

Why Real Mistakes Lead to Bigger Innovations

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Decision-making often makes or breaks innovation success. Most organizations are capable of generating ideas, but struggle with the process of choosing when, where, and how to commit dedicated resources to explore or develop promising ideas.

In most cases, this struggle can be traced to an internal tension between innovation efforts and operational priorities. Most innovation practitioners adhere to the “fail fast, fail often” mantra, with a bias toward quick experimentation and action. In contrast, most senior managers must follow a more rigid, risk-averse decision-making rubric. How an organization reconciles these two viewpoints determines whether innovations thrive or evaporate.

Exploring Risk and Reward

Just as in medicine, science, and statistics, innovation decisions are prone to **two fundamental errors**.^[1] In the classic example of a *false negative* is a doctor decides a patient is healthy when in fact life-saving treatment is needed. In this case, it’s better to take action, just in case. The classic *false positive* is quite different – a judge condemns an innocent person to death by execution. In this case, it’s better to refrain from taking immediate action, just in case.

Real-world business decisions can easily produce either error type. For corporate innovation, it’s critical to understand which type of error is preferable in real-world situations – launching an innovation that ends up failing (false positive), or not funding one that could be successful (false negative)?

		Outcome	
		Failed innovation	Successful innovation
Decision			
Go		false positive (failed innovation)	correct decision
No-go		correct decision	false negative (missed opportunity)

At first blush, it's not a straightforward calculation. The answer depends on an honest assessment of the risk/reward tradeoffs for each error type – rather than blindly following the default big-company bias toward risk aversion. Finding the right balance is crucial. Let's explore examples of each error type in action.

CALLOUT: Not all mistakes are created equal, and by allowing calculated failures to occur, big and exciting things can happen.

False positives drive unnecessary risks. Corporations exert tremendous effort to make data-driven decisions, in an attempt to avoid myriad cognitive biases (see HBR's 2012 **feature on Big Data**).^[2] This typical bias toward objective, rational decision-making tends to penalize false positives (failed innovations) far more than false negatives (missing out on opportunities). Examples are easy to find: punishment was swift and unforgiving for the executives who attempted to improve the Coke formula, required iOS users to use Apple Maps, who set up a new pricing structure for JC Penny, or who separated streaming from DVD distribution at Netflix.

False negatives create missed opportunities. On the other hand, periods of industry change or upheaval often create a strong need to encourage false positives. Much has been written about the advent of online retailing as the cause of Borders' eventual demise. However, not all booksellers succumbed to these disruptions: Barnes & Noble (B&N) survived the transition, in part by developing their own Nook E-reader as a competitor to Amazon's Kindle. Although there may have been no consequences for Borders executives when B&N launched their E-reader, eventually Borders was severely punished for its failure to embrace new business models.

Thankfully, not all companies behave like Borders. Recently, Sir Richard Branson claimed Virgin has created businesses in eight different sectors, each valued at **more than \$1 billion dollars**.^[3] Yet a company poised to capture opportunities necessarily ends up with flops, too. Despite the success of Virgin America, Virgin Galactic, Virgin Media, and Virgin Mobile, there was also Virgin Cola, Virgin Brides, Virgin Cars, and Virgin Digital. These false positives, rather than failures, are in fact healthy markers of an innovative company culture.

What's the right way for businesses to navigate the balance between missed opportunities and unacceptable risks? In the next section, I offer several tips drawn from real-world experience.

	Type of benefit	
Type of solution	Avoid false positives	Avoid false negatives
Governance	Build portfolio discipline	Flatten hierarchy through technology
Process	Never stop experimenting	Expand feedback circles
Culture	Actively learn from failures	Embrace intuitive and creative criteria

Make Failures Profitable

Although “failures” from false positives cannot be avoided, shying away from risk-taking altogether is almost certainly a losing strategy. Rather than choosing between two lackluster alternatives, executives can tilt the rules in their favor by working to “make failures profitable”. Several strategies allow for calculated risk-taking with confidence.

