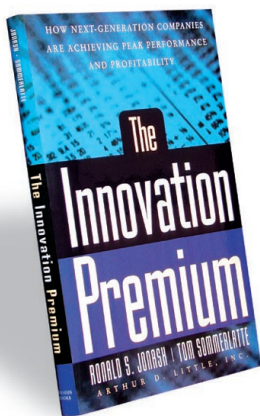




Executive Book Summaries®



By Ronald S. Jonash and
Tom Sommerlatte

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Achieving Peak Performance and Profitability

THE INNOVATION PREMIUM

THE SUMMARY IN BRIEF

Businesses that deliver earnings growth thanks to innovation have consistently been valued higher on Wall Street than those companies that maintain stodgy, outdated ideas and routines. Investors reward and pay a premium for innovation. Authors Jonash and Sommerlatte call this the Innovation Premium.

Based on studies of companies that have harnessed this concept and thus, become more flexible and quickly responsive to change, the authors present a framework for capturing the innovation premium focusing on five areas:

- **Strategy.** Next-generation companies do not merely build products; they also build platforms — innovative programs that develop key technologies and capabilities — then apply them as the basis for growth and innovation.
- **Process.** Next-generation companies manage the front and back ends of their innovation processes in such a manner that a steady stream of new concepts and ideas lead to a steady stream of innovative products.
- **Innovation resources.** Next-generation companies must be committed to putting resource muscle behind their mechanisms for innovation, making plentiful investments and eliminating barriers to innovative ideas and the people who create them.
- **Innovative organization.** The next-generation organization must be fluid, networked, partnered, global and led by devoted professionals in order to meet the challenges of an increasingly border-free business environment.
- **Innovative learning culture.** Next-generation companies must build a culture of continual change and learning, distributing the free flow of knowledge across their entire enterprises.

According to the authors, first- and second-generation companies kept innovation limited to research and development departments. In the third-generation companies of today all departments, from marketing to production to R&D, have a role to play in enhancing the company innovativeness. In next-generation companies, however, innovation is pushed beyond the boundaries of the company. Customers, suppliers, and strategic partners are all involved in making the company an innovative leader.

This summary shows you how to make your company a next-generation company.



THE INNOVATION PREMIUM

by Ronald S. Jonash and Tom Sommerlatte

— THE COMPLETE SUMMARY

Meet the Next Generation

True innovation is the driving force not only for individual companies but also for entire economies. Managers must realign strategies, processes, and resources to focus directly on innovation and technology, in order to thrive in a business environment increasingly keyed to those efforts. In contrast to traditional research and development (R&D) efforts, next-generation businesses must model their operations on two fundamental principles:

- **Management must drive innovation across the entire enterprise to create value.** Just as true innovation never occurs in isolation, next-generation companies must accelerate learning, build cross-enterprise networks and expect real-time expertise.

What Used to Work So Well No Longer Does

Venturing into new management territory can be daunting; many of us stay with what is familiar and safe, clinging to a routine and avoiding change. There are, thankfully, other aspects of business that counter this inclination — pride in achievement, will to succeed and a thirst for knowledge among them. These characteristics are the same things that spur next-generation companies to innovation and advantage, even in the face of several daunting obstacles:

- Intellectual property is becoming increasingly difficult to protect, preserve, measure and manage.
- Businesses and industries are no longer insulated from their competitors, making innovation leadership difficult to sustain.
- The nature of competition has shifted to cost leadership, and reengineering-driven cost reductions have overwhelmed many innovative initiatives.
- Technology advances have altered research and development, leaving some R&D departments mired in old competencies.
- Traditional R&D managers focus on internal operations, leaving the extended enterprise (suppliers, partners, etc.) unmanaged.

The skills and capabilities of their employees must be aligned with business goals and linked to cross-disciplined networks, which enables the enterprise as a whole to flourish encouraging teamwork and inspiring innovation.

- **Management must leverage technology and competency to drive sustainable innovation and capture competitive advantage.** Next-generation companies must construct technology and competency platforms, consisting of a powerful combination of human skills, competencies, and state-of-the-art technologies. As shown below, these platforms can then be tapped to generate improvements and innovations in growth and performance. ■

Strategy: Build Platforms, Not Just Products

To set the pace for innovation, companies must not only build products. They must also build technology and competency platforms — sets of key technologies and/or capabilities applied as the basis for growth and innovation in a variety of products and services. These technologies and capabilities may be slow to develop and are typically quite demanding, but, once developed, they represent a tremendous advantage over competitors that do not acquire them.

