

Open-market innovation

By Darrell Rigby
and Chris Zook

When Pitney Bowes learned a year ago that envelopes tainted with anthrax had spread infection and death through the US postal system, it recognized the human disaster as an attack, too, on its core business. Overnight, desperate requests from corporations and postal services flooded the world's largest manufacturer of mailing systems. Pitney Bowes's customers were seeking a solution—any solution. But the \$4.1 billion market leader had nothing in its pipeline to shield clients against a disruption as unexpected as anthrax contamination.

By systematically opening their innovation borders to vendors, customers and even competitors, companies are increasing the imports and exports of novel ideas—improving the speed, cost and quality of innovation.

The only way Pitney Bowes could respond quickly to the market's sudden shift was to look outside for ideas. In a few weeks, a team of engineers gathered more than 100 promising concepts, from fields as diverse as military security and food-handling. These were whittled down to half a dozen worth developing, ranging from low-tech solutions to expensive, high-end detection systems. With help from the outside inventors, Pitney Bowes was able to quickly respond to the bioterrorism threat.

The drama at Pitney Bowes is a time-lapse version of a problem more businesses are confronting: how to reach outside their own four walls for the ideas they need. A growing number of companies are moving in the direction of open-market innovation, an approach that brings the benefits of free trade to the flow of new ideas. By opening their innovation borders to vendors, customers and even competitors, companies are increasing the import and export of novel ideas.

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The Big Opportunity

A Bain & Company survey of more than 200 senior executives around the globe found evidence of pent-up pressure to pursue open-market innovation. Even in the throes of a global recession, often a time of restructuring and cost reduction, 80% of respondents rated “becoming more innovative” among their top three priorities. Nearly two-thirds admitted their firms were not “close to full potential” in tapping outside ideas and deemed such action a “big opportunity.” Perhaps most astounding, 91% of executives across all industries named increasing their capacity for innovation “critical to creating future competitive advantage and earning profits.”

We also asked about the prospects and results of tools to increase innovativeness, ranging from online knowledge exchanges to idea-creation sessions to financial incentives for ideas. Across all of these ideas, companies found significant success only about one time in six. The highest-rated technique, interestingly, was external technology searches—a component of open-market innovation. Thirty-four percent of respondents said this tool helped significantly to boost their firm’s innovation.

It’s clear that corporate innovation is falling short. The best ideas are not coming from pressured executives’ own R&D labs. It’s time to do “research without walls,” as drug maker Eli Lilly says.

This is not all pie-in-the-sky theoretical. The benefits of open-market innovation can be seen on the bottom line—from patent licensing and royalty agreements. In 1980, the market for patent licensing was \$3 billion. Today, it is \$110 billion and growing. IBM earns nearly \$2 billion a year—or 15% of its profits—in royalties from the patents it

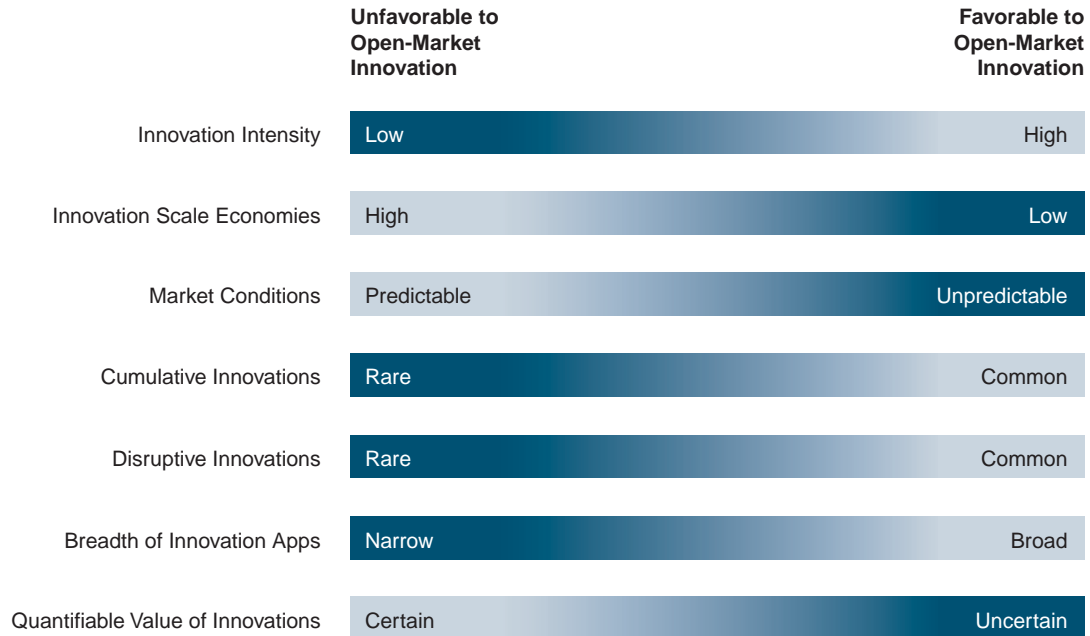
exports. But the money may be less important than the signal it sends to an organization: act fast on promising ideas or risk seeing them offered to outsiders, even competitors. The motivation and loyalty of innovators within the organization improves. “Good ideas won’t get buried,” you tell them, but instead may find a home in the outside world.

