EXECUTIVE GUIDANCE FOR 2012

Transformative Innovation
Reinvigorating Teams and Processes to Spur Breakthrough Ideas
Business executives today share the same acute challenge: driving more growth. This challenge is even more daunting in the face of stagnation and economic uncertainty in developed markets, the rise of new—and increasingly competitive—emerging markets, and the rapid evolution of global consumer preferences. As the pressure to grow and win in complex new markets rises, firms are looking for breakthrough ideas that can lead to transformative innovation in their products and services. Companies pursuing breakthrough ideas are able to generate up to twice the product sales of their peers.

**Transformative Innovation Doubles New Product Sales**

Current Year Percentage of Sales from New Products

*Transformative Innovators*\(^1\) Versus Others

\[\begin{array}{c}
\text{Others} & \text{Transformative Innovators} \\
14\% & 30\% \\
(n = 57) & (n = 17)
\end{array}\]

\(^1\) Transformative innovators are R&D organizations that generate more internal and external momentum for new growth ideas than their peers.

Source: CEB, Research & Technology Executive Council.
Unfortunately, reenergizing transformative innovation is an uphill climb for most companies. The past decade of economic uncertainty made executive teams risk averse—focusing on incremental innovation to improve existing products and ensure more predictable, near-term revenue. In effect, these firms have been trading larger, higher-impact (and riskier) ideas for a greater number of smaller, more manageable (and less risky) ideas, causing incremental and next generation initiatives to dominate most innovation portfolios. While Corporate Executive Board (CEB) research shows that investment in transformative innovation projects is growing slowly, incremental innovation still accounts for more than 80% of funded innovation initiatives.

**Incremental Innovation Projects Dominate R&D Portfolios**

R&D Budget Allocation by Project Type

*Percentage of Budget, n= 55.*

- Breakthrough Projects
- Incremental and Next Generation Projects

Source: CEB, Research & Technology Executive Council.
This modest and slow reinvestment in transformative product innovation is unlikely to generate the kind of growth required by many corporate plans. In fact, CEB’s global business leaders survey shows that three out of four executives think their firms lack the kind of ideas needed to drive growth. Shifting toward transformative innovation is proving difficult because the underlying networks needed to generate, refine, and productize breakthrough ideas have atrophied. Many organizational changes over the past five years have resulted in downsized, reorganized, or increasingly dispersed innovation teams—weakening the structures that support strong idea development. In many cases, these organizational changes contribute to reduced ideation capability, more ambiguous innovation management, and deteriorating working relationships.

**Executives Doubt They Have Powerful Ideas to Drive Growth**
Concern About Seeding the Pipeline with Transformational Growth Ideas

*Percentage of Respondents Citing Area as Top Concern, n = 92.*

Source: CEB, Research & Technology Executive Council.
Challenges in Accelerating Transformative Innovation

While many factors contribute to low innovation output, a predisposition for incremental innovation coupled with dramatic organizational changes have damaged the networks necessary for breakthrough ideas. Executives hoping to rebalance their innovation portfolios toward more transformative projects face the following broad challenges:

- Downsizing and reorganization have weakened ideation networks.
- Mid-level delayering has reduced experience in the innovation process.
- New globally dispersed research centers lack established, effective working relationships.

**Downsizing and reorganization have weakened ideation networks.**

Consistently generating, refining, and prioritizing breakthrough ideas requires participation and collaboration from a web of relationships across the entire organization. Unfortunately, recent organizational changes have altered these networks and relationships substantially—especially for “innovators” (e.g., employees in R&D, Engineering, and design functions). In 2009, almost 80% of innovators had experienced a significant change in their organization or role within the previous year. While it has slowed, change unfortunately remains sizeable with nearly 50% of innovators surveyed in early 2012 experiencing organization or role changes in the past year. With these persistent and significant organizational changes, employees and their organizations have difficulty maintaining the formal and informal networks required for innovation.
Organizational Changes Disrupt Innovation Teams
Percentage of Innovation Employees Experiencing a Significant Organizational Change in the Past 12 Months

Source: CEB, Global Labor Market Survey.
Mid-level delayering has reduced experience in the innovation process.

In addition to overall employee network disruptions, management delayering over the past five years has destabilized innovation networks. This reduction in mid-level innovators has depleted a critical store of organizational, customer, and market knowledge essential to driving ideation. Mid-level innovators are seemingly being squeezed out of large global organizations, with the number of mid-level innovators falling from 57 to 38% between Q4 2010 and Q1 2012. As mid-level innovators leave, so too does their experience. Between 2010 and early 2012, the average tenure of mid-level innovators fell from 12 to 10 years, and their average age fell from 39 to 36. With less experience and management acumen, innovation networks and processes are naturally weaker. The number and quality of ideas suffers with fewer experienced mid-level innovators to drive connections, source and refine ideas, and manage the process.

