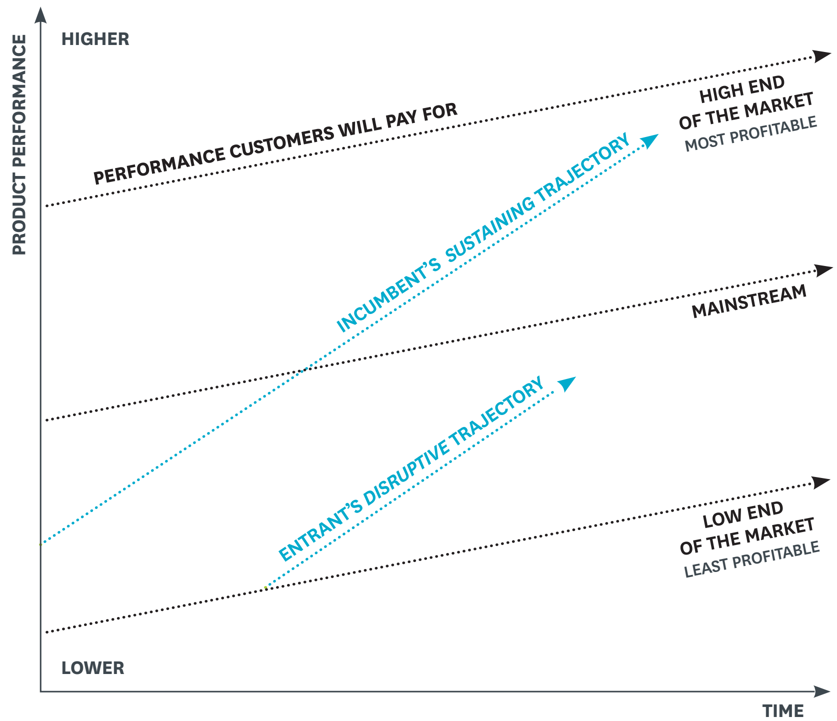
1 "BBVA Acquires Simple to Accelerate Digital Banking Expansion," BBVA.com, https://info.bbva.com/en/news/economy/corporate/finance/bbva-acquires-simple-to-accelerate-digital-banking-expansion/.

2 Sharon Terlep, "Unilever Buys Dollar Shave Club," *The Wall Street Journal*, July 20, 2016.

FIGURE 1

UNDERSTANDING DISRUPTIVE INNOVATION

Incumbent companies introduce products for the high end of the market, overshooting the mainstream and low end of the market, and leaving an opening for disrupters to introduce less-profitable products at the lower end of the market. Disrupters then move upstream to challenge the incumbents.



SOURCE CLAYTON CHRISTENSEN INSTITUTE FOR DISRUPTIVE INNOVATION

KPMG ANALYSIS

A recent KPMG study of more than 400 U.S.-based CEOs found that 85 percent do not believe they have the right amount of time to strategize about the forces of disruption and innovation. And nearly 40 percent assess their approach to innovation as unpredictable, siloed, and outsourced—if they have an innovation strategy at all.

Reinvention isn't easy, of course. Occasionally the mark of a first mover, it is more often a defensive move, and almost always comes with significant risk. To avoid being forced down the reinvention path, companies need to create a culture adept not only at spotting disruptive technology, but also—and perhaps more importantly—at elevating innovation to a core competency. See sidebar: In Focus: How AIG Is Creating a Culture of Innovation

Indeed, the most innovative companies ruthlessly foist innovation upon themselves before others do it to them. Consider General Electric Co., whose reputation for innovation stretches back to cofounder Thomas Edison. Today GE's many diverse operations include a $16 billion-plus business serving the oil and gas industry, but the company is not content to merely tend that market. It has simultaneously created a $6 billion-plus renewable energy business that looks to the day when fossil fuels no longer play a dominant role in generating the world's energy.

Companies hoping to create a culture of innovation can start by defining what innovation means to their organizations. In industries that have largely become commoditized, it might mean finding better, faster, more efficient ways of doing business. In others, it might mean focusing not only on making existing products and services incrementally better, but also on developing new technologies or business models that can deliver products or services customers didn't know they needed or never imagined they could afford. At insurer American International Group Inc., it means both. "Our mission is to reduce fear of the future and empower our clients with our risk expertise and our financial strength," says AIG President and CEO Peter Hancock. "The insurance industry is a reflection of society. What people fear today isn't necessarily what they feared in the past or will fear tomorrow. To the extent society is going through constant innovation, the insurance industry needs to innovate in parallel. Internally, meanwhile, there are constant opportunities to improve the effectiveness and efficiency with which we are able to meet our clients' needs."

