

# The Innovation Imperative

## How Leaders Can Build an Innovation Engine

Companies today face a harsh ultimatum: Innovate or die. Senior executives tell us repeatedly that failing to innovate would create a critical risk to their enterprise's growth, even its survival.

*by Carole France, Christina Mott  
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The greatest challenge in this area is “leaders creating a climate for innovation,” according to a recent survey of almost 300 senior executives worldwide in 17 industries and interviews conducted by the Economist Intelligence Unit on behalf of Oliver Wyman (see exhibit 1). This was followed closely by the related challenges of “creating an organizational structure that facilitates innovation” and “focusing innovation in the right places.”

This article aims to help executives set their priorities in building an innovation engine. What's most useful is not a generic framework, but rather a close focus on three areas: leadership, values and culture, and organizational structures.

## Exhibit 1 “What is the greatest challenge to delivering business results?”



Source: Oliver Wyman/Economist Intelligence Unit survey.

### What is innovation and who owns it?

Innovation involves the introduction of something new, particularly something radically different. The “something new” could be products and services, business processes, product/service delivery, business designs, or new ways of managing.

Sophisticated companies distinguish among different types of innovation. One financial services company defines innovation as “a viable new business concept” and distinguishes between “incremental” improvements to existing business lines, which can be implemented with limited risk, and “transformative” innovation, which results in path-breaking products or services. Other companies focus innovation efforts on business processes to cut costs or deliver a superior customer experience.

Executives generally agree that innovation should be everyone's responsibility, but that employees can't innovate unless their leaders empower them to do so in an environment that values and rewards their contributions. Developing leaders who can create that kind of climate is seen as a key challenge, but there are many ways to allocate accountability. Whether a company creates a center of innovation expertise in corporate headquarters or diversifies ownership of innovation across business units depends both on the company's market focus and on its organizational structure.

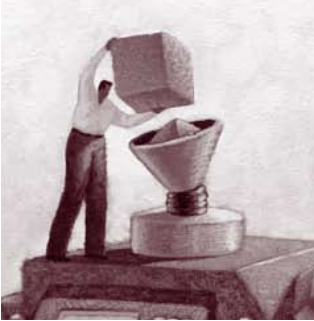
### **Corporate innovation models**

Our 2007 survey found that executives recognize the need for enterprise-wide approaches to innovation. More than 70% said that their companies either had a well-established innovation strategy or were developing an approach, and about three-quarters said that developing an innovation strategy is important or critical.

Such enterprise-wide approaches to innovation are better described as models rather than strategies. Many executives describe these efforts in terms of broad multifaceted approaches stratified across the organization.

Yet many companies that view sustained innovation as essential lack an innovation strategy per se because innovation is ingrained in their fundamental values. Creative ideas are expected. As Annmarie Neal, vice president of talent management and development at Cisco, says, "Innovation is in the DNA of the company and is core to everything that we do. There's almost this entrepreneurial or creative expectation that everyone is innovating in their space."

David Greenberg, senior vice president of human resources for L'Oréal USA, described innovation at his company as more of a “social model” than a strategy, where creativity and innovation emerge from the many interactions that happen on a daily and informal basis among employees.



Other firms have launched concerted initiatives to enhance innovation. Some have revamped underlying systems to gain better control over their established innovation capacity. When Sara Lee underwent an abrupt transformation from a diversified holding company to an integrated operating company in 2005, it implemented a new strategy to leverage the value of its broad spectrum of brands by focusing on products and listening to customers.

As important as a strategy or model is, then, the executives interviewed emphasized that the real challenges lie in filtering ideas, developing the best ones into economic models, and then executing them.

### **Building an innovation engine**

Successful innovators share traits in three critical areas:

- **Leadership.** Successful innovators have leaders who establish a climate for innovation. They create a compelling vision for their people, become champions for innovation, challenge the status quo, and explore unconventional ways of solving big problems.
- **Values and culture.** Successful innovators say they believe innovation is a business priority, that employees are expected to develop new ideas or create new ways of doing things, that they recognize and reward employees for innovation, and that they are open to ideas from external sources, especially customers.

- **Organizational structures and processes.** Successful innovators report that their organizational structures facilitate cross-functional or cross-business collaboration, that they include diverse networks of external organizations that share ideas, and that their companies are skilled in collaborating and managing external partnerships.

Let's examine each trait in more detail.

### **Leadership: Creating a climate for innovation**

Leadership competencies for creating a climate for innovation focus more on how to instill values than on traditional management skills. Survey respondents believe their leaders possess broad competencies for leading innovation in this sense. Almost half said establishing a compelling vision for their people and creating a climate open to new ideas and change are most important.

Successfully leading large and complex organizations requires whole leaders – those who use their heads, demonstrate heart, and act with guts. The appropriate balance among the three types of competencies is situational: When data is plentiful and reliable, the head dominates, but when decisions must be made with little or no data, guts and heart become more important. So it takes whole leaders with all three types of competencies to drive sustained innovation in a constantly changing environment.

In this regard, executives surveyed say the most important competencies are these:

- Head – establishing clarity of purpose. Leaders need to make a personal commitment to innovation,



communicate what it means inside the company, and lead by example, emphasizing innovation in their day-to-day decisions.

- Heart – cultivating an open and supportive environment. Leaders must have the ability to build trust and mutual respect with employees, foster open airing of problems and disagreements, and solve conflict in creative ways.
- Guts – facilitating idea generation. Leaders should challenge people to consider alternative approaches and give them time and resources to pursue innovative ideas.