CALLOUT: Many organizations have grown into idea-killing machines, where only the safest projects survive.

Build portfolio discipline. Smart investors don’t expect all ventures to succeed, instead building investment portfolios to maximize returns at a given risk tolerance. Implicitly, most corporations expect all funded projects to succeed, effectively dooming innovation to perpetual mediocrity. Managing innovation as a corporate portfolio requires active, coordinated leadership discipline – no small feat. But it’s the only way to encourage sufficiently ambitious, high-risk efforts with the potential for major returns.

Never stop experimenting. Often, new ideas are “guilty until proven innocent,” and never allowed to prove their worth. That’s a shame, because modern development methods like rapid prototyping allow most new ideas to be quickly explored and vetted, with minimal downside risk or cost. Adopting “agile” innovation methods means modifying workplace habits, which can feel awkward and unnecessary. But the benefits are staggering: a steady influx of market feedback from targeted experiments, and significantly faster and smoother rollouts for those ventures chosen to move forward.

Actively learn from failures. The best entrepreneurs view failures as valuable guideposts on the path to success. The key is to learn from each, and then re-direct efforts appropriately. Large organizations can do this too, by building flexible work structures that accommodate pivots. Adapting process expectations takes willpower and persistence, especially in a typical corporate environment. But for enterprises serious about innovation, it’s the only way to empower on-the-ground teams with the agility for successful follow-through.

Bloodhounds Trump Bureaucrats

Innovation suffers under normal corporate decision-making procedures. Instead of entrusting innovation success to bureaucrats, great organizations introduce “bloodhound” instincts into every level of innovation decision-making and execution. Below are several strategies which, when employed in concert, make it possible to hone and institutionalize the killer instincts for spotting and amplifying brilliant opportunities that other organizations almost always miss.

Embrace creative and intuitive criteria. Breakthrough opportunities cannot be measured by existing standards. Rather, assessments using more speculative indicators of future success, combined with creative methods such as lateral thinking and analogous worlds, can help would-be bureaucrats evaluate each innovative idea on its own terms, not theirs. Further, individuals or teams with track records of uncovering novel opportunities should be celebrated, not marginalized.

Expand feedback circles. Most corporate decision-making involves a natural default for projects that feel similar to past successes. That’s great for risk-reduction, horrible for innovation. Innovative companies encourage input from a diverse mix of employees, and ideally also external stakeholders such as customers and partners. This places emphasis squarely on potential business benefits rather than perceived implementation hurdles. The extra coordination overhead is a small price for correcting inherent decision-making bias.

Flatten hierarchy through technology. Decision-making authority tends to be concentrated in executives with both responsibility for, and means to carry out, the ensuing activities. The problem is that no single person can be exposed to, or even aware of, the myriad on-the-ground factors that affect a decision’s ultimate success. The good news: thanks to modern web-based collaboration systems, decision-making can involve many voices and perspectives without removing authority unduly from executives’ hands. Further, by employing virtual tools for online and offline reflection, reviewing and reporting processes can allow for rich discussions that act as foundations for consensus building.

Organizations will never be able to keep pace with market changes if they reduce the risk of failed launches to a bare minimum. For ambitious innovations to have a reasonable shot at success, leaders must develop opportunity-friendly decision-making mechanisms throughout the innovation lifecycle. This is the only way to set the conditions for big successes as well as incremental innovations.

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[1] *Wikipedia* entry, “False positives and false negatives”.

http://en.wikipedia.org/wiki/False_positives_and_false_negatives

[2] *Harvard Business Review*, October 2012. “Big Data: The Management Revolution”

<http://hbr.org/2012/10/big-data-the-management-revolution>

[3] *Entrepreneur*, September 16th, 2013. “Richard Branson on the Secret to Virgin’s Sustained Success”

<http://www.entrepreneur.com/article/228382>