Innovation Management

Strategies for success and leadership
Innovation is no longer the sole province of a company’s research & development division. Companies that have mastered innovation—well-known industry leaders such as Apple, BMW, Google, Netflix and Procter & Gamble—have gone beyond R&D to ensure that innovation is an integral part of their organizations and their extended-value chains. In doing so, these companies have not only achieved notoriety but also significant and valuable competitive advantage. Now other companies are watching and learning from these innovation leaders.

While following the leaders is hardly an innovative idea, there is much to be learned from companies that excel at innovation management. The most striking lesson is the way in which innovation leaders have shifted their efforts toward their entire value chains and beyond. The best companies are committed to “open innovation”—working with a wider network of partners in their industry. They are not afraid to collaborate both up and down the value chain, capturing and sharing ideas with customers, suppliers, distributors, scientists and countless others.

Such open innovation allows companies to:
- Speed the development of new products and services and thus increase revenues and market share
- Shorten time to market for new products and services and accelerate profits
- Reduce direct spending on R&D
- Improve the success rate of new products and services

There are numerous ways to encourage open innovation. For example, Netflix, the Internet-based DVD-rental company, launched an online innovation contest offering $1 million to anyone who could find a better way to recommend movies to its customers. The objective was to create a movie-recommendation algorithm that performs 10 percent better than Netflix’s current algorithm. In one month, the company received more than 1,000 submissions. By mid-year 2008, more than 30,000 teams from 171 different countries were working on solutions, with the leading teams continuing to make progress toward Netflix’s goal. When Netflix ultimately meets its goal, it will do so at a fraction of the cost of using an in-house R&D approach.

Seeking a deeper understanding of innovation management, A.T. Kearney performed the North American Best Innovator study to examine the “art” and “science” of innovation. As part of a global research project, our focus was to
A.T. Kearney expanded its successful European Best Innovator Competition to a global competition. More than 250 companies worldwide, from virtually all industries, participated. Participants completed an online survey, with select follow-up interviews conducted to further validate the data-collection effort.

Several criteria were used to identify leaders in innovation management (see figure). Criteria included an assessment of companies’ practices compared with best practices in innovation identified by A.T. Kearney’s experience with leading innovation-management companies throughout Europe and North America. The best-practice evaluation was augmented with a quantitative assessment of companies’ ability to market the innovation and the percentage of revenue driven by products released in the past 12 months. We then checked the comparison against an industry peer group to confirm the positions of leaders and followers. Based on this assessment, leading practices were identified among innovation leaders and validated against the practices of the remaining companies in the survey.

**Figure: Criteria for identifying innovation leaders**

![Figure: Criteria for identifying innovation leaders](image)

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*Peer cross-check was only available for public companies.
Source: A.T. Kearney analysis

identify the qualities and practices of successful innovation, while also recognizing companies that demonstrate a mastery of innovation (see sidebar: About the Study).

The findings suggest that the science of innovation management can be examined separately from the art. By thinking of innovation in these terms, it is possible to consider not only what innovation leaders do well but also what actions innovation followers can take to improve.

We found that companies with a solid understanding of the science behind innovation are better
able to produce artful innovations as a by-product of the process. Asking people to generate new ideas, such as proposing a broad idea-generation process, is an open-ended, fairly general strategy that can be considered art. Focusing employees and external partners on identifying tangible innovation fields and goals is more scientific. The art-focused companies tend to be left with little more than the initial ideas generated by their employees, while the science-focused companies usually develop commercially viable ideas.

**Characteristics of an Innovation Leader**

As we examined the interplay among the areas of innovation, one notable finding was that the best innovators—companies that were designated as true leaders in our study—invest more than three times as much effort in the beginning stages of the innovation process than do the followers (see figure 1). This “front-loading” helps the leaders achieve superior results. Leaders also consider a larger percentage of submitted ideas than followers do, while bringing fewer of those ideas to the concept-testing stage. They focus their resources on the most promising ideas and take well-considered risks, rather than leaving success to chance.

