

Strategy



The Eight Essentials of innovation performance

December 2013

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The Eight Essentials of innovation performance

Do the Eight Essentials really matter at all?

It turns out that the Eight Essentials matter a great deal.

When we set out several years ago to determine whether there really was a set of enhancements that all companies could make to dramatically improve one of the most notoriously difficult management activities, we were skeptical. To our surprise, both our experience working with companies and our quantitative research uncovered a set of practices that really do matter.

Our ongoing research and current database of more than 300 companies containing survey results from over 2,500 executives and representing a full range of industry sectors demonstrated the measureable innovation performance improvement that can result when the Eight Essentials are rigorously put in place. Unlike other innovation “rankings”, our survey analyzes a company holistically from the inside out, focusing down on the critical mindsets, processes, skillsets and decision-making routines needed to make innovation happen. Responding companies were categorized into their respective performance quartiles and compared with other companies in their industry as well as across the entire data set. “Top-quartile” innovators were then compared with others to understand what, if any, practices differed. From this extensive research emerged the Eight Essentials and their critical contribution to making innovation successful.

Our central question was whether getting the Eight Essentials right then translated into better innovation performance. *Do the Eight Essentials really matter at all?*

Yes, they do. Top-quartile innovators are far more likely to have strong practices consistent with the Eight Essentials versus lower-quartile innovators (Exhibit 1).

We then asked the question: *How much does it help a company to master multiple Essentials?* To do this, we assessed innovation performance relative to how many of the Eight Essentials each company had mastered. As Exhibit 2 shows, the more Essentials a company masters, the greater its innovation performance. Mastering seven or eight Essentials creates a significant likelihood of being a high-performing innovator.

Based on the data analysis described above and our own experience of working with innovation leaders and followers,

we believe that any company serious about valuable innovation creation needs to master each of the Eight Essentials. This paper discusses what this means for each Essential.

1. Aspire: Do you accept innovation-led growth as absolutely critical, and do you have cascaded targets that reflect this?

Answering our first Essential, Aspire, with a 100 percent yes is not as straightforward as it may first appear. We come across many leaders who have set aggressive and often inspirational goals—think about President Kennedy announcing his vision “to go to the Moon in this decade;” that motivated a nation to drive an unprecedented level of innovation.

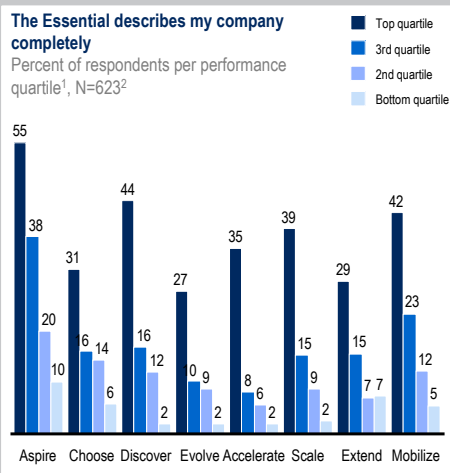
Yet, simply articulating a compelling vision is far from sufficient. An innovation aspiration should answer this question: *How much innovation is needed to meet our financial growth objectives?* Quantifying the innovation-led growth requirement over time is an exercise that every company should consider. While a handful of companies do this as part of their strategy and planning processes, in our experience the vast majority do not.

Only once this is quantified is a company able to ensure that managers make the proper trade-off to drive innovation alongside other business activities and put in place the appropriate metrics to track progress. We have observed numerous companies where the CEO pronounces the importance of innovation yet business as usual dominates when resources come to be allocated.

To address this common problem, companies should quantify and total all the non-innovation growth levers (potential gains from participating in market growth, expanding market share, pursuing mergers and acquisitions, driving better execution on pricing, and so on), and add this to the base, or momentum, forecast. The result should be compared with the company’s planned performance targets over time. The resulting “innovation growth gap” is the value a company needs to create through innovation. The gap itself must be large enough to encourage managers to include support for innovation in their business plans. If managers can “make the numbers” using other tactics perceived to be less risky, our experience demonstrates that they will (rationally) do so.

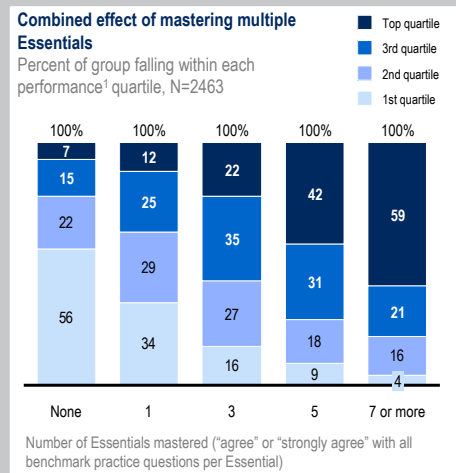
Exhibit 1 & 2

Eight Essentials: High-performing companies follow them.



¹ Performance defined as a weighted index of measures for organic growth and innovation performance (percent of growth from new products or services developed in-house; percent of sales from new products and self-assessment of innovation performance). ² Respondents who answered "yes to some degree", "no" or "don't know/not applicable" are not shown.
SOURCE: McKinsey Quarterly panel survey, Innovation at Scale, November 2012

Mastering multiple Essentials greatly enhances your chances of becoming a high-performing innovator.



Number of Essentials mastered ("agree" or "strongly agree" with all benchmark practice questions per Essential)

Even an inspiring vision and a clear, quantified innovation goal are not sufficient to fully embed an innovation aspiration. World-class innovators break down these ambitious goals into specific targets with quantitative and qualitative metrics, and cascade them down throughout the organization. This degree of objective setting clarifies who should be involved in innovation along with the specific elements of the vision they are accountable for delivering.

