

Mark L. Frigo, Editor

# Customer Connection: The Innovation 1000

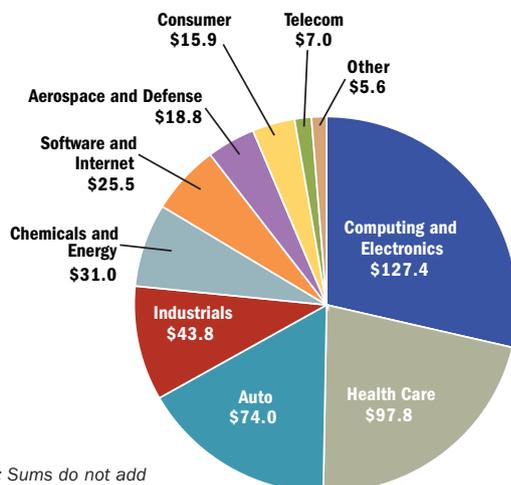
BY BARRY JARUZELSKI & KEVIN DEHOFF

From the U.S. to India and from Europe to the Far East, companies all over the world are turning to innovation in hopes of boosting corporate growth. Spurred on by management gurus lauding the virtues of innovation and offering the secret to success, companies continue to spend significant portions of their overall revenues on research and development efforts in hopes of finding the magic link between innovation and performance.

This year, according to the Innovation 1000, Booz Allen Hamilton's annual study of the link between R&D spending and financial performance, the 1,000 global public corporations with the greatest R&D spending in 2006 spent a total of \$447 billion on R&D. That's a 10% increase over 2005's \$407 billion and a rate of growth double that of the annual rate in the previous four years. Those same companies took in

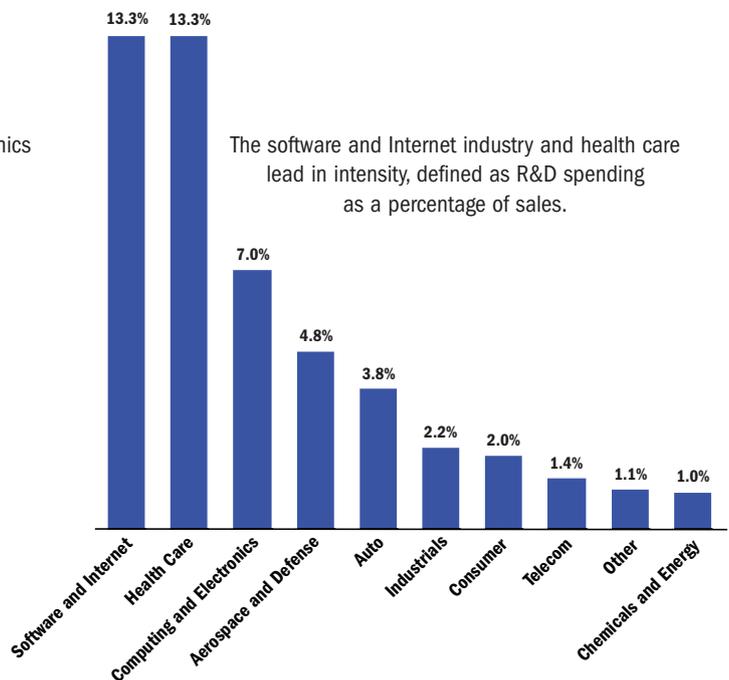
**Figure 1: Innovation Spending Intensity by Industry**

The two highest-spending industries were computing and electronics and health care.



Note: Sums do not add up to the total due to rounding.

The software and Internet industry and health care lead in intensity, defined as R&D spending as a percentage of sales.



Source: Bloomberg data (2007); Booz Allen Hamilton analysis

revenues of \$11.8 trillion, meaning that the average company spent 3.8% of revenues on R&D. (Figure 1 shows R&D spending by industry sector and as a percentage of sales.)

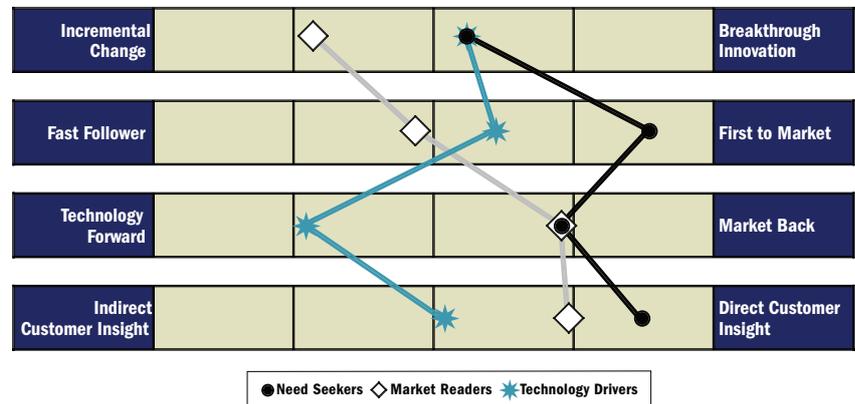
Yet after three years of examining this issue, we have yet to find a statistically significant relationship between R&D spending levels and overall corporate results. This year, however, through surveys and interviews, we isolated two innovation practices that can indeed have a meaningful impact on financial performance. First, over the past three years, companies that said their innovation strategies are tightly aligned with their corporate strategy boasted 40% higher growth in operating income and 100% higher total shareholder returns than those whose innovation strategies are least aligned. Second, companies that directly engaged their customer base at every stage of the innovation process produced twice the return on assets and triple the growth in operating income of the other survey respondents.