The study found other important differences between innovation leaders and followers. For instance, leaders explicitly define innovation strategies within the overall corporate business strategy, and systematically use their network of partners and others to help feed their innovation pipelines. They move rapidly from the generation of an idea to profiting from it, and can ignite and sustain a corporate-wide passion for innovation.

From our analyses, four areas were found to be fundamental to a successful innovation management process:

- Innovation strategy
- Idea generation
- Idea screening
- Concept development

**Figure 1**

Leaders focus more on the front end of the innovation management process
While concept development should not be neglected, we found that the true key to innovation excellence lies in the first three areas: innovation strategy, idea generation and idea screening. This emphasis on the initial steps (the strategic portion of the innovation process), along with targeted, open collaboration with outside parties at several points along the process, correlates most strongly with a company’s success in innovation management.

The following offers findings and analyses of these areas of innovation management, and the factors that enable the process.

**Innovation Strategy**

**Characteristics of an innovation leader:**

• Has a strong executive champion who drives the development of the innovation strategy
• Invests significant time and resources in the innovation strategy
• Actively manages open innovation networks

Innovation leaders have a strong executive champion who develops and propels the innovation strategy. These senior managers assign internal ownership of ideas and match promising ideas to the appropriate business units or functions. They act as sponsors of innovation, and encourage the entire organization to think beyond the status quo.

A prominent example of an executive champion is Ratan Tata, chairman of Tata Motors and developer of the Nano, a $2,500 compact car. Unveiled last January, the car has all the essential features of India’s higher-priced automobiles but a sticker price that will forever change the economics of low-cost cars.

The mission to build an ultra-low-cost “people’s car” began in 2003 when Mr. Tata launched the idea and gave the engineering team three requirements for the vehicle: It should be inexpensive, meet regulatory requirements, and achieve performance targets such as fuel efficiency and acceleration. Tata personally supervised the execution of the strategy, removing roadblocks and pushing for more research, even after several initial drawbacks. The lesson from this example: The right level of involvement by senior management is crucial to the definition and realization of an innovation strategy.

In addition to the role of executive sponsorship, innovation leaders devote significantly more time to developing, refining, deploying and enforcing their enterprise-wide innovation strategies—12 percent of total innovation management time, or an investment six times greater than that of followers. This difference can be partially explained by the fact that most innovation leaders employ an explicit innovation strategy, while few
of the followers do. Also, many followers do not enforce the innovation strategy.

The best companies articulate the level of activity required to close the strategic growth-through-innovation gap. They use search fields—future-focused areas such as technology and customer trends—to move toward making the innovation vision a reality. Anticipating customers’ future needs and defining a new group of prospective customers (planning a decade or more ahead) can boost innovation. A successful innovation strategy includes clear operational targets and timing, adequate budgets and an understanding of projected benefits.

Figure 2 illustrates a leading chemical company’s innovation strategy. The company positions its network of strategic think tanks at the start of the process to identify future megatrends that must be addressed to keep the company competitive. The megatrends are then translated into action fields, which consist of specific areas where customer needs are matched to product concepts. Action fields are used to identify innovation fields, against which product ideas are developed in promising strategic areas.

In leading companies, the innovation strategy forms the basis for an innovation-focused corporate culture. The vision is well understood and can be turned into actions, with clear goals measured through key performance indicators (KPIs). These companies even create multiyear innovation roadmaps, and often the innovation strategy is indistinguishable from the overall corporate strategy.

