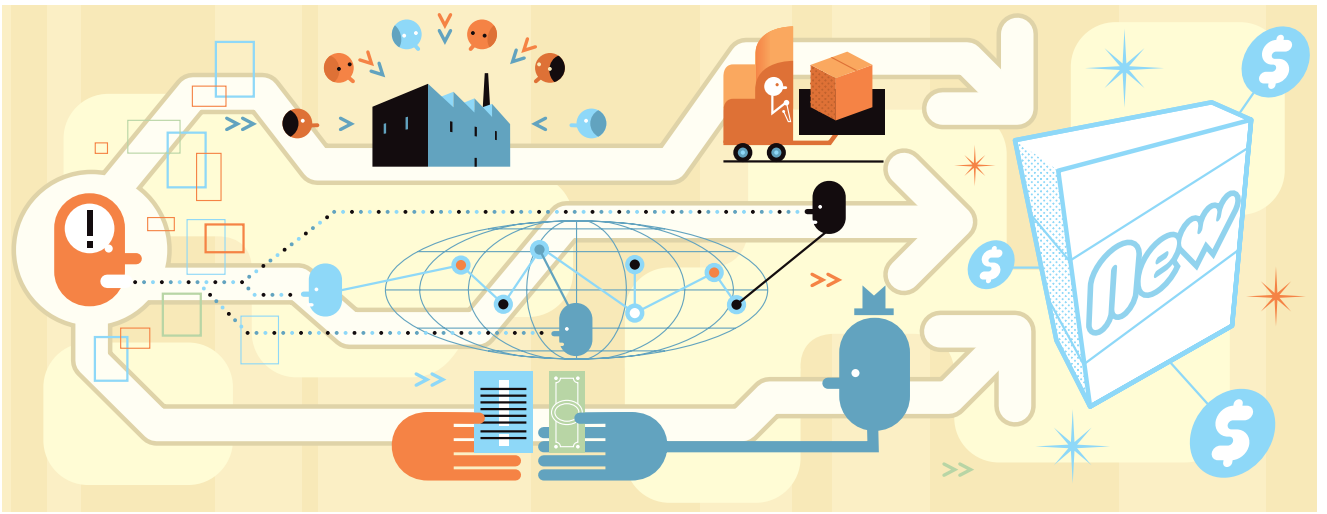
THE BOSTON CONSULTING GROUP

Innovation 2005



BCG | SENIOR MANAGEMENT SURVEY

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Executive Summary

Recently, The Boston Consulting Group conducted its second annual global survey of senior executives on innovation and the innovation-to-cash (ITC) process. This process covers the many interrelated activities involved in turning ideas into economic returns. It goes well beyond new-product development, to include such issues as portfolio management, life cycle management, and organization.

A total of 940 executives, representing 68 countries and all major industries, participated. We would like to express our deep appreciation to all of them.

This executive summary highlights some of the top-level findings from the survey. The rest of the report explores the implications of the findings and provides more detail. It also offers a framework to guide managers as they continue to think about how to turn their ideas into profits. For additional information or analyses, please see the list of contacts at the end of the report.

Key Findings

- Seventy-four percent of the executives surveyed said that their companies will increase spending on innovation in 2005, up from 64 percent in 2004.
- Almost 90 percent of the executives surveyed said that generating organic growth through innovation has become essential for success in their industry.
- However, less than half of the executives surveyed said that they were satisfied with the financial returns on their investments in innovation.
- Executives ranked Apple, 3M, GE, Microsoft, and Sony as the most innovative companies. Apple rose to the top spot from number five last year.
- Globalization and organizational issues were cited as two of the biggest challenges facing many companies in 2005.

The Outlook for 2005

Searching for new sources of growth, companies across all industries and regions are increasing their spending on innovation in 2005. For many of these companies, doing so is a long-term bet—but it is one motivated by current pressures that will only become more intense. Indeed, in most industries, almost everywhere in the world, growth is harder and harder for companies to generate. Commoditization is an increasing threat, and competition is more and more challenging.

As a result, 74 percent of respondents to a global survey we conducted in late 2004 said that their companies would increase their investment in innovation in 2005. Notably, of these executives, 28 percent characterized their higher spending as a "significant increase." In contrast, only 5 percent—or just 42 out of more than 900 executives—said that their companies would decrease their spending this year. (See Exhibit 1.)

The findings are up markedly from our last survey. In the same survey a year before, only 64 percent of the executives said they would boost spending on innovation.

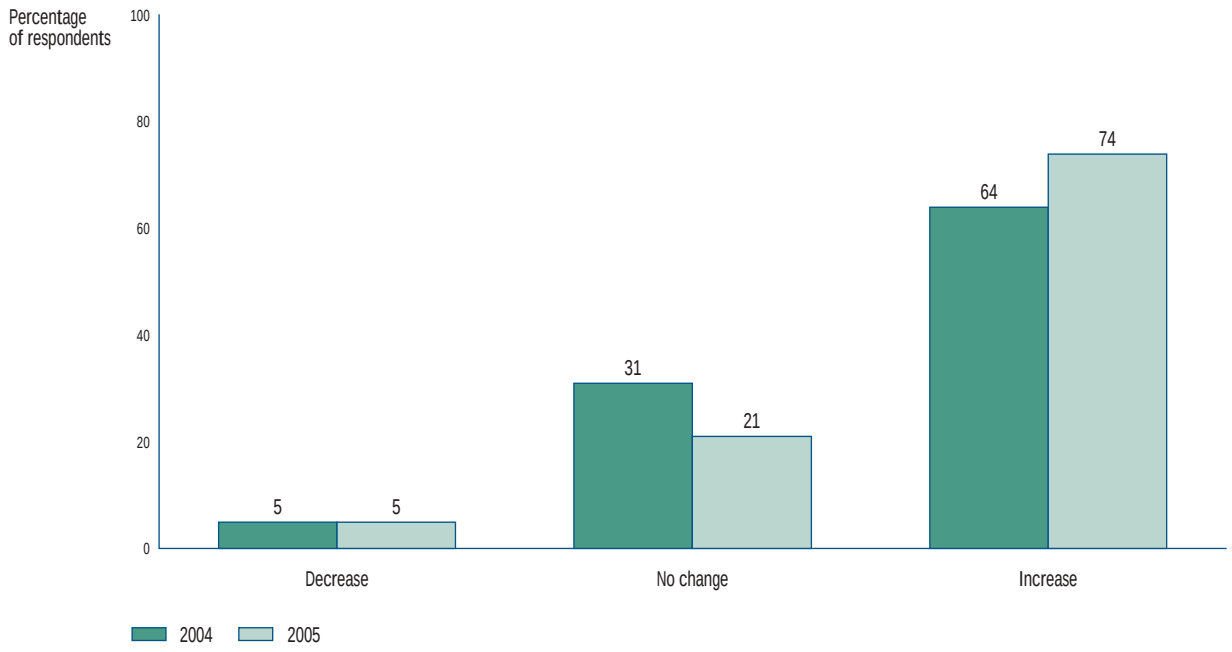
Hot Spots

In some industries the need for innovation is particularly acute. For instance, consumer products and retail companies currently face an environment characterized by rising commodity prices, increasing advertising spending, and consolidation. Even the industry heavyweight Procter & Gamble has said it expects only five percent to seven percent long-term sales growth—and that it will spend $4 billion or more annually on R&D to achieve it. It is perhaps not surprising, then, that consumer products and retail had the highest percentage of respondents planning to increase spending, at 79 percent. Indeed, 34 percent of executives in consumer companies planned a significant increase in spending; and out of nearly 200 participants from the industry, only one planned to decrease innovation spending. (See Exhibit 2.)

EXHIBIT 1

THREE OUT OF FOUR EXECUTIVES PLAN TO INCREASE INNOVATION SPENDING IN 2005

How will your company's investments in innovation change this year?



SOURCE: BCG 2005 ITC Survey

Similarly, more than three-quarters of the executives from technology companies said they would boost spending. Again, this clearly is a reflection of intense economic and competitive conditions in the industry. Extremely brief product lifecycles, low barriers to entry, frequent disruptive innovations, and truly global competition all help create an environment in which the ability to create and commercialize new products and services is essential—not only for success but also for survival.