Once companies have defined what innovation means to them, they can start to develop an innovation strategy—a commitment, as Harvard Business School professor Gary Pisano has explained it, "to a set of coherent, mutually reinforcing policies or behaviors aimed at achieving a specific competitive goal." The idea, Pisano writes, is to "promote alignment among diverse groups within an organization, clarify objectives and priorities, and help focus efforts around them."[3]

Here are three broad steps toward getting there.

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STEP 1

KEEP YOUR HEAD ON A SWIVEL

Innovation can pop up anytime, anywhere, but it's not always easy to spot. While new technology is often at the root of disruption, it can take years before viable business models emerge around that technology and drive real change. Mobile phones and location-based services were technology innovations, for example, but it took Uber's business model to combine them and throw the car service industry into turmoil. In addition, political, economic, and social developments can roil markets and create new opportunities and challenges.

Companies that hope to keep pace need the ability to find and assess potentially disruptive innovations before they begin chipping away at market share. One way to do that is by appointing a senior-level executive to oversee innovation activities without having to be distracted by other day-to-day responsibilities. Another is by creating and empowering cross-functional teams to conduct ongoing research aimed at identifying potential new disruptors.

A consistent and organized effort to spot innovation early is important simply because doing it well can be difficult. In the same article announcing Unilever's acquisition of Dollar Shave Club, *The Wall Street Journal* reported that Procter & Gamble executives had privately acknowledged being caught off guard by the startup's success, with one unnamed insider conceding that "we weren't necessarily having the right conversation around what might disrupt us."[4]

3 Gary P. Pisano, "You Need an Innovation Strategy," *Harvard Business Review*, June 2015.

4 Sharon Terlep, "Unilever Buys Dollar Shave Club," *The Wall Street Journal*, July 20, 2016.

Because it is hard to break the mold of a legacy business, companies often find it more difficult to identify opportunities to disrupt their own markets than to spot disruptive innovations outside the company.

Now, another *Journal* article reports, P&G's 7,500-person R&D operation is remaking itself, hiring more industrial designers and looking to hire more people with entrepreneurial backgrounds.[5]

Casey Carl, chief strategy and innovation officer for retailer Target Corp., agrees that companies can't allow themselves to become too insular. "Organizationally, we have to be incredibly external facing and incredibly open to adaptive learning, always actively listening and surveying the external landscape," Carl says. As part of its efforts on that front, Target fosters relationships with venture capital firms and investment banks to monitor and understand what's in their investment portfolios. It also has created a digital advisory council whose members, drawn largely from the tech community, meet regularly with Carl and other Target leaders to help inform and shape the company's digital strategy.

Because it is hard to break the mold of a legacy business, companies often find it more difficult to identify opportunities to disrupt their own markets than to spot disruptive innovations outside the company. It's not impossible, though. In 2002, Dow Corning altered the market for commodity silicones when it created Xiameter, an online, lower-cost, self-serve sales channel and brand for B2B customers who knew what they wanted to buy and were happy to forgo research or technical support in order to get it at a cheaper price.[6] Dow Corning didn't abandon its traditional customers—it continued to serve them as it always had—but it created a new way to attract those who might have been priced out of its traditional distribution model. Elsewhere, Netflix drove a nail in the coffin of DVD rental stores in 1998 when it started renting DVDs via mail service, and later did it again when it started streaming content to customers' homes via the internet. Today Netflix is helping to disrupt the television broadcasting business by producing its own original programming.

Assessing Threats—and Opportunities

A big part of the innovation challenge is determining which innovations have the power to be truly disruptive. Accurate assessments are important not only to making sure companies don't overlook potential disrupters, but also to making sure they don't overestimate threats and so embark on costly changes, such as price cuts, that unnecessarily hurt their margins.

