Gary Hamel has been labelled “the world’s reigning strategy guru” and “the most influential thinker on strategy in the Western world”. He calls for radical innovation in business, telling companies that they must continually reinvent themselves, not just at times of crisis. His landmark book, co-authored with C K Prahalad, *Competing for the Future*, was *Business Week*’s book of the year in 1995. Its 2000 sequel, *Leading the Revolution*, was also a best-seller. Hamel is a founder of Strategos, an international consulting firm, director of the Woodside Institute, a non-profit research organisation, and a visiting professor at London Business School. Gary Hamel talked with Stuart Crainer from his office in Woodside, California.

**What is the basis of your latest thinking?**
The basic proposition of my recent work is that most of the things that moved earnings and share prices upwards during the last decade have reached their arithmetic limit.

One hundred years from now people will look back at the last decade, especially the last half of the decade, as an economic aberration. It was a time when a variety of forces conspired together positively to create a buoyant economic climate.

First, there was huge growth in technology and IT spending. Go back to 1990 and US companies invested about 19 per cent of their capital expenditure on technology. By 2000 they were spending 59 per cent. Capital spending tripled. It was the longest capital spending boom in history. That fuelled the share prices of IBM, Cisco and Sun and everyone else in the technology sector. That’s not going to happen again. Capital spending...
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is not going to triple over the next decade. The second positive force was an unprecedented attack on inefficiency. Over the last decade we have seen re-engineering, restructuring, downsizing, enterprise resource planning and customer relationship management. All focused on how you take working capital out of your business, how do you take time out of your processes, how do you operate call centres with fewer people? They were a product of global competition and the Thatcher revolution.

Every company on the planet was tearing up processes for the sake of operational efficiency. There’s a lot of data that says that companies now have reached the point of diminishing returns in their efficiency programmes. They are having to work harder and harder.

The third thing was an orgy of mergers and acquisitions (M&As). In 1990 there was roughly $600bn worth of global M&As. There were $3.5trn by the end of the decade. If M&As had continued to grow at that pace there would have been one company left in the US.

Look at the management heroes we had – Chris Gent, Percy Barnevik, Bernard Arnaud, Jerry Levitt, Dennis Kozlowski, Jack Welch. All of them were dealmakers or efficiency addicts to one degree or another. Look at Welch at GE. He launched efficiency initiatives – Work-Out and so on – and programmes to take the costs out of the business. That was kind of his signature. At the same time he made over 500 acquisitions in the 1990s. There’s nothing wrong with that. But the skills they brought to the party, the recipes they had for creating wealth or the illusion of wealth aren’t going to get the same returns in the decade going forward.

In September 2000 when GE was worth more than $400bn and Welch was at the height of his influence, I wrote an article which said that GE was reaching the top of the performance improvement curve. I didn’t know at that point that Jeff Immelt was going to succeed Welch but I knew that he couldn’t reproduce what Welch did using the same strategies. After a while there is a limit to power dieting and binge buying.

The punch line to all this was that over the last few years it was possible for executives to rely on a very positive economic environment, a rising economic tide on which to float their boat. The tide is now receding. There is no evidence that somehow substantial economic expansion is going to rescue the day. I don’t think it is.

So you take a pessimistic view on the prospects for economic growth?

I am not pessimistic on growth overall, but right now most companies don’t have any strategy that goes beyond retrenchment. Suddenly, timidity is in fashion once again. Retrenchment doesn’t buy you growth; it doesn’t buy you a future. At best it buys you time.

There is enormous enthusiasm for moving back to basics. You can’t argue with that at one level. Of course, you need to focus on the basics. The dilemma is most companies don’t have a lot of options. Most companies, for example, can’t grow revenues by selling the same things in the same old way to the same customers.

Look at the problems with growth in North America facing McDonald’s. You can introduce a new cooking system, better choice, Happy Meals and negotiate a new deal with Hollywood for cross-promotion but, at some point, you may have to admit to yourself that Americans are eating as many burgers as they are likely to eat.

On the other hand, Imode in Japan in about 30 months created 30 million customers. It’s not that you can’t grow. But you can’t grow by doing the same things you’ve always done.

The same is true if you think of raising prices. In a deflationary world, very few companies have the power to raise prices. Most are being pushed the other way and customers are ever more powerful mostly thanks to the Internet. Yet Starbucks can charge £3 for a latte.

One of the huge blind spots for a lot of managers is that they’ve forgotten that productivity has two elements – the efficiency with which you use your inputs, your labour and your capital, and the value placed on your output. Executives know a
lot about the efficiency side of the equation but not about their output.

Despite all the consolidation in the global car industry over recent years, the most profitable carmakers are BMW and Porsche and they are a couple of the smallest. They may not have the global purchasing efficiencies of GM or Ford but they create things people love.