The lessons of these results are straightforward: Every company, no matter its size or industry sector, must look closely at its innovation strategy to make sure it is tied directly to overall strategy and that it has built-in, formal processes for getting customers involved at every step of the way from product conception to manufacturing and marketing. Executives at many of the companies we've identified as High-Leverage Innovators—companies that outperform their peers financially while spending less on R&D—consistently point to both of these as factors in their success.

### Which Strategy Is Best?

Is there a particular innovation strat-

**Figure 2: Profile of Three Innovation Strategies**



Companies fell into three consistent categories—Need Seekers, Market Readers, and Technology Drivers—based on the different ways they identified their innovation strategies across these four critical dimensions.

Source: Booz Allen Hamilton

egy companies should pursue in search of better overall financial performance? The answer to that question, it turns out, is “no.” Further analysis of the responses from the executives we surveyed shows that their companies’ innovation strategies break down into three distinct types, none of which outshone the others in terms of long-term financial results, on average:

**Need Seekers** actively engage current and potential customers to shape new products, services, and processes; they strive to be first to market with those products.

**Market Readers** track their markets carefully while focusing largely on creating value through incremental change and well-timed product introductions.

**Technology Drivers** follow the direction suggested by their technological capabilities, deploying their investment in R&D to drive both breakthrough innovation and incremental change.

Figure 2 shows the results of the survey in short form. Need Seekers, for instance, were much more likely to encourage direct customer insight than were Technology Drivers.

Since no one of these three strategies performed consistently better overall than any other, a company can be large or small, first to market or not, high-tech or low—and still be a successful innovator. What matters is choosing an innovation strategy that matches the corporate strategy, building the capabilities that best fit the needs of the chosen innovation strategy, executing that strategy successfully, and getting customers involved no matter what strategy you decide on. Figure 3 lays out the specific capabilities required at each stage of the innovation value chain for each of the three strategic categories.

### Staying Close to the Customer

Thanks to its ability to execute at both levels—strategic alignment and customer involvement—Plantronics Corp., a maker of headsets and other audio equipment with \$800 million in sales, was identified as a High-Leverage Innovator both this year and last. Plantronics falls into the Market Readers strategic category: It watches its markets carefully when approaching the innovation process, preferring incremental product in-

**Figure 3: Essential Capabilities**

	Ideation	Project Selection	Product Development	Commercialization
<b>NEED SEEKERS</b>	Identify unmet customer needs through direct feedback and strive to be the first to market with breakthrough products. Example: DeWalt (power tools)	◆ Gather customer insights and analyze customer needs ◆ Segment customer base	◆ Rigorously manage return on innovation investment	◆ Design products that respond to customers' priorities ◆ Successfully launch, position, and price wholly new products
<b>MARKET READERS</b>	Focus on incremental changes to products and use a second-mover strategy to keep risk low. Example: Plantronics (audio equipment)	◆ Conduct market research ◆ Gather competitive intelligence	◆ Maintain strong process discipline	◆ Bring products quickly to market with an emphasis on increased modularity and simplicity ◆ Carefully manage product life cycle and retirement
<b>TECHNOLOGY DRIVERS</b>	Rely on technological breakthroughs from internal R&D efforts and seek to meet their customers' unarticulated needs. Example: Siemens (engineering and electronics)	◆ Scout new technologies ◆ Map emerging technologies and analyze trends	◆ Manage risks	◆ Test rigorously for quality ◆ Capture customer feedback

For each of the innovation strategy categories, success depends on a different set of ingrained capabilities at every stage of the innovation value chain.

Source: Booz Allen Hamilton

novation and bringing those incremental product innovations into the market as the second mover.

Plantronics makes headsets for both the commercial market—headsets for operators, workers in call centers, and the like—and the consumer market. The challenge, says Barry Margerum, Plantronics's vice president of strategy and business development, comes in having to time the company's innovation efforts for both markets. Consumer tastes change more rapidly than commercial requirements, and the technology on both sides is changing much more rapidly than it used to, given the rise of such technologies as Bluetooth, Wi-Fi, and Voice over IP. That makes it incumbent on Plantronics to stay as close as possible to both markets.

"We are data rich in customer insights, whether about the mobile professional or the office worker," Margerum explains. "We do demographic research to determine which customers we want to focus on. Then we perform various types of market research to understand what

those customers want. This process provides the insights we need to develop the right products."

Staying close to the customer is critical to ensuring that Plantronics keeps its innovation efforts aligned with overall corporate strategy, which Margerum defines explicitly in financial terms as "sustainable long-term earnings-per-share growth." That strategic concern for numbers is reflected not only in customer data but also in the company's insistence on measurement as part of its innovation strategy. In addition to such metrics as revenue from new products, the company has begun to track market response against early sales forecasts. Says Margerum: "There are a number of strategic filters—potential return on investment, sales forecasts—we're going to use to grade each of our products under development, and that will help us line up in a rationalized way what products we should bring to market."

Using metrics to link its customers and markets tightly to innovation and corporate strategy has

worked well for Plantronics. That's a lesson every company looking to boost its return on innovation should learn. ■

For more information on the Booz Allen Global Innovation 1000 study, go to [www.boozallen.com/2007Innovation1000](http://www.boozallen.com/2007Innovation1000).

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**EDITOR'S NOTE**

The Innovation 1000 provides insight into how companies can better align innovation strategy with customer needs. Previously in this section we have discussed how high-performance companies in the Return Driven Strategy research study ([www.returndriven.com](http://www.returndriven.com)) have engaged customers and focused innovation strategy to develop and deliver offerings that fulfill otherwise unmet customer needs that drive sustainable superior growth and returns.—Mark L. Frigo, Ph.D., CMA, CPA, *The Center for Strategy, Execution, and Valuation, Kellstadt Graduate School of Business, DePaul University.*