How to aspire

- 1. Communicate an inspirational vision.** This vision should align with the strategy and the growth gap; it should be understandable by all and should set out a clear path to enable employees to contribute. Use the opportunity to introduce a common innovation language to foster a wide dialogue and facilitate joint learning and sharing.
- 2. Set a clear objective for innovation-led growth.** Quantify the vision into an unambiguous goal that sets the amount of innovation required to meet your overall performance goals. This innovation goal must be substantial to prompt action. If there is no gap, you may want to revisit business goals. Determine if your current innovation

investments are substantial enough to fill the growth gap. Be sure to account for failing or underperforming innovation investments, which many companies unknowingly overlook.

- 3. Align leadership around the criticality of innovation.** Secure a commitment from senior leaders that they will take action. Allocate targets for growth from innovation to business units. Include these targets in strategic planning and budgeting, as well as in performance appraisals. Translate the allocated targets per business unit in the right mix of financial and nonfinancial metrics and cascade them throughout the organization.

How have others done it?

Lantmännen, a major Nordic agricultural cooperative, was challenged by flat organic growth and innovation projects that lacked direction. It made a step change by creating a clear vision and strategic plan, linked to financial targets of 6 percent growth in the current core and 2 percent in new organic ventures. These quantitative targets were cascaded down to business units and ultimately to product groups in order to drive innovation projects. During their development, each innovation project had to show

how it was helping to achieve the growth targets for its category and markets. As a result, Lantmännen went from 4 percent annual growth to 13 percent, underpinned by the successful launch of several new brands. Indeed, it became the market leader in pre-made food only four years after entry and created a new premium segment in this market. Other examples of great Aspirations that set clear pathways for organizations to act with an aligned innovation purpose come from P&G and LG Electronics among others.

2. Choose: Do you invest in a coherent, time-risk balanced portfolio of initiatives that are resourced to win?

Answering this second Essential requires leaders to have a strong sense of where the best current and future market opportunities can be found and then finding the optimal portfolio balance for all their initiatives across time, risk and value.

We call these market opportunities *innovation themes* or *innovation marketspaces*. An innovation marketspace defines the boundaries within which a company will search for insight to unlock new forms of value. These boundaries can be technical limits, business-model parameters, or other constraints; they can be value-based or derived from market and category definitions. Managers should feel comfortable that there are sufficient growth “platforms” within a given space to justify investing time, money, and other resources. Prioritizing and selecting marketspaces involves tough choices, especially when spaces are too new to determine the ultimate size of their profit pool. In the end, choices should align with the company’s long-term strategy, as investments in these spaces will create the foundation for a company’s future growth.

A common barrier to making these choices is a lack of confidence. “Will it be big enough? Is the technology good enough? Is this really differentiated?” These kinds of questions are like grenades aimed at a fledgling business proposition. Confidence erodes as uncertainty increases, and this can overwhelm decision making if an opportunity is substantially different from the core business. Simply put, the perceived risk outweighs the expected reward.

Uncertainty may be greatest when an industry is in transition—there are numerous examples from consumer electronics, media, and retail of companies missing major market shifts through failure to explore innovations emerging around their core business. Yet change also breeds opportunity for companies willing to make smart bets. Identifying and investing in the right innovation themes confounds many management teams, particularly during market discontinuities. Recognizing signals of change and understanding the most likely upcoming scenarios will increase investment confidence and positive outcomes.

All industries at times signal looming shifts in the status quo: the launch of a breakthrough technology, for example, or the appearance of a disruptive business model. Recall the airline industry before the emergence of low-cost carriers: a decade ago, it was hard to imagine travelers making multiple connections on a journey in exchange for a substantially lower fare. Similarly, no one had heard of an enterprise IT manager “renting” core applications from a company on the other side of the globe, or of consumers carrying mobile devices with today’s plethora of functionalities. Today, we don’t think twice about using the point-to-point networks that dominate air travel; on-demand, pay-as-you go “cloud” services; and smartphones with a multiplicity of apps. Incumbents in these sectors generally failed to spot the impending transitions; they also failed, by and large, to make the investments needed to support the next wave of growth, until competitive dynamics forced painful changes.

Successful innovators also demonstrate a clear advantage in *portfolio management*. McKinsey research has found that over 80 percent of successful innovators have a well-understood portfolio-management process in place to evaluate and prioritize projects. These companies begin by gaining transparency into what people are working on. They rigorously assess the expected value, timing, and risk of these initiatives. Every company should be able to understand its innovation portfolio and assess whether it is in line with growth requirements and risk tolerance (Exhibit 3).

Some firms are content merely to gain transparency, but in our experience, this of itself is not enough. Most of the value from a rigorous portfolio-management approach comes from getting the right people to the table—people with the appropriate level of experience and relevant decision-making authority—to discuss the pipeline. Far too often, innovation pipelines become overloaded with incremental projects (not breakthrough innovations) because decision makers allocate resources to their own passions,

unchecked by any kind of group discussion or control. Even Google, whose “20 percent” rule famously allows engineers freedom to pursue their dreams, also has a systematic approach to allocate resources to priority initiatives and opportunities.

The right balance can be found in portfolios of varying composition. There is no single mix that is universally applicable. Depending on a company’s innovation strategy, it may be fine to be heavy in incremental projects; however, a different strategy may require a portfolio much heavier in “big-bet”, risky projects.