Innovation Networks Are Weakened with Fewer Mid-Level Innovators to Drive Ideation

Share of Innovators by Level in United States and Europe

Q4 2010 to Q1 2012

<table>
<thead>
<tr>
<th></th>
<th>Q4 2010 (n = 97)</th>
<th>2011 (n = 561.)</th>
<th>Q1 2012 (n = 176.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Level</td>
<td>18%</td>
<td>16%</td>
<td>23%</td>
</tr>
<tr>
<td>Mid-Level</td>
<td>18%</td>
<td>16%</td>
<td>23%</td>
</tr>
<tr>
<td>Entry and First Level Innovators</td>
<td>26%</td>
<td>36%</td>
<td>39%</td>
</tr>
<tr>
<td>Innovators</td>
<td>57%</td>
<td>48%</td>
<td>38%</td>
</tr>
</tbody>
</table>

Note: Totals may not equal 100% due to rounding.

Source: CEB, Global Labor Market Survey.
New globally dispersed research centers lack established, effective working relationships.

Finally, innovation teams are more geographically dispersed than ever before, complicating the negative effects of organizational restructuring. Firms are shifting funding and resources to emerging markets to get closer to new customers in these regions and take advantage of local (often inexpensive) skilled labor. Quickly reestablishing critical networks is extremely difficult when newly established teams in global markets are leading innovation.

Unfortunately, simply shifting and investing in new staff and R&D facilities is not generating the expected results. Firms continuously struggle to transition their new emerging market innovation centers away from incremental development work and toward transformative new product development. In fact, these innovation centers are on average only one-third as productive as developed market centers at generating revenue from new products. The lack of productivity is not due to capability or skill gaps but ineffective collaboration between the established and the new innovation teams. Innovators have not created enough trust in their counterparts to enable effective collaboration—especially trust between emerging market and developed market teams.

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2 As measured by an R&D center’s Vitality Index; the three-year Vitality Index for emerging market R&D centers measures the percentage of current year global sales attributable to new products originating in emerging market R&D centers.
A Sizeable Innovation Gap Remains for Emerging Market R&D Centers
Comparison of Median Three-Year Vitality Indices\(^3\) for Developed and Emerging Market R&D Centers
\(n = 72.\)

To realize the significant sales contribution expected from emerging markets, R&D organizations would have to more than double their current vitality from emerging market R&D centers.\(^4\)

\(^3\) The three-year Vitality Index for emerging market R&D centers measures the percentage of current year global sales attributable to new products originating in emerging market R&D centers.

\(^4\) This is based on the assumption that a similar volume of locally innovated products is required to drive revenue growth in emerging markets as in developed markets.

Source: CEB, Research & Technology Executive Council.
Four High-Return Steps for Reinvigorating Teams and Processes for Breakthrough Innovation

With weakened ideation networks, stretched management, and ineffective global working relationships, many companies are hard-pressed to restock their innovation pipeline with breakthrough ideas. Without reestablishing the necessary organizational capabilities, companies are unlikely to shift their innovation portfolio fast enough to compete and win in new markets. While daunting, the challenges are not insurmountable. Progressive firms take steps to repair disrupted networks, manage idea quality, and remove collaboration barriers. CEB’s work with companies that are accelerating transformative innovation shows that innovation leaders should take four steps to reinvigorate teams and processes:

1. Repair and Reconnect Dispersed Internal Networks to Drive Idea Exchange
2. Manage Social Media and Crowdsourcing to Generate Ideas
3. Enable Staff to Self-Assess Ideas to Improve Idea Quality
4. Rebuild Effective Global Relationships to Encourage Collaboration
Reorganization and downsizing have caused too many innovators and their networks to become insular and disconnected from broader corporate efforts. In these situations, teams lack awareness of the best ideas, as well as access to the perspective, advice, and support of their colleagues and managers. Without effective networks, ideas and innovation projects will likely be underdeveloped and stuck in functional and geographic silos.

To reestablish networks and the flow of ideas across increasingly decentralized organizations, innovation leaders should take the following simple, but powerful, steps:

- **Formalize Idea Sharing Across Regions**—Create regular multifunctional, cross-team interactions beyond the annual strategic planning cycle to share product ideas, market insights, and recent successes across regions.

- **Tap Innovative Ideas from Dynamic Markets**—Ensure innovation teams in fast-growing, competitive markets regularly meet with executives in other regions and with leaders capable of championing local ideas and moving them into formal innovation pipelines.

