

David Robertson: Innovating In A Time Of Change

Innovating In A Time Of Change One of the most prominent images associated with innovation is that of tinkering. It is easy to envision an entrepreneur tinkering away in a workshop or garage trying to develop that big idea. The characterization was captured well by Thomas Edison's declaration:

"Success is 90% perspiration and 10% inspiration!"

This approach can work well, especially when the goal is incremental improvement. It can come up short, though, during times when the understanding of what is considered valuable changes. As Covid-19 has inspired a lot of fresh thinking about how we do things, there is an emerging opportunity to innovate differently.



Better Mousetraps

It is hard to overstate the importance of innovation as a concept in business. Innovation can secure or increase competitive advantage. It can also be the path to generate growth in an environment with precious few organic opportunities. Douglas Holt outlines some exciting insights regarding innovation in the *Harvard Business Review* article, "[Cultural Innovation: The secret to building breakthrough businesses](#)." He starts by describing innovation as a form of institutionalized tinkering:

"This is innovation as conceived by engineers and economists? a race to create the killer value proposition. It wins on functionality, convenience, reliability, price, or user experience. Better mousetraps innovation is often the right bet if you're a tech company."

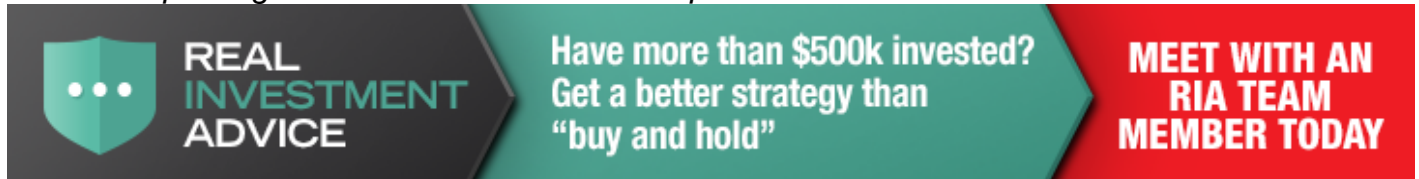
Indeed, it is easy to spot examples of such innovation almost everywhere. One of the best may be smartphone apps. These tend to be highly functional (often replacing dated single-function devices), mobile, continuously updated and improved, easy to navigate, and often free. The delivery of news content is a prime example as it is usually delivered through apps on mobile devices and is often free.

Innovation

Innovation follows a similar path in the world of finance. Stock commissions continue to decline to the point where trades are free on platforms like Robinhood. Besides, management fees for investment funds have been under pressure for years, led by the proliferation of low-fee passive funds. In these cases, offerings today are superior to older offerings on metrics like convenience, price, and user experience. Holt highlights another example:

?Procter & Gamble, for example, pursues what it calls constructive disruption. The company has designed its innovation process like a start-up's, with a venture lab that pulls in tech entrepreneurs and a lean probe-and-learn prototyping process."

The process sounds good, and the description employs the proper balance of catchwords. The only problem is, increasingly, *"That approach is not working."* What often happens is the over-zealous pursuit of improvements that are narrowly defined leads to over-specialization. Broader changes in needs go missing. In short, *"Companies struggle because they put all their chips on one innovation paradigm?what I call better mousetraps."*



REAL INVESTMENT ADVICE

Have more than \$500k invested?
Get a better strategy than
"buy and hold"

**MEET WITH AN
RIA TEAM
MEMBER TODAY**

Cultural Innovation

The antidote is to expand the set of innovation paradigms. One alternative approach to innovation is to transform the value proposition by reimagining the category entirely. **Holt describes, "In consumer markets, innovation often proceeds according to a logic I call cultural innovation."** He goes on to explain, **"Cultural innovation operates according to qualitative ambitions: Change the understanding of what is considered valuable."** Well-known examples include "Starbucks, Patagonia, Jack Daniel's, Ben & Jerry's, and Vitaminwater." Holt chronicles the case study of the startup Blue Buffalo and how it succeeded against powerful incumbent competitors. In a classic case of "David vs. Goliath," **Holt shows the innovation lesson lies as much in what Blue Buffalo did as what its competitors failed to do:**

*"For decades Nestle Purina, Mars, and Procter & Gamble dominated the profitable U.S. dog food category with powerful brands, distribution muscle, strong R&D, and big marketing budgets. Yet all three were beaten badly by Blue Buffalo, a tiny start-up, which was so successful that General Mills eventually bought it for \$8 billion, while Procter & Gamble threw in the towel and sold its entire pet food division to Mars for less than \$3 billion. **Blue Buffalo bested the established brands by reinventing dog food culture.**"*

