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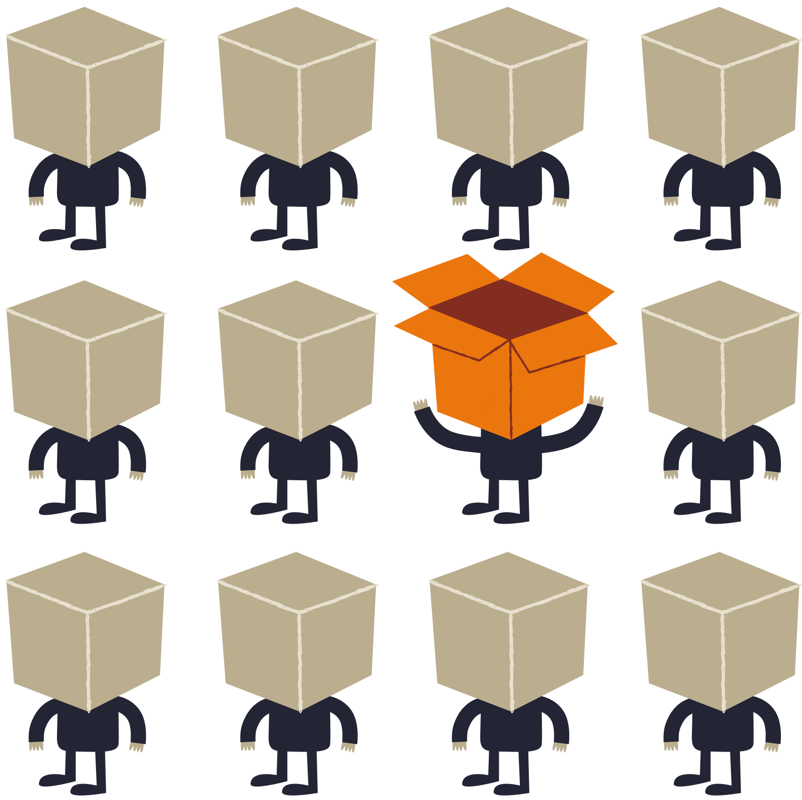
By ***Luca Berchicci***



It is almost taken as religious dogma that innovation in business is an inherently good thing. Adapt or die, we are endlessly told. Change or perish. Only the fittest will survive. But what form should innovation take?

Should a company focus on innovation in its product line, and so seek to create new demand in new markets selling at higher prices; the next logical steps are then to further enhance the new products, so driving up the value to the end-customer. Or should it innovate on the production side, to improve its processes, increase its efficiencies and increase its margins by reducing costs?

The question assumes a certain piquancy in times of economic downturn, such as we have been experiencing since the US wholesale credit markets began to implode in the summer of 2007. In boom times, no one obsesses about controlling modest marginal costs. In hard times it is almost literally a different story, as every cent counts, more than ever.

Identifying the right answer, should there be such a thing, is almost impossible, given the arguments that abound in favour of both. But in the paper, *The influence of industry downturns on the propensity of product versus process innovation*, written with Christopher L. Tucci of the Ecole Polytechnique Fédérale de Lausanne and Cristiano Zazzara of the RiskMetrics Group in London, we attempted just that, and arrived at a conclusion that might feel counter-productive to those who feel instinctively that the cutting of costs is the most obvious prime candidate for increased management attention in an economic downturn. It represents the path of least resistance. It offers the relatively easy gains of plucking low-hanging fruit. And results can be immediate.

Product investment

What came as some surprise during the preparation of the paper was that a study of the behaviour of Italian companies responding to the challenge presented by economic downturn suggests that quite the opposite happens. Companies facing the pressures posed by an economic downturn will in fact often carve their way out of trouble by innovating their product line. The route of building a new product to drive up sales rather than lowering the cost of existing products is often preferred.

We found in our data that Italian companies tend to invest in new products in a downturn rather than in new

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processes. Building sales by adding value and delivering new products with new features is a more sustainable way forward than managing decline. For companies that find themselves recording lower levels of sales in a downturn, making products more attractive to customers is not enough. They need to give customers something new that will deliver more value to them and therefore higher revenues.