IBM’s Eclipse open-source community is a good example. IBM launched the Eclipse software platform in 2001 to promote the cooperative

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**Figure 2**
Innovation strategy for developing new chemical products

Illustrative

10 mega trends
10 action fields
20 innovation fields
40 product ideas

Source: A.T. Kearney analysis
development of complementary products, services and capabilities. Now independent, Eclipse is an “open ecosystem” of 162 software vendors, solution providers, corporations and education and research institutions, including IBM’s direct competitors Oracle and Intel. Members share the high cost of building and supporting the IT infrastructure, freeing them to focus on features that make their products stand out. Eclipse and other systems are a key part of IBM’s innovation strategy.

Some companies choose to use a single open-innovation technique, rather than establishing an entire open-innovation network—for example, “crowd sourcing” sends an open invitation to request help in solving a specific problem. Sharing ideas and strategies with suppliers helps to improve product design and manufacturing. In some cases, a company will enlist a direct competitor to become part of the innovation strategy, as Clorox did when it engaged the assistance of Procter & Gamble to design its GLAD ForceFlex garbage bags.

As companies become more adept at managing open innovation, they develop more sophisticated open-innovation networks. At its most rudimentary level, open innovation is performed at the transaction level. It is centered on a clear commercial exchange—for example, pay-for-play arrangements—and helps solve clearly defined problems. The next level is to create community-based networks where innovators share and often build on each other’s knowledge. The biggest innovation gains are achieved through relationship-based networks, where companies bring together top-level strategic partners to capture their unique capabilities. In contrast to the one-off cooperation of the transaction level network, relationship-based networks focus on long-term relationships that result in the co-invention of innovative products.

Companies that include open innovation as part of their strategy can improve their products and organization and gain a knowledge-transfer advantage.

Idea Generation

Characteristics of an innovation leader:

- Involves a broad array of partners to drive the idea-generation process
- Embraces open innovation to harvest ideas from many sources
- Employs the Internet to capture information on a global scale

No single company is large enough or inventive enough to be an innovation leader without collaborating with an array of partners. When developing new ideas, innovation leaders say they rely on their customers, business partners and
competitors to supplement their own internal functions. In fact, companies that profess best practices in innovation produce nearly half of their innovations from ideas generated outside the company (see figure 3).

These companies also use a structured approach to innovation, systematically partnering with others throughout their industry. They challenge their traditional innovation-management processes (and workers who use them) by transforming the internal organization, and managing multiple relationships while also creating project- or concept-specific networks as needed.

Organizations that embrace open innovation can pull together ideas from many sources, understanding that each contributor brings a different and valuable perspective. For example, consumers frequently pose questions based on their experiences with a product or service, or they share solutions they’ve used when faced with a product’s limitations; these solutions can be worked into the development of new products. Suppliers are continually developing, and being exposed to, new technologies that their customers can use. Academics and futurists often have access to the latest technological and scientific developments—they obtain strong insights into the ways that today’s news will drive tomorrow’s trends. Competitors are also valuable contributors, since the strong points of their new products or features can be emulated, and shortcomings can be exploited by developing better products.

An open-innovation philosophy spurs a range of techniques to generate new ideas, including brainstorming sessions, collaboration with external organizations, patent scouting, scenario analysis and cross-industry workshops. Each technique is used with far greater frequency by our study’s leaders than by its followers, and the leaders typically use four or five techniques simultaneously.

Most senior executives in our study expressed an appreciation for the power of open innovation, and named the Internet as the most successful tool for filling their idea pipelines. For example, Staples, a leader in the office supply business, launched an annual online competition that asked consumers to share their ideas for new products. Winning ideas were selected by a panel of judges and supplemented by the online votes of Staples customers. Winners received a cash prize and a contract for royalties to be paid should their products be produced and sold. More than 10,000 entries were received each year. Similar competitions were held for students and the company’s employees.

One study participant, a manufacturer of medical devices, set up a website dedicated to soliciting ideas from customers and suppliers to supplement the company’s internal innovation councils. The company cites its customer-focused innovation efforts as a major reason for cutting its product development time by 50 percent.