The Challenge Of Convention

In ordinary times, we spend so much of our time doing the things we need to do; we rarely get a chance to reflect or experiment with other possibilities. Working from home a day or two a week can be perceived as problematic when everyone else is coming in to work. With all the challenges of 2020 and COVID lockdowns, however, values are being reassessed all over the place. Whether it is regarding working from home, commuting, interacting with other people, or any of a multitude of different activities, most of us have had to reflect on the things that are most important to us, even if begrudgingly. Now, everyone is getting a clean slate to prescribe the types of arrangements that would work best for them. This environment provides fertile ground for challenging conventional practices and beliefs across many dimensions:

"Great companies are also disrupted by innovations that don't involve new technologies; a cheap, low-performance product; or a price-sensitive target. Incumbents are so intent on winning the category as it's currently defined that they fail to identify cracks in its foundation. Cultural innovators outmaneuver them because they look for opportunities to blow up the dominant ideology in

favor of a new regime."

Examples

So, what are some dominant ideologies that are ripe for reinvention? One relates to news content. The dominant ideology is that the cost to produce news content gets paid for by advertising. Such has been the business model used by newspapers and broadcast networks and adopted by companies that distribute news digitally. It is all about reach, engagement, and, ultimately, value to advertisers. Another example is passive investing. One of the central organizing principles is that it is virtually impossible to outperform the market. By this logic, the best way to be exposed to risk assets is to own a share of the total market. The second organizing principle is that such programmatic exposure allows management fees to be deficient.

RIA Pro

Get the latest trades, analysis, and insights from the RIA Pro team.

> Sign up now

New Regime?

Both models are flawed, however, and the vulnerabilities are becoming increasingly evident. In the case of news content, the overarching effort to increase reach and engagement has a deleterious effect on the quality of content. Appealing to broader audiences requires the subject matter to get broken down into digestible bits. As a consequence, the reading level reduces to make it accessible to a broad audience. Further, writing and headlines get injected with sensationalism to elicit higher engagement. In short, content gets diluted into something less interesting and less informative. A recent [New York Times article](#) highlights how the publishing platform, Substack, is taking advantage of the "changing relationship between readers and media outlets":

'You might follow a publication,' Mr. Newton said, 'but it's more likely you care about an individual reporter or writer or YouTuber or podcaster. People are increasingly willing to pay to support those people'.

One of the changes is the desire for content that is interesting, independent, and unsanitized by a publication's editorial staff. Part of that includes the appetite for content that is offbeat or that challenges mainstream beliefs. Those who are intellectually curious don't want to read the same narratives; they want to learn.

Passive Flaws

Passive investing also has flaws. One of the big ones is the "no-frills" proposition, which is just the other side of the coin of "low cost." When markets are behaving well and generally trending up, this works just fine. **When turbulence erupts, however, as it did in March, "no-frills" becomes a glaring shortcoming for a lot of investors. Spiking volatility and falling prices create an entirely different set of needed services. Under such conditions, investors want insights, clear explanations, transparency, and access. Fees become a lot less critical when one's retirement is at stake.** Although many institutions invest in passive funds to some extent, many also use active managers. An essential part of the value they get from that relationship includes insights from the managers themselves. In an important sense, part of the active management fee serves as a retainer to access that insight. While this is harder for individual investors to accomplish, there are opportunities to plug the information gap.

Lessons

One takeaway, then, is that it is essential to accept a broader set of innovation paradigms. While tinkering and incremental improvement have their place, they are not the only pathways to change. As Holt highlights,

?P&G, Purina, and Mars never understood that they were fighting an existential battle to sustain their brands' authority as experts on healthful, nutritious dog food?not just racing to clean up their ingredients panels.?

Despite all the adversity and inconvenience that has emerged from the coronavirus, there is a silver lining. Radical and widespread lockdowns have created an incredibly fertile environment for cultural innovation. Such makes the potential for meaningful disruption in many industries. It also tends to favor newcomers who have nothing to lose by transforming value propositions and reinventing categories. There is a good chance significant changes will sweep over the investment business as well. The types of investment vehicles and services that perform well in a benign growth environment are vulnerable to change. Much like in the news environment, low-cost, mainstream, diluted information content is distinctly unhelpful when real challenges present themselves. Finally, innovation is rightfully a focus for many companies, but there are different innovation paradigms. While "better mousetrap" innovation often works in stable environments, cultural innovation can dramatically reshape competition when broader changes are afoot. Although Covid-19 has created a great deal of hardship, it provides a unique impetus to reimagine many of our goods, services, and conventions that are no longer fit for purpose. In other words, there is an enormous opportunity to finally correct many of the annoying flaws and shortcomings of the past