Developing a Corporate Culture That Stimulates Employee Innovation

Presentation to Clients of China Merchants Bank

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Good afternoon.

I am delighted to have the opportunity to speak with you this afternoon about a topic that is of enormous importance to any twenty-first century organization: how to establish a corporate culture that stimulates employee innovation.

We have about an hour together this afternoon. I will plan to speak for about half that time, so that we will have at least 30 minutes for questions and discussion.

I will divide my presentation into two parts. In the first part, I will give a very rapid overview of the tremendous scholarly literature discussing creativity and innovation – both in startups and in mature organizations. In the second part, I will talk specifically about organizational culture and how it can promote or block an organization from innovating in the ways that it needs to if it wants to make enduring contributions to the world.

Over the past five years, all of us have felt an explosion of interest in creativity and innovation. The national leadership stressed the importance to China of moving up the value chain, from an economy based on high quality adaptation and execution of ideas created elsewhere to an economy based on the creation of new value.

I myself experienced this during a meeting with then-Premier Wen Jiabao. At the time I was leading the Peking University School of Transnational Law, and I told the Premier that, in teaching China's best stu-

dents, I felt like I was in Hogwarts, teaching a class full of Harry Potters, students with magical talents. Premier Wen responded, "President Lehman, what China needs is for your school to help those Harry Potters grow up into the next Steve Jobses."

This interest in creativity and innovation has also triggered a certain amount of concern. Some people have voiced worries that China's educational systems and business cultures are not structured in ways that nurture the natural creativity and innovativeness of China's young people. And I am often asked whether I think these are qualities that can actually be developed in the right kind of schools or the right kinds of business environments.

My experiences in China have taught me to be very optimistic on these topics. I firmly believe that the right kind of education can nurture the strong natural creativity of Chinese young people. And I also believe that the right kind of organizational environments can allow that creativity to produce highly innovative businesses.

At NYU Shanghai, our curriculum and teaching methods are designed to help our students learn how to make full and effective use of their natural creativity, and to understand how that creativity can contribute to group activities. I am happy to say more about this during Q&A, but for now just let me say this: we do it, we see it, and it works.

But what about business innovation? I believe Chinese youth can definitely be taught how to turn creative ideas into innovative business products. At NYU in New York, an entrepreneurship laboratory has been created that does just that. And now, as part of our Program on Creativity and Innovation at NYU Shanghai, we are doing the same thing.

To give you a sense of what students can learn through programs like this, I would like to give you now a very, very quick introduction to six scholars who have studied business creativity and innovation, both in the world of mature companies and in the world of entrepreneurial start-ups. Over the past 30 years, these scholars have published important insights into how to create an environment where creativity and innovation flour-

ish. You may know some of their names, and I think it is good for everyone to know all of them.

The first name is Peter Drucker, one of the most famous scholars of management ever. In 1985, he published an article called, "The Discipline of Innovation."

In that article, he made the following key points:

First, innovation is a systematic practice that involves smart searching for opportunities

According to Drucker, opportunities come from seven different directions:

- "unexpected occurrences,"
- "incongruities,"
- "process needs,"
- "industry and market changes,"
- "demographic changes,"
- "changes in perception," and
- "new knowledge"

According to Drucker, taking advantage of these opportunities does not require genius; it only requires hard work. You should keep it simple, be focused, and start small. And you should not try to figure it all out inside your own head. You should "go out, look around, ask questions, and listen to the answers you get."

The second scholar is Clay Christensen. In his book, The Innovator's Dilemma, he explained why, over and over again, excellent, innovative, well-managed companies – the best companies in the world – don't stay on top and are toppled by unexpected new competitors.

He made the following key points:

Well-managed companies are focused primarily on taking their products and making them better. They use what he calls "sustaining innova-

tions" to keep adding new features that respond to what their core customers say they want.

These companies tend not to be concerned if a new company offers a product that is not as good. But sometimes this new company is using what he calls a "disruptive technology." Their product may not be as good at first. It may not have all the features of the leading product. But it has all the key features. And it is cheaper, simpler, smaller, and more convenient.

This disruptive technology creates a new market for this different product, and the new company has the advantage of being the first mover into that market. The new product quickly improves, and suddenly the old company is out of business.

The third scholar is actually two people, Charles O'Reilly and Michael Tushman. In 2004, they published an article called "The Ambidextrous Organization." Ambidextrous means being able to use both your right hand and your left hand equally well.