In their *Harvard Business Review* article "Surviving Disruption," Christensen and venture capitalist Maxwell Wessel suggest a three-step process companies can use to assess the threat of potential disrupters. It begins with identifying the strengths of the disrupter's business model, identifying your own company's relative advantages, and, finally, evaluating "the conditions that would help or hinder the disrupter from co-opting your current advantages in the future."[7]

5 Sharon Terlep, "P&G Seeks to Turn Tide by Direct Selling," *The Wall Street Journal*, July 20, 2016.

6 Linda Rosencrance, "Dow Corning Launches Business Unit, Xiameter," *Computerworld*, March 14, 2002. See also: Bob Frei and Chris Musso, "Innovation in Chemicals: An Interview with Dow Corning's CEO and CTO," May 2011, McKinsey & Co.

7 Maxwell Wessel and Clayton M. Christensen, "Surviving Disruption," *Harvard Business Review*, December 2012.

That's largely the approach employed at GE. Vic Abate, GE's chief technology officer, says he pushes engineers and researchers in the company's 10 Global Research Center locations around the world not only to think at the nanoscience level when pursuing and evaluating innovative ideas, but also to simultaneously consider the ecosystems in which GE competes. He then challenges them to figure out how GE's products compare against those of its competitors, identify the technology advantages GE enjoys, and find a way for GE to leverage those advantages to offer products that better meet customer needs. The more broadly and deeply executives understand how technology can transform not only the products but also the whole ecosystem, Abate adds, the better equipped they'll be to spot important innovations and adjust their strategy accordingly. "If you understand how technology and the whole ecosystem works, you have a bigger seat at the table."

The more broadly and deeply executives understand how technology can transform not only the products but also the whole ecosystem, the better equipped they'll be to spot important innovations and adjust their strategy accordingly.
Vic Abate, CTO, GE

"Our leadership team spends a lot of time talking about what early signals of disruptive innovation mean for our agenda," says Target's Carl. "Some innovations are just really cool, so we watch them. With others, we may see a great opportunity and decide to accelerate what we're already doing to take advantage of them. Others suggest we need to pivot and maybe go in a different direction. But we always bring it back to our strategic agenda."

At AIG, Hancock says that when his team looks at disruptive companies that may be small but are attacking parts of AIG's value chain, he encourages them to focus not on the reasons the disruptors might fail, even though most will, but rather on the reasons why one of them might succeed—and then to embrace those companies' innovations in a form of self-disruption. "I think the height of hubris for a large company is to assume that all those small disrupters will fail," Hancock says. "By the time one succeeds, it's too late."

STEP 2

BUILD, BUY, OR PARTNER

Once companies have grasped the disruptive forces at work in their industries, they can begin to assess how those forces are impacting, or could impact, their specific businesses and operating models. Then, they can begin to reshape themselves in response. Inevitably, this will require making a decision about whether to build out a new technology or business model themselves (innovate organically), buy the technology or business model (acquire innovation inorganically), or ally with someone else (partner with another innovator).

These options are not mutually exclusive, and often a mix of two or all three will be the right answer. Ultimately, companies need to develop the strategic agility to arrive at the optimal solution quickly. "It's a very situational decision," says Target's Carl. "The better we are at seeing around corners, the more optionality we have around our suite of choices: buy, build, or partner." See sidebar: Choosing a Route to Growth: Organic vs. Inorganic

Innovating Organically

To bolster their internal innovation capabilities, companies may want to slice off a segment of their R&D resources to act as a startup within the company, where they may wind up disrupting their own industry. New York-based IBM famously built a team in Boca Raton, Florida, for example, to create the first IBM PC in the early 1980s.[8] More recently, a GE team in China developed an inexpensive, portable ultrasound machine using a laptop computer equipped with special peripherals and software. That innovation not only found a home in China, but also went on to have application in the developed world.[9]

While considered desirable, locating research activities away from core operations can nonetheless present researchers with a difficult balancing act, says David Eun, president of Samsung Global Innovation Center. That center, which supports the company's consumer electronics and mobile device businesses, pursues innovation from offices in four cities around the world: San Francisco, New York, Tel Aviv, and Seoul. "You can't get in the way of people working on core products, because anything that isn't core is a distraction or a threat or both," Eun says. "However, you can't be so far away that people forget about you. You want to be at arm's length from the mother ship, but still close enough to influence and navigate the mother ship."

Not all companies have the scale and resources of Samsung Electronics or a GE, of course, and so may not be able to operate stand-alone innovation centers. But GE's ultrasound example illustrates the potential creativity that can be unleashed when employees are given the freedom to explore new ideas absent day-to-day oversight from corporate headquarters.