- **Build Cross-Function and Cross-Region Awareness in Central Product Teams**—Create broader perspectives by “getting in the field.” Require central product teams to visit regional offices or co-locate with other stakeholder functions (e.g., Sales, Marketing, R&D), which can be invaluable in building cross-silo awareness and communication.

- **Lead by Example and Manage Information Flow**—Innovation leaders should task themselves with breaking silos. They should continuously communicate the need for new products that cut across groups and regions and publicly reward those who pursue innovation opportunities that span product segments or business units.
In addition to reconnecting formal innovation networks, many firms are attempting to build broader, more informal networks to generate ideas. These efforts use social media technologies to bring more employees with diverse ideas and perspectives into the beginning of the innovation process. “Crowdsourcing platforms” allow broad-based communities to virtually share, assess, and refine ideas. This low-cost forum for idea sharing can unlock the firm’s most powerful innovation asset: its employees.

Unfortunately, many of these platforms are inherently less controllable and focused than traditional ideation processes and are proving less productive than hoped. To be successful, these platforms have to be well managed and require the following:

- **Key Employee Participation**—Encourage and provide incentives to the right employees to use these platforms and participate in formal innovation processes.

- **Clear Branding and a Narrow Focus**—Ultimately, crowdsourcing needs direction, which includes focusing the forum on its purposes (e.g., idea generation, idea refinement, and focused collaboration). Managers need to ensure the platform stays business focused and avoids slipping into social interaction.

- **Active Innovation Leader Participation**—Key innovation leaders should fuel and manage discussions, engage participants by moderating conversations, filter ideas, ensure the best ideas are fully formed, and migrate them into formal innovation processes.
Enable Staff to Self-Assess Ideas to Improve Idea Quality

Managing the quality of ideas early in the innovation pipeline and purposefully sharpening concepts reduces the overall time to market for new products by one-fourth. While it is relatively easy to set up crowdsourcing platforms to generate ideas, it is considerably more difficult to ensure they are high quality—especially when fewer tenured innovators are able to help assess, refine, and steward ideas through the process.

As a result, generating viable, high-potential ideas requires new ways to assess ideas early in the innovation process. Progressive firms enable employees to self-assess idea quality by creating simple tools and templates to teach employees the most important factors to consider when evaluating and vetting innovation ideas. The tools can be as simple as idea evaluation questionnaires that enable staff to quickly assess, modify, and improve their concepts. By allowing employees to test their ideas earlier and more often against a shared set of criteria, firms see fewer high-quality ideas rather than many low-quality ideas coming from their ideation networks. While the criteria used to determine a “good” idea will vary, progressive firms focus on major success factors, such as:

- Alignment with firm strategy and priorities,
- Potential effect of major market trends,
- Fit with customer needs and consumer trends,
- Support for product differentiation,
- Technological and operational feasibility, and
- Commercial viability and economic potential.

As an added benefit, frequent use of broad-based, self-assessment tools among staff reinforces a culture of continuous idea assessment and improvement—in effect, focusing the entire innovation team on quality.
Transformative Innovators Maintain a More Effective Idea Pipeline
Comparison of Pipelines and Processes
Other Versus Transformative Innovators

<table>
<thead>
<tr>
<th></th>
<th>Others</th>
<th>Transformative Innovators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Ideas</td>
<td>115 Ideas</td>
<td>56 Ideas</td>
</tr>
<tr>
<td>Idea Funding Rate</td>
<td>55%</td>
<td>74%</td>
</tr>
<tr>
<td>Idea to Market</td>
<td>6 Months</td>
<td>8.5 Months</td>
</tr>
<tr>
<td>Concept</td>
<td>24 Months</td>
<td>18 Months</td>
</tr>
<tr>
<td>On-Time Completion</td>
<td>65%</td>
<td>79%</td>
</tr>
<tr>
<td>On Budget</td>
<td>72%</td>
<td>86%</td>
</tr>
<tr>
<td>Product Success Rate</td>
<td>47%</td>
<td>75%</td>
</tr>
</tbody>
</table>

*Products that are more successful in the market and do not cannibalize existing offerings*

(n = 45) (n = 10)

Source: CEB, Research & Technology Executive Council.
Rebuild Effective Global Relationships to Encourage Collaboration

As noted earlier, new and emerging markets are increasingly important—not only for growth but also as a source of ideas and innovation. To capitalize on their expanded global presence, many companies are transforming their development centers in emerging markets into innovation hubs. This shift is intended to move emerging market teams away from merely versioning global products for local markets (incremental innovation) to developing new products for the region or even for the rest of the world (transformative innovation). Based on a CEB survey of heads of R&D, 30% of companies were active in emerging markets in 2011, and 57% are expected to be active by 2015—an increase of 27 percentage points.