For example, Corning has a long history of innovation successes with what it would describe as a big-bet portfolio. While the risk associated with this portfolio is higher, the payout from any resulting successes is even more substantial. Given its track record in categories such as optical networking and glass for smartphones, Corning has proved its portfolio approach creates real value over time. This is in contrast to the different kind of success achieved by many consumer-packaged-goods (CPG) companies, which use a more balanced approach. CPG marketers pursue a number of

incremental wins each year to maintain category share, while R&D departments search for the next breakthrough.

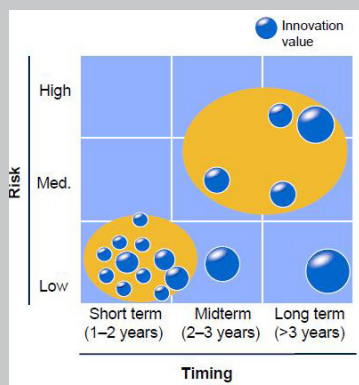
How to choose

- 1. Make sure you are clear on the innovation themes you are pursuing.** A combination of market intelligence and scenario analysis will yield a selection of innovation themes. Invest in these through R&D, capability-building initiatives, and business-development bets. Conduct disciplined ongoing reviews of these choices and allocations.
- 2. Align the portfolio of innovation projects with corporate financial objectives and business strategy.** Comb the enterprise to find out what people are doing. Then map the innovation pipeline into a portfolio matrix using proven metrics—the anticipated size of the opportunity, the associated risk, and the probability of success within a defined time frame. Ensure that the set of projects and the investment allocated to them reflect the business’s belief about where the

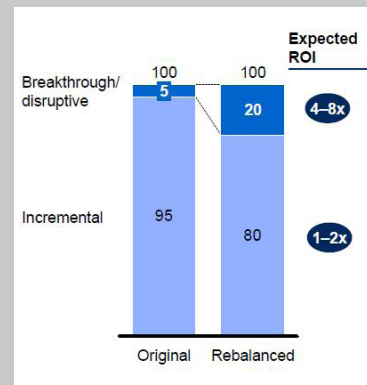
Exhibit 3

Successful innovators have a well-understood portfolio-management process in place.

Illustrative innovation-initiative portfolio.



Rebalancing the portfolio can increase return on investment (ROI) by up to 20%, with marginal increase in risk.



most significant growth opportunities are. Management must be quite confident that the portfolio will deliver on financial performance targets.

- 3. Make sure your initiatives are resourced to win.** This entails investing enough in innovation to achieve your targets. Particular care should be taken to resource breakthrough innovation initiatives enough to win against both current and future competition, and to ensure adequate funding to maturity.
- 4. Create a portfolio governance system.** High-risk, high-return initiatives should be managed differently than incremental, low-risk projects. The two require different levels of attention. Management must have a routine to discuss and debate the portfolio, as well as a way to aggressively weed out low-value, low-priority projects and reallocate resources to opportunities that are of higher value.

How have others done it?

General Electric is a global conglomerate with a diverse set of solutions in energy, health and home, transportation and finance. GE actively manages its innovation portfolio to ensure an adequate balance between breakthrough and incremental innovation investments. While each business unit defines and manages its own innovation portfolio within the realm of its scope, combined corporate and business-unit-level teams assess potential additional innovation investments. Where exciting innovation opportunities are identified, senior management asks high-potential leaders to submit at least three “Imagination Breakthrough” proposals each year. These ideas must expand business into a new category, geography, or set of customers. GE has funded more than 120 such projects, generating an estimated \$3 billion in annual revenues.

3. Discover: Do you have actionable and differentiated business, market, and technology insights that translate into winning value propositions?

Great “discoverers” re-interpret their existing context and imagine future ones. They use a combination of observation, intuition, and inspiration to work within the chosen innovation space and frame the important problems to solve. It takes experience and skill to bring together areas of knowledge systematically and uncover truly differentiated, actionable insights to understand the problems that are worth solving.

In our experience, there are three distinct views (or “lenses”) that matter most: customer, technology, and business; in select cases these are supplemented by additional views, such as a regulatory lens.

The **business lens** examines the competitive context, prevailing economics, and positioning within the value chain. Companies with a deep understanding of their relative market position and the profit flows within their industry can better make and assess innovation investments. Companies that go further to understand developments in the competitive landscape—as well as adjacent or emerging business models that could be disruptive—gain an advantage. For example, identifying the areas where the existing business model is under severe pressure can highlight impending discontinuities driven by others’ innovation. The business context must also include the regulatory regimes that govern the competitive environment, and their influence on firms’ profits and positioning.

The **market lens** uncovers customer preferences—those that can be described and those that can only be discovered through careful observation of behavior. Great insight comes from deciphering why behaviors happen in certain contexts. Across Southeast Asia and Africa, independent roadside stores sell small bottles of kerosene to fuel mopeds. In a crowded subway in China, passengers are deeply engaged in apps on their mobile phones. For many, social-networking services such as Facebook have replaced e-mail as the primary form of communication with friends and family. Industry-focused Web sites and blogs have become the source of “insider” news coverage for growing numbers.

Companies must be aware of emerging customer behaviors and, more importantly, their underlying drivers. In such cases, existing customer segmentations—often defined by product categories or demographics—fail to explain why customers adopt certain behaviors and what they are trying to achieve. These behavioral insights should be synthesized into the most significant problems to solve in a given context or for a certain target customer. Gaining this new level of understanding provides critical clues to mold new value propositions and keep existing product portfolios current.

The **technology lens** assesses feasibility and often provides benefits that can create and sustain competitive advantage. Technology, broadly defined, is the enabler of almost all innovative products, services, processes, and business models. It can be a molecule, a service platform, or software. Too many companies define technology narrowly as an ingredient or component of a new product. Deep knowledge of the benefits of emerging technologies provides an important window into what is possible.

