

# R&D Budgets: Leaders Allocate Project Portfolios Differently

*Maintaining breakthrough innovation drives commercial success for lead innovators and fast followers, even as budgets decline*

## EXECUTIVE SUMMARY

- ▶ Few R&D organizations will be able to increase their overall budgets in the current economic climate and while many will be required to reduce overall R&D spending.
- ▶ In response, most R&D executives are likely to reduce investment in breakthrough innovation projects to focus on incremental innovation projects with quicker payback and lower risk. Instead, leading companies will favor breakthrough projects regardless of their total spend levels.
- ▶ Our detailed benchmarking research of 110 companies and business units found that project portfolios that give above-average emphasis to breakthrough innovation produced higher operating margin growth, relative to industry. The findings were consistent for both lead innovators and fast followers.

### Solutions from Peers

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### Use the Council to Take Action

1. Use the online tools on the Council's Web site for instant R&D benchmarking against industry peers.
2. Access data on metrics strategies to set up your organization's R&D measurement dashboard.
3. Check out related resources on measuring the value of R&D.
4. Ask your peers how they influence business decision making. Set up your profile using the Executive Productivity Network.
5. Use the Web site to e-mail peer executives.

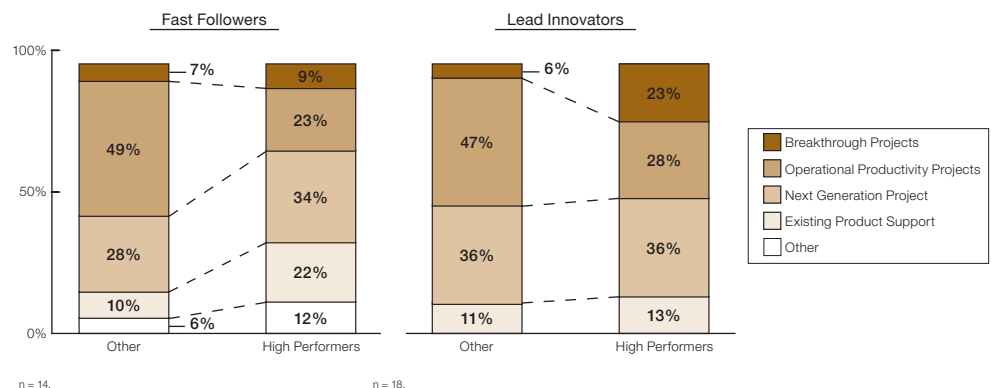
## R&D Funding Pressures

The long-term trend toward disinvestment in R&D can only be significantly exacerbated in the current economic climate. Recent research indicates that R&D spend has little correlation with business performance and has led many senior managers to look elsewhere for sources of future growth. A recent survey found that only 27% of business executives cite that "innovation takes place in R&D."\*

## Funding Breakthrough Innovation Matters More Than Budget Size

In response to these challenging budgetary pressures, the Council launched its R&D Effectiveness Benchmarking Survey in 2007 to see how leading companies set budgets and staffing, allocate project portfolios, and measure performance. Leading organizations were defined as those outperforming their industry averages on operating margin growth.

Leaders Spend More on Breakthrough Innovation, as a Percentage of Total Spend  
Allocation of Project Portfolio Budget



\* The Quest for Innovation: A Global Study of Innovation 2006-2016; Washington, D.C.: American Management Association, 2006, p. 74.

**Circulate to:**

- ▶ Executive Committee Members
- ▶ Business Unit General Managers
- ▶ R&D Portfolio Managers

The findings suggest these industry leaders place more emphasis on the composition of R&D spend than the level of spend, focusing disproportionately on investments in breakthrough innovation. The findings were consistent for both lead innovators and fast followers:

- ▶ High-performing lead innovators stay true to their “first-mover” strategy and invest almost 25% of their R&D investments in breakthrough projects. They also spend significantly less on next-generation projects.
- ▶ Successful fast followers invest significantly more in operational productivity or process improvements (22% of their portfolio) and existing product support (34%), while deemphasizing next generation investments relative to their less profitable peers.
- ▶ The most profitable growth companies limit the ratio of incremental launches to new product launches by a nearly 2:1 margin relative to low performers, regardless of their industry cycle.

**Favoring Breakthrough Innovation Improves Performance**

R&D portfolios with more-than-average allocation to breakthrough innovation generated a 3% operating margin advantage over portfolios with less-than-average breakthrough allocations. Surprisingly, the study indicated no connection between the lagged R&D-to-sales ratio and financial performance. R&D executives should:

- ▶ Increase investments in breakthrough innovation to improve bottom-line growth regardless of innovation strategy.
  - ▶ Reduce investments in next-generation projects relative to breakthrough projects to prevent erosion of profitability growth.
  - ▶ Minimize investments in commercializing incremental R&D at the expense of new product launches to drive margin growth.
  - ▶ Emphasize collaboration with external partners whose commercial success is closely linked to that of your own organization.
- ▶ *How do I build a high-growth R&D portfolio that aligns with business goals?*
- ▶ *How do I eliminate low-value incremental projects?*
- ▶ *How do I prioritize breakthrough investments?*

**Contact the Council**

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**Research Methodology**

Research & Technology Executive Council surveyed 45 company-level and 65 business unit-level R&D organizations across its global membership. The data spans R&D strategy, expenditures, project portfolio allocations, staffing ratios, management effectiveness, and functional performance indicators such as new product sales and cycle times, effectively making it one of the broadest collections of R&D benchmarks available. The team analyzed the data using econometric techniques such as factor analysis and regression analysis.



Ecoblab's cross-business prioritization process ensures alignment between portfolio allocation and financial targets.



Schlumberger's product customization filters help target incremental efforts toward highest-value opportunities.



Corning's prioritization screens help base investment decisions on ability to create competitive differentiation.

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