For example, sophisticated technology platforms allow Millennium Pharmaceuticals, Inc. to engage in gene mapping and produce a broad range of scientific compounds. And Canon builds competency platforms to improve digital imaging.

There are four levels of platforms, each one representing different levels of commitment of resources and

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Strategy: Build Platforms, Not Just Products

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time expected from your company:

- **Knowledge and learning.** This exploratory, tangential platform encompasses an area about which you may know little, but which seems promising for innovations. This platform requires minimal managerial control, low investment and a loose alignment with overall strategy.
- **Excellence and leadership-building.** This platform is developed in response to a situation — a technology or trend that will have some as-yet-unidentified impact on your business. In order to stay ahead, develop competencies that will help you meet the challenges imposed by that impact.
- **Innovation and development.** You recognize an area of expertise as the center of a great deal of innovation and creativity — new products will definitely emerge from this platform, and management actively pursues growth in this area.
- **Business-performance and growth.** This platform defines an area that is already turning out

How Do You Begin Setting A Next-Generation Innovation Strategy?

Ask yourself these questions:

- **Are continual improvement initiatives going to gain competitive advantage, or will they be enough only to keep pace with aggressive, cost-cutting competitors and erosion of prices?**
- **What is the average life span of your typical R&D effort?** How long can one continue without a successful product or service launch? How are R&D efforts funded? How are their budgets evaluated and measured?
- **Are new cost-reduction breakthroughs necessary?** Are they possible?
- **Are merger-and-acquisition initiatives sufficient to close critical gaps, or are cost and strategic synergies too few and elusive to justify such a move?** Do new partnering opportunities offer better value propositions than mergers?

Follow up with these essential moves:

1 **Develop effective analytical tools to assess key strengths, weaknesses, opportunities and threats (SWOT).** Conduct SWOT analysis across the breadth of your extended enterprise, identifying key gaps and ways to close them.

The Chassis Innovation

Platforms originated in the auto industry when companies like General Motors, Ford, Mercedes-Benz and others countered the staggering development costs of maintaining a growing number of models and types of cars by imposing a common chassis on an entire family of autos. Development efforts could then be concentrated on improving brake systems, traction and other features, allowing the companies to broaden their competence in this development, reduce logistical costs and speed up innovations and new models.

successful products/services, one in which you will continue development and defend your position from competitors.

Next-generation companies are constantly searching for new platforms — at any of the four levels — for growth and innovation. Building technology and competency platforms is at the heart of innovation strategy. ■

2 **Develop roadmaps of emerging technologies and business opportunities, and forge a clear view of your subsequent alternative futures.** Look for harbingers of future innovations from every imaginable source and create scenarios of what the future looks like and what it will take to establish leadership in each potential future.

3 **Prepare contingency plans and set forth responses to potential scenarios.** Create plans to cope with any possible exigency that could intrude on your strategies.

4 **Establish a compelling innovation vision tied to a clear strategy.** Develop a plan to achieve your goals and firm up your commitment to innovation.

5 **Play to your strengths.** Focus your firepower on core areas of expertise.

6 **Manage external partners and resources.** Outsource or enter into partnerships with other organizations to shore up gaps in your innovation platforms.

7 **Align projects with your innovation vision and with platforms and partners.** Realign activities with platforms and partners to build long-term potential while still producing short-term results.

8 **Clarify everyone's roles.** Make certain everyone knows their place in your new strategy. ■

Process: Move Seamlessly From Concept to Customer

There are two fundamental features of next-generation innovation process:

- **A wide-open front end in which concepts are varied and plentiful.** The initial stages of a process must drive a search for ideas among a great variety of sources, increasing the likelihood that you will find effective new developments in product and service methods, concepts, ventures or businesses.

First-stage next-generation innovation gives “idea chiefs” the material with which to fashion new concepts, even as they monitor external activities to help clear up a sometimes foggy picture of the future. These activities may include forthcoming governmental regulations, new modifications to technology and unmet needs in the marketplace or with future customers.

