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INVESTIGATE HOW INNOVATION CAN BE USED TO REDUCE RISK AVERSION IN GROWING ORGANISATIONS

RISK MANAGEMENT AND ORGANISATIONS

Lesson 3

Learning Outcomes

- 3.1 Analyse the possible risks of innovation in an organisation
- 3.2. Produce examples of how to manage innovation risk so that innovation can be used to create advantage

3.1 ANALYSE THE POSSIBLE RISKS OF INNOVATION IN AN ORGANISATION

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What is innovation?

Innovation is not just about developing new products and services, it is about reinventing business processesand building entirely new markets that meets untapped customer needs.

Innovation cannot be left to chance, it needs to become the lifeblood of the organisation, and take advantage of the opportunities that persist for innovation.

Innovation has become an integral part in almost every organisation as it has become a prerequisite for continuity. Organisations such as Kodak that thrived in the past felt right down in the ladder as a result of failure to innovate.

Categories of Innovation

Innovation can be catagorised into the following main groups:

- Product innovation
- Process innovation
- Position innovation
- Paradigm innovation

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Categories of Innovation

- **Product innovation**– making changes to the product offered by the organisation (moving from CD's to MP3, MP4 players)

- **Process innovation**– changing the way products are created and delivered (online payments for car tax)

- **Position innovation**– changes to the context in which products are introduced (mobile phones which combine email, internet, music, radio, satellite navigation etc)

- **Paradigm innovation**– changes in the underlying attitude of an organisation (Northern rock which initially moved from a small building society to one of the largest mortgage lenders in the UK)

Innovations and Risks

Many executives believe innovation carries a risk-reward tradeoff that dictates "money invested can only generate higher profits if there is a greater risk of failure."

However, managers can foster innovation success and reduce its risk by gaining insight into what customers want and executing the innovation process effectively.

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Innovations Risks

You can face several **types of innovation risks** in a business. Risks can be:

- Operational Risk
- Commercial Risk
- Financial Risk
- Technological failure of the innovation
- Organisational risks

Innovations Risks

Commercial Risk

An innovation only confers a competitive advantage if competitors arenot able to replicate it in their own businesses. Whilst patents provide some legal protection, the reality is that many innovative products and processesarehard to protect. One danger is that one research-driven, innovative company makes the initial investment and takes all the risk – only to find it is competing with many me-too competitors riding on the coat-tails of the innovation.

Financial Risk

Much research is speculative and there is no guarantee of future revenues and profits. The longer the development timescale the greater the risk that research is overtaken by competitors too.

Innovations Risks

- Operational Risk

Operational risks include failing to meet quality, cost or scheduling requirements. Innovation success depends on suppliers and middlemen who are often not within the complete control of the organisation.

- Technological failure of the innovation

The biggest risk any company takes in the innovation process is whether or not the new product or idea will work once it is launched in the real world or whether it remains to be a white elephant.

- Organisational risks

This refers to the risks that are faced in the structure and running of the business once the innovation is introduced.

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3.2. PRODUCE EXAMPLESOF HOW TO MANAGE INNOVATIONRISK SO THAT INNOVATION CAN BE USED TO CREATE ADVANTAGE

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Risk Portfolios

Companies that are successfully managing innovation, diversify their innovation portfolio by balancing their mix of innovation across three levels of innovation ambitions:

1. **Core Innovation Ambitions** – These include initiatives that are incremental and enhancements to core offerings, such as new additions to existing products or services that utilizes assets the company already has in place (i.e. a small risk undertaking).

2. **Adjacent Innovation Ambitions**– These expand the existing business by leveraging what the business already does well (part core initiative) into adjacent new spaces or uses.

3. **Transformational Innovation Ambitions** – These initiatives represent those viewed as breakthroughs or creations of entirely new offerings, businesses, or markets (i.e. a very high level of risk to manage).

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Balancing Risks

- A key to managing innovation risk is understanding the underlying objectives or ambitions being sought by innovation and then considering the organisation's portfolio of innovations across these three levels.

- Knowledge of innovation ambitions helps managers better understand the nature of their underlying risk-taking in light of their appetite for innovation risks.

- Naturally, transformational innovations bear greater risks than the other levels. Managers need to consider the associated risks in light of the level of innovation risk tolerance their stakeholders are willing to accept.

- In order to establish a balance of innovation risk a business' decides to be appropriate (predicated on the risk culture of the firm), managers must become knowledgeable of the risk associated in each ambition.

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Balancing Risks

There are various factors to consider when pursuing a proper balance of focus of resources on core, adjacent, and transformational innovation. Each factor should be acknowledged as a guidance tool that is relative to the company, and not a prescription for adopting a perfect innovation strategy.

Three of the primary factors management should evaluate are the following:

1. Industry risk
2. Competitive position risk
3. Development stage risk

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Balancing Risks

1. Industry risk

Some industries, on average, have similar innovation risk strategies. Forexample, a company in the technology industry is likely to focus more on transformational innovation due to market desires for a new product. In contrast, a consumer producer will likely focus on making minor changes to existing products

2. Competitive position risk

Industry leading companies may want to keep their current balance of innovation risk or mitigate risk by shifting focus on core initiatives if the market has cooled. However, a strugglingcompany may want to bet big on transformational innovations that could spike market share and therefore growth potential.

Balancing Risks

3.Development stage risk

Start up companies have a tendency to favor disruptive (transformational) product innovation. Even if the investment is not highly successful, they have caught the attention of the media, as well as customers and investors. Conversely, an established company has a core business to build on and therefore has the optionto focus on core initiatives.

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Other Risk Mitigation Strategies

- To avoid market failure, the organisation should undertake extensive and in-depth market research before committing limited resources to its development and production.

- Proper planning and allocation of resources has to be ensured by the leadership to ensure that innovation doesn't lead to organisational risks.

- To manage risk of technological failure, the company may carry out trials on a small scale to test its effectiveness. Once this is done and observations made on, the necessary adjustments may be made accordingly to avert any huge losses once the product is mass produced.