Innovating Inorganically

In instances where companies lack the internal resources to capitalize on an innovative idea or trend on their own, they need a mergers and acquisitions strategy that lets them take advantage of disruptive capabilities outside the company. This means buying those capabilities, investing in them, or simply partnering with a disrupter to co-opt their technology or business model. Walt Disney Co. effectively pursued the latter approach in the mid-1990s when it signed a distribution deal with Pixar, ultimately giving Disney a string of successful Pixar movies to market at a time when its own animated films weren't winning the box office wars.[10]

When Target decides whether to build, buy, or partner, Carl says, the company first looks to see whether there is anybody already functioning as a leading player in the space. By way of example, he points to Target's sale of its pharmacy and clinic businesses last year to drugstore chain CVS Health, which in turn contracted to operate pharmacies within Target stores. "We aligned with CVS because we shared a similar philosophy about the importance of wellness, and they clearly were the leader in that space," Carl says. "It was a great association for our brand to have them running pharmacies in our stores."

KPMG ANALYSIS

An Appetite for M&A

In a recent survey of CEOs by KPMG, 44 percent of the respondents said they would form new partnerships/alliances to accelerate execution of their strategy, behind only "hire new talent." In addition, 65 percent confirmed that "collaborative growth" (utilizing external partnerships or collaboration with other firms) will be a key ingredient in driving shareholder value.

8 "The Birth of the IBM PC," IBM.com, https://www-03.ibm.com/ibm/history/exhibits/pc25/pc25_birth.html.

9 Jeffrey R. Immelt, Vijay Govindarajan, and Chris Trimble, "How GE Is Disrupting Itself," *Harvard Business Review*, October 2009.

10 Bruce Orwall and Nick Wingfield, "The End: Pixar Breaks Up with Distribution Partner Disney," *The Wall Street Journal*, January 30, 2004, http://www.wsj.com/articles/SB107541081328315628.

CHOOSING A ROUTE TO GROWTH: ORGANIC VS. INORGANIC

Where innovative technologies or business models offer the potential for growth, companies must decide whether to develop them organically in-house or inorganically via a merger, acquisition, or partnership. The decision process often starts with determining which factors are likely to drive growth in the new business or market, and assessing the potential value of the opportunity. Companies then need to undertake a clear-eyed assessment of their own competencies and assets to see whether they are well-positioned to take advantage of the opportunity organically. Inorganic growth makes sense if they are not positioned to go it alone, or if a market is evolving so rapidly that it makes a fast response critical.

Companies should stage their investments and be ready to pivot as they learn.

Regardless of the approach, smart companies will want to go into such decisions recognizing they are more likely to be wrong than right about the opportunity they're pursuing, at least initially, simply because the trend they are responding to will continue to evolve. Accordingly, rather than place a large bet and commit themselves to one direction or expected outcome, companies should stage their investments and be ready to pivot as they learn.

By contrast, Carl says, Target had not identified any lead players in the Internet of Things space when, in 2015, it opened Target Open House, a 3,500-square-foot space in San Francisco where the public can explore how devices like door locks and thermostats are being connected with each other and with homeowners via the internet. "We had the capabilities to build a physical experience, so we did that—and pulled some partners in on an agency basis," Carl says. "With each opportunity, we have a unique conversation and assess how it matches around our current capability set and our strategic positioning. We ask if it makes sense for us. If it's super interesting, but we're not well-positioned to do it ourselves, we ask whom we should partner with to really help accelerate our efforts."

STEP 3

SET THE RIGHT TONE FROM THE TOP

Leadership from the C-suite is always important to driving change, and innovation is no exception. At Samsung Electronics, says Eun, senior leaders regularly remind employees that the company cannot afford to rest on its laurels. "It's a constant theme," Eun says. "The glass is always half empty. It's a slightly different version of [Intel Corp. cofounder] Andy Grove's mantra that only the paranoid survive. We're in relentless pursuit of making sure we're ahead of not just the competition, but also of ourselves. That is communicated right from the top."

