Innovation 101 for CFOs

"Innovation is for CFOs, too," say IESE's Tony Davila and co-authors in their article for Strategic Finance, with six levers of innovation for any field.

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Although accounting regulations limit some finance innovations, there's still so much that can be done. Innovations in the finance function may include novel ways to close the books faster or new sources from which to raise capital.

In their article "Innovation Is for CFOs, Too," Professor Tony Davila of IESE, Professor Marc J. Epstein of Jones Graduate School of Business at Rice University, and innovation consultant Robert D. Shelton take lessons from their book, *Making Innovation Work,* and apply them to accounting and finance.

In their book, the authors identified six levers of innovation: three business model levers and three technology levers. CFOs can use these six levers to find surprising ways to improve both the efficiency and effectiveness of their activities.

Renovating your business model

The three levers of business model change are:

1. *Value Proposition*. The basic value proposition of any firm is what is sold and delivered to the market. Changes may include bundling products and services together or selling previously bundled products as stand-alone offerings. Another option for change is expanding the boundaries of the business.

2. *Value Network*. How value is created and delivered relies on its network. Changes to the network may include reworking the supply chain, seeking out alliances with companies that

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offer complementary products and services, building and monetizing social media networks, and modifying the revenue, cost or margin model.

For example, while most airlines derive the bulk of their revenue from ticket sales and pay airports to use their gates, Ryanair famously persuaded airports to pay them instead. In return, they committed to deliver a specified number of passengers to the airport and offered passengers cheap airfares to do it. The company also receives a portion of sales generated by the airport's retailers.

3. *Target Customer*. Changes here may include looking for customers that competitors have missed. These may be unserved customers who have bought similar offerings from competitors or non-customers who have never bought your kind of product or service from anyone.

The Indian automaker Tata Motors did just this when it designed the Nano, a $2,500 two-seater car targeted at millions of people in India who couldn't previously afford a car.

Making technology work inside and out

The three levers of technology change are:

1. *Product and Service Offerings*. Changes may include upgrades or introductions of entirely new products or services. This is the most easily recognized type of innovation because consumers see the changes firsthand. (This is not usually the domain of the CFO.)

2. *Process Technologies*. Though less visible to customers, technology is also used to improve the manufacturing process or service delivery; resulting in better, faster and less expensive products and services.

3. *Supporting Technologies*. Rather than changing the functionality of a product or process, changes to supporting technologies help a company execute its strategy faster and leverage time as a source of competitive advantage.

For example, improvements in information technology can facilitate the exchange of information among the various participants in the value chain.

Add insight

Insight inspires and informs all six innovation levers. CFOs and other finance executives have

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their own unique insights into how a corporation works. They should apply these insights to bring about business model and technology changes.

How you innovate affects what you innovate

In order to make the best strategic decisions, the authors say it is necessary to understand the characteristics of three types of innovation and when it's appropriate to use each.

1. *Incremental Innovation*. Many companies thrive on incremental innovation and see it as a way of wringing out as much value as possible from existing products or services without the need for significant changes or major investments. This is the most prevalent form of innovation and it's seen as relatively safe. Incremental innovation may work well for accounting and finance processes, which have historically been slow to change. For example, the business technology consulting firm Infosys is able to close its books and report more quickly than its rivals, thanks to incremental improvements it made to its enterprise resource planning (ERP) system.

2. *Breakthrough Innovation*. Breakthrough innovation involves substantial changes to either the business model or technology of an innovation — but not to both.

3. *Radical Innovation*. While radical innovations can create tectonic shifts in an industry and put a company in the lead, astute CFOs should approach them with caution.

The authors conclude that CFOs can be fonts of innovation if they understand how innovation works and apply their insights to it. With innovation know-how, finance executives can make new contributions to drive positive change.

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