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VALUEPOINT™

Articulate the Evidence of Value

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Innovation is a source of fascination and fear for executives and managers of enterprise companies. Various surveys of business leaders by Harvard Business School, Boston Consulting Group (BCG) and Innovation Leader put the problem for enterprise companies into focus:

- 30 percent of board members rank innovation among their enterprise's top three challenges.
- 19.5 percent of BCG's clients rank commercializing ideas as their biggest innovation challenge.
- 31 percent of innovation leaders say a risk-averse company culture is their biggest innovation roadblock, while 25 percent say it's a lack of coordination.

In my previous life at HP, I learned several valuable lessons about the challenge of managing innovation. Most people who hear "managing innovation" think of supervising teams of scientists, engineers and developers to come up with amazing new technologies and products. The real challenge of managing innovation, however, is in taking a holistic view of what needs to happen for an innovation to be commercially as well as technically successful.

Over the next few issues of ValuePoint, I will share three chapters of my story from my experience at HP:

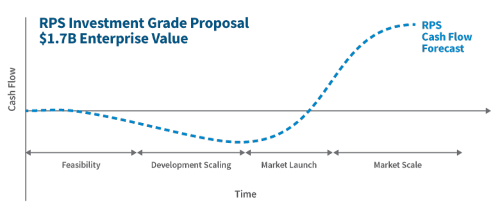
Chapter 1: The importance of articulating the evidence of value.

Chapter 2: The need to focus on the value of evidence.

Chapter 3: How to combine the two to match the innovator's dialect to investor language.

Chapter One: Articulating the Evidence of Value

In the early 2000s, I was the finance director for HP's effort to enter the on-demand photo printing market. HP had an exciting new technology for page-wide inkjet printing, eliminating the need to move the print head horizontally across the page and increasing the print speed exponentially. The incumbent competitors in the market had conflicts between their digital printing initiatives and their legacy photographic chemistry paper businesses, while HP had no legacy product in the space to defend but lots of adjacent technology and product experience.



Based on these favorable factors, we created an investment grade proposal for the new on-demand photo printing business. The projected size of the market led us to project a cashflow that valued the enterprise at $1.7 billion. We would invest in feasibility demonstration, development and production scaling, and market launch, and then earn back our investment and profit in market scaling.

As the project progressed, we met our objectives in feasibility demonstration. It took a bit longer than we expected and cost a bit more, but our cashflow projections still forecasted a $1.6 billion valuation. Development and production scaling and market launch took

A business discovery starts with a hypothesis, then a skillful experiment in which the world reveals itself, and ends with the discipline to act accordingly.

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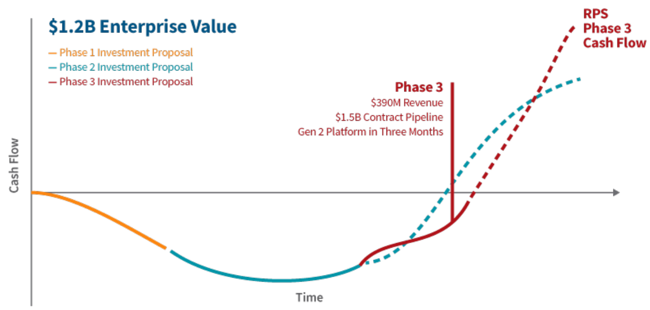
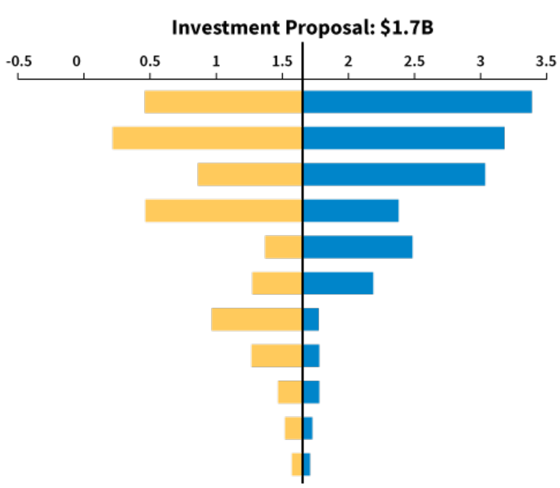


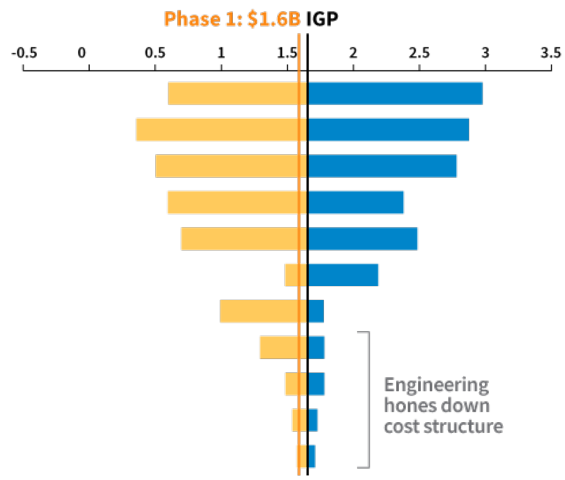
substantially longer than we'd planned, but we were still on track to a $1.4 billion valuation. We had initial market acceptance, nearly $400 million in revenue, and a contract pipeline of $1.5 billion. There was more schedule stretch during our market scaling, pushing our valuation down to $1.2 billion.