Figure 3
Leaders’ sourcing mix for generating new ideas

![Circle diagram showing 44% External sources and 56% Internal sources.](source: A.T. Kearney analysis)
One final example comes from Procter & Gamble, which is well-known for generating more than a third of its new ideas from external channels. P&G has an “innovation gym” that consists of brainstorming facilities stocked with simulation tools. The company built mock retail stores to experiment with store layouts and advertising, bringing in focus groups to help understand the customer’s shopping experience. These facilities even feature stock rooms and warehouses to convey supply-chain implications.

**Idea Screening**

**Characteristics of an innovation leader:**
- Reviews more ideas than a follower during the screening process
- Takes more risks initially (bigger bets)
- Uses a broad array of criteria to review ideas

Although soliciting new ideas from all links of the value chain is essential to an innovation strategy, the process of screening those ideas is equally important. Our findings suggest that innovation leaders not only review more ideas than followers but also use well-defined criteria during the review process.

In fact, innovation leaders are twice as likely as followers to use specific criteria—financial, technology trends, ease of manufacturing and alignment with the business strategy—when reviewing new ideas. Two other criteria that the leaders favor—product development and social and economic trends—are used by just one in six of the followers.

One of the leaders in our study, a financial institution, decided in advance how many incremental, transformational and disruptive ideas it wanted to pursue, then used various screening criteria to evaluate each one. The result was an optimal mix of ideas. The company maintains a pipeline of implementable ideas that offer a clear short-term return on investment while also taking risks and pursuing game-changing ideas—the kind that can be transformational and uncover new markets.

In our survey we also found that leaders take bigger bets initially, but then review ideas more rigorously based on the previously mentioned broad array of screening criteria. Placing bigger bets is related to the willingness to pass on disruptive business concepts and ideas, where often the potential pay-off is not obvious in the early stages of the Innovation Funnel. While placing bigger bets initially, then rigorously pruning the least-promising ideas, innovation leaders manage to accelerate the most-promising ideas aggressively through to market.

**Concept Development**

**Characteristics of an innovation leader:**
- Draws on supply-chain partners and customers for insights
- Draws on insights from potential customers in new markets

Both innovation leaders and followers devote a significant portion of their time and resources to concept development. The leaders devote 44 percent of their resources to this phase, while the followers spend 76 percent of their time on more tactical tasks. One explanation is that leaders complete key tasks beforehand, and therefore do not have to test concepts for their market-readiness.

The innovation leaders maintain better relationships than followers with their suppliers, yet there is still room for improvement in collaborative concept development. By capturing supplier input during concept development, these companies can recalibrate product design for ease of manufacturing and low-cost sourcing. Still, efforts to improve compatibility, resource flexibility and sharing of best practices and financial risks could be better.
Innovation leaders understand that supply-chain partners and customers can offer valuable insights during the concept-development phase.

Not surprisingly, the area of multiyear commitments is the one where supplier collaboration succeeds the most. In designing its 787 Dreamliner, Boeing coordinated the collaborative design of all components across 50 suppliers to achieve significant savings. Microsoft’s partnership with an Indian software developer allowed it to improve its testing capabilities and cut testing costs in its Windows division by 70 percent.

Also during concept development, we found that innovation leaders draw on a broader set of external resources than followers. While both leaders and followers solicit ideas from their current customers, leaders are far more likely to work with prospective customers to shape their new products and services. These companies use a systematic approach to get feedback from, and validate their ideas with, customers in potential new markets. Such collaborative efforts help mitigate some of the product and process uncertainties that accompany innovation.

Tesco, a U.K.-based grocery retailer, is a good example of this principle in action. Before launching its Fresh & Easy local grocery store concept in the United States, Tesco spent more than two decades studying American shopping habits and preferences through pilot stores and in-home research. By studying its future customers in an entirely new marketplace, Tesco was able to craft marketing approaches and shopping experiences that appealed to different groups of consumers from those interested in convenience to those interested in sustainability. Further innovations continue in simplified store layouts, organic foods and energy-efficient equipment, to attract environmentally-conscious consumers.

