



The New Age of Innovation

Driving Co-Created Value Through Global Networks

THE SUMMARY IN BRIEF

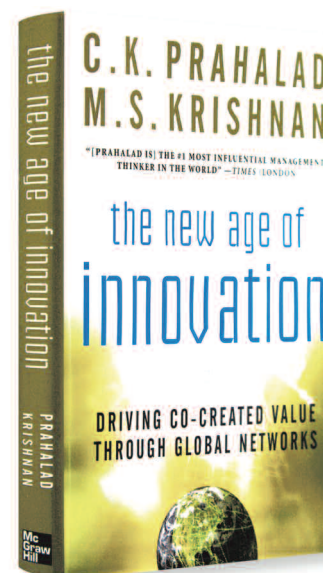
Sometimes it seems that technology is now the master and we are the slaves. After all, these days many of us find ourselves wondering why everybody in the office has to enter the same data into three different computer systems; we worry about how to appease fickle, computer-savvy customers who want control over how and when they do business with us; and we question how we're going to keep up in a world that increasingly requires everyone to "go global."

The New Age of Innovation describes how this state of affairs reflects the convergence of two new rules of business: Customers want personalized "experiences" rather than just goods or services, and companies can only provide those experiences by assembling — and disassembling — talent quickly and cheaply.

In this summary, two top management gurus demonstrate how business processes make or break a company's attempts to turn this "resources of many to satisfy the needs of one" concept into reality.

IN THIS SUMMARY, YOU WILL LEARN:

- Why business processes are the lifeblood of your company and the facilitators of success.
- How your company's patchwork of data systems got that way, and how you can turn it into a value-creating platform that truly identifies trends and opportunities.
- Why engaging talent from around the world is more than just a way for companies to save a buck.
- How to redesign systems to co-create value with customers and connect all parts of a firm for this process.



by C.K. Prahalad
and M.S. Krishnan

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THE COMPLETE SUMMARY: THE NEW AGE OF INNOVATION

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The Transformation of Business

There is a fundamental transformation of business underway. This transformation is built on two basic pillars:

1. Value is based on unique, personalized experiences of consumers. Firms have to learn to focus on one consumer and her experience at a time, even if they serve 100 million consumers. *The focus is on the centrality of the individual.* We will designate this pillar as $N = 1$ (one consumer experience at a time).

2. No firm is big enough in scope and size to satisfy the experiences of one consumer at a time. All firms will access resources from a wide variety of other big and small firms — a global ecosystem. *The focus is on access to resources, not ownership of resources.* We will designate this pillar as $R = G$ (resources from multiple vendors and often from around the globe).

Not a Choice

From cement to jet engines, education and health care, from children's toys to delivery of parcels to your home or office by UPS, all industries are going through this transformation. *This transformation is not a choice.*

What are the key elements of this transformation that we can identify? There are five:

1. Value is shifting from products to solutions to experiences.

2. No company has all the resources it needs to create unique personalized experiences. All companies will therefore have to access talent, components, products and services from the best source.

3. Internal management systems can become an impediment. Flexible systems are a prerequisite and must be developed.

4. Resources in the ecosystem must be continually configured.

5. Specific models must be developed to enable organizations to focus on one consumer from the millions.

Developing New Principles for Innovation

There are new principles of value creation as well as capabilities that we need to build in order to compete.

Principle 1. ($N = 1$.) The individual is at the heart of experience. Value creation must focus on the individual consumer. In the $N = 1$ world, the traditional firm confronts several critical new demands:

- **Flexibility.** The focus is not just on traditional load balancing but on *continuously balancing the load and the nature of the task with appropriate resources* to maximize the experience of consumers.

- **Quality, Cost and Experience.** Six Sigma and low cost must be integral building blocks of the system. Affordability becomes a major criterion for success.

- **Collaborative Networks.** This is a shift from models based on ownership and control to models based on privileged access and influence.

- **Complexity.** This new level of complexity can be managed only through a sophisticated system of technology architecture and its attendant business processes.

- **Customer Interfaces.** While managers have to cope with a complex system, the consumer's experience must be simple and intuitive.

- **Scalability.** As organizations expand across the globe, the diversity of languages, customs and norms must be matched with the sheer scale of operations.