O'Reilly and Tushman studied how it is that some companies are able to sustain their existing businesses while at the same time producing what they called "discontinuous innovations" – the kind of dramatic innovations that develop entirely new businesses.

The answer, they found, was in how the businesses built their organizational structures. They established independent units with responsibility for producing the dramatic innovations. These units are given their own processes, structures, and creative cultures. At the same time, however, the leadership of those units is closely tied in with the leadership of the traditional business units, so that experience and resources and customers can be shared.

The fourth scholar is Roger Martin. In 2009, he published a book called, Design of Business. In that book, he described an approach that is known as "Design Thinking," a systematic way of approaching problems that can get you to innovative solutions.

Sometimes people argue about whether "analytical thinking" or "intuitive thinking" is more important to innovation. Martin argues that you need both, and that is what design thinking does.

Martin says that business opportunities start with what he calls "mysteries." You could think of them as problems that need solving, or you could think of them as Peter Drucker's seven different kinds of opportunities. Spotting which mysteries are interesting requires intuitive thinking.

Martin says that the next stage of innovation involves moving down what he calls a "knowledge funnel." First you use a mixture of intuitive and analytical thinking to go from lots of mysteries into a middle stage where you have a bunch of guesses about possible solutions, which he calls "heuristics." And then you use purely analytical thinking to test out and refine those heuristics until you reach a small set of rigorous solutions that he calls "algorithms."

The key feature of design thinking is that you don't stop there. You are not content with what your analytical thinking has brought you. You allow your intuitive thinking to cycle you back up to the mystery phase, to keep wondering about how to keep improving your system.

The fifth scholar is Steve Blank. Steve Blank may be the most sought-after scholar alive today in the field of innovation and entrepreneurship.

In 2013, he published an article entitled, "Why the Lean Start-Up Changes Everything." In that article, he described what he calls "The Lean Launchpad": a system for producing successful startups without a lot of money, without a lot of time, and without the need for a lot of secrecy.

Blank argues that the traditional style of launching businesses is a big mistake. In the traditional style, where entrepreneurs create five-year business plans and "pitch" them to venture capitalists who invest a lot of money and take a certain amount of control over the business.

Blank argues that this puts entrepreneurs into a mindset of "pitching" and "defending" their business plans, before they really know whether those business plans are any good.

Instead, Blank argues that the most successful entrepreneurs work differently. They create "lean" start-ups, start-ups without a lot of fat on them. They create them in their apartments. And instead of creating business plans in their own minds, they create structured business models that are built out of hypotheses that they are committed to testing.

Blank's Lean Launchpad requires entrepreneurs to develop hypotheses about nine different areas of how the business would work. These nine areas have to do with the product, the market, and how the business will operate to make money.

The next stage requires the entrepreneur to build something that he can show to potential customers to give them a sense of what the product will be, so that he can get their reactions. This is not a fancy sample product. It is what he calls a "minimal viable product" – just enough to get reliable reactions from potential customers.

Next the entrepreneur goes out and gets reactions. He expects the reaction to be negative, but he also expects to get information he can use to keep improving the product and the overall business model. He cycles back and forth from model development to customer engagement very fast until he is confident he has a model that can work.

The sixth scholar is Amy Wilkinson. A few months ago she published a book called, The Creator's Code. She interviewed hundreds of successful entrepreneurs about their work, and she identified six qualities that they all share:

First, they "Find the Gap" – they look for places where there is a real gap between what people want and what they can get.

Second, they "Drive for Daylight" – they are focused on the long-term goals and not bothered by small short-term obstacles.

Third, they follow the "OODA loop" (Observe, Orient, Decide, Act). They watch what is going on around them. They see what the issues are. They decide what to do. And then they do it.

Fourth, they "Fail Wisely." They all fail. But they fail in ways that don't destroy them and instead give them new learning so that they will do better next time.

Fifth, they "Network Minds." They understand that problems are best solved by teams of people who have different skills. They know how to build those teams.

And sixth, they "Gift Small Goods." They are generous people. They help others out with their problems. They become known for having that kind of personality. And that means other people want to work with them.

So those are the six scholars. I believe that anyone who is responsible for a company will benefit from reading these six books and articles. There are dozens of lessons you can draw from them. This afternoon, however, I want to focus on five of them that point directly to the question of organizational culture.