On a regional level, Asia had the highest percentage of companies planning to increase spending, at 78 percent, compared with 73 percent and 72 percent, respectively, in North America and Europe. Asia's lead was driven by a substantially larger number of companies planning "significant" increases in spending: 36 percent compared with 25 percent and 26 percent in North America and Europe, respectively. (See Exhibit 3.)

India was largely responsible for Asia's lead in plans for significant investment increases, with 46 percent of respondents planning to do so. Until recently, Indian investment innovation has been relatively low. However, over the last 12 to 18 months, more and more firms have been boosting spending on R&D in a bid to compete globally. In other parts of region, Australia and New Zealand had 32 percent of executives planning a significant increase, while China had 25 percent and Japan had 17 percent. Elsewhere, 30 percent of executives in the United Kingdom, 26 percent in the United States, 26 percent in France, and 18 percent in Germany said they would increase spending significantly.

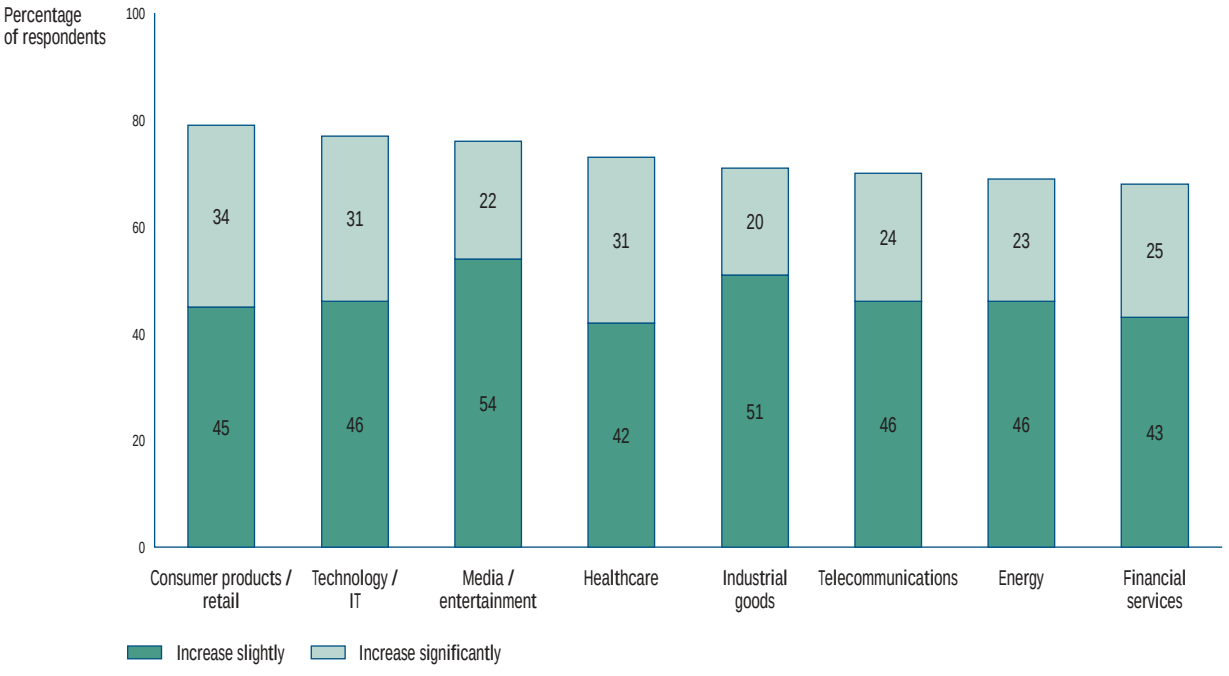
But There Is a Problem

Increased investment in innovation is undeniably good news. Countries, companies, and consumers benefit. Above all, such investment reflects a much healthier economic outlook — one that is still concerned with efficiency, but also with growth. But the *result* of this investment is what ultimately matters: better processes, new or improved products, and new or improved services. These improvements can be dramatic breakthroughs or modest, incremental advances. But all of these things are vital to success, growth, and progress. As a European executive remarked, the objective of innovation should be to "change traditional ways of operating in order to

EXHIBIT 2

CONSUMER AND TECHNOLOGY LEAD IN SPENDING INCREASES

How will your company's investments in innovation compare with 2004?

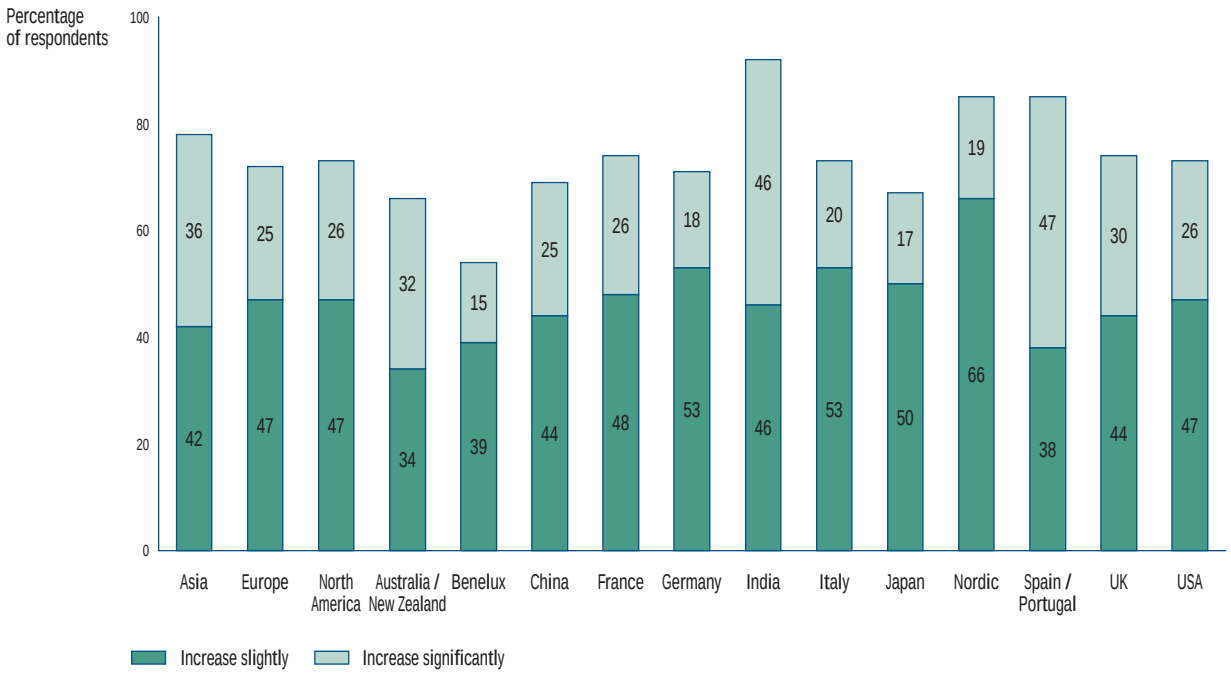


SOURCE: BCG 2005 ITC Survey

EXHIBIT 3

MORE THAN NINETY PERCENT OF INDIAN RESPONDENTS PLAN TO INCREASE INNOVATION INVESTMENT

How will your company's investments in innovation compare with 2004?



SOURCE: BCG 2005 ITC Survey

respond to customers' needs, to grow, and to be more efficient."

Still, successfully managing the innovation process is far from easy—which probably explains one of the most troubling findings from the survey. When executives were asked whether they were satisfied with the financial return on their innovation investments, one out of every two participants worldwide answered no. In fact, Asia was the only major region where more than half the executives were satisfied, and even there the percentage was only 52 percent. (See Exhibit 4.)