Principle 2. ($R = G$.) This principle refers to the approach to understanding the nature of the resource



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base of large firms and learning how to access high-quality resources at low cost. The challenges facing business in adopting the $R = G$ perspective are the following:

- **Access to Resources.** Today firms have moved away from a model of vertical integration and have initiated programs to access specialized, global suppliers.
- **Speed.** The opportunity cost of managerial procrastination continues to climb.
- **Scalability.** The selective outsourcing of work to others is a necessity for building scale in a short time period.
- **Innovation Arbitrage.** Through selective licensing, collaboration or acquisition, the quality and speed of innovation can be dramatically altered.

Forgetting and Learning

Just as we have to learn the rationale and the implications of managing in an $N = 1$ and $R = G$ world, we have to forget the approaches to managing using traditional ways of categorizing businesses such as manufacturing or services. It is not that the discrete categories are disappearing but that a new set of requirements is emerging.

For example, all businesses are becoming more *knowledge intensive*. Simultaneously, the source of value is shifting from physical products (for example, tires) to solutions (for example, specific applications for managers of large fleets) to personalized experiences. Similarly, not all of the elements of the knowledge intensity needed can be fully developed within a single firm. A multivendor strategy is required, which forces the firm to accept $R = G$.

This is the key to innovation and value creation in the future. If we move toward $R = G$, we find that we can gravitate to $N = 1$. If we want to move to $N = 1$, we also will have to move toward $R = G$.

$N = 1$ and $R = G$: A Social Movement

The movement toward $N = 1$ and $R = G$ is not a choice. The focus of the young on Web sites like MySpace, YouTube, Orkut, Facebook and others suggests that *a whole generation of consumers will grow up expecting to be treated as unique individuals, and they will have the skills and the propensity to engage in a marketplace defined by $N = 1$.*

Within the corporation, engaging employees emotionally and intellectually in the mission of the firm will require that each employee is treated as unique ($N = 1$). Mobilizing global teams based on the unique skills of individuals to address unique tasks is no different from $R = G$. ●

Business Processes: The Enablers of Innovation

Startups do not need well-developed processes. However, any firm of reasonable scale needs business processes to make its values, concepts, ideas and business models operational. But if left unattended and not consciously adapted to the changing business environment, business processes can become *impediments* to innovation and change.

Building a Framework

The *business process* is the link between the business strategy, business models and day-to-day operations. Business processes define the logical relationships among activities within the firm (and its network collaborators, $R = G$) and its relationships with consumers ($N = 1$). Business processes impact and are impacted by both the *technical architecture* (such as information and communication technology systems — ICT) and the *social architecture* (such as organization structure, decision rights and performance management systems of the firm).

It is useful to think of the ICT architecture in multiple layers.

The lowest layer is Layer 4, which comprises the physical telecom connectivity and hosting architecture, wired and wireless cables and connections, and the server farms and routers that enable connectivity to the public telecom and data networks.

On top of this public architecture is Layer 3, the firm's private IT architecture that includes the hardware boxes — that is, the computers and servers (database and application servers) and the systems software, such as the operating systems, databases and any middleware platforms that the firm may use.

On top of Layer 3 is Layer 2. This layer of ICT applications focuses on business-specific applications and attendant business processes. The pressure for quarterly business results focuses senior management's attention on change levers such as performance measurements, compensation and organization structure.

Above Layer 2 is Layer 1. Comprised of proprietary and standard analytics, this layer represents the primary interfaces of a business with its customers, suppliers, partners or investors. It is Layers 1 and 2 that can provide the source of competitive advantage.

Business Processes as a Source of Competitive Advantage

While few grasp the importance of business processes as a source of competitive advantage, several major firms recognize and leverage it to their advantage. Wal-Mart

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uses them to be the most efficient retailer. FedEx allows the consumer to be a part of the operations experience by sharing its databases and applications so that individual customers can track their packages. In eBay, the consumers co-create the business processes as well. None of them uses a standard software package of business processes to run its operations.

Most typical firms, under pressures of cost reduction, are moving toward outsourcing their IT operations. While outsourcing of some aspects of the ICT stack may be justified, indiscriminate outsourcing may compromise these firms' ability to get to $R = G$, much less $N = 1$. ●

Analytics: Insights for Innovation

Competitiveness favors those who spot new trends and act on them expeditiously. Therefore, managers must develop insights about new opportunities by amplifying weak signals. These weak signals emerge from insights derived through a deep understanding and interpretation of a wide variety of information. For example, recognizing that SMS (text) messaging using a cell phone will be an important method for settling small payments is critical for the long-term success of Visa and MasterCard.