While each lens can provide powerful knowledge, it is the combination of all three elements (in some cases, supplemented with other considerations, such as an understanding of distribution) that leads to the problem statements on which companies can focus their resources to create valuable solutions.

Simply collecting insight across these lenses is insufficient. Insights must be combined to create winning value propositions. All great innovation successes are at the intersection of a customer “problem to solve”, an enabling technology that helps solve it, and a business model that enables the innovator to extract value from solving the problem. The difficult task of insight synthesis and “collision” is something few companies do and even fewer do consistently well.

How to discover

1. Systemically scan for opportunities using multiple lenses. For customer or consumer needs, use a range of qualitative evidence such as in-context observations and ethnographic research, together with quantitative surveys to describe the motivation behind purchases of certain products and services, and to see how these are used. Great insight must go beyond known needs and pain points. Examine existing and emerging technologies and focus on the benefits they can offer. Consider the business dynamics in and around your category and the market position within your category. Ask, for example, what innovation opportunities would be possible if your value

chain were redesigned with the end customer in mind? How could you dramatically save your customer time or improve his or her economics?

- 2. Synthesize information into insight and describe specific problems to solve.** Use teams with members from different disciplines to interpret the data and develop a concise list of the activities and outcomes that customers hope to achieve. Assess the relative importance of their desires, wishes, and wants. Scan existing solutions, no matter how simplistic they may appear. Judge how well the current solutions address customers’ stated and unarticulated preferences.
- 3. Create differentiated value propositions.** Any new value proposition should identify who the target is, what problem is being solved, and how a company will make money over time, given anticipated competition. World-class innovators have systematic approaches to gaining this unique level of insight and translating it into valuable new propositions that are clearly differentiated from those of the competition.

How have others done it?

Proctor & Gamble is a multinational manufacturer of personal care, household products and prescription drugs. A key principle of P&G’s innovation process is driving innovation derived from consumer insights that identify and address key category needs. P&G consistently invests in market research to stay close to the consumer and understand unmet consumer needs. It focuses its R&D programs not just on technology, but on technology that has clear benefits which align with those consumer needs its brand teams hope to target. They deliberately incorporate unmet needs into their innovation process. Every year, P&G lists the top unmet consumer needs for each business and the company overall and builds its innovation strategy around them. P&Gers increasingly look for adjacent new solutions to take advantage of existing brand equity. For example, Pampers expanded into wipes and changing pads and Crest into other “healthy mouth” products like white strips. P&G teams predict new applications with technology game boards, asking a series of questions to understand how technology acquisition in one area might affect products in other categories.

P&G is also recognized for innovation in consumer-learning tools, for instance benefiting from crowdsourcing insight via digital platforms such as Vocalpoint to connect with an “army of moms” (Vocalpoint has 250,000 members) for insights on products like Dawn, Febreze, and Millstone coffee, as well as a “virtual

world store” that simulates a retail environment to test consumer reaction to promotions and layouts.

4. Evolve: Do you create new business models that provide defensible, robust, and scalable profit sources?

Eighty percent of global chief strategy officers surveyed recently believe their business models are at risk. Among their biggest concerns are new entrants wielding disruptive technologies and process innovations.

This situation is not new. In dynamic markets, product innovation alone is insufficient. A strong innovation portfolio goes beyond new products to include other factors, including new business models and distinctive business processes that can create advantage. Of all innovation types, business-model innovation can create the most significant long-term value. These innovations can include new distribution and production methods; both can disrupt current practices and erect powerful barriers to competition.

For example, Coca-Cola, a global leader in the beverage industry, has effectively transformed its distribution model in Africa by partnering with local entrepreneurs. Independently owned manual distribution centers (MDCs) use bikes and pushcarts to serve emerging urban centers where traditional distribution models (trucks, mainly) are not effective or efficient. More than 3,200 MDCs now generate more than \$950 million in annual sales and employ over 19,000 people in Africa.

How to evolve

1. Develop market intelligence and explore possibilities.

Many companies set up a special team to collect and analyze marketing information in order to separate the noise from the signal and so derive implications. Another team may investigate new technologies that have the potential to change the industry business model. Regularly review this intelligence with senior management, actively discuss and debate lessons learned, and incorporate the implications.

2. Selectively invest in a diversified set of initiatives to explore innovative business models.

Establish focused cross-functional teams charged with developing successful

pilots into sizable businesses. Set widely understandable and accepted metrics to measure performance and learn from market experiences. Ensure that you have an effective funding model in place for new businesses that do not currently fit into your structure.

3. Continuously re-evaluate your position in the value chain.

Explore market signals and separate trivial shifts from those that are truly disruptive. Map the ways your business could develop, paying close attention to the factors that will change quickly and those that will only change slowly. Develop an understanding of the impact of the different scenarios on your business, paying attention to the evolution of critical technologies and the likelihood of business-model disruptions.

4. Consider business models that you can use to deliver value to priority groups of new customers.

Do not get locked into a narrow conception of your business model—have the confidence to explore broader opportunities. Always be on the look-out for new profit pools. Explore potential delivery model changes and new customer groups. Pilot projects and experimentation will help you make smart decisions about where your resources can be allocated efficiently; stress-test resulting new value propositions against counter moves by competitors.

How have others done it?

EMC, a leading provider of IT storage hardware solutions, evolved from hardware and break-fix services only to full services by first adding implementation services (2001-2006) and then adding consulting services (2005-2010). For the first phase, it introduced integrated pricing for implementation (materials + labor) and acquired a small implementation service provider to gain the experienced managers. The organization overcame early traction problems by creating a services sales overlay group to help describe and position EMC services. It also created an implementation services team that was initially separate from the existing hardware maintenance team. EMC expanded the breadth of its professional services capability through several major partnerships. For example, an agreement with Accenture in 2002 added storage consulting services to the portfolio.