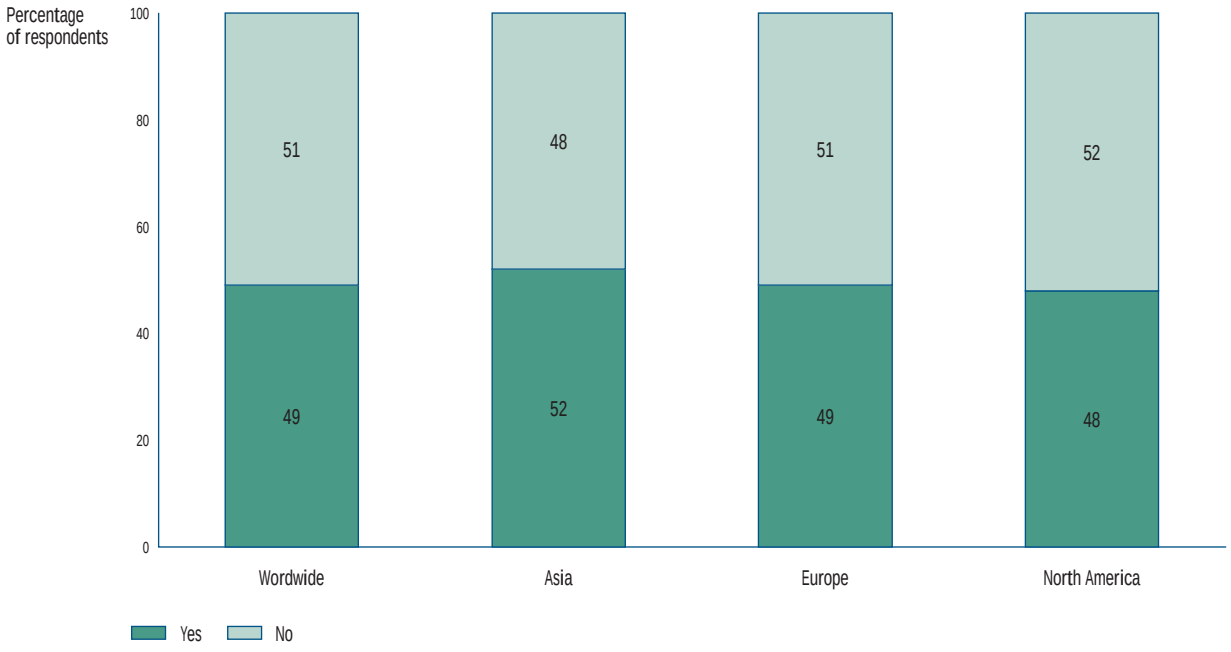
Executives in some industries were particularly unhappy. In industrial goods, for instance, 60 percent of the respondents were dissatisfied with the financial return on their innovation investment. This is especially troubling given the huge sums industrial firms invest in R&D every year. In fact, according to MIT's *Technology Review* magazine, four of the world's top five spenders on R&D are not technology companies but major industrial companies, the four of which invested $26 billion in 2003 and still more in 2004. Other sectors in which a majority of respondents were unhappy with innovation's ROI included energy (64 percent), health care (56 percent), and financial services (54 percent). (See Exhibit 5.)

In another worrisome sign, 40 percent of all executives in our survey said that their company was not as good as its competitors at turning ideas into profits. Another 12 percent were unsure. Together, such numbers suggest a rather stunning admission. Although it is almost taken for granted that innovation is critical to competitive success, there seems to be a serious mismatch between what companies are telling their shareholders, employees, analysts, and customers about their commitment to innovation and their real experience with it. The unspoken truth seems to be that for a very large number of companies, innovation spending continues to rise, but it is generating neither enough profit nor competitive advantage.

EXHIBIT 4

MOST EXECUTIVES ARE NOT SATISFIED WITH THE RETURN ON INNOVATION SPENDING

Are you satisfied with the financial return on your investments in innovation?

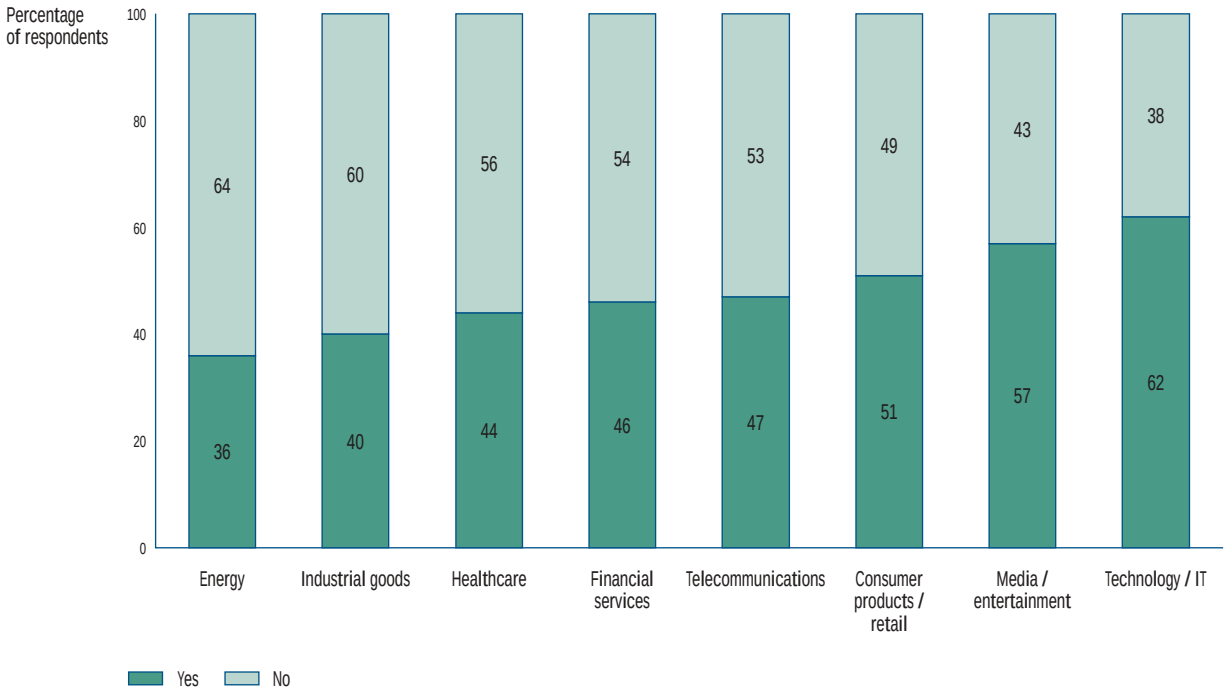


SOURCE: BCG 2005 ITC Survey

EXHIBIT 5

ENERGY, INDUSTRIAL GOODS AND HEALTHCARE ARE THE LEAST SATISFIED WITH INNOVATION'S ROI

Are you satisfied with the financial return on your investments in innovation?



SOURCE: BCG 2005 ITC Survey

Priorities

So why do companies continue to invest more in innovation? Judging from our work, many companies already have more ideas than they can effectively pursue. In addition, the investment profile is far from perfect: substantial sums of money are involved, the outcome is highly uncertain, and past performance is generally poor. What's more, executives' dissatisfaction with the return on investment in innovation isn't a new story—a similar percentage of executives were unhappy with innovation's ROI in last year's survey, and a look across history shows the same picture. Even Thomas Edison had more failures than successes.

To a certain extent, executives expect to lose money on innovation—but only some of the time, not in total. People like to say ten ideas are needed for every one success. And even with the poor performance many companies report, they are unwilling to stop or, in most cases, even reduce their commitment to it. Even small cuts in spending are often perceived by analysts, investors, and employees as a sign of weakness.