HP went through a series of CEOs, one of which drained the corporate coffers with an acquisition. Our next CEO encountered a cash flow triage situation and asked for a review of all business units. As a result of the review, the decision was taken to shutter the on-demand photo printing business unit. Judging by the cashflow projection above, that decision might seem puzzling: why would HP turn down a billion dollars? It wasn't cold feet: HP was accustomed to making billion-dollar bets on new technology platforms to generate ongoing consumables revenues.

How did this opportunity go awry? Several VP's wanted a solid answer, especially since subsequent investments of equal magnitude were underway in other print markets. A post mortem review was concluded, and the conclusion centered on the evidence of the value of the business. At the outset, it appeared that there was an opportunity with ample upside potential.

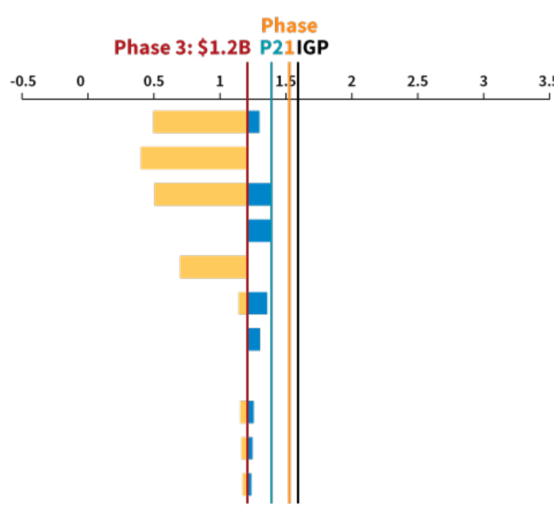


Phase 1 focused on product engineering, driving down the cost structure. It went well, and the valuation of the program remained very high.



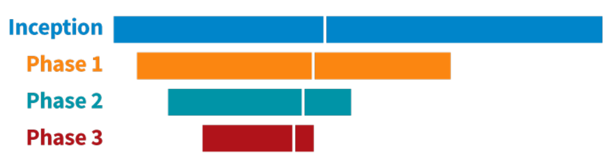
However, as we moved on to market factors, driving demand generation and seeking greater throughput of photo production, we learned that the remaining uncertainties skewed away from our initial upside estimates. By the time we reached Phase 3, market scaling, the upside almost completely evaporated and there was a disturbing downside.

This reflected the knowledge we gained over the course of the three phases. On the plus side, we were far less ignorant of the product-market fit. On the minus side, the fit was not nearly what we had hoped. The probability was that the future would keep pushing the value of the business ever lower, erasing the projected valuation.

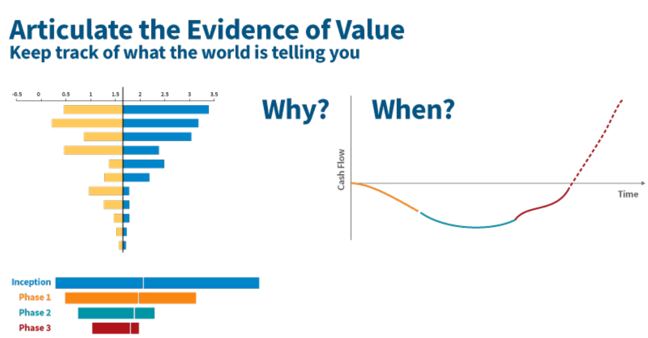


At each phase, the business unit had focused on action plans to “drive results” along each dimension without a review of the investment thesis. We were gathering market feedback through our operations and while all of it went toward annual planning goals, little of it went toward a review of the evidence of value.

The bars below represent the total range of possible program value at each phase, with the white line showing the most likely value for that phase. With each phase, the total uncertainty (the length of the bar) shrank, but the balance between upside and downside progressively shifted in the downside direction. Have you ever witnessed a program doggedly (heroically?) trying to survive against market forces?



The moral of the story is that articulating the evidence of value is critical. Why you should pursue an innovation (what value you will derive from pursuing it) is much more important than When to pursue it (the timing of projected cashflows).



In the next two editions of ValuePoint, I’ll relate the subsequent chapters of my story about my time at HP, one about how our smartwatch business evolved and ended and another about how combining the evidence of value with the value of evidence yielded a successful innovation program that in three years generated 25 times the return on innovation.

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