The new competitive landscape requires *continuous analysis* of data for insight. Hence, delays in recognizing, interpreting and acting on the trends are emerging as critical impediments to competitiveness. Gut feel and intuition are important, but in a fast-changing competitive environment, experience of the past is less and less valuable. *Foresight, not hindsight, is of value.*

Global Resource Access ($R = G$)

The capability to leverage global resources will demand new levels of visibility and agility in managing logistics of physical goods and resources (globally) to meet unique demands of customers.

Visibility in the global supply chain is almost a prerequisite for managing the complex web of product and information flows. The capacity to reconfigure resources globally can start with a simple trend analysis of the key metrics across different markets and product categories. But this beginning should be expanded to a capacity for rapid response to changes in either external market demand or internal process capabilities available at a given point in time.

Granularity

Granularity is as important as visibility. Granularity allows managers to examine in depth the process steps, as well as the appropriate skills needed to perform them. These systems

are measurement intensive, and they prosper with the capacity for real-time feedback and corrective actions.

What is often less obvious is that for a global firm, getting real-time data from multiple sources — point-of-sale systems, RFID tags, consumers, suppliers and other stakeholders — requires an investment in telecommunications and network capabilities as well.

Co-Creation of Value: $N = 1$

The capacity to serve individual customers — that is, personalization and co-creation of value — will demand capabilities to work with customers to anticipate and predict their preferences on a continuous basis.

The transformation to a customer-centric co-creation view of value pushes firms to new frontiers of the price-performance envelope. This transformation in combination with global resource leverage through visible business processes and integrated analytics provides an opportunity for new customer insights and unique value creation opportunities. ●

IT Matters: Technical Architecture for Innovation

We have to start with two assumptions. First, no firm today has the systems in place for being fully compatible with the innovation demands leveraging global resources to serve individual customers uniquely. Second, unless senior managers start with a clear point of view on the specifications of such a system, this migration from where they are to where they need to be will be costly and time-consuming.

Confronting Reality

The ICT architecture familiar to most firms is the result of (a) the freedom that was given to individual business units in different geographies, (b) the legacy of mergers and acquisitions, and (c) a continuous stream of “patch-ups” to systems. In an $N = 1$ world, managers must have the ability to access multiple databases, both within the firm and outside — public databases as well as databases of collaborators. Many of them are often incompatible.

Acting in real time to solve the problems of a consumer requires that we have the tools and methods to access databases to gain insights and provide a service in a specific consumer context. For example, OnStar must be able to access multiple databases to send help in case of an accident — the local police, the ambulance, family, insurance and the like. Access is not just a problem imposed by the size of databases but, more importantly, by the multitude of databases that must be coordinated for a real-time response.

Proprietary Systems and Transparency

Managers migrating to an $N = 1$ and $R = G$ world realize that they rely on a large number of suppliers and their consumer communities to help improve their service offerings. This implies that their systems must be simultaneously proprietary and transparent such that other consumers can participate effectively. The tension between “openness” and “proprietary intellectual property” is not easy to deal with.

Collaboration to create value is commingled with competition to extract value. This tension is a reflection of the inherent nature of the emerging value creation process. This tension manifests itself in other forms such as in balancing efficiency and flexibility of business processes. The new ICT architecture should be capable of providing the required transparency as well as being capable of controlling access where needed.

Compliance and Change

The demand for change in business processes will stem from a wide variety of sources — the regulatory environment, changes in the competitive landscape, technological disruptions and the need for a unique approach to personalized value creation. This implies that managers must focus on the system’s capability to adapt rapidly at low cost and without sacrificing quality.

New levels of transparency demanded here pose unique challenges for managing security and privacy in the ICT architecture. Systems should be flexible, anticipatory and responsive. Anticipation of new trends such as patterns of customer preferences in an $N = 1$ world demands management of both explicit and tacit knowledge. Demands stem from these business specifications:

- **Security and Privacy of Data.** Protection of customer privacy will be a critical requirement of the new ICT architecture.