The Growth Imperative

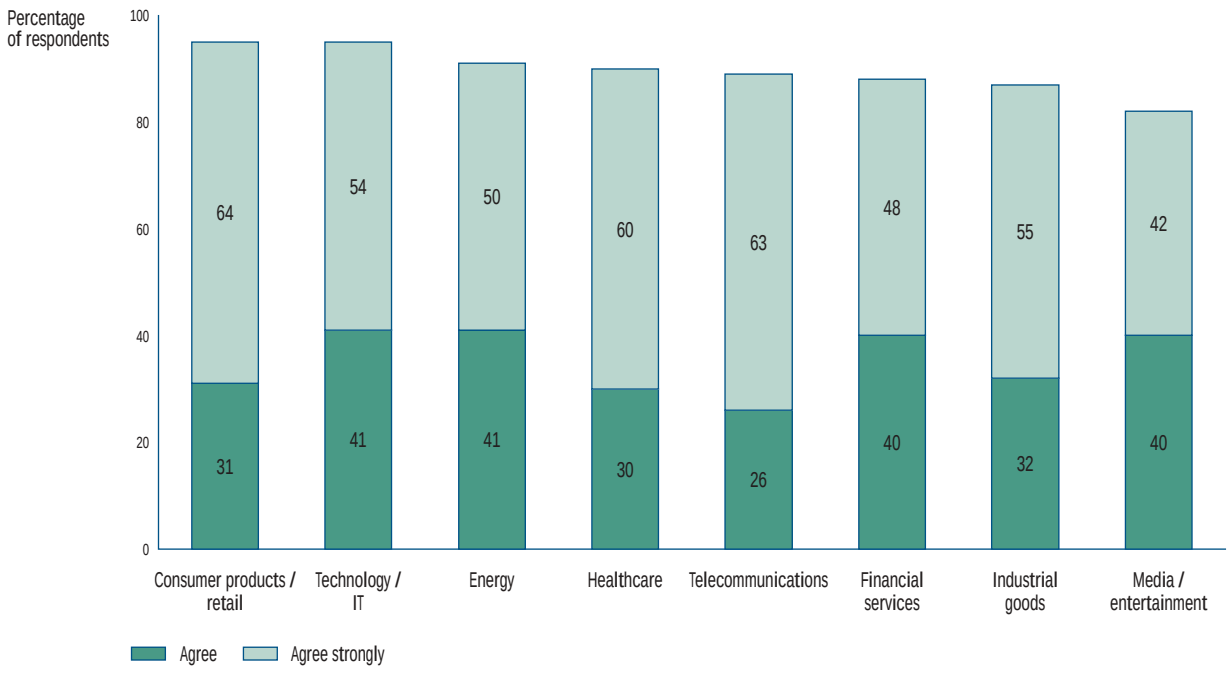
The big reason for the almost unwavering commitment to innovation is of course growth. Fully 87 percent of the participants in our survey said that organic growth through innovation had become essential to success in their industry. No less than 54 percent of the participants said they "strongly" agreed with the statement.

What such responses tell us is that, in the long run, most companies feel they must find ways to generate growth on their own, rather than through acquisitions alone. Indeed, acquisitions obviously are not always an option, nor always a good one. In the computer industry, for instance, Hewlett-Packard has struggled since its acquisition of Compaq, yet Apple has grown well on its own thanks to the iPod and other successful new products. More recently, the success of the merger of Procter & Gamble and Gillette—two highly innovative companies with many potential synergies for new products—is by no means a sure thing.

EXHIBIT 6

CONSUMER AND TECHNOLOGY COMPANIES PLACE A HIGH PRIORITY ON ORGANIC GROWTH

Agree or disagree: Organic growth through innovation is essential for success in my industry.



SOURCE: BCG 2005 ITC Survey

To grow organically, companies must not only keep coming up with improvements in products and processes, but most must also enter new markets. Some industries are focused more intently on the issue than others. In energy, consumer products, and health care, more than 90 percent of respondents agreed that organic growth was essential. High-tech companies were among the leaders, however, with 96 percent emphasizing the importance of organic growth—which could be one reason why the industry also had one of highest percentages of companies planning spending increases. (See Exhibit 6.)

What's more, in some cases, small innovations are not expected to be enough. In energy and health-care, for instance, more than 80 percent of respondents said that true breakthrough innovation is required to win in the industry. The technology industry was right behind with 78 percent. Financial services, however, provided a contrast: over one-third of executives in the industry disagreed that big breakthroughs are essential. This result could be a reflection of the perceived effectiveness in the industry of acquisitions as a way to grow. (See Exhibit 7.)

At the Top of the List

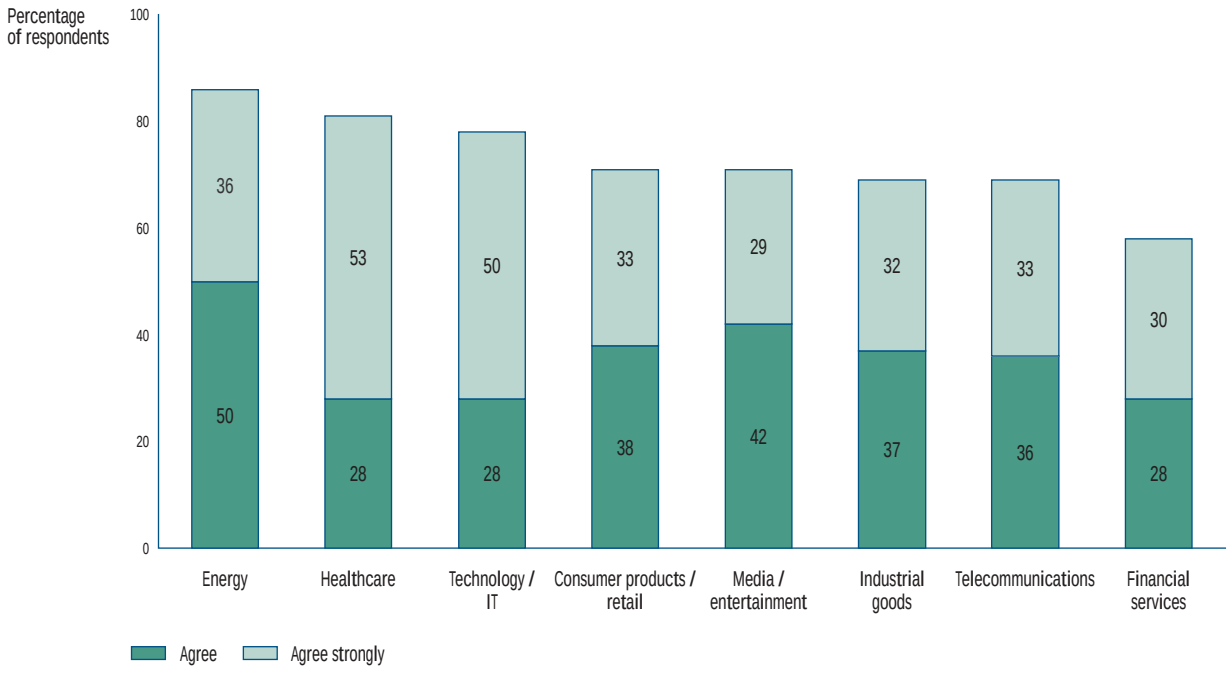
Given the competitive pressure to innovate, it should be no surprise that innovation also shows up high on the list of strategic priorities. Worldwide, 66 percent of respondents said that innovation was one of their company's top three strategic priorities for 2005—including 19 percent who said it was their companies' single most important initiative. These percentages were essentially unchanged from the same survey a year earlier. (See Exhibit 8.)

As one might expect, however, there were some interesting differences in the numbers across geographies. For instance, 23 percent of executives from Europe listed innovation as their highest priority for 2005, while in North America only 15 percent did so. Executives from Asia were in the middle, with 21 percent listing innovation as top priority. On an individual country level, the United Kingdom had among the highest percentages of executives listing innovation as their top priority, at 29 percent. India (at 24 percent), Germany (21 percent), the United States (16 percent), France (15 percent), and

EXHIBIT 7

ENERGY AND HEALTH CARE FEEL THE GREATEST NEED FOR BREAKTHROUGHS

Agree or disagree: True breakthrough innovations are required to win in my industry.