With the learning from the implementation services experience, EMC mapped out a multiyear strategy for its professional services business, focusing on the addition of a small number of new offerings each year. It identified capability gaps and developed an

active acquisitions strategy to gain the right resources at each step, and only slowly consolidated the organizations to promote the retention of top talent.

Amazon, the world's largest online retailer, has been one of the best at continually evolving and diversifying its business model. Retail remains Amazon's core business, but the company has added personalization and recommendation features, improved billing options, and added other functions to enhance and complete the user experience. Even more impressively, Amazon uses its operating infrastructure and supply chain to create new businesses, ranging from hosted computing services to warehouse management for its sellers. The result: a current market capitalization exceeding \$150 billion.

5. Accelerate: Do you beat the competition with fast and effective development and launch of innovations?

All too often, several people independently develop the same innovation simultaneously. To derive the proper reward from your ideas, it can be vital to be more fleet of foot than the competition: faster to file critical patents and quicker to market.

This first-mover advantage can create benefits in terms of brand recognition, customer loyalty, and even manufacturing and distribution scale. In some industries, like semiconductors, such first-mover advantages drive a repetitive winner-takes-all situation, where the leader captures 50 to 100 percent of all the economic profits, as with Samsung in memory chips, Taiwan Semiconductor Manufacturing Company in foundry, and Intel in microprocessors. However, even in less capital- and R&D-intensive industries, there can still be profound rewards for time-to-market leaders.

What is needed to beat competition with fast and effective development and launch of innovations? The design of effective innovation processes is a complex topic in its own right, and there are many flavors depending on regulation (for example pharma versus on-line media), complexity of technology (for instance, semiconductors versus pet food) or timelines (aerospace versus apparel)—yet two important themes remain almost universally valid.

First, the development process should knock down barriers that stand between a great idea and the end-user. This encompasses tackling both the classic internal barriers—for instance, lack of resources or functional silos—as well as external impediments, such as whether channel partners and suppliers are willing and able to take on and support innovation. In our experience, too many companies have very detailed and refined “funnel” processes with elaborate stage gates and committees that together ensure any innovation is completely watered down by the time customers or end-users interact with it.

Second, the process should ensure customers/clients/end-users test ideas early—before corporate dilution—and that the customer value proposition is kept in full focus along the way. In our experience, getting these two elements right can dramatically accelerate successful innovation delivery.

How to accelerate

- 1. Install strong project management.** The purpose of a strong management structure is to determine who can say “yes”, not who can say “no”. This starts with appointing a heavyweight project manager to be responsible for project success. A strong project manager will not only set day-to-day priorities for the team and direct resources, but will also provide substantial inputs to the performance reviews of project contributors. It is important that the project manager also holds integral responsibility for budget adherence, time-to-market, and key specs.
- 2. Make the innovation teams cross-functional in reality, not just on paper.** Creating truly cross-functional teams allows for better coordination of work under a single leader—all required functions should be represented. The best companies have comprehensive skills databases that facilitate staffing with the most qualified people. Require team members to be fully dedicated or for at least 50 percent of their time. This will greatly improve the nurturing of a project culture that puts the success of the innovation project above the success of each contributor's own function. In a 2009 article in the *Wall Street Journal*¹, our colleagues Mike Gordon and Chris Musso reported that two-thirds of top performers, compared with just 39 percent of poor performers, focused more on the success of the project than of the functions.

1 Mike Gordon et al, “The Path to Developing Successful New Products,” *The Wall Street Journal*, Nov 30, 2009.

- 3. Co-locate project teams.** Invest in a physical space for co-locating cross-functional teams. Any team members from the same campus who share a significant proportion of their time on the project should be co-located. In many cases, team members from other locations or countries should take part in daily meetings via videoconference or dial-in facilities, and be flown in for workshops when required.
- 4. Conduct frequent project reviews.** Project reviews need to be frequent, carefully orchestrated and with mandatory attendance for project managers, team leaders and functional line managers. Meetings must drive towards clear decisions in terms of go/no-go and next steps. A world-class project review process ensures that meetings are not focused on standard check lists for “stage gates” but on the key decisions that are required for ultimate success.
- 5. Keep full focus on the customer value proposition and ensure early market learning.** There are good and bad reasons why the innovation that is ultimately launched may differ from the original concept. It is important to track the compliance of the innovation to the intended customer value proposition at each step as it moves through the development funnel. All changes to the concept need to be deliberate and informed by new information. Guard against unintended changes to the value proposition originating from miscommunication as it is handed across from one part of the team to another. Any material change requests initiated by one function—for instance, engineering or procurement—should be approved by a cross-functional review board to ensure the integrity of the value proposition is not compromised.

Nevertheless, the development team should be actively pursuing enhancements to the value proposition based on an improved understanding of relevant customer needs and how to meet them. For instance, early validations of customer acceptance may lead to tweaks in the design. Sometimes the most significant innovations in the development process entail novel ways to rapidly validate consumer acceptance of the overall proposition or its technical feasibility before substantial costs are incurred. The aforementioned *Wall Street Journal* article describes how more than 80 percent of top performers periodically tested and validated customer preferences during the development process, compared with 43 percent of bottom performers. The top performers were also twice as likely to

research exactly what customers needed. That enabled them to address design concerns much earlier on, thereby minimizing project delays.

How have others done it?