- **A broad ending in which an array of products and services are rolled out to customers willing to pay a premium for strong, compelling value propositions.** The final stages of a process promote the commercialization that captures value at every conceivable point — licensing, patents, imaginative distribution channels and the like. In these stages, the innovations at the core of the process are exploited to achieve maximum value — whether you are pursuing the endeavor alone or in concert with partners.

An organization’s “idea basket” must be constantly full with concepts that relate to both expected and unexpected demands. Every component of your enterprise must contribute — customers, distributors, suppliers, alliance partners and so on. The result will be an innovation process in which a steady stream of innovative ideas move seamlessly from concept to customer.

Abandoning the Product-Development Mindset

Some companies believe that they have a broad, open innovation process in place. Actually, their process is still focused on product development. The product-development process is based on screening and discarding ideas; it does not encourage as many ideas as possible.

Breaking out of product development and into innovation requires adherence to several key points:

- **Exploit the knowledge and intelligence of your entire extended enterprise.** Networking is power; you must share knowledge with your organization’s allies and partners, and keep a close eye on both competitors and new trends and technologies.
- **Integrate your customers and suppliers into the process.** Deploy staff to meet customers and absorb their needs, using one-to-one meetings, focus groups

and brainstorming sessions to bring customers and suppliers on board with your innovation efforts.

- **Open up the front end of your innovation pipelines.** The opening stages of any innovation process can be chaotic, something for which many managers have little use. They only want to see the “winning” ideas, not the other, discarded concepts that also inhabit your brainstorming stream. However, this process can be managed by establishing good criteria for what is being sought and using an efficient mechanism to sort and channel what is found.
- **Increase the pace with innovation networks and platforms.** Business moves at ever-increasing speeds. Be aware of the shelf life of products, services, even ideas, and create a high-velocity innovation process to address it.
- **Ask questions that lead to increased value from innovations.** As you work to expand the final, commercialization-driven end stages of your process, address these and other pertinent questions:

Does your market position allow you to effectively and profitably introduce new products or services?

Do you have the logistics capacity to pull it off? Can you quickly achieve the best economics of scale?

What is the marketing potential of your innovation, both regionally, nationally and internationally? Do you have sufficient geographical reach to cover the space you need?

Can commercialization be effected through your own means or are partners required? ■

Nokia’s Innovative Telephone

In 1992, Nokia, the Finnish telecom giant, applied its entire organization to the task of creating a portable telephone that provided access to the Internet, including a World Wide Web browser, calculator, clock and built-in e-mail and fax capabilities. It was a bold move in a market still in its relative infancy; the company had to develop new technology platforms and partnerships, and a management scheme that could deliver the product on an aggressive schedule.

To do so, Nokia relied on its proven product-development process, which was driven by a fluid, flexible team drawing on a number of cross-functional resources. The key factor in its success, however, was in the way the company devoted that process to achieving maximum value from innovation, extending it from R&D all the way to users — a concept-to-customer stream that allowed it to achieve heretofore untold success.

Resources: Invest in Innovative Platforms and Partners

Strategy will set the pace of innovation in your company and next-generation innovation process maintains that pace. To accelerate the pace of innovation, you need to focus on next-generation resources.

Next-generation resources include your company's facilities and equipment and your financial support. They also include employees, suppliers, partners, customers, even competitors. Finally, these resources include your company's knowledge, competencies and technologies.

Here's a closer look at some of the above resources:

Suppliers. Next-generation suppliers help cut costs, streamline product development and perfect the design and delivery of products and services. There must be a coordinated effort between suppliers and customers, with both sides working in unison to reduce costs and save time. There are mutual rewards to be had, and an underlying recognition that survival may depend on how well each side cooperates on projects and programs with mutual benefit.

For example, Chrysler led the development of a concept car in which the brake manufacturer fully funded the brake work, while Chrysler funded all systems related to the auto's suspension. Costs for the seats were shared equally with another partner, and the costs for the exterior trim were divided 60-40 between Chrysler and yet another partner, with Chrysler assuming the larger amount.

People and Competencies. Traditional roles and occupations within next-generation organizations give way to team-based networks comprised of employees who, in addition to their usual assignments, use their expertise to pursue special innovation projects.