SOURCE: BCG 2005 ITC Survey

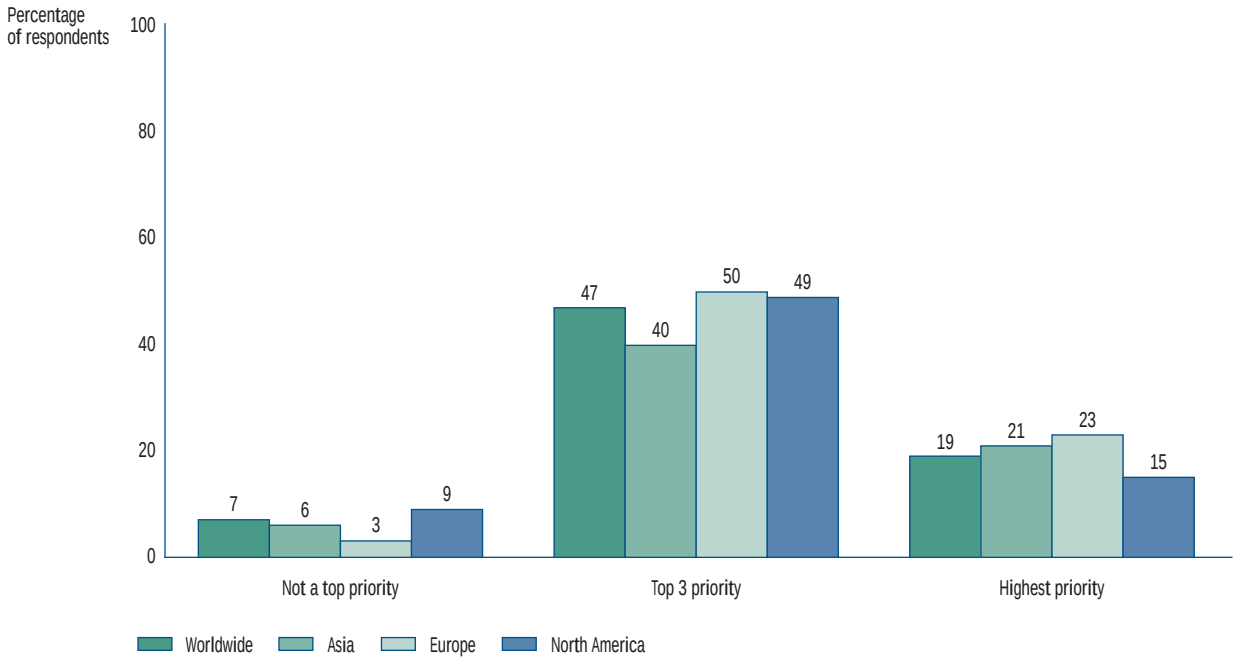
Australia and New Zealand (8 percent) all came afterward in the ranking.

Despite variations across regions, the emphasis on innovation by so many companies remains remarkable. Given how fundamentally *different* all companies are—for instance, in terms of their own objectives, capabilities, current position, and so on—it would be hard to find another strategic imperative that shows up so consistently on so many companies' list of top priorities. In fact, the focus on innovation is so universal that it is also one of the reasons why it is hard for companies to outperform competitors in this arena. No matter how much they invest, in all likelihood their competitors are investing heavily, too—which, of course, may be why so many companies are unwilling to cut back on their investment. Falling behind is no way to win.

EXHIBIT 8

EUROPE HAS THE MOST EXECUTIVES LISTING INNOVATION AS A TOP PRIORITY

How does innovation rank among your strategic priorities for 2005?



SOURCE: BCG 2005 ITC Survey

Areas for Improvement

But surely tough competition is not the only reason why executives remain so unhappy with the return on innovation. Great improvements have been made in recent years, after all. Take speed: time to market in many industries has shrunk dramatically. In the auto industry over the last decade, the time it takes to develop a new automobile has been slashed from four years to two years or less. In many other industries the changes are equally significant. Some technology and consumer companies now launch a new product every week, or even every day.

Other areas in which companies have made improvements include tapping new sources for ideas and improving insight into customers. Consumer products companies, white-goods manufacturers, and financial services providers all have invested heavily in tailoring products to meet rapidly changing customer demands. Beverage companies and credit card providers, for instance, sometime release dozens of new products in rapid-fire succession in order to tap into fast-shifting consumer tastes. Even auto companies are experimenting more with new models aimed at niche segments of the market. Toyota's Scion line and BMW's Mini Cooper are good examples.

It is surprising, then, that some of these same factors—time to market, uncovering new ideas, and even customer insight—were among the most common answers executives gave when asked to identify the biggest problems they have in turning their ideas into significant economic returns. Many executives used remarkably similar words or phrases. "Time lags" and "delays" were mentioned repeatedly. Similarly, many executives across industries noted that their innovations too often "missed the mark" in terms of sales expectations.

In quantitative terms, when participants assessed their organizations' capabilities along several key dimensions for commercialization, "moving quickly from idea generation to initial sales" had 50 percent of respondents scoring themselves as either "weak" or "very weak." This was second only to "leveraging suppliers for new ideas"—where 51 percent felt weak—in terms of areas where most executives feel they need to improve. Interestingly, many respondents scored themselves strong on developing deep customer understanding, which contrasted starkly with complaints that too many innovations ultimately prove less successful than expected with customers. (See Exhibit 9.)

Portfolio Problems

Other areas where executives consistently said they struggled include enforcing project success hurdles, or "gates," as well as balancing risks, time frames, and returns across an entire portfolio of new projects. Both issues are likely behind the problems many participants reported in not killing mediocre projects soon enough. As one executive remarked, "We are pursuing too many things simultaneously, and our organization cannot successfully build and commercialize them all. Yet at the same time, there are numerous market opportunities with limited windows of competition, and we don't want to miss the next 'big thing.'"

Another area where most companies feel they need to improve is in creating a corporate culture that fosters innovation. Almost 40 percent of respondents said they were weak on this dimension. The noteworthy exception, however, was technology firms—three out of four technology respondents considered their companies either strong or very strong when it came to having an innovative culture.

Where, then, are companies strongest? Almost two-thirds of respondents felt good about their company's ability to provide strong project-team support. The most common strength, however, was in ensuring executive-level sponsorship for projects: fully 70 percent of the participants said their company was strong or very strong in doing so. Of course, the survey participants themselves were executives, which quite possibly biased their view. Many times we have seen companies where there were fairly dramatic disparities between senior management's assessment of strengths and weaknesses and that of the managers underneath them. And even in this survey, CEOs and presidents had quite different views on innovation as compared to other executives in the respondent group: by and large, the top executives were much more optimistic about their innovation skills compared with other executives.

Even so, many of the factors most commonly underpinning the dissatisfaction with innovation have to do with implementation or execution—in other words, the commercialization process more than the ideation process. As one participant put it (and many echoed), "We have great ideas, but we don't have the right people or capacity either to go to market, or to sustain an investment over the lifecycle."

Metrics Needed

Measurement also seems to be a problem. According to our survey, few companies believe they have the right metrics for innovation in place—most settle for broader measures such as customer satisfaction, overall revenue growth, and the percentage of sales derived from new products or services. In fact, less than half of the executives in our survey said that their company carefully tracked the financial returns on innovation at all. (See Exhibit 10.)