Almost every interviewee at highly innovative companies agreed that there is not just a need but a responsibility to hear every idea, however contrary to others. They have widely differing views about how creative disagreement can be harnessed as a positive force, but almost none of them describe this process as “conflict management,” since disagreements are expected, and even valued, as long as all players keep their eyes on the company’s strategic objectives.

### **Values and culture: Instilling the right principles**

Changes to the corporate culture may be necessary to improve a company’s innovation capacity. A culture that encourages innovation includes values of risk taking, challenging the status quo, and freedom of expression.

Employees should be expected to generate ideas for improving all aspects of the business and believe that their ideas are welcome and valued. When companies achieve this state, they can establish the critical mass necessary to sustain a process of continuous innovation.

Senior executives of innovative companies say building capacity for innovation involves refocusing existing leadership competencies toward innovation rather than developing new skills. This process puts more emphasis on values than on capabilities. Nonetheless, existing leadership-development systems can be ideal tools for instilling cultural values while building related competencies. Participation of the CEO or other senior executives in leadership-development events is the most effective vehicle for instilling cultural values, according to several of those interviewed.

Communicating the innovation process is also critical to instilling corporate values. Specifically, executives interviewed pointed to three key communication needs: instilling corporate values that encourage innovation across the organization; focusing idea generation in areas where the company is most likely to act; and maintaining the transparency of the idea pipeline and providing systematic feedback so the originators of ideas not acted on don't disengage.

### **Organizational structures and processes:**

#### **Aligning crucial systems**

A bountiful flow of creative ideas is worthless without business processes to assess them, put them into action, and motivate risk taking and other behaviors that drive execution. Corporate systems and processes that facilitate cross-functional or cross-business collaboration as well as partnerships with external organizations also play an important role.

Companies with well-established strategies report substantially more success in implementing these types of corporate systems. Moreover, respondents from

## Exhibit 2 Corporate structures and systems



Source: Oliver Wyman/Economist Intelligence Unit survey.

those companies are much less likely to say that their bureaucracy slows down decision making and hinders innovation (see exhibit 2).

Many executives agree that the biggest challenge in improving corporate systems is developing a pipeline of ideas that can be evaluated systematically and filtered for execution priority. Companies that have established innovation as part of their daily business activities describe the components of a fully developed idea pipeline as follows:

- An innovation portal on the corporate intranet or some other forum for sharing, testing, and developing new ideas, with participation from external partners.

- Cross-functional focus groups or product groups to assess new ideas according to established criteria, classify them, and build prospective economic models.
- Links between product/service development and marketing/sales teams to expose new proposals to market realities.
- A senior-level board to systematically allocate investment among the best ideas.

McDonald's enjoys the advantage of an owner-operator community that provides a filter whereby ideas are evaluated by the entrepreneurs who must put up their own money to launch new products. Adam Kriger, senior vice president of corporate strategy, says that this is a powerful way to prioritize all the products, systems, and services in the pipeline.

Other executives say that a company can reduce the need to choose among strong concepts if it can increase its capacity for execution. Developing leaders capable of executing new ideas, however, is broadly recognized as an obstacle by respondents of the survey.

Innovative companies agree that transparency along the pipeline is essential, because seeing the process work is a big part of what motivates people to think creatively – whether or not their ideas are implemented.

Firms that succeed in taking innovations successfully to market have developed a system that assesses leaders not only according to what was accomplished, but also by how it was accomplished. Performance-management systems,

therefore, provide essential crosswalks between values, behaviors, and performance.

Such systems typically need to be updated when a company elevates innovation to a top priority; for instance, short-term business results may suffer, and a certain amount of failure is guaranteed. This means that performance-management systems must assess whether business challenges are being addressed in line with the company's values, regardless of the short-term outcome.



Luxottica has integrated innovation into performance management. “We focus our leadership competencies around a profile described in the book *The Leadership Challenge*,” says Mildred Curtis, senior vice president of human resources. One practice that executives are expected to follow under their performance assessment system is called “challenge the process,” which Curtis says is really about innovation.

“Our performance management tools tie back to those practices, so this is one element that our leaders are evaluated on,” she says. “It’s partly individual competencies, but we also believe that it has to be a mindset within the organization. We want the leadership at the highest level, as well as the doers, movers, and shakers of our world, thinking about ‘Within my realm, how can I do things differently?’ ‘What is the customer asking for?’ ‘Can I do something that more effectively addresses their needs?’ ‘Can I exceed their expectations?’ So we see it as being integral to the culture as much as individual competencies.”

### **Implications for enterprise leaders**

Failing to innovate can put global organizations at risk and diminish their ability to sustain or gain a competitive advantage. This challenge can be met if companies realize

that their ability to innovate is inextricably linked to their leaders, culture, and organizational design.

Some challenges can be managed largely by building leadership bench strength, but sustained innovation depends on developing whole leaders who can create the right climate. Inculcating certain values – such as risk taking, challenging the status quo, and freedom of expression – into the corporate culture is also key. Leaders must also take responsibility for designing and building the right organizational structure and processes to support the development and implementation of ideas that create value – the essence of effective innovation.



While the conditions that promote innovation must be supported by leaders across the company, the innovation process must start at the highest levels. Enterprise leaders must think about the three key drivers – leadership, culture, and organizational structure and processes – in an integrated and mutually reinforcing way. Only then can senior leadership build an adaptive and sustainable organization that is truly an innovation engine.

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