Lessons from history

So what can we demonstrate from the lessons provided by corporate history that support our findings? Mark Atkins, chief executive and president of Boston, Massachusetts-based Investment Machine Corporation, sets out his philosophy on the InnovationManagement.se website. CEOs, he believes, must be committed to setting and driving the innovation agenda as well as monitoring success on an ongoing basis, especially during a slow economy. Rather than slashing R&D budgets in a recessionary economy, CEOs should encourage management and teams to deliver market-leading products.

Given that most revenue-generating products are going to become obsolete, companies need to continue investing in new product development as well as reengineer existing products for new markets, he continues. The process of innovation should be sustainable not accidental, especially during a recession.

Scott D Anthony, president of Innosight, and co-author of the *Innovator's Guide to Growth*, wrote in *Harvard Business Review* earlier this year that the arithmetic involved is simple: 'A dollar of investment in incrementally improving the core is almost always going to earn a greater near-term return than a dollar invested in a growth business that might take years to incubate. It's one reason why it is so critical that companies begin to invest in growth before they need growth so they create space and time for those investments to mature. Unfortunately, few companies do that.

'I'm the last to argue against making today's business as resilient as possible,' he continues. 'After all, the free cash flow generated by today's business is what funds investment in tomorrow's business. However, slashing investment in new growth is perhaps the most dangerous thing that a company can do. Every business and business model has a finite life. Products come and go. Customer preferences

Product launches

History is replete with examples of products launched in a downturn, including:

Fortune magazine launched in 1930, four months after the worst stock market crash in history.

Miracle Whip *(by Kraft Foods)*, launched in 1933. Mayonnaise sales were one of the many casualties of the stock market crash of 1929 and the Great Depression that followed. Executives at Kraft saw signs of doom and gloom and urged CEO and founder JL Kraft to get out of the mayonnaise business. Instead of shutting the business down or trying to sell it, Kraft hired a talented young engineer to design an emulsifying, or whipping, machine that could make better mayonnaise. The result was Miracle Whip, launched at the 1933 Chicago World Fair.

Sensor Razors *(Gillette)*, launched in 1990. As the economic slowdown of that time evolved into the recession of 1990-1991, Gillette spent US$125 million globally on Sensor advertising, dwarfing the competition's ad budgets. By the end of 1991, Sensor's share of the blade market had doubled to about 15 per cent in both the US and Europe.

iPod *(Apple)*, launched in 2001. Apple launched the industry-disrupting iPod just a month and a half after the terrorist attacks of September 11, 2001, as the signs of a global recession began to appear. Over the next few years, Apple continued creating and marketing new products. Quarterly profits fell in mid-2002 and the company announced layoffs. There were no cuts, however, in engineering and product development. In those areas, Apple continued to hire.

change. The companies that last over long periods of time do so by creating new products, services, and business models to replace yesterday's powerhouses.'

A recent example presented itself in the middle of November 2014. As serious talk began about the possibility of a renewed global economic crisis, BNY Mellon, a global leader in investment management and investment services, announced that it has established an innovation centre in California's Silicon Valley. This is part of the company's plans to use emerging and disruptive technologies such as cloud computing, big data and the "internet of things" to gain new business insights, develop inventive, operational and technological capabilities, and identify potential new ventures that anticipate and cater to emerging client needs.

The company already operates similar centres in Jersey City, New Jersey; and Pune and Chennai in India, where employees share ideas that encourage dialogue, creativity and collaboration with staff anywhere in the world. In financial services just as in manufacturing, investing in innovation is clearly the way to a continuing successful commercial future.

I will conclude by returning to the paper underpinning these reflections. As we said in our conclusion, taken together, the findings we arrived at provide some explanation for conflicting results of previous research where there was no distinction made between product and product innovation.

By comparing two different perspectives, our results also provide an overarching theoretical explanation of firms' propensity to innovate in industry downturns, in a limited universe. Future research might explore different types of industries and how they react differently to industry fluctuations. ■

"Building sales by adding value and delivering new products with new features is a more sustainable way forward than managing decline."

This article draws its inspiration from the paper *The influence of industry downturns on the propensity of product versus process innovation*, written by Luca Berchicci, Christopher L. Tucci and Cristiano Zazzara, and published in the journal *Industrial and Corporate Change*, Volume 23, Number 2, pp. 429-465. http://doi.org/10.1093/icc/dtt011

Luca Berchicci *is Associate Professor of Entrepreneurship and New Business Venturing, Department of Strategic Management and Entrepreneurship, Rotterdam School of Management, Erasmus University.*

EMAIL *lberchicci@rsm.nl*

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