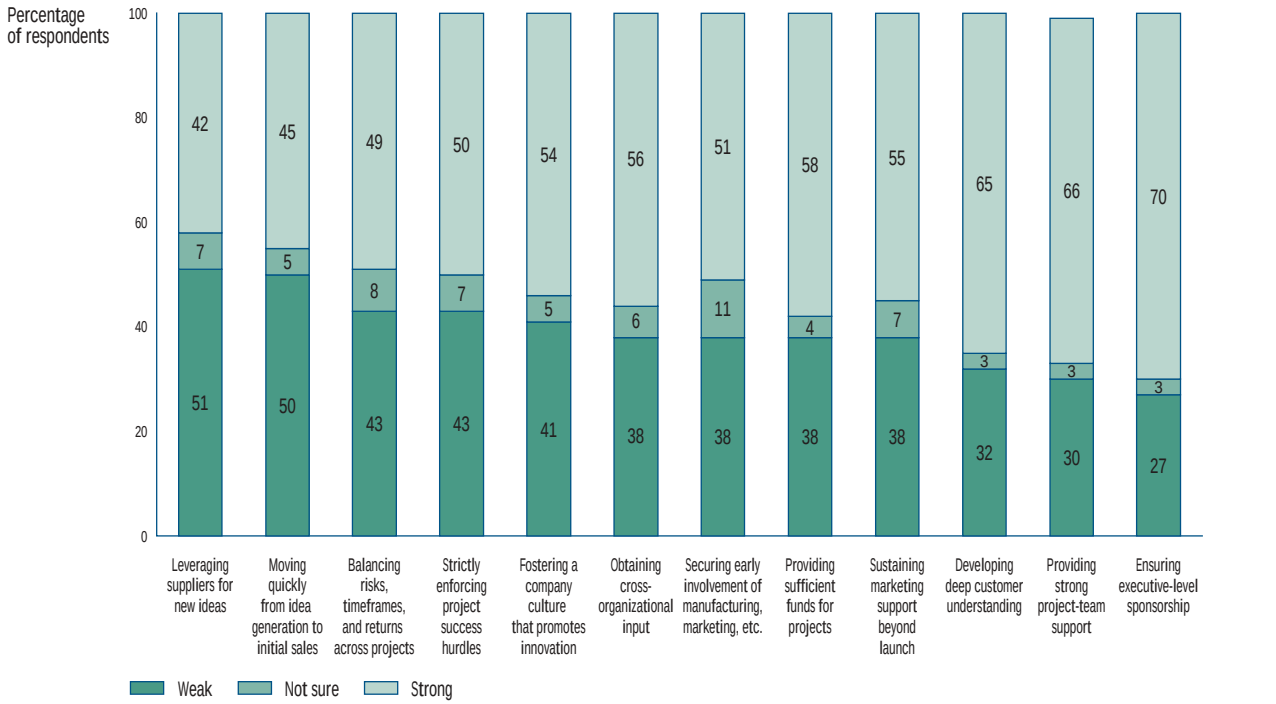
To be sure, innovation is hard to measure. It is fairly easy to track—and reward—success in something like cutting costs, but it is a lot more difficult to do so for innovation. And this is especially true when it comes to looking forward (how do we encourage someone to take risks?) rather than back (how many of our new products were a success?). However, despite the many uncertainties of innovation, it is possible to assess, at the outset, the likely impact of different approaches to managing the full *innovation-to-cash* (ITC) process. In our experience, this assessment typically is best accomplished by examining the cash curve of an innovation. A cash curve depicts the cumulative cash investments and returns for an innovation over time—it runs from the very beginning of development until the point at which the product or service is removed from the market. Since management's decisions affect the shape of the cash curve, companies can use it to openly discuss how to manage the curve, and the resulting returns, and make the required decisions and tradeoffs. (See Exhibit 11.)

Still, metrics are a real source of frustration for the executives in our survey, and it was clear that their absence was holding many companies back on innovation. In fact, a lack of good metrics may be one of the biggest problems companies have—after all, it's hard to be happy with the ROI when you have no idea what it really is in the first place.

EXHIBIT 9

WORKING WITH SUPPLIERS AND TIME TO MARKET ARE SOME OF COMPANIES' BIGGEST WEAKNESSES

How strong is your company's current performance?

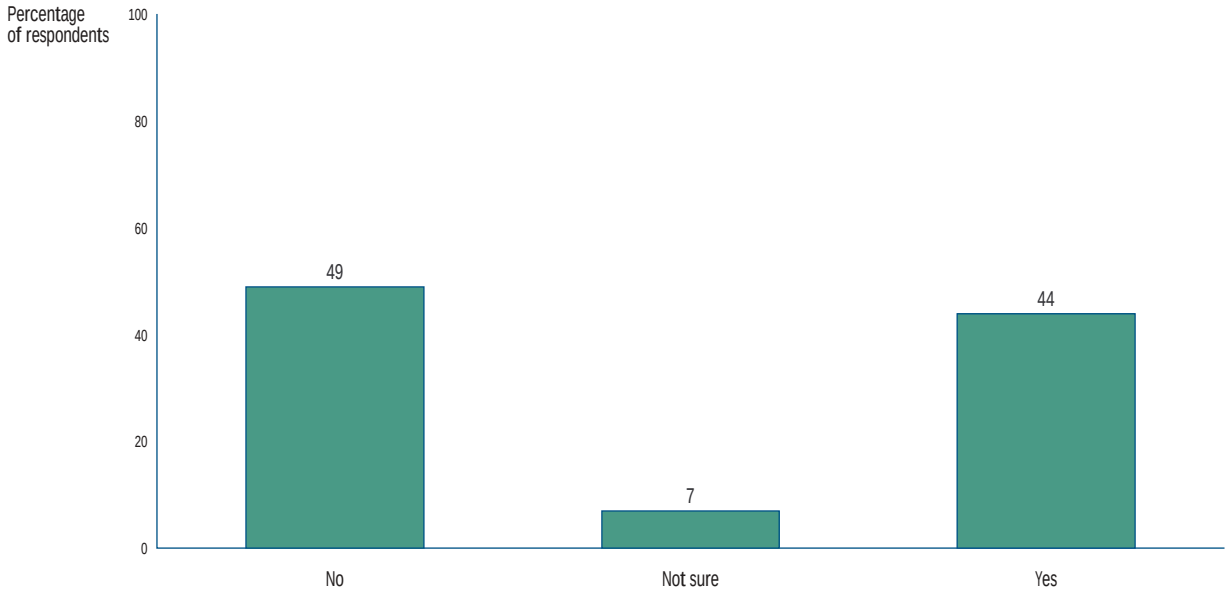


SOURCE: BCG 2005 ITC Survey

EXHIBIT 10

LESS THAN HALF OF EXECUTIVES SAY THEY CLOSELY TRACK CASH GENERATION FROM INNOVATION

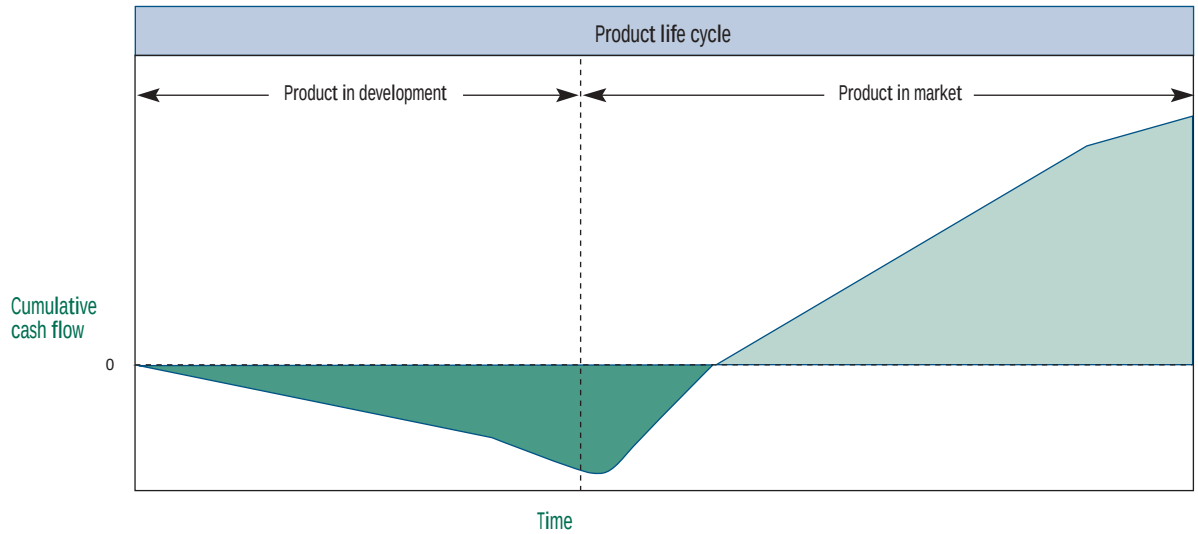
Does your company carefully track the financial returns associated with each innovation.



SOURCE: BCG 2005 ITC Survey

EXHIBIT 11

THE CASH CURVE OF INNOVATION



SOURCE: BCG 2005 ITC Survey

The Top Performers

So who is best? The answer largely hinges on how you choose to define and measure innovation. There are many, diverse gauges—such as the frequency of launch of new products; technological breakthroughs; and changes in market share, revenues, and profitability—and the relevance of each varies according to industry.

Nonetheless, when executives do identify those companies they consider most innovative, there is a remarkable consistency of opinion. In our survey, the top five were Apple, 3M, General Electric, Microsoft, and Sony. (See Exhibit 12.)