- **Complexity and User-Friendliness.** As firms move toward $N = 1$ and $R = G$, their ICT architecture will be complex irrespective of what dimensions we use to measure complexity. However, the complexity should not make the system unusable to all but the very savvy and skilled.

- **Knowledge Management and Knowledge Creation.** Firms need to focus more attention on leveraging the implicit knowledge continually generated in their ongoing interactions with consumers, global suppliers and partners. Creating *new knowledge* is critical. Blogs, wikis, real simple syndication (RSS) and podcasts allow for new kinds of transparency and capacity to leverage tacit knowledge contextually.

Enabling Foundations

Almost all of the existing business systems were built as a way of archiving and managing the large volume of transactions that capture the activities of a firm — from sales to purchasing to employee benefits to manufacturing. However, in an $N = 1$ world, the mandate to create unique personalized experiences requires that systems capture the essence of interactions, not just transactions. Analytics provide the insights.

We need to focus on “global standards” of quality, transparency, interoperability, compliance, speed and cost. But we must also provide space for the local operations to be flexible. A common exercise undertaken in many large firms is to match their business processes and practices across their global units and arrive at a common template for some of the standard processes and allow for unique local flexibility in other required processes. Some evolving standards in ICT, such as Web services and the use of extensible markup language (XML), allow for such integration, and the new ICT architecture should include a common fabric to integrate new processes and legacy systems at both the logic and data levels.

Specifications for ICT Architecture

The following are the minimum requirements of an ICT platform capable of delivering capacities for innovation in an $N = 1$ and $R = G$ world of competition:

Requirement 1: A Component-Based Design of Business Processes. A business component-based approach to ICT architecture disaggregates business processes into their logical building blocks and standardizes each of the building blocks with respect to its internal logic and its access to data and hooks to other related components. This approach reduces the skill level necessary and the cost of change, and it improves the quality of the finished business process.

Requirement 2: Ubiquitous Access Through a Corporate Intranet and the Internet. Ubiquitous access enables transparency, faster delivery and efficient changes in business processing. The platform should enable integration with emerging Web 2.0 technologies such as wikis and blogs, leading to a capability to leverage tacit knowledge and to shift from mere transactions to interactions.

Requirement 3: Open Interfaces to Data and External Systems. The new ICT platform should support open interfaces such as XML and Web services for data and process access. It should also allow for open standards in the emerging service-oriented architecture to connect with external systems and devices. The new platform should have a capability to wrap the whole or

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parts of existing software packages and legacy systems and the corresponding data as a business component into the platform.

Requirement 4: Integrated Capability for Analytics. The new platform should present a dashboard for managers to conduct rapid experiments with analytics to detect new trends and changes in business process performance metrics. This interface should provide an ability for the firm or its external partners (through ubiquitous access) to drill their large databases for insights through appropriate analytics. ●

Organizational Legacies: Impediments to Value Creation

It is a truism in organizational life that “what you see depends on where you have been.” Similarly, the technological architecture — the applications, databases and systems — is often a patchwork representing the pattern of evolution of the firm. Organizational legacies can erode the capacity of an organization to innovate and create value.

Social Architecture and the Dominant Logic

Social architecture is the sum of the systems, processes, beliefs and values that determine an individual’s behaviors, perspectives and skills in an organization. It includes managerial behavior determinants such as organization structure, performance metrics, reward systems, career management, training, beliefs and values. Reinforced over time and embedded in the organization in standard operating procedures and rules, the determinants lead to a predictable way of thinking about opportunities, competitiveness, consumers and performance. We call this the dominant logic of the firm.

The reasons why business process transformation initiatives do not bear fruit in many organizations are largely managerial and social. There are technical failures as well. The reasons are:

1. *Lack of senior management evangelism.* Few CEOs have the stamina to stay the course.
2. *Weak accountability.* While the scale of these initiatives can be vast, managers often fail to address ownership of the initiatives and decision rights.
3. *Misalignment of goals.* All stakeholders should grasp the fluidity and transparency of customer value offered by the $N = 1$ and $R = G$ model.
4. *Lack of discipline and underestimation of the connection to ICT.* Process inconsistencies stem from a lack of standards for how business entities are defined.