ASML is the world’s leading supplier of lithography systems for the semiconductor industry, enabling ever smaller and more powerful generations of microchips. Being first to market with the next generation of integrated circuits is what makes ASML’s customers like Samsung and Intel win against their competitors. ASML has been relentlessly focusing on being first to market with each new generation of systems, enabling its customers, in turn, to be first to market with their next generations of ICs. ASML has made this happen through very focused customer orientation, a strong project management culture, co-location of cross-functional project teams and a decision-focused product development system. As a result, ASML has been gaining market share over its competitors year after year, with now over 80% share.

6. Scale: Do you launch innovations in the relevant markets and segments at the right magnitude?

As Facebook was launching in the United States, there was a very similar social networking start-up called Hyves in the Netherlands. Both rapidly became dominant in their local markets. Yet, while Facebook was able to attract substantial funds to fuel continuing investment in Internet presence and further innovations, Hyves’ growth plateaued. As it turned out, the Hyves architecture and set-up did not easily facilitate scale-up to many markets outside the Netherlands (each with different languages and internet ecosystems); by the time that was sufficiently clear, Facebook was firmly established as an impossible-to-beat competitor, and investors lacked the appetite to provide the finances to take on Facebook.

As it turns out, even though most social networks are relatively localized, the actual business of delivering social networking services is fundamentally global, with profound scale advantages.

This highlights the need to launch innovations at the appropriate scale. Not every concept can, or indeed should, be at global scale. Explicitly considering the **appropriate scale** and reach of a given idea is important to ensuring that the appropriate resource and risk is taken to pursue it—so it is not stretched beyond a natural boundary to become a failure. Technology now enables products to target specific niches with precision—for instance, smartphone apps or ebooks—but the luxury goods and fashion industries have long been masters of profitable niche brands, which cater to easily targeted market segments. For such highly differentiated products the “constraint” of limited supply translates to exclusivity and makes the offering more desirable. There are also many non-luxury products and services that work best in a particular cultural or geographic context. For instance, the retail industry globally is not dominated by multinationals but by many large regional players.

Conversely, some ideas only work at large scale; so, if the big bet is not made, it is better to spend the resources elsewhere. The emergence of multiple “winner-takes-all” digital business illustrates this point well, but the concept has been valid for much longer. During the early years of electricity distribution, Edison’s direct current model was the standard for the United States and he had invested heavily in supporting technologies like DC motors and usage meters. In 1887, Edison had over 100 power stations in the United States that delivered electricity to customers. However, these could not easily be interconnected and power generation could not be separated from distribution. DC current simply could not work on continent-wide scale. Conversely, Westinghouse was willing to invest in the newer competing technology of alternating current. The infamous “War of the Currents” ensued with both sides hoping that the next big investment or marketing campaign would enable them to prevail. Ultimately, AC won because it could be distributed over large distances at much lower energy loss. It was an innovation that worked better at massive scale.

How to scale

- 1. Prepare for the launch early in the process.** Go-to-market planning should include the creation of consumer test markets or reference customer installations before proceeding to large-scale rollouts. Consider how you can take full advantage of all available sales and distribution channels to ramp up fast. Create anticipation and excitement among your customers or consumers well in advance of launches.
- 2. Invest in technical launch expertise and product maturity.** Ensure that your organization, together with all

suppliers and partners, are able to execute a rapid, full-scale rollout. Verify manufacturability upfront, prepare your own plants, train staff and assess supplier capabilities to ramp up production. Avoid last-minute changes that can drive significant delays. Put in place a launch governance structure that facilitates fast escalation and rapid problem solving. This should include a dedicated launch manager with clear authority and responsibilities, co-located teams as far as possible and clear escalation paths.

- 3. Build operational capacity.** Look at the entire operational infrastructure—that is, your own facilities, supplier, and other partner facilities—as a whole. Make it easy for everyone to succeed while working in parallel. For example, design most work modules so that suppliers can work autonomously on specific content and performance characteristics. Anticipate capacity or resource constraints downstream (for example, suppliers or sales partners), and have contingency plans ready. Secure the supply of scarce materials or service-provider capacity for which there may be a rapid rise in demand from competitors or other industries. Lastly, take all steps to verify your ability to deliver the new product or service at the aspired volume and quality under realistic test conditions.

How have others done it?

When Gillette (now part of P&G) replaced its highly successful Sensor Excel shaving system with a higher-priced, higher-value system, the company faced several challenges. Scale was critical because the brand needed to migrate existing customers fast to maintain market share while also gaining new customers in the competitive disposable razor segment. The new product was the Mach 3, the world’s first three-blade shaver. Gillette rolled out the product globally in less than a year. It easily supplanted Sensor Excel as the number-one brand in only four months; in a mere six months, it reached the sales level that took its predecessor two years to reach.

7. Extend: Do you win by creating and capitalizing on external networks?

More and more organizations are opening their doors to create innovation. The X-Prize Foundation has challenged innovators

to solve some of the world's toughest problems; as a result, we are now on the cusp of commercially viable space exploration. The City of New York and its "Simplicity" program enticed 300,000 city employees to suggest ways to make metropolitan operations more efficient. In the past few years, people have turned to open networks to locate the missing after natural disasters. The common thread in all these examples is that technology provides access to the knowledge, skills, and abilities of broad, even global, networks of external partners.

For decades, organizations relied on strong internal R&D or technology functions to deliver innovation programs. Many were successful. But the increased pace of technological advancement, a globalizing economy, and lower capital barriers have established an environment where a university student can create the next multibillion-dollar innovation. Companies that extend their reach outside their organization's walls to find innovation partners can gain greater returns on their investments.