These findings were consistent across virtually all industries and geographies. In addition, the consensus was extremely strong: the top ten companies captured more than 85 percent of all the votes. (Put another way, the top ten captured *five times* the combined votes of the remaining 550 companies that received votes.) It's also noteworthy that the full list closely mirrors the results of 2003. Only three companies in the top ten were new: Google, IBM, and Procter & Gamble.

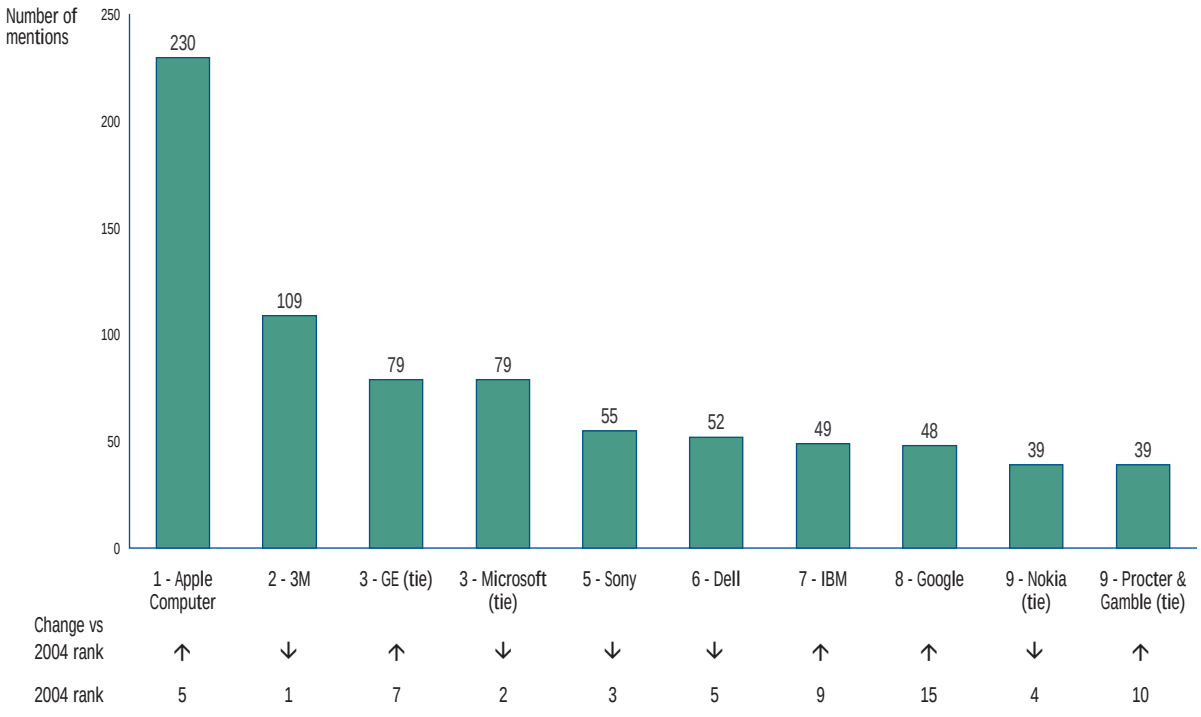
In terms of individual companies, the biggest story in our 2004 poll was the surge in favorable opinion toward Apple, which captured more than twice the mentions given second-place finisher (and last year's leader) 3M. This largely is the result of the wave of success the company finds itself riding, propelled by the wildly popular iPod.

But beyond a smash hit, what gets companies on a list like this one? It is not necessarily PR, nor public acclaim alone—many well-known, high-profile companies are far down in the rankings. Neither is it R&D spending alone—many of the biggest spenders (think auto and pharmaceutical companies) are far down the list as well.

Instead, while executives cited many characteristics that they admired about the top innovators, a few distinct capabilities were mentioned most often. For instance, market insight—the ability to get into

EXHIBIT 12

THE "MOST INNOVATIVE" COMPANIES



SOURCE: BCG 2004, 2005 ITC Surveys

the heads of your customers and understand, and even shape, their desires—was one. A second characteristic that was cited by many executives was an ability to "institutionalize" innovation; that is, to create and maintain a corporate culture that leverages the best thinking from each and every employee.

Yet another characteristic attributed to the most innovative companies was their ability to create something new from something old. Successful innovation doesn't necessarily mean breakthroughs—it can also mean looking at an existing product, technology, or service and improving on it or tailoring it to capture a new audience. The iPod was just such a case. In 1999, engineers at Compaq developed the PJB-100, a personal music player featuring a small hard-disk drive, which stored much more music than Diamond Multimedia's Rio, a flash-memory player that pioneered the market. Compaq's device never made a splash, but in late 2001, Apple launched the iPod, also featuring a hard-drive. The rest is history.

Why Apple?

Apple has always been known as innovative, but the company today seems to have reached a new level. Executives in our latest survey said they admired Apple's understanding of its market ("Apple knows consumers like no one else") and its ability to serve that market with innovative new products ("Apple creates new products that meet consumer demands before the consumer is even aware of them"). The iPod, of course, was the product most frequently mentioned. One respondent called it "a brilliant evolution—an old idea but a new application." Another noted how Apple had "turned a product line that was quickly becoming a commodity into a high-status icon."

Apple's use of design also won it considerable praise. "The company focuses on ease of use, successfully extending uses of technology into everyday life," said one respondent. Simultaneously, said another, Apple "understands that aesthetics and image are important elements for consumer adoption" and thus "focuses on design, colors, and lifestyles as key success factors." Another summed it up: "Apple packages and markets complex technologies in a very simple and attractive way. It's beautiful design."

Most important—and more difficult to emulate—many executives cited Apple's ability to reinvent itself. ("Apple has maintained its niche position by continuously reinventing the rules of the game") In addition, many were also impressed by its ability to distinguish itself from competitors: "Apple has the creativity to shape the industry, and will likely continue to do so."

And What About 3M?

3M, which took the top slot in our 2003 poll, slipped to second place in the latest survey. Still, most executives admired its strategic commitment to innovation. "3M has developed a profitable and sustainable business model around innovation," said one. Many executives also cited the company's innovation-centric culture. "Innovation is formally encouraged and rewarded," noted one respondent. "The company has institutionalized creativity." Several executives specifically cited the freedom 3M gives its researchers: "Its scientists can spend up to 15 percent of their time on pet projects of their own choosing. With such motivation and resource backing, how can a company not be innovative?"

Respondents also highlighted 3M's ability to execute—as one said, "3M has established proven processes, not just for creating ideas, but for taking them to market." In addition, several cited the company's consistency: its ability to "produce a constant stream of useful new consumer products over a 30- to 40-year period." Said one executive, "3M, the company that gave us the Post-It, continues to surprise." Said another, "It scans the terrain for new products extensively and on a regular basis, and has the proven ability to transfer new ideas into reality."

Implications: Closing the Gap

In the end, it is clear that the biggest challenge in innovation remains *execution*, not invention. Successful innovation is profitable innovation, which depends not just on initial creativity but also on excellent commercialization.

Given our experience and research, however, most companies continue to struggle with commercialization. Consider some of the issues highlighted in this survey. Despite all the time and money companies have spent on improving innovation over the last ten or even 20 years, hundreds of executives across all industries said their organizations still are:

- Not as fast as they need to be
- Not successful as often as they need to be
- Too fragmented across too many different projects
- Not well-aligned across the whole organization (functions, geographies, etc.)

At the same time, when looking at the external environment, executives highlighted recent developments that have made commercialization even more challenging. These developments include:

- New competition
- Intense, and increasing, price and cost pressure
- Ever-shrinking product lifecycles
- Increasing integration of the world's economies
- Major technology shifts

These are not simple issues to address—many of them are complex and interrelated. Taken together, however, they suggest that two fundamental issues will be particularly important for companies to deal with if they want to close the gap between what they want and need out of innovation and what they currently achieve. The first is the globalization of innovation efforts. The second is the alignment of the organization.

Globalizing Innovation: Offshoring R&D Processes to Low-Cost Countries

Many of the external challenges that executives identified link back to the continuing spread of globalization. China, India and other low-cost countries are fundamentally changing the game by offering a vast pool of high-quality, low-cost technical talent, increased access to foreign markets, and potentially faster development times. Indeed, almost all the executives in our survey acknowledged that globalization is having a significant impact on the way their company conducts innovation. Yet only a third said they actually planned to increase R&D in low-cost countries in 2005.