An Approach to Organizational Evolution

One approach to organizational evolution (migration) to seek $N = 1$ and $R = G$ opportunities includes small calculated steps, learning from those and consolidating by scaling. The whole process of change must focus on “de-risking big changes.”

The transformation process must start with a shared and consistent point of view. Once there is agreement on the point of arrival, as it were, we can develop specifications for the new world of value creation and competition. We can then begin to develop small, contained organizational experiments to learn about how to build new capabilities. There is enough organizational evidence that shows that continuous experimentation and learning followed by consolidation can lead to major new capabilities in a short period of three to five years without major organizational trauma. ●

Efficiency and Flexibility: Managing the Tension

Success in innovating new business models for the $N = 1$ and $R = G$ environment, whether the business is in tires, shoes or insurance, is all about finding the right mix of capacities for flexibility and efficiency. The dominant logic and current business models shape the capacity for efficiency and flexibility in business processes.

The reality is that most companies are unable to cope with the simultaneous needs of flexibility and efficiency. However, the technical architecture is not the only culprit. The capacity for agility in decision making through flexible business processes in large firms also rests on appropriate social architectures involving decision rights, skills and the capacity to accept change among managers.

In most cases, the business managers maintain a distance from IT decisions for two reasons. First, it is not their zone of comfort. Second, senior managers in many large firms believe that ICT services are utilities and can be delivered by any outside vendor once they have clarity to business problems.

Business Process Governance Council

Managing disconnects among the line managers, CTOs and CIOs, the vendors and the firm and coping with emerging demands for flexibility and efficiency requires that firms create a framework for managing the quality of their business processes. *No firm today can ignore business process governance.*

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Experts suggest that firms should create a business process governance council that will include the senior line managers, human resources officers, the CIO and the CTO. The council will be charged with managing the evolution of business capabilities embedded in business processes and in the skill of managers.

It is important to note that the role of this council can rapidly turn into an exercise in prioritizing and allocating new IT investments. Rather, the council must focus on the evolving needs of the business. This should be followed by prioritizing and mapping the respective IT and HR investments to make these business process changes. ●

Dynamic Reconfiguration of Talent

We have to change the way we manage — how we continually match opportunities with resources. The focus must be on the skills of individuals and their attitudes to learning, as well as on the competence of teams and the ability to continually configure task-based teams with the best talent from around the world.

Mobilizing Talent, Not Outsourcing

The initial impetus for outsourcing was primarily cost arbitrage — meaning that firms can access comparable skills in India for a fraction of the costs of those skills in the United States or Europe. But firms have moved along. A research study from Stanford reports that multinational corporation R&D centers in China are not just providing technical product support, product localization and product development for the local market. They are also developing products for the global market.

It is increasingly clear to global managers that outsourcing is not about “exporting jobs”; it is about “importing competitiveness.” The focus is not just on cost. Cost is a consideration, but equally important are the quality, the innovativeness of the solution, and speed.

We are moving to a system of project management in which projects are *temporary organizational systems*.

Know Where the Talent Is

Examples of the emerging nature of managerial work — managing a series of micro- and macro-projects within the firm — suggest that a dynamic configuration of talent cannot take place unless we pay specific attention to the following:

- Managers need to know where the talent is within the organization and where it can be accessed easily from the outside.
- Managers need to help project team members cope with stresses caused by time pressures, ambiguous power

and authority relationships, and cross-cultural and interpersonal interactions.

- Managers need to create the capacity to reduce “frictional losses” in the dynamic configuration of resources — the difficulties in getting teams to work together effectively without delays and loss of creativity.

Managers must be able to, in real time, access the human resources database and assemble the names, locations and availability of people with specific skills.

The Rush for Talent

Building and accessing a talent pool requires four distinct tasks:

1. Increase the number of skilled people.
2. Challenge the industry norms about the way work is done, so that people with lower levels of skills can be trained to do the work effectively.
3. Create an excitement around your firm and your skill needs.
4. Disaggregate work and deskill it so that people with little formal education can do it.

Building a Velcro Organization

Real-time dynamic reconfiguration of people resources presents a problem: All of us are socialized to think of organizational life in a certain way — the role of the hierarchy, power and authority for resource allocation and decision making; relationships within organizational silos (for example, a business unit or a function or geography); and role clarity.