CEOs can help on this front by making employees comfortable with innovation. This means motivating employees to pursue new ideas, technologies, and business models, and making it acceptable to fail fast in the name of finding a true solution. It also means making sure they understand that failure is not an automatic threat

IN FOCUS: HOW AIG IS CREATING A CULTURE OF INNOVATION

American International Group Inc. president and CEO Peter Hancock takes innovation seriously. Five years ago, even before taking over as CEO of the giant insurer, Hancock created the position of chief science officer at AIG. That person leads a diverse team of researchers who leverage partnerships with academic institutions, think tanks, and other research-minded, for-profit organizations to improve AIG businesses and processes and uncover opportunities to innovate. Meanwhile, AIG also leverages insights from its 90 million customers around the world, not only by reviewing and analyzing the roughly one million claims it pays each month—what went wrong and why—but also by forming and hosting client councils that allow AIG and its customers to share insights directly.

"We don't have to be the source of all the good ideas," Hancock says. "We just need pathways to collaborate with the best thinkers in the world, whether they be Nobel Prize winners—we've been collaborating with three in the past five years—or the very broad and diverse span of clients we do business with, which ranges from 98 percent of the Fortune 500 and the equivalent in Europe to small farmers in India."

To nurture an innovative spirit in the farthest reaches of the company's ranks, Hancock pushes AIG to give its employees a mission they can believe in. "In financial services, innovation has, in the relatively recent past, gotten a bad name because, I think, it was misused," Hancock says. "We're making it very clear that our culture is to use innovation to help our clients. That attracts a certain type of individual; they're mission-driven, and prioritize innovation projects that add to long-term, repeatable earnings—which in turn come from satisfied clients."

Hancock notes that innovation doesn't have to lead to wholly new products or services but can combine existing ones in new configurations that delight customers—much as Starbucks did when it reinvented the coffee shop by offering a mix of coffee, free Internet service, and comfortable chairs. At AIG, a similar example can be seen in the company's new approach to the large-limit property insurance marketplace. For the past four years, the company has been supporting that business with a team of more than 500 property engineers, who provide consulting advice on construction methods that mitigate exposure to quake, flood, wind, and fire risks at very large industrial installations. "That advice was already available from independent consultants," Hancock concedes. "But what's new is that it's now integrated with our willingness to put up as much as $2.5 billion dollars of insurance capacity per building. This integrates our balance sheet strength with scientific consulting advice, and it's the combination of the two that creates a customer experience that's quite different." Since adopting this approach, Hancock says, AIG has won more than 400 mandates in the large-limit property insurance market, where it's also enjoyed a much higher persistency of policy renewals and better underwriting results.

Today AIG is embracing innovative new ways to collect data from new sources, exploring the use of sensors and the Internet of Things and employing a fleet of drones to assess loss sites, and looking to marry that data with existing internal and external data sources to create new insights and opportunities for the company. "There are certain enduring aspects of insurance that will not change over the decades or centuries," Hancock says. "But there are ways in which to pool risk that are very different, that cut across conventional boundaries, that exploit microsegmentation, that are feasible and cost-effective today in a way that was unthinkable before."

to their careers. (At Google parent Alphabet Inc., employees of its X research lab are eligible for bonuses for pulling the plug on a project they conclude is no longer promising.[11])

CFOs can contribute to an innovation culture by identifying metrics for measuring success or failure, clearly defining the organization's tolerance for risk, and finding creative ways to fund innovation initiatives. CIOs and CTOs can help employees understand how they can use data, analytics, and cognitive computing to spot emerging trends and assess their disruptive potential. In short, all C-suite executives can function as allies to the innovation effort. "I have a senior title, but I'm just one person," notes Samsung's Eun. "To have others at the senior-most level of the company providing support is really crucial."

Sean Belka, senior vice president and director of Fidelity Labs, the research and development arm of the diversified financial services company Fidelity Investments, says employees at his company "are expected to innovate as part of their jobs," and that "this is communicated from the very top." He notes that the group he leads was started by Fidelity Chairman Edward C. Johnson III in 1998, and that Fidelity CEO Abigail Johnson also is "very focused on innovation." Mistakes and restarts are expected, he says. "In the language of startups, we may start somewhere and pivot two or three times because we've learned that something about our original hypothesis was not accurate. We're pretty open to that."