When to Move Walls

Some situations are more conducive than others to open-market innovation. (See *Figure 1*) When the economies of innovation peak at a fairly low stage, for instance, it’s critical to start looking outside for new ideas. Call it the *garage effect*. If a few people working independently can produce innovations as good as, or better than, your corporate lab, with no overhead, it’s time to consider an open-market approach. The dot-com bell curve has made many dismissive of the business potential of garage entrepreneurs. But in some industries, like software, network technology, and financial services, the capacity for innovation has long been widely distributed among big and small.

The open-market approach becomes a strong recourse when *unpredictable situations* arise that require sudden, new competencies. Sometimes the need for innovation can burst upon a company from out of nowhere, as Pitney Bowes discovered with the anthrax scare. Companies often find themselves in turbulent industry conditions that require them to adapt and innovate without knowing exactly what direction to take. Open-market innovation can be used as a hedge, as companies explore multiple strategies with outside partners until one emerges as most likely.

Figure 1: Where is open-market innovation most valuable?



How to Hasten Idea Exchange

Opening your borders is not as easy as it sounds. It must truly become part of your company’s soul. A company has reached that stage when it can’t approve a strategic plan or a budget without talking about what’s going on in the outside world. Cargill is moving in that direction, with a coordinated three-tiered approach that speeds up the decisions made about outside deals and alliances. Commitments at the scale of the Cargill Dow initiative are driven from the top. Deals of a few hundred million dollars, once approved by the corporation, are handled by special teams at each of the 13 business “platforms” making up Cargill. For smaller ventures, up to \$15 million, the business units take responsibility.

An expertise-based review of the deal is provided by a corporate “transaction desk,” which serves as the nerve center and traffic cop to oversee decisions about alliances. Since every deal at Cargill passes through that desk, it has become a critical resource for knowledge about assessing, structuring, negotiating and integrating transactions. The point is not just bringing outside perspective to bear; it’s also speed. “We work to make decisions very fast,” says Jim Haymaker, Cargill’s corporate vice president of strategy and business development. “If we’re going to make managers more entrepreneurial in looking outside Cargill, we don’t want to bind their hands. Most of the businesses can get a decision within 48 hours.”

The desk works because it shares the outside information it gathers. Indeed, besides removing barriers to ideas flowing into and out of companies, open-market innovation aims to improve the flow of ideas **around** a company. In the Bain survey, 81% of respondents expected innovation to come from internal, cross-functional collaboration.

So where should you turn if you suspect open-market innovation holds a key to your competitive advantage? First, look in the mirror, without flinching, and compare your firm's capacity for free trade in ideas to that of your sector peers and to exemplars across industries. It sounds easier to do than it is. Hard data exists for comparing costs or profitability. In the case of innovation, where the data is open to broad interpretation, managers can deny or distort the truth, resulting in even more entrenched preconceptions about innovativeness and threats from the outside.

Audit Your Need for Innovation

In our experience, companies wishing to use open-market innovation to their benefit should soberly consider the following:

- Start with the business objectives. Which businesses will be central to your future?
- Map the hot spots for relevant innovation around the periphery of your business boundaries. Ask yourself: "How many innovations burst on the scene from the periphery and surprised us?"
- Survey people inside your company about barriers to innovation. Do the same with vendors and customers. Ask yourself: "Where are the key bottlenecks in my organization? Who can offer solutions?"

- Identify the 10 most important innovations in your company and in your industry in recent years. Understand the origins of these ideas. Ask yourself: "Are there techniques that could have given me access to the external innovations?"

Once companies have conducted an innovation audit, they can begin building the basic infrastructure:

- Set up the system for capturing and circulating ideas inside the company. It's an easy way to start, and you'll need the system to draw full value from the ideas that you bring into the company.
- Start technology searches for import opportunities.
- Set up the rules for exports (technologies, time frames) and start outlicensing and selling.
- Measure and reward progress, using as metrics the contribution of open-market innovation to revenues and profits, time to key milestones, and quality.

As companies look for the next wave of competitive differentiation, these steps can help sharpen their focus. Putting a system in place to ensure the free flow of ideas and crafting a strategy based on open-market innovation may sound like major undertakings. They are. But, as Pitney Bowes discovered, companies can move swiftly to improve their market positions when necessity demands it.

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