Partners. Next-generation companies are willing to work with others as equals, sharing information and

“The Iceberg Survived”

The Advanced Technology unit of the Chrysler Corporation is devoted solely to the development of concepts for Chrysler cars — a development process that is often five to ten years ahead of the time when the cars will reach the public. Company insiders often refer to the unit as “the tip of the iceberg” because its relatively small size belies the resources it marshals.

Once, a visitor asked a Chrysler executive whether the iceberg analogy was appropriate, in light of its association with the Titanic disaster. “Well,” the executive responded, “the iceberg survived.”

Where Do You Stand with Regard To Next-Generation Resources?

- **Can you name your intangible assets?**
- **Do you see employees as an expensive, albeit necessary, asset?** Do you recognize their worth?
- **Can you recognize the value in funding R&D projects, or does it seem like you're throwing money down a black hole?**
- **How wide is your resource net?**
- **How does your company feel about risk?**
- **Can you rely on and share resources with your partners?** How often do you meet with partners to share ideas? At what point in the product life cycle do you include them in your processes? Do you trust them?
- **When was the last time you listened to and acted upon an idea proffered by an external source?**

treating one another with respect and openness, all in a relentless search for the information premium. For example, since 1996, Sun Microsystems has, teamed up with Novell, Inc. to combine networking software and Java technology for a host of quality products. Sun does not allow innovation to be confined or constrained within its own corporate walls; rather it allows innovation to extend forward and backward along the value chain, and outward, to include suppliers, partners and other key people and entities. ■

Developing and Maintaining Next-Generation Resources

Next-generation resources are assets that must be systematically managed. They lie fallow until they receive the investment and serious commitment that turns them into actions. The following are some of the ways that you can make the most of your next-generation resources:

- **Resist the temptation to see resources in purely budgetary terms.** Do not overlook the value of your suppliers, partners, customers and employees to your information premium. If you treat R&D as a cost center, it will behave like a cost center; if you treat it as an investment vehicle for growth, it will respond accordingly.
- **Leverage what you've got.** Assess your innovation assets and leverage what you have to what you can accept. Warning: This may require a change of attitude about control and proprietary information.
- **Eliminate barriers.** Be willing to break down walls

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Developing And Maintaining Next-Generation Resources

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or, at very least, create pathways through them, in an effort to allow suppliers, partners and customers to engage in the give-and-take of knowledge required of next-generation companies.

- **Use innovation platforms and partners to make investments in human resources and competencies.** Develop world-class competencies in areas that are most critical to your growth. Then put the best people in charge of bringing that innovation to life.
- **Get the most from your intellectual property.** Develop an understanding of your intellectual property, bundled in a variety of different ways. Then target areas for future investment, by developing explicit asset management plans around the patents, trade secrets, knowledge and other bundles of intellectual property.
- **Develop innovation, resource and asset management plans.** Combine quantitative elements from traditional valuation methods and systematic qualitative assessments, isolating the contributions that different resources make to your business. ■

Organization: Create Worldwide Networks of Innovators

Strategy, process and resources are all important elements of the next-generation company. But your company's organization is also key to capturing the innovation premium.

What Constitutes a Next-Generation Innovation Organization?

It is fluid. Ideas flow effortlessly from one part of the enterprise to another without having to pass through corporate red tape. This means that senior executives, managers, employees, partners, customers and suppliers can freely exchange ideas without having to deal with boundaries or other roadblocks.

Leadership is critical. A chief development officer (CDO) must manage the innovation process from concept to customer, and must create and capture value in both the technology and product process development pipelines. He or she must also act as a coach for senior innovation leaders and as the central point of accountability for management of resources and technology.

It is networked. Innovation networks are the arms, legs, eyes and ears of the next-generation organization. They involve people from different hierarchical levels in your company, each of whom is accountable to con-

tribute a critical capability so that the network as a whole reflects the organization's insight and experience.

It has partners. Your partnerships with entities outside your company must outlast the specific "deal" or transaction that brought you together. Focus on aligning your organizational structure with theirs, and on managing a broad range of details and links necessary to create growth and innovation for all parties.