Belka adds that the 100-plus software developers, designers, researchers, product managers, librarians, and "entrepreneurs in residence" at Fidelity Labs pass this kind of leadership down through the ranks of the organization by providing the tools, techniques, and research their business-unit colleagues need in order to innovate. Fidelity Labs also runs "hackathons" in which Fidelity employees from around the world assemble into teams for two days to develop new ideas, build prototypes of the product or service they've imagined, and pitch it to their colleagues and Fidelity executives. Like the innovation team at Target, Fidelity Labs personnel also spend a lot of time in the entrepreneurial community and have forged relationships with venture capital firms, startup companies, and academics.

In driving the innovation agenda, C-suite executives should encourage researchers and business unit leaders to pursue a balance of long-term and short-term projects. Some should be incremental and close to the company's core operations, designed to maintain competitiveness. Others should look further out, aimed at engaging new customers or inventing additional things to sell to current customers. Still others should be step-out opportunities where the company is designing new business models for new customers and new offerings. The balance across these differing types of innovation may shift based on market conditions.

KPMG ANALYSIS

Eighty percent of CEOs surveyed recently by KPMG believe they are capable to highly capable of fostering a culture of innovation. A key component of this is creating an environment where failure and experimentation are encouraged. Sixty-eight percent of CEOs believe their companies are capable to highly capable of creating such an environment.

11 Conor Dougherty, "They Promised Us Jet Packs. They Promised the Bosses Profit," *The New York Times*, July 23, 2016.

Be willing to incubate new technologies or business models outside the core business, even if the new technology or business model yields lower margins than do legacy businesses.

Other keys to creating a culture of innovation include:

- **Making sure any teams tasked with identifying potentially disruptive innovations are truly cross-functional**, staffed with people from all the company's key disciplines.
- **Keeping innovation teams connected to the core business.** While companies may fund early-stage innovation centrally, they will want to graduate completed capabilities to the business that will own them. That's exactly what happens at Fidelity, says Belka, who notes that promising ideas developed within Fidelity Labs get pushed into the business units for further refinement, drawing on the deep understanding business unit leaders have about what their customers want. At GE, Chairman and CEO Jeff Immelt has sought to tie innovation more closely to the company's core businesses, Abate says, by filling more of GE's officer ranks with engineers. Abate, a mechanical engineer by training, was the first such promotion by Immelt. Prior to taking over the CTO post, Abate had been president and CEO of GE's Gas Power Systems, and before that president and CEO of its Renewable Energy business.
- **Assuring the active engagement of senior leaders.** At GE, Abate oversees an Engineering Leaders Council in which he and the company's leading engineers meet quarterly to discuss and review innovation initiatives and opportunities, and to share information about their work that could be transferred across GE's businesses. They also plan the rotation of staff engineers between business units and different types of engineering assignments to facilitate knowledge-sharing and career growth. In addition, each of the various GE business unit leaders and their lieutenants meet quarterly for a couple of days to talk about technology, products, and services at the company's Global Research Center in Niskayuna, New York.
- **Being willing to incubate new technologies or business models outside the core business, even if the new technology or business model yields lower margins than do legacy businesses.** Again, companies either disrupt themselves or have it done for them. "Within Fidelity Labs, we're always looking for opportunities adjacent to our core business," Belka says. "We're trying to do things for which the market isn't there yet."
- **Identifying and mitigating the governance risks associated with innovation, and maintaining the right balance of controls to encourage efficient experimentation.** Specifically, companies should establish deliberate milestones with tangible go/no-go criteria for moving from one stage of development to the next. These milestones should be reviewed and evaluated by an independent executive team. "We have very precise approaches and methods on go/no-go, including set milestones for what we expect each startup's evolution to be like," says Samsung's Eun. "Yes, we want people to be open, flexible, and iterative, but that doesn't mean we're not buttoned up. We want to be thoughtful and rigorous about the decisions we make. In fact, we have to be—even more so than other groups—because of the nature of what we're doing. It's all new, and it takes time to get tangible evidence that something has been truly disruptive. So along the way we want to make sure people aren't doubting how responsible we're being with the capital and the trust they're putting in us."

IN FOCUS: TARGET RECLAIMS ITS INNOVATION ROOTS

Discount retailer Target Corp. began life as a disruptive innovation. The chain was launched in 1962 by department store retailer The Dayton Co., which recognized that consumer buying patterns were changing in ways that would test the sustainability of traditional department stores. Its experiment with Target—launched the same year Walmart and Kmart were founded—proved wildly successful. By 1975, Target would become the top revenue producer in what was by then Dayton-Hudson Corp. Over the ensuing decades, Target largely maintained its reputation for innovation. In 1988, for example, it became the first mass merchandiser to introduce UPC scanning at all of its stores and distribution centers. By the start of the new millennium, however, Target was directing the bulk of its investment activity to building new stores, and paying a little less attention to innovation.