For many companies, collaborating with external partners reduces costs and is also a faster route to market. Successful innovators discover they can achieve significant multiples for every dollar invested in innovation by accessing the skill and talent of others. Co-creating with business partners and crowd sourcing with customers and other stakeholders present opportunities to extract more value from innovation investments. Companies should therefore aim to become the "partner of choice" in the areas where they need to extend.

How to extend

- 1. Create the right mind-set for extending innovation networks.** The organizational culture must be ready to welcome ideas from outside corporate walls, with no bias against innovations developed elsewhere (the "not-invented-here" syndrome). Keep in mind that external technologies or ideas may not appear useful to your business at first glance; do not dismiss them too quickly.
- 2. Actively manage connections.** It is unusual for a company to find exactly what it is seeking from external sources unless it issues a specific request for others to fulfill. Therefore, this type of sourcing requires tightly managed interfaces with the external innovation community and the ability to translate what is out there into something that internal development teams will accept and value. Processes and resources must be devoted to managing the flow of ideas from outside

the company, as well as developing formal and informal partnerships to ensure a steady pipeline of ideas.

- 3. Use strategic networks to source new ideas.** In some industries, creating relationships with other types of networks—universities, think tanks, and research institutes—is an effective way to bring in novel perspectives and additional insights. But don't just ask outside parties for new ideas; use these sources to solve existing problems. Be cautious about the stage of development at which you seek an outside solution, and make sure there is a mechanism that matches what is outside with the appropriate resources inside.

How have others done it?

Softbank, a Japanese telecommunications and internet company, started in business software and as an early ISP. It acquired telecommunications infrastructure through multiple takeovers. Today, Softbank operates the fastest-growing mobile carrier, largest broadband network, and most-popular search engine and ecommerce site in Japan. "Innovation through best partners" is an important enabler of its innovation vision. The company actively questions how much innovation it needs to take on itself versus partnering. Having the best partnerships is more important to Softbank than focusing on any particular technology or business model. Softbank's best-in-class business development process makes it the partner of choice for many who are attracted by its quick decision making, willingness to offer high prices and commitment to fully support and fund joint ventures. Their vision is to grow into an ecosystem comprised of 5,000 partner companies. In addition to joint ventures and partnerships, Softbank has minority stakes in 27 promising technology and content ventures worldwide through a fund holding worth over \$2bn.

8. Mobilize: Are your people motivated, rewarded, and organized to repeatedly innovate?

Successful and sustainable innovation requires high levels of energy and commitment. The often-cited quotation from Thomas Edison that innovation is "1 percent inspiration and 99 percent perspiration" captures this notion well. Executives play a critical

role in creating the right culture and environment to stimulate and support the sometimes long and tedious work required to make a successful innovation.

Committed leadership is the greatest predictor of innovation success. When innovation at scale was extremely successful, 60 percent of senior executives said they were either fully accountable or actively involved from the early stages, according to a recent McKinsey survey. When innovation projects fell short of objectives, in only 35 percent of times leadership was fully accountable or actively involved early on (Exhibit 4).

Companies must motivate the entire organization and give people the necessary tools to contribute. Corporate innovation competitions are one good way to motivate and inspire employees to offer numerous meaningful ideas. LG Electronics sponsors one of the biggest corporate innovation competitions in the world. In 2009, 17,000 of its 80,000 employees submitted entries. However, to be this successful, such competitions need careful definition, orchestration and management—simply asking an organization for ideas is rarely effective.

Dedicated innovation resources can act as a catalyst to mobilize the wider organization. Such dedicated resources might take the form of an innovation team at the business-unit level, tasked with framing opportunities and developing new value propositions based on market and customer insights. Alternatively, they might take the form of a corporate-level team responsible for driving innovations that span business units and assessing and building innovation-driven sourcing relationships.

How to mobilize

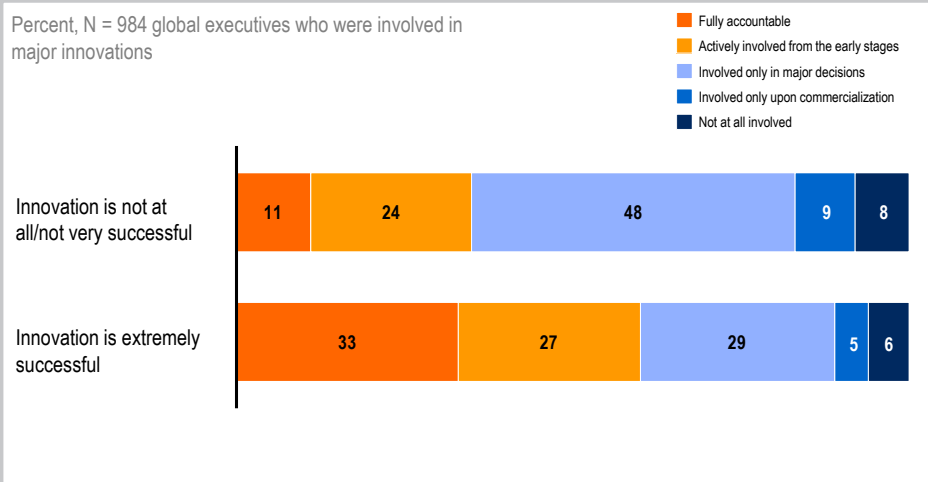
- 1. Define clear roles and responsibilities for driving the innovation agenda.** Every person in the company should understand his or her contribution to creating valuable innovation. Although not every employee is directly involved in creating a product or new business model, those who are need meaningful incentives and rewards; management teams must ensure that key performance indicators and targets drive the right behavior among decision makers at each level.
- 2. Foster a learning organization.** People must be able to share ideas and knowledge freely. Use a combination of virtual

Exhibit 4

Leadership is the greatest predictor of innovation outcomes.