A transparent system of performance evaluation — skills, attitudes, behaviors and performance — is a prerequisite. Training for specific opportunities, as well as training of a person, is critical. *Furthermore, individual employees must know what new challenges they can expect over a period of five years. Making this transparent to the employees makes it easier to reduce tensions.*

A New View of Managerial Work

The $N = 1$ and $R = G$ world demands that the work of the firm be divided into a large number of micro- and macro-projects. *Micro-projects* involve specific, simple tasks that can be accomplished in a short period of time and often remotely. *Macro-projects* are broader, more complex, and more open-ended, and they involve talent from multiple locations.

The new approach to value creation focuses on demands based on what consumers need at any given time. The execution of strategy, in this model, is accomplished through a series of micro- and macro-projects.

The Journey to $N = 1$ and $R = G$

Managers need to develop a vision of their future: the nature of their interpretation of the $N=1$ and $R=G$ world in their industry. Each firm will have to define the steps that it has to take to move the organization in that direction. It is obvious that each firm, even within an industry, will have a different migration path.

The approach to migration suggested by experts depends on the following premises of large-scale transformation:

1. All transformation starts with a distinct and clear point of view about the future.
2. There must be a clear articulation of the current capabilities of the organization and clarity about the point of departure.
3. It must be recognized that the managerial processes and capabilities that got us to where we are cannot get us to where we want to go.
4. Migration must be broken down into smaller milestones and critical doable steps.
5. It must be recognized that we cannot know all the details of the total journey.
6. We have to have the sense of urgency (the speed of a 400-meter runner) and the stamina to stay the course (the persistence of a marathoner).
7. We can develop detailed metrics to measure the progress for each one of the steps or milestones.
8. A long-term focus with short-term actions is the essence of organizational transformation.
9. This process recognizes that managers have to “perform” during the transformation.
10. Capability building is an arduous process in a large firm.
11. Capability building must focus on both the technical and the social infrastructures at the same time.
12. Finally, there are bound to be time lags between efforts and results.

We have to start with the assumption that we are moving away from clear and fully defined organizational homes for people — represented at any given time by the hierarchical organization (the organizational chart) — to a *Velcro organization* in which individuals come together temporarily to perform a task in a role related to that task and that particular task can change next week. Young men and women are accustomed to this “role of the moment” in their lives. We have to make it a part of their reality in the large organization. ●

An Agenda for Managers: Focus on the Essence of Innovation

For most firms, transforming their organizations toward an $N = 1$ and $R = G$ world of innovation and value creation will not be trivial or easy.

In a very short period of seven to 12 years, this transformation will not be big news. Consider the following:

- More than 5 billion people will be connected through cell phone networks and the Internet.
- The rapid progress of social networks and the access people have to information will create the ability for all of us to exercise our individuality.
- Everyone will get access to infrastructure.
- Powerful analytics and large database management capabilities will add to the propensity to co-create.
- Most important, the generation of active consumers in 2015 is 12 to 15 years old today.

Three Key Trends

We can crystallize these changes into three key trends that will determine how consumers will relate to institutions such as firms as well as to each other:

1. Convergence in ubiquitous connectivity in voice, data and video through cell phones, PCs and the Internet.
2. Ubiquitous access to computing at continually decreasing costs through advances in new technologies and innovations in delivery models.
3. Rapid and vibrant experimentation in new platforms for collaboration that span both personal (social) and professional lives.

Consumer activism, ubiquitous connectivity, convergence of technologies and industries, globalization of markets, and global search for and access to resources — these are trends that are not within control of any one firm.

Embrace the inevitable. Make the trends work for you. The role of leadership in organizations will be crucial in this transformation. You have the opportunity to shape the next round of globalization and build a more empowered society. ●

RECOMMENDED READING LIST

If you liked *The New Age of Innovation*, you'll also like:

1. ***The Future of Competition* by C.K. Prahalad and Venkat Ramaswamy.** The authors set the agenda for top management for co-creating the future by revealing opportunities for value-creation and innovation.
2. ***Competing for the Future* by Gary Hamel and C.K. Prahalad.** Learn how to become a driver on the road to the future and not just a bystander.
3. ***The Fortune at the Bottom of the Pyramid* by C.K. Prahalad.** This best-seller offers a blueprint for driving the radical innovation you'll need to profit in emerging markets — and using that innovation to become more competitive everywhere.