Making Innovation Pay

By James P. Andrew and Harold L. Sirkin

After years of focusing intensely on cost, quality, and productivity, companies seem to have rediscovered growth. In every industry, senior executives are turning to their organizations and asking for new "organic" sources of revenue. They want more innovation, and they want results—now. The problem is that innovation is an act, not an idea. Too many people believe that an insight will carry the day. Rarely are they right. Successful innovation—which is to say, *profitable* innovation—depends on the entire set of actions required to turn an idea into cash returns: the *innovation-to-cash* (ITC) process. This process cuts across organizational boundaries and presents many difficult choices. It must be managed explicitly and thoughtfully.

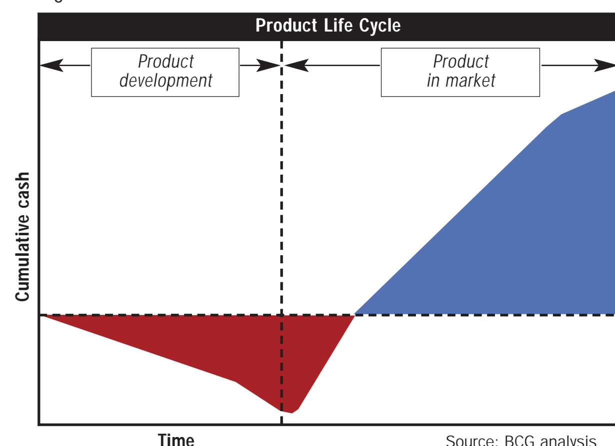
Let's be clear, though. The managerial challenge isn't to "integrate" all the separate steps and functional decisions of the ITC process. Rather, it is to have the rigor and discipline to evaluate and manage the inherent trade-offs—consistently and across a whole portfolio of different innovation efforts. This takes real collaboration and problem solving, not just better handoffs between functions.

Managing the "Cash Curve"

Despite the many uncertainties of innovation, it is possible to assess at the outset the likely impact of different approaches to managing the full ITC process. This is 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 beginning of development until the point at which the product or service is removed from the market. (See Figure 1, "The Cash Curve.")

Management's decisions affect the shape of the cash curve and determine its dynamics. As a result, managers need to understand and openly discuss how, say, "pushing" the curve in one place horizontally or vertically is likely to move it someplace else and how other actions can enhance or dampen that movement. For instance, before a product gets to market, speeding up development compresses the length of time cash flows out before sales start to occur (in other words, you spend less time

Figure 1 **The Cash Curve**



below the breakeven line). Yet being fast may come at a cost—say, adding more engineers—which can make the depth of the required investment deeper and, therefore, require more sales to reach the point of cumulative positive cash generation.

Consider the example of a manufacturer trying to develop a product that is new to its market. Because it knows its customers well, has manufacturing plants around the world, and has solid design expertise, the company's first inclination is to go it alone. After all, why share the margins? Because the product is a breakthrough, however, plants would need to be retooled, and employees would need to acquire some new critical R&D skills. Moreover, marketing and launch expenditures would be higher than normal. In addition, new technology in the product and customers' lack of familiarity with its application would add time to development and slow market penetration. When all this is considered, the cash curve our company creates for its breakthrough may not look so good after all.

Integrator, Orchestrator, Licensor

Yet there are other ways to bring the innovation to market that have different effects on the curve. For instance, could risks be shared and market penetration accelerated by "orchestrating" the process? This could mean acquiring some of the required technologies rather than developing them in-house and focusing instead on design and marketing. Or it could mean turning to other organizations to handle the manufacturing or supply chain activities. Indeed, there are three basic ITC approaches to consider: the Integrator, in which the company handles almost all activities in-house (think Nokia); the Orchestrator, in which the company relies on partners to perform key activities (Dell); and the Licensor, in which the company essentially sells its innovation to others (Qualcomm).

Each approach has different strengths, weaknesses, and requirements, which means that each is better or worse suited for different innovations, situations, and companies. By carefully modeling the effect of different choices on the cash curve of an innovation, managers have insight into the relative impact of key drivers of value. This approach also provides a mechanism for raising important questions about risks. For instance, would our manufacturing company's culture actually allow it to be a successful Orchestrator rather than the classic Integrator? In addition, the curve offers managers a basis for discussing possible interventions to reduce the risk of failure. For example, could project management enhance coordination with new suppliers? Does the company need to beef up management of its intellectual property? Could promotions enhance positive "word of mouth" reviews in the marketplace and accelerate sales? Too often, these questions are never asked, let alone answered.

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The bottom line is that financial analysis of innovations, which is fairly common, combined with a dynamic view of the cash curve, which is rare, blends strategy and execution. It can make the difference between developing another inconsequential product or service and winning big—because it gives the top management team a language for and an appreciation of interrelated financial, market, and technology risks. In the end, executives have common ground to make better trade-offs and break compromises.

Not Just One Curve, But Many

Of course, it isn't a matter of managing just one cash curve. To grow consistently, companies need a much more steady series of hits, both big and small. This means coming to grips with a full portfolio of innovations, aligning investments explicitly with the overall strategy, and ensuring that someone is actually accountable for the performance of the entire process.

Revitalizing the Portfolio. To get more from innovation spending throughout a company, management must handle an entire portfolio of cash curves successfully. It must decide on the right balance of spending across a range of initiatives: maintenance projects (in essence, keeping market share), incremental projects (gaining share), and breakthrough projects (entering completely new markets). Which mix is right, given the competitive environment? Where do you want to be? Where do you need to be? What will get you there? Then, how do you align your resources and, more important, your people with these different priori-

ties? No one can do it all.

Linking Innovation with Strategy. Decisions about innovation shape a company's future. Like any major investment, innovation needs to be focused on clearly defined objectives. This requires a view on where innovation is possible and to what degree. It means understanding whether the ideas can be developed within a company or whether the company must look outside. It means selecting an appropriate strategic approach, such as fast follower or first to market, because each may be right in different situations, depending on the objective. And it means understanding how different investments in different types of innovation—breakthrough vs. incremental vs. maintenance—match up with the overall strategy.

Ensuring Accountability. In many companies, no one "owns" innovation; instead, it is the responsibility of many. Too often, this means that no one is actually accountable for the "cash" part of innovation. ITC must be subjected to the same culture of accountability and measurement that governs other processes. Accountability for results, authority to make things happen, and a clear view of current performance are critical if a company is serious about generating more cash.

It's impossible, however, to manage something that can't be measured. Key innovation inputs, such as time, people, and financial resources, need to be tracked carefully by project and product. In addition, measuring the performance of the process itself (for instance, the time to market relative to certain benchmarks) is essential. Finally, critical output metrics, such as new-service or new-product cash generation, market share in new segments, and true new markets entered, provide essential information as to ultimate success. Companies need to measure the performance of their ITC process if they want anyone to manage it and be accountable for it.

Ideas Aren't Enough

None of this is to say that ideas and creativity don't matter. They do. But ideas aren't enough. Companies need to decide whether they want to be just innovative or whether they want to be truly innovative enterprises. After all, there is a world of difference: The former produces lots of great ideas but often has little to show for them. In contrast, innovative enterprises use their ideas to produce competitive advantage, superior shareholder returns, and, above all, cash. There are precious few of these companies, and they stand apart from the pack. They manage the innovation-to-cash process aggressively and well. They grow. And, most of all, they make innovation pay. ■

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