More Companies Expect to Be in Emerging Markets in the Near Future

Distribution of Companies in Emerging Markets

\[ n = 61. \]

\[ \Delta = 27 \text{ pp}^5 \]

<table>
<thead>
<tr>
<th>Year</th>
<th>Currently in Emerging Markets</th>
<th>Expecting to Be in Emerging Markets</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>2015</td>
<td>57%</td>
<td>57%</td>
</tr>
</tbody>
</table>

\[ ^5 \text{ pp = percentage points.} \]

Source: CEB, Research & Technology Executive Council.
Many firms struggle to move challenging work to their emerging market centers fast enough, which is leading to disengaged local innovation staff and lower productivity at a time when it can be afforded least. One of the biggest barriers to innovation and new product development is the lack of effective collaboration between central innovation teams and their colleagues in the new innovation hubs. To be successful, companies need to more effectively encourage collaboration—from sharing knowledge up front to jointly bringing new products to the market. CEB research with more than 75 companies and their innovation staff indicates that making these hubs successful (and by extension, improving the success rate of innovation efforts globally) requires something that cannot be bought or installed—cross-team trust.

Unfortunately, central innovation teams and their counterparts in the new regional innovation hubs simply do not trust each other and have not established the working relationships that allow shared ownership of ideas and the innovation process. Increasing trust is a critical prerequisite for team collaboration and is the primary driver of R&D vitality,6 delivering almost three times the increase in new product sales than capability building alone.

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6 The three-year Vitality Index for emerging market R&D centers measures the percentage of current year global sales attributable to new products originating in emerging market R&D centers.
Trust Matters More Than Common Approaches to Capability Building
Maximum Impact of Capability-Building Approaches Versus Trust on Emerging Market Vitality

Based on Regression Analysis, Dependent Variable = Vitality Index of New Products from Emerging Markets, n = 73.

Mutual trust enables key innovation through the willingness to exchange ideas, take risks, and learn from failure.

Common approaches to building capabilities do not significantly drive vitality.

- Increased R&D Spending: 1%
- Building New Open Innovation Network: 5%
- Innovation Skills Building: 7%
- Improved Market Insight Capabilities: 10%
- Mutual Trust Across Global R&D Network: 22%

Note: Analysis controls for the number of years a company has been in emerging markets, industry, innovation strategy (e.g., if a company is a lead innovator or fast follower), and the global R&D organizational structure.

Source: CEB, Research & Technology Executive Council.
While building trust seems straightforward, it is not easy. Overcoming this misalignment requires more than investment and skill development; innovation leaders and senior executives must take concrete steps to increase their profile, engage their staff, communicate clearly and credibly, and ensure that work processes require collaboration. Particularly, senior executives should minimize under-communication and miscommunication, which can result in negative assumptions and behaviors on the part of regional innovation staff. To regain mutual, cross-team trust and enable effective collaboration within the innovation process, executives need to realign their dispersed staff on the three elements of trust: *intent, vision,* and *execution.*

**Mutual Trust Requires Intent, Vision, and Execution**

Three Key Elements of Building Trust Across Dispersed Teams

![Diagram showing the intersection of intent, vision, and execution](source: CEB, Research & Technology Executive Council.)
Intent: Surface Unarticulated Global R&D Staff Perspectives—Global staff must feel they are equals in the organization and see sincerity in the communication and actions of company leaders. Executives must surface and counter trust-eroding behaviors, such as lack of openness to contrarian ideas and lack of transparency in corporate planning and decision making.

Vision: Demonstrate the Credibility of Plans—Regional teams should hear in-market plans from a trusted local source. Companies should quickly establish local leadership, despite short-term pressures that favor the use of expats. For example, the best companies deliberately limit expat tenures while also using expats to ensure new local leaders are equipped for success.

Execution: Show Willingness to Share High-Value Work and IP—Generating more significant innovation from global teams requires executives to speed the migration of high-value work and IP to these centers. The best companies ease fear of sharing too much too fast by showing the opportunity cost of slow project migration and building objective criteria to assess the risks of sharing IP.
In an environment where three out of four executives think their firms lack breakthrough ideas, the need to generate transformative innovation has never been greater. Unfortunately, this push to innovate in new markets and for new customers will be far from easy. Innovation teams have been reorganized, delayered, downsized, and (increasingly) dispersed, weakening the underlying structure of many companies’ innovation efforts. Business leaders can accelerate innovation globally by repairing vital internal networks, increasing idea quality, and reestablishing the cross-team trust necessary to fuel collaboration.
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