On the cost side most companies have reached the point of diminishing returns. But if you look at companies that are doing best in difficult times, companies like Dell, Wal-Mart, Jet Blue and Ryanair, all brought radical innovation to the cost structure. Their costs are not five or ten per cent lower but 50 per cent or 80 per cent.

So if not retrenchment then what?
My argument is that the more difficult the economic times and the more one is tempted to retrench, the more radical innovation becomes the only way forwards. In a discontinuous world, only radical innovation will create new wealth.

At one level, executives are getting that message. They know that they can’t do the same things. But there is a huge gap between the rhetoric and the reality.

CEOs will say that they need to innovate and put innovation as one of their top two or three priorities. But if you go down a few levels in the organisation and talk to mid-level employees you should ask “have you been trained in innovation? What is the process you plug into if you have a new idea? How quickly can you locate talent to push ideas forward?”

Ask these questions and it’s obvious that most companies have not institutionalised innovation in a meaningful way. Innovation is a ghetto. It is seen as something for a few people in product development, R&D or the corporate business development function. It is not seen as the responsibility of every single employee every single day. Most companies haven’t even begun to either unleash or monetise the imagination that exists.

It is the same situation as around 1970 in terms of quality. People knew that quality was important but didn’t know the processes or systems to use. All the processes and systems – pareto analysis, quality circles and so on – later known as total quality management, were being built at the time. Executives in the West had very little knowledge of them and didn’t know what to do.

The question I have been asking is how do you do for innovation what W Edwards Deming and others did for quality?

If you ask people where does innovation come from you will receive one of two answers. They will say innovation comes from a visionary – Jeff Bezos at Amazon or Richard Branson – or they will say it comes from a function – a product development or R&D function. It’s like 30 or 40 years ago. If you’d asked then where does quality come from, it came from an exceptional person or a function, an inspector.

We are slowly making progress in institutionalising innovation. For example, one of the companies we work with has trained thousands of blue-collar hourly employees in the new innovation discipline – how to challenge industry orthodoxies, how to meet unmet needs.

What is the pay-off from better understanding innovation?
Despite the dot-com collapse, look back over the last decade and most new wealth was created by new entrants, if not literally at least newer companies. Innovation drives wealth creation. There’s no other conclusion you can reach.

A product advantage can come and go but if you commit early to building a complex and deeply embedded capability it is very difficult to catch up. Companies that commit themselves to...
innovation – like Whirlpool, Cemex, Shell and a few others – are going to have a profound advantage. It might not be evident right away but once you get a lead it is difficult for others to catch up. Over the last 40 years Western car makers haven’t recaptured even a single point of market share from their Japanese competitors. The Western car industry has continued to lose market share.

How can companies develop the capability to innovate?
Making innovation a real capability requires not an overlay of a few small adjustments, it requires a fundamental rethink of your most basic business principles. Today, the goal of becoming incrementally better is ingrained in our thinking, in our language, in our reward mechanisms and everything we do. Innovation is seen as an exceptional thing that happens once in a while, almost by accident, on the fringe. To change that is not easy.

Think of the legacy of the industrial age – hierarchy, control, replication, quality. These are hugely important but in many ways they are toxic to the process of innovation and creativity, experimentation, imagination, self-organisation.

We haven’t really challenged the primacy of optimisation and incremental improvement. Fundamentally, innovation can’t be at the edge. Innovation has to be central to the purpose of organisations. We have to systematically train people in new ways of thinking. We have to create new metrics. Most of the metrics companies use – ROI, EVA and so on – push us into thinking simply about incremental improvements. We still have a very deep belief in management processes that are the antithesis of innovation.

One of them is that alignment is always a virtue – everyone reading from the same page, all the wood behind the arrow, whatever metaphor you use. Perfect alignment is death.

In a world of enormous change the scope for experimentation inside your company has to match the scope for experimentation outside. We have to re-engineer management processes to minimise the time between an idea and wealth creation. It’s not the supply chain that needs shortening and automating, it’s the innovation chain that needs shortening and automating.

What needs to happen now?
Companies shouldn’t mistake what happened in the 1990s as real innovation. The 1990s were a product of the dealmakers and the dream merchants.

Three principles are the foundation for trying to move forward: first, radical innovation. In an increasingly non-linear world only non-linear ideas create wealth. Innovation is the only insurance against irrelevance.

Second, requisite variety. Is there scope for experimentation within the company? Is there a willingness to make mistakes? Most organisations have way too little strategic experimentation.

Third, resource attraction – which is different from resource allocation. We need to learn from markets how we attract resources. Markets outperform hierarchies every time. Most organisations today look a whole lot more like the Soviet Union than we would like to admit.

Stuart Crainer is executive editor of Business Strategy Review.

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