Leadership involvement in innovation.

Percent, N = 984 global executives who were involved in major innovations



SOURCE: "McKinsey Global Survey Results: Lessons from successful innovations," *McKinsey Quarterly*, July 2008

and co-located teams for different types of innovation and to encourage collaboration. Review team structures regularly to ensure they are aligned with the current portfolio of innovations. Document lessons learned from the market as well as innovation ideas, and actively learn from both innovation successes and failures.

3. Do not overemphasize organizational structure.

Organizational changes may be necessary, but they will not be the entire solution. The organization design should promote collaboration and the development of insights, but these cannot come solely from a structure.

4. Create a supportive culture and reward system.

Talent management must put the right people in the right positions and, more importantly, surround them with a supportive culture, and also employ systematic approaches to deliver better innovation performance. Every major innovation project should have a top-management sponsor who is clearly invested in its success. Encourage experimentation and visibly recognize employees for their innovation efforts.

How have others done it?

W.L. Gore & Associates, a science and technology company, makes electronics, fabrics, industrial and medical products, and is best known for its Gore-Tex® range of fabrics. It is also known for its unconventional organizational architecture: the almost 10,000 employees (known as associates) who work at the company's more than 50 worldwide locations are not organized in any formal hierarchy.

The structure looks more like a lattice or network, with every associate able to go to anyone in the company for what they need. All associates are co-owners and each person decides what he or she wants to work on based around where they can contribute most. However, once they have decided, they are fully committed to deliver. Their evaluation is carried out by 20 to 30 of their peers as a forced ranking according to the size of their perceived contribution to the organization.

Gore encourages hands-on experimentation and prototyping of new product concepts, and does extreme performance testing before releasing new products. Recognizing that even talented innovation teams can suffer from a lack of objectivity when it comes to terminating projects, managers outside the project are

encouraged to identify potential snags overlooked by the team. Such outsider “marksmen” are rewarded with prestigious “Sharp Shooter” trophies for helping to kill projects faster than would otherwise happen.

Leadership authority, in turn, is derived from associates' ability to attract followers for their initiatives. The organizational model is governed by norms and values, such as the right to question and challenge leaders' decisions and the rationale behind them. Associates are exposed to all the complex trade-offs (for example, short versus long term) that only leaders have to make in other organizations, and leaders have to explain all decision-making factors. While it may seem that such a buy-in process is slow, Gore believes that the front-end investment helps to refine ideas and increase decision-making quality. By the time the decision is made, the whole organization is fully mobilized around it.

Gore co-locates research, manufacturing and sales for better teamwork. It deliberately keeps unit sizes down to a few hundred people to maintain focus and ownership. Keeping the units small and splitting them up when necessary also prevents large business units from hogging critical resources and creates new leadership paths.

Getting started on your innovation journey

Companies do not easily become leading innovators; remaining a leading innovator is yet harder still. We believe that the first steps to building an innovative organization require understanding of where you are today and then assessing the gap to what you want to become.

To enable these first steps, McKinsey has developed the Innovation Fingerprint: this measures the extent to which an organization follows the best practices embodied in the Eight Essentials. By drawing on input from across the organization in a structured way, companies can gain a quantitative sense of their current capabilities and begin to measure the gap to leading performance.

Our experience and research suggests that, to maximize its potential of becoming a leading innovator, an organization needs to deliver solid performance on most Essentials—and to truly excel in one, preferably several, of them.

The Essentials in which companies choose to excel are typically driven by the type of innovator they aim to be. We commonly see several broad types:

- **Visionary innovators**—companies driven by a strong leader who sees the paradigm shift earlier than anyone else. Such organizations deliver innovation to set new rules of the game. As demonstrated by companies like Apple, they excel at the capabilities exemplified by the Aspire Essential, backed up with strong Scale capabilities.
- **Strategic innovators**—companies that ensure they are optimally positioned in the right place, at the right time, with the right portfolio. They typically excel at the capabilities captured by the Choose and Evolve Essentials.
- **Discoverers**—organizations capable of identifying offerings to fulfill hidden customer needs. Typically, such companies—for instance, P&G and Johnson & Johnson—need to excel at the Discover Essential, backed by good Scale.
- **Fast followers**—companies that master the ability to out-deliver innovation to market, even if they are not the first

to come up with the idea. Success demands excelling at the Accelerate Essential, with appropriate support from Scale and Mobilize to make sure speed is backed up with size in delivery.

- **Experimenters**—those who are willing to explore a high number of avenues within their broad chosen areas. To encourage hundreds (if not thousands) of flowers to bloom, you need distinctive Mobilize skills, backed by strong Choose capabilities.

□ □ □

Determining the extent to which your organization possesses these Eight Essentials is an important starting point for improving innovation performance. Do not expect (or even attempt) to perfect all eight at once; innovation excellence must be built over time, beginning with a strong foundation and improved upon continually. For most, the journey to becoming a leading innovator is a multi-year effort that will touch most, if not all, parts of the organization. While it is not an easy journey, for those that make it, the rewards can be spectacular.

Acknowledgments

The authors would like to acknowledge the significant contributions to this paper from the following people: Marla Capozzi, Vanessa Chan, Jayson Chi, Brian Gregg, Martin Hirt, Amy Howe, Alex Kazaks, Ari Kellen, Minyoung Kim, Gordon Orr, Erik Rutten, Sander Smits, Navjot Singh and Alexander Veldhuijzen.

Company examples cited in this report were compiled using publically available information.

December 2013

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