It reaches across borders and beyond boundaries. Consider decentralizing your R&D functions, spreading them across the breadth of your business units, closer to customers and the exchange of new innovations and technologies. ■

Alcoa's Innovation

Just as walls within organizations must be broken down to allow the free flow of innovation, geographic borders likewise mean very little in the face of companies' worldwide expansions, cross-border integrations and other international pursuits. Organizations must be able to reach into all corners of their international operations; innovation can no longer be isolated and restricted to one central location. Such was the case at Alcoa, which had to find ways to expand from its headquarters in Pittsburgh, Pennsylvania, to a global network of innovators, working together, sharing knowledge and exploring the possibilities of next-generation innovations.

To effect this change, Alcoa did three key things:

Create teams. The company created new teams to insure that the organization works as smoothly as possible. The organization's Technology Board is the forum for senior leadership to set direction, emphasize critical issues, determine high-level goals and set strategies to meet them. Alcoa also created Technology Management Review Boards (TMRB) to drive initiatives and investments across business units, and to set strategy, lead technology deployment and drive innovation.

Establish a wide range of formal and informal innovation networks and platform teams. The company fosters innovation throughout its own internal operations, as well as outward, with valued partners. Together, they leverage their technologies and competencies to great and successful effect.

Lower costs. The company embarked on an aggressive campaign to lower costs and increase the return to shareholders through continuous improvement and the introduction of the Alcoa Production System (APS), which monitors and minimizes waste and encourages efficiency across the breadth of the company's operations.

Building a Next-Generation Organization: Where Do You Stand?

- How often do you get your business unit managers together in the same place to share knowledge?
- Are your key R&D experts on the front line or in the back room?
- Is innovation ingrained in your company's culture, or is it merely a buzzword?
- Do innovative ideas get tangled in bureaucracy somewhere between conception and commercialization?
- Is your company active in pursuing its strategic vision of the future, or merely reacting to the moves of your competitors?

Build a Culture of Continual Change and Learning

Having the right organizational structure and the right culture is vital in capturing the innovation premium. To sustain the pace of innovation, your company must build a culture of continual change and next-generation learning. Learning is the key.

● **It is central and all-encompassing.** Learning must be continuous and company-wide, enabling an organization to capture a set of sustainable benefits that define the innovation premium. Intelligent strategies must be combined with innovative process and the creative use of resources and supported by an efficient organizational structure.

● **It is distributed across the enterprise.** Companies must gather ideas from every corner of its extended enterprise, while at the same time maintaining a firm commitment to finding out firsthand what customers really want. This is done by fostering a model of learning based on innovation of both product and process — each are essential to your continuous learning effort.

For example, British Petroleum was able to transform itself from a debt-ridden and divided behemoth into a sleek, flexible and innovative organization. At the heart of the transformation were cross-unit performance improvement teams (PITs) that encouraged cross-unit and enterprise-wide learning.

How BP Did IT

“Learning is at the heart of a company’s ability to adapt to a rapidly changing environment,” says John Browne, chief executive and managing director of the British Petroleum Company (BP). “It is the key to being able to both identify opportunities that others might not see and to exploit those opportunities rapidly and fully.”

Before Browne took his position in 1995, BP was a debt-mired, confusing amalgam of divisions involved in different

fields. Now, the company’s debt is down almost 60 percent, it has an annual growth of over five percent, and has embarked on a series of high-profile acquisitions. Many credit Browne’s stewardship for the turnaround; with him at the helm, BP has created a strong innovation-and-growth engine that extends from the company’s fresh commitment to consistent, company-wide learning.

Browne instituted two critical entities within BP:

● **Performance-improvement teams (PITs).** PITs help employees recognize their individual responsibilities to the performance of the entire enterprise by putting into place quantitative performance measurements that stretch across divisions, business units, and enterprise boundaries. Since BP’s business groups are, by definition, asset-based, there exists a danger that individuals may become so internally focused that they lose sight of endeavors outside their own realms of responsibilities. PITs help create a more balanced focus on the management of knowledge-based and intangible assets.