The benefits of global R&D are not just things one might read about in the press — they are real and happening now as some companies move aggressively. In China, for instance, there now are more than 180 R&D facilities operated by foreign corporations. Some of these initiatives are designed to target the local markets, where, due to the markets' size and rapid growth, the next wave of global customer demand may start and then roll outward. Some initiatives focus instead on providing cutting-edge technology or engineering, such as 3-D modelling, for a global organization. Some do both.

But not all companies are moving forward in this area, as our survey points out. And many of those that have taken the first (or even second) steps are pausing to assess their progress, rather than accelerating. Yes, the challenges of offshoring are real. But they can be overcome, or at least mitigated and contained, by careful design and planning. What's more, some of the challenges posed by increased global competition will remain even if companies never move R&D activities to new locations. For instance, many intellectual property issues fall into this category.

In our work, we have seen firsthand the productivity, capability, and flexibility benefits of offshoring

R&D processes. As a senior executive leading a major company, if you are not yet pursuing this in a meaningful way, ask yourself these questions:

- Why not? What is it that is stopping you from taking advantage of this potential opportunity?
- What are the implications, over only the next year or two, if your competitors establish a capability for R&D abroad that is either significantly lower cost than yours, much larger in size (think in terms of five to ten times greater) at the same cost, or both? How will that change the relative position of your company? How will your customers feel?
- What will you do, this year, to change your organization's current position and perspective on this subject?

If your company has already begun to move parts of the innovation process abroad, the questions to be asking are:

- How will you maintain or even increase the momentum?
- How will you manage the inherent tensions between the new centers and the still critically important existing staff, facilities, and capabilities?
- How will you manage the building of internal demand and overcome the resistance that, without leadership, could cause the entire effort to sink?

Globalization of R&D and many other facets of innovation is here to stay. Finding the right path to take advantage of it is one of the major challenges, and opportunities, facing senior executives this year.

Aligning the Organization: Focus on Three Key Levers

Internal or organizational issues about innovation remain a key concern for executives, regardless of geography. For most of them, the key issue is *alignment*—that is, having the entire organization on the same page concerning objectives, tactics, and, ultimately, commitment. Like any other business activity, the entire innovation-to-cash process needs to be systematically managed with focus, rigor, and attention. Failing to do so essentially leaves the return on innovation to chance.

But this simple objective is elusive. In this year's survey, for instance, more than half of the respondents said they either were "not sure" or plainly disagreed with the statement that their companies had the right organizational structures in place to foster innovation. In addition, just under half of respondents either did not know or disagreed with the statement that their senior management team shared a common perspective on how to manage innovation and assess its success. Although the fact that top executives have different views on these key issues is not surprising, the *prevalence* of such disagreement is a problem—assuming the goal is in fact to align an organization around an innovation (and business) strategy.

In our work on innovation, the most common question we are asked by senior executives is, "How do I create an innovative culture?" If taken to mean something beyond creative—in other words, a culture that encompasses turning inventions and ideas into cash that ends up on the bottom line—then this question is fundamentally one about alignment. The answer, however, is decidedly *not* organizational structure. There are very innovative companies (excelling at both invention and commercialization) that use virtually every organizational structure one can imagine.

So the question here remains, what can company leaders do? Managers can start by looking hard at three key areas. While focusing on these areas won't necessarily change things overnight—there are other things that matter, obviously—it can start to move things ahead rapidly. Moreover, these things are largely in a leader's direct control:

- **The people you have.** Alignment requires people who both understand the value of working together and have the skills and temperament to do so. Not everyone can or does. Managers who don't are poisonous to the rest of the organization. If you really want alignment, identify those people who are hindering your goals. Understand why. Give them clear and direct feedback. Take appropriate action as needed. The time for silos of any type—functional, process, geographic, or others—is long since past. Don't let yours remain.

- **The environment you create.** Ask yourself how much time you spent in your last operations review on innovation. The loudest message you can send is how you spend your time. Money and capital are cheap in comparison. Your organization knows this, perhaps even better than you do. If *you* are interested in innovation and show it, many barriers will start to fall away quickly.

- **The measures and rewards you use.** What matters in your organization? Hitting your numbers, of course. But what else? What else, if anything, gets measured regularly? What drives compensation and captures attention? Merely hitting your numbers is, for most companies, no longer enough. Other items (such as building a pipeline and skill base for the future) also need to be measured, or in many organizations they won't be given enough, or any, attention. More important than finding exactly the "right measures" are beginning to use measures that are merely not too "wrong." Pick a few. Get started tracking. Look at them over time and you will soon see who and what is being successful. Reward them appropriately.

The steps above may sound simple, perhaps even simplistic. But alignment *is* conceptually simple—it is just difficult to execute in practice. So test yourself. Why isn't your organization aligned? There are always "good" reasons, but truly aligning the organization is for many companies the single most powerful lever they have to increase their return on innovation.

* * * * * *

Many of the most creative or innovative companies in history have at times struggled to turn their ideas into cash. AT&T, for instance, developed the transistor, the Unix operating system, and many other breakthroughs in communications. Yet it will now be acquired, and eliminated, by a company it spun off years ago. What happened? A front-page headline in the *Wall Street Journal* summed it up: "Missed Calls: AT&T Inventions Fuelled Tech Boom—And Its Own Fall." In other words, other companies ultimately profited from AT&T's innovation far more than it did.

Judging from the responses to this year's survey, many companies would do well to remember AT&T's story, and come to grips with why their own returns on innovation are not enough. For many companies, effective globalization and organizational alignment will be a big part of the answer. For almost all, though, a greater focus on commercialization will be critical. As many executives say in our survey year after year, "Ideas alone are not enough."

Methodology

The BCG 2004-2005 senior management survey on innovation was distributed electronically to executives worldwide in late 2004. The survey was closed in February 2005. In total, 940 executives and managers participated, representing 68 countries and all major industries. Participation was voluntary and anonymous.

The responses broke down as follows:

Country:	
U.S.	407
India	50
U.K.	46
Germany	39
Australia	35
Canada	29
France	27
Spain	23
Netherlands	19
Switzerland	18
China	16
Italy	15
Brazil	12
Japan	12
Singapore	12
Portugal	9
Mexico	8
Belgium	7
Finland	7
Sweden	6
United Arab Emirates	6
Indonesia	5
New Zealand	5
Denmark	4
Malaysia	4
Russian Federation	4
Israel	4
Norway	4
Other / unspecified	107
Total	940

Source: BCG 2005 ITC Survey

Industry:	
Consumer products / retail	186
Industrial Goods	173
Financial Services	106
Technology	86
Healthcare	64
Telecommunications	55
Media / entertainment	45
Government / non-profit	25
Energy	22
Other / unspecified	178
Total	940

Source: BCG 2005 ITC Survey

Position:	
President / CEO	147
Strategy executive	147
Brand or product manager	112
Marketing executive	78
Director of R&D	65
New product development manager	51
Chief Operating Officer	36
Business Unit leader	31
Chief Financial Officer	21
Chief Information Officer	13
Finance executive	11
Chief Technology Officer	10
Business development director	10
HR director	8
Board member	2
Other / unspecified	198
Total	940

Source: BCG 2005 ITC Survey

For More Information

This survey is part of BCG's extensive work and research on innovation and the innovation-to-cash process. A sample of related publications includes:

- "Innovating for Cash," Harvard Business Review
- "Boosting Innovation Productivity," BCG Opportunities for Action
- "Making Innovation Pay," BCG Perspectives
- "Innovating for Cash: Orchestrating in the Consumer Industry," BCG Opportunities for Action
- "Innovating for Cash: Lessons From the Handset Wars," BCG Opportunities for Action
- "Raising the Return on Innovation: Innovation-to-Cash Survey 2003," BCG Report

For copies of any of the above publications, please send an email to: BCG-info@bcg.com.

For more information on the latest survey or to discuss issues related to BCG's work on innovation, please send an email to ITCsurvey@bcg.com, or contact any of the following leaders of our practice:

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