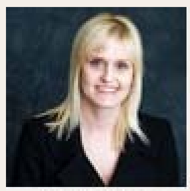
February 2011, Issue No. 33

SOCIETY OF ACTUARIES

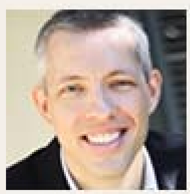
Entrepreneurial Actuaries Section

THE INDEPENDENT CONSULTANT

CONTENTS



Amy Elliott Hemeter



Nate Hutchins

How Can Innovation Have Impact?

by Amy Elliott Hemeter and Nate Hutchins

For the last few years, the business press and experts have stressed the strategic criticality of innovation. However, as we consider investing your scarce resources in innovation, should we all step back and ask ourselves, "What exactly IS innovation? " And more particularly, "How can and does innovation have impact?"

Look toward the business press for the answer and it may actually cause even more confusion. For example, if you search for *Forbes'* or *Bloomberg Business Week's* lists of the greatest innovations, you will find they contain mobile phones, laptop computers, ATMs, and stents. But is innovation only about inventions? Instead, it should be about finding ways to deliver new benefits to our clients or perhaps existing benefits at significantly lower fees–with or without breakthrough technology. In other words, innovation isn't just at the product level, but can be found throughout the business model including consulting and financial professional services, i.e., who we serve, how we deliver our seriously, how we support our clients, etc.

Take the air transportation industry as an illustration. In 2001, Boeing unveiled its plan to build the Sonic Cruiser. This technical wonder would have cut transatlantic flight time from 7 hours to 5 1/2 hours—a substantial improvement—but at a premium price of $10,000 compared to $5,000 for a first-class ticket on flights in conventional planes. Yet when considering transit time, including ground transportation to and

Issue and a Responsibility
by Jay M. Jaffe

Just Added: Easy Way to Join Our LinkedIn Group

SOA News Today Has a New Look! Improved Navigation!

ENTREPRENEURIAL ACTUARIES SECTION

Entrepreneurial Actuaries Section Leadership

William Ely, Editor

SOA Staff

Meg Weber, Staff Partner

Jacque Kirkwood, Staff Editor

Sue Martz, Section Specialist

OTHER SITES OF INTEREST

Entrepreneurial Actuaries

Newsletter

Resource Center

Member Benefits

from airports to city centers, the total travel time from downtown London to downtown New York would only have been reduced from 12 hours to 10 1/2 hours.

Around that time, a surprise competitor entered the market: semi-private time-share jets. Instead of cutting flight time through technology, these jets provided shorter on-the-ground time by flying from London's Northolt to Teterboro, New Jersey, while avoiding the many delays associated with commercial flights and major airports. This enabled the time-share jets to cut total travel time to 9 hours, at a per passenger cost of just $7,500. As noted by sources such as *The Economist*, Boeing ended up shelving its technology-based solution, while the time-share jets—which were the business model innovators—took off. NetJets has been such a great success that, rather than compete, the likes of Lufthansa have preferred a joint venture approach with NetJets to offer their customers better service. The new kids on the block have become embedded within the incumbent.

Since the Wright Brothers' first flight in Kitty Hawk, there have been countless technological inventions that made air flights more efficient than driving (as for comfort and convenience, that's a whole separate debate). However, since the formation of the first commercial airline, Deutsche Luftschiffahrts-Aktiengesellschaft, in 1909, numerous *business model* innovations have become just as important by making air travel into a simple commodity that many of us can't do without.

Today, one of the most commonly cited innovators of the industry is Southwest Airlines. It challenged and overturned the conventional wisdom for nearly every element of the business model. Southwest Airlines operated just one type of aircraft on a system of city-pairs, instead of a mixture of aircraft on a hub and spoke system. It had no assigned seats or other in-flight perks. Its flight attendants and flight crew helped to clean up the cabin after every flight. Everything in its business model was about efficient use of its capital assets and reduction of total costs.

With this cost advantage, Southwest was able to expand the market for air travel. While other airlines looked at the existing air transportation market when making market entry and scheduling decisions, Southwest examined the total number of people traveling between two cities, including those traveling by car and bus. By appealing to these previously underserved customers, Southwest grew the market dramatically.

In Europe, EasyJet and Ryanair have taken the Southwest Airlines model a few steps forward. As Ryanair surpassed British Airways in market capitalization, much of the value created was explained by its enabling mass travel at a level traditional models could not compete. However, having gained market share, Ryanair in particular has increased revenues by leveraging its strong customer loyalty and low base fares to charge for extras (e.g., food and beverage, airport check-in, etc.) that come free with the mainline operators. Like Southwest Airlines, Ryanair is making money by innovating around the business model—keeping core prices lower than the competition and providing customers with substantial choice about which "optional" services they choose to buy—choices major carriers might not as easily incorporate given their user base, recent consumer push back on fees, etc.

On the other end of spectrum, Virgin Atlantic and Singapore Airlines distinguish themselves by offering a differentiated and attractive experience. Virgin offers a fun and vibrant experience by providing a bar in the sky, complimentary in-flight massages and manicures, and a wide range of entertainment amenities. Additionally, it extends the quality throughout the total travel time to include transit to the airport as well as in their airport lounges. In particular, Virgin's lounge at Heathrow is so popular that passengers show up hours before departure just to spend time there. Singapore Airlines stresses the highest quality service at every customer interaction. Flying with them is like being in a five-star hotel in the sky. These companies operate at a level where they compete not with other airlines but with 'the last best experience' you had—and they exceed it.

While countless technological inventions have made air transportation extremely safe and cost efficient, pioneers like Southwest Airlines, Ryanair, Virgin Atlantic, and Singapore Airlines were able to innovate and create winning business models without inventing any new technologies. As a result, they regularly lead the pack in customer satisfaction, and their innovative methods are imitated by other airlines around the world.

Back to *Forbes'* greatest innovation list, obviously the other inventions mentioned—like the internet and media file compression—were critical predecessors to iTunes and iPods. But which is more innovative: iTunes, which delivered many new-to-the world benefits to the end-consumers, or the media file compression technology that enabled it? Ultimately, it doesn't matter. Great technology without the right business model can't deliver any potential benefits and an imaginative business model without the needed technology is simply words on paper.

The most important takeaway for entrepreneurs and actuarial specialists may be this: don't see innovation as simply the vast array of technologies now on the scene, invented by others and available for your use. Instead combine a distinctive and innovative business model of your own making with the useful enabling technologies. In that way, you'll have a real shot at delivering novel benefits to your clients, thus ensuring innovation offers all stakeholders the most positive impact.

Amy Elliott Hemeter and Nate Hutchins are principals at the innovation consulting firm Strategos, a division of Innovaro. To learn more, visit Strategos.com.