● **Peer-assist programs.** These programs encourage employees to seek out solutions to problems within a shared learning environment, simultaneously solving the problem, increasing the knowledge base of BP’s internal resources and reinforcing the importance of teamwork. BP recognizes that, until an employee’s acquired knowl-

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How You, Too, Can Champion Next-Generation Learning

- **Make sure your innovation leadership provides learning leadership.** Your organization’s learning efforts should have a central individual to take the lead, enlisting every member of your company to buy into the program, thus accepting the challenge to achieve innovation and maximum value.
- **Reinforce the notion of organization-wide teaching and learning.** A greater emphasis on learning must be spread throughout the entire organization; innovation will wither without it.
- **Establish standing teams to foster sustainable learning.** Long-term success requires more than single-focus, ad hoc teams and one-shot projects; the growth achieved through these measures is simply not sustainable. Organizations must establish standing teams whose learning curve is not task-specific, but steady, cumulative and sustainable.
- **Set aside time to reflect on lessons learned.** Time for reflection is crucial for the sustained learning demanded by next-generation innovation. Dialogue and reflection are vital in order for you to learn from what you do.

Build a Culture of Continual Change and Learning

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edge and expertise is combined with that of his or her peers, and then is made available to others in a clear and usable form, they cannot generate the intrinsic driver of innovation: ideas. ■

Capture the Innovation Premium

True innovation is powerful enough to change the economy. It is the prime force behind the longest-running economic expansion in the history of North America. Standard business cycles are, in many cases, circumvented, thanks to the innovations brought about by next-generation companies in key business areas such as strategy, customer management, operational performance, product development, process and service creation.

One reason that innovation is such a powerful economic force is that the benefits of capturing the innovation premium are not limited to the company itself, but extend to all of the company's stakeholders, including customers, employees, partners and shareholders.

What does it mean for customers?

Creativity benefits customers by providing new products and services and high levels of customer satisfaction. With next-generation strategies in place, companies can focus on specific customers, and service their needs in innovative ways, making it exciting and worthwhile for their customers to do business with them. Organizations can focus on the core facets of doing business in our age:

- **Targeting specific segments of customers,**
- **Tailoring their offerings to each segment's buying needs and preferences,**
- **Soliciting feedback from the customer to continue the process in an efficient and productive manner.**

Next-generation companies also create differentiation strategies to help pinpoint *why* their customers buy from them. They solicit two-way communication with customers, mixing traditional options with newly emerging technologies like the Internet to give customers more ways to make their preferences known.

What does it mean for employees?

Just as the exchange of value between innovative companies and customers creates a rich and self-perpetuating cycle, next-generation companies build employee relationships on the same principles of mutual benefit and perpetuating excellence. Innovative companies attract the best and brightest work force, who turn in the best performance, which attracts more of the best employees,

who further fuel the organization's innovation.

Next-generation companies lift the performance of their employees by freeing the initiative, creativity and drive inherent to each one — a far cry from the stifling confines of the traditional corporate environment. The programs these companies put in place to help employees develop individual capabilities and collective competencies lead employees to view the workplace as a place where they can attain their personal and professional goals. This, in turn, leads to increased levels of creativity and lower rates of turnover.

What does it mean for partners?

Next-generation companies recognize the fact that they cannot go it alone in the face of shrinking product development cycles, rising development costs, rapid changes in technology and increasing customer sophistication. Partnering and extending networks are crucial to the value equation that enables next-generation companies to command the innovation premium, capturing value for those very same partners.

While many companies claim to have productive external networks and partners, only the most innovative ones create value and improve earnings performance across the extended enterprise — developing and exploiting opportunities and building a sense of trust, both of which make them very attractive to investors, customers, employees and partners alike. Innovators like Chrysler and Sun Microsystems provide value to their partners, suppliers and customers by implementing programs that help build that extended enterprise.

What does it mean for shareholders?

In industry after industry, market after market, company after company, innovation that cuts across strategy, customer management, processes and products and services has earned next-generation companies greater growth in value; that value, in turn, pays off for investors. A good example of this phenomenon is Chrysler. By tending to innovations in its sourcing and partnering relationships, its customer service and customer segmentation, the company has been able to generate \$3 billion of new shareholder revenue and, in the process, has changed the rules of engagement in the auto industry.

There are risks involved in investing in next-generation companies, just as there are risks in investing in any company. Innovation implies risk, and when companies set out on the pathway that leads to the innovation premium, they are, in fact, taking a risk. But to risk is to dare, and to dare is to seize the opportunity to succeed in previously unimagined ways. Properly conceived, executed and managed, innovation repays risk several times over, making seeking the information premium a risk well worth taking. ■