**Enabling Factors**

**Characteristics of an innovation leader:**
- Designs an organization focused on open innovation
- Crafts gain-sharing agreements with partners
- Uses change-management principles to move the organization toward open innovation

The design of the innovative organization plays a major role in success. To avoid the “not invented here” syndrome, some leading innovators establish separate research and development organizations to manage the interface with their innovation partners. Under such a setup, both the external and internal R&D departments provide information that fuels innovation.

Procter & Gamble is one such company. To manage its pipeline of external innovation, P&G established a dedicated innovation organization.

**Employees may require new incentives to break out of their functional “silos”—the promise of shared rewards can encourage all to participate.**
Under a global shared-services model and independent of the R&D department, this new organization and the business units jointly contribute to the pool of information that fuels innovation. And regardless of the origin of an idea, the rewards are the same. To date, P&G has reduced its R&D costs by 30 percent while remaining an innovation leader.

An important consideration is determining which function or person should screen ideas. If the finance function acts as the gatekeeper, the approach will likely be risk-averse, and the results, in terms of innovation, will likely be unsatisfactory. Brand managers, on the other hand, are closer to the marketplace and will generally be more willing to place the kind of game-changing bets that differentiate leaders from followers.

Sharing the rewards from innovation is also important. Every collaborative effort with an outside partner should be based on a tailored gain-sharing agreement. State-of-the-art agreements, used by innovation leaders, include the following:

- Metrics to measure partner and supplier performance
- A formal proposal-evaluation process that involves all relevant functions
- “Escalation mechanisms” to defend rejected ideas, sending them to the innovation leader
- Cross-functional sponsors assigned to each idea
- Idea tracking from inception to implementation
- Process discipline and continuous visibility of idea-sharing status
- Supplier reward system to ensure suppliers are fairly rewarded for ideas that contribute to sustainable business success

Creating a passion for innovation within an organization can be a challenge, in large part due to the cultural change that must occur. The best companies recognize the added value that innovation brings, while those on the path to improvement often need some coaxing. Before productive collaborations with external partners can occur, the internal organization must appreciate the need to pull together and focus on a common goal. When “idea generation” occurs across functions, ideas are assessed early on by a broad group of stakeholders.

Employees may require new incentives to break out of their functional “silos”—the promise of shared rewards can encourage all to participate. Our study leaders understand the need to reward innovative thinking, while the followers acknowledge that they generally do not understand that need. As ideas flow both vertically and horizontally within the company, the power of innovation is unleashed. Leading companies give their employees more exposure than followers to other functions and business units, and leaders communicate more regularly than followers across functions and hierarchies.

**Placing Bigger Bets on Innovation**

In this paper, we have illustrated that senior executives across a range of industries and functions are of one mind—that a strategic approach to open innovation is crucial for business success. Innovation leaders focus more on understanding their customers and the strategic aspects of innovation management, making bets and taking deliberate risks in collaboration with their network of partners. Indeed, in an era of open innovation, companies cannot afford not to leverage intelligence outside their four walls. Dedicating management resources to building up a company’s network is a prerequisite for remaining competitive and a player in the innovation game.

While the benefits of open innovation are clear, the challenges should not be underestimated. Bringing in an entire spectrum of network partners and nurturing these strategic rela-
tionships to develop and maintain the network cannot be accomplished without altering the organizational structure. The support and active involvement of senior managers will be crucial—as will new metrics to track the origins of ideas and measure success.

True innovation requires searching in the most promising areas, creating a vibrant, healthy portfolio of ideas and then screening them in the best possible way. The key is to place bigger bets while maintaining a balanced portfolio of disruptive, transformational and incremental ideas.

Companies that delay adopting such innovation techniques risk falling behind and watching as others corner the best innovation partners.

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