- A process of trial and error

- Generate "wild" new ideas and test them, expecting most to be wrong

- First design, then be responsive to feedback from potential customers

- Plan for failure

    o Be sure failure does not cost too much

    o Use failure to gain valuable understanding

- Do not waste precious time or money

At NYU Shanghai, our Program on Creativity and Innovation is giving us a way to introduce these key points to our students – as a matter of theoretical study, and also as a matter of experience. Our own "Live Laboratory," which will open this fall, will create a space in which students can connect their own study and reflection about these topics, their own personal experiments with entrepreneurship, and the experiences of successful entrepreneurs right here in Shanghai.

So now let me turn to what these lessons about innovation might imply about the working culture of an organization and use as an example the work that we have been doing at NYU Shanghai.

NYU Shanghai is not a for-profit business. It is a not-for-profit university. Its agenda is therefore in some ways different from that of a corporation. Nevertheless, we believe that we have learned a lot from our studies of high-performing for-profit corporations, and we believe that much of our own experience will be directly relevant to the situation of for-profit businesses.

For a university, the key stakeholders are two groups: students – whom we exist to serve – and faculty. Faculty members are not merely employees. They are the key leadership talent. Universities must fight hard to recruit and retain them against raids by other top universities in the world. Moreover, they have responsibility for carrying out our core functions – teaching and research – at world-class levels of quality.

NYU Shanghai's mission is to be innovative for China in all our efforts: teaching, research, and administration. That means our administrative culture needs to support innovation by our faculty in teaching and research. And it also means that our administrative culture needs to itself be innovative and not simply follow whatever models are traditional at other Chinese universities.

It is sometimes said that the key moment for an organization comes when you get past 40 employees. At that point you are no longer a start-up. You need to be thinking carefully about what aspects of your culture matter, and how you will implement through systems and processes.

NYU Shanghai is now well beyond 40 employees, so we have been focusing on how to create systems and processes that will sustain a high-performing administrative culture. This past year we listened carefully to feedback we have received from students and professors about our administration. That feedback helped us to develop 16 principles of administrative philosophy. We tested these principles over a period of several months with different audiences, ranging from faculty and students

to scholars of organizational behavior. We refined them and edited them based on what we heard, until they were generally well received.

Last month we began to roll them out, in a process that we expect will take a full year.

The principles begin by emphasizing the fact that, on the administrative side, our responsibilities are "enabling." Our job is to enable NYU Shanghai to attract the world's best faculty to carry out core functions as well as they can, and to enable NYU Shanghai to attract the world's best students to attend NYU Shanghai and derive maximum benefit from their university experience.

Organizations that are devoted to creativity and innovation depend on employees who are motivated and happy, employees who are willing to go beyond the minimum, to help promote the organization's success. A high-performing university administrative culture therefore encourages employee initiative, prudent risk taking, mutual trust, and mutual support. If NYU Shanghai is working well, morale among employees will be high. The university as a whole will have higher productivity and reduced turnover; more importantly, employees will feel better about their lives.

Seven of the sixteen administrative principles are relevant to the work of everyone in the university. Nine of them are directed in particular at managers.

The seven aimed at all employees are these:

- Value Operational Excellence
- Enable, Don't Disable
- Recognize Bureaucracy as an Existential Risk
- Find Solutions
- Sustain a Culture of Connectedness and Cooperation
- Sustain a Culture Where Everyone Speaks Up
- Avoid Technological Depersonalization

The nine aimed particularly at managers are these:

- Promote Simplicity and Agility

- Decentralize Where Possible

- Decentralize Intelligently

- Align Individual Incentives

- Keep Authority and Responsibility Clear

- Assess the Right Things

- In Budgeting, Find the Healthy Middle

- In Setting Performance Goals, Find the Healthy Middle

- In Risk Management, Produce Information for Strategic Decisions

A key challenge is how to make sure that these principles do not become mere slogans that people can memorize and recite but that do not affect behavior. An operations professor from NYU's business school is working closely with us to develop an effective training system to help ensure that these principles are really "owned" by everyone in the school.

In the meantime, we will continue to test and revise these principles in response to what we learn from others.

Which of these principles are unique to a university and its innovative mission, and which ones apply generally to all kinds of innovative organizations?

Honestly, I believe they all apply to every kind of organization that is committed to evolving and innovating in a rapidly changing environment. I hope that you will all think about them and how they would apply to your own organizations – whether they would be helpful or harmful.

Permit me to stop there, so that I can hear your own thoughts on the various topics that I have discussed this afternoon.

Thank you for your attention.