> By the start of the new millennium Target was directing the bulk of its investment activity to building new stores, and paying a little less attention to innovation.

"We became far too insular as an organization," says Casey Carl, a longtime Target executive who was named to the newly created post of chief strategy and innovation officer in late 2014. "We didn't invest enough in new areas of growth and the capabilities necessary to bring those to life successfully, whether that was forays into international retailing or the importance of data security and privacy. We had some tough days as it relates to not investing in those capabilities early enough to understand their importance to our strategic agenda and what they meant to our guests."

More recently, the company has reembraced its innovation roots. In 2013, the company introduced Cartwheel, a digital coupon app developed in partnership with Facebook that Target says has saved its in-store customers approximately half a billion dollars. That same year, it opened the Target Technology Innovation Center in San Francisco to help it find and test new technologies, including things like augmented reality, wearable computing, and gamification.

"We've recognized we need to be far more externally facing, far more effective at seeing around corners to position our organization strategically for what's coming, take full advantage of that, and create new levers for growth," Carl says. "This is paramount for the retail industry as a whole. The U.S. market is growing quite conservatively, so the only way to grow market share is by stealing it from competitors or creating entirely new business models. We need to do that through new platforms, channels, and services."

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Target, continued

Recently, Target teamed with Techstarts, a tech startup accelerator, to provide funding and mentoring for small companies developing retail technology.[12] The company also is working on a concept store where, it has been speculated, it may test the use of robots in a retail environment.[13] Just outside Boston, Target has established the Future + Food coLab in the Kendall Square tech district, a partnership with design firm IDEO and the MIT Media Lab that is exploring innovations in food. And in San Francisco, Target has launched Target Open House, a 3,500-square-foot smart house open to the public. In a variety of ways, the company is focusing on how trends in artificial intelligence, social media, and the Internet of Things will impact its business near-term and farther into the future.

"The creation of my position a little over a year and a half ago was a great signal to the organization and the external community about the importance of innovation at Target," Carl says. "It's not just that we have that position, which reports directly to the CEO and is tasked with driving innovation, but also that it's coupled with strategy. Our mission isn't to go explore passion projects, but instead is linked to our strategic agenda. How do we create new growth platforms to help extend our core business, but also help diversify our overall business portfolio?"

In service of that mission, Casey assigns team members to work with Target's merchandisers and marketers to build product assortments, and with suppliers to create promotions and deals—activities aimed at deepening relationships with existing customers and attracting new customers. But he also has built up a small stable of in-house innovators, including a trio of "entrepreneurs in residence" who are specifically focused on launching new businesses. "These people all have strong backgrounds as 'intrepreneurs' within large corporations or as entrepreneurs, with proven track records starting new businesses multiple times over," Casey says. "They're engaged in specific bodies of work: the future of food, looking around corners to where the grocery industry is going, where the agricultural industry is going, and positioning Target to take advantage of new business opportunities related to the trends they are able to identify."

All this, Carl suggests, is a process. "We are still very much on the journey, building up new muscles for the organization," he says. "We by no means have it all figured out. We have a lot of irons in the fire, but they are all strategically positioned."

CONCLUSION

Faced with a potentially disruptive innovation, weak companies often succumb to analysis paralysis as they try to define the future with perfect certainty before acting. Others struggle to see the world without the lens of their current business model in place, as Blockbuster did when it couldn't see how to build a Netflix-like business without using its stores as an asset and differentiator. For companies like these—indeed, for any company that has yet to establish an innovation culture and build an innovation strategy—it is important that they do so quickly. Companies that embrace the challenges and opportunities presented by disruptive innovation are the ones that will be best positioned to build sustainable businesses.

12 Phil Wahba, "Target Wants to Turn Minneapolis into a Mini Silicon Valley," *Fortune*, September 20, 2015.
13 Jacob Siegal, "Target Plans to Test Robot Workers at Its Upcoming Concept Store," September 21, 2015, http://bgr.com/2015/09/21/target-robot-workers-concept-store/.

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