strategy+business

ONLINE MAY 23, 2011

The Three Paths to Open Innovation

To build your capabilities and cast a wider net for ideas, you must figure out which of the three types of innovation strategies you already have—and design your R&D approach accordingly.

BY BARRY JARUZELSKI AND RICHARD HOLMAN

This article was originally published by Booz & Company.

The Three Paths to Open Innovation

To build your capabilities and cast a wider net for ideas, you must figure out which of the three types of innovation strategies you already have — and design your R&D approach accordingly.

by Barry Jaruzelski and Richard Holman

Finding and developing good ideas is what corporate innovation strategy is all about. That's why the concept referred to as *open innovation* has dominated so many discussions about research and development during the past decade. The logic is unassailable: Every company and every line of business within a company can benefit from looking outside its organizational boundaries for innovative business ideas, for collaboration in developing those ideas, and for validation of those ideas in the real world of consumers. It is nearly impossible to be consistently smarter than the rest of the world; tapping into new sources of business ideas can be a powerful exercise for overcoming this challenge.

Moreover, the benefits of actively pursuing open innovation have been clearly demonstrated. Booz & Company's research shows that companies with robust open innovation capabilities — including strong technology-scouting practices and cross-boundary collaboration — are seven times as effective as firms with weak capabilities, and twice as effective as those with moderate capabilities, in generating returns on their overall R&D project investment portfolio. Some companies, most notably Procter & Gamble, have maintained leadership in their industries through renowned open innovation strategies, building links between inside groups and outsiders such as customers, inventors, academics, and even competitors.

But many companies have embraced open innovation only to conclude that it doesn't work for them. Often they take it on as a panacea for innovation ills. They then discover that putting processes in place to find, capture, and commercialize business ideas, and creating a corporate culture that promotes and protects collaboration, are not easy tasks. The problem is not the concept: Good ideas *can* be found outside the R&D lab, and this type of research and development strategy can be made to work. The primary problem is not even the "not invented here" form of innovation culture that is blamed for blocking outside ideas in many companies. In truth, many companies are willing to build an innovation culture that is open to the ideas of outsiders, but it isn't always obvious how to make the shift.

The basic problem is the isolation between open innovation and a company's current R&D strategy. Most companies already have a basic, ingrained approach to innovation, tied tightly not just to generating ideas (which is comparatively easy) but to developing and executing them (which is the hard, value-creating part of innovation). In short, if you are looking to build an open innovation practice, it will work only when you match your company's efforts to look outside with the capabilities you already have on the inside. To do that, you must recognize the kind of

Barry Jaruzelski
barry.jaruzelski@booz.com
is a partner with Booz & Company based in Florham Park, N.J., and is the global leader of the firm's innovation practice. He focuses on the high-technology and industrial sectors, and specializes in corporate and product strategy.

Richard Holman
richard.holman@booz.com
is a Booz & Company principal based in Florham Park, N.J., and a leader of the firm's innovation practice. He specializes in highly engineered product industries such as aerospace and high technology.

This article was adapted from "Casting a Wide Net: Building the Capabilities for Open Innovation," by Barry Jaruzelski and Richard Holman, *Ivey Business Journal,* March/April 2011.

R&D system you already have in place — and treat it as your strategic core.

A Trio of R&D Strategies

Every year, Booz & Company surveys data on R&D spending and performance for 1,000 publicly held companies around the world — those with the highest annual budgets. This study, the "Global Innovation 1000," has yielded a number of insights about the best way to design an innovation strategy. Among them is the recognition that successful companies tend to choose one of three distinct approaches. They become Need Seekers, Technology Drivers, or Market Readers, and that choice, in turn, determines how they can succeed.

• **A Need Seeker strategy** directly engages current and potential customers to better capture their unarticulated needs, shapes new products and services, and strives to make the company the first to market with those new offerings. An example is Stanley Black & Decker Inc.'s DeWalt division, a maker of power tools for professionals, which regularly sends members of its R&D group out to construction sites to research builders' needs, observe construction crews in action, and test new products with them.

• **A Technology Driver strategy** follows the direction suggested by the company's technological capabilities, leveraging its investment in research and development to drive both breakthrough innovation and incremental change, often seeking to solve customers' unarticulated needs with new technology. An example is the German technology giant Siemens AG, which spends 5 percent of its overall R&D budget on planning for the long term, and develops detailed technology road maps within individual business units.

• **A Market Reader strategy** monitors customers and competitors with equal care, but the company maintains a more cautious approach, focusing largely on creating value through incremental change and being a "fast follower" of proven concepts. An example is the Visteon Corporation, which conducts well-designed research into market trends before investing in new innovations — such as reconfigurable digital displays for cars — but is prepared to move with full force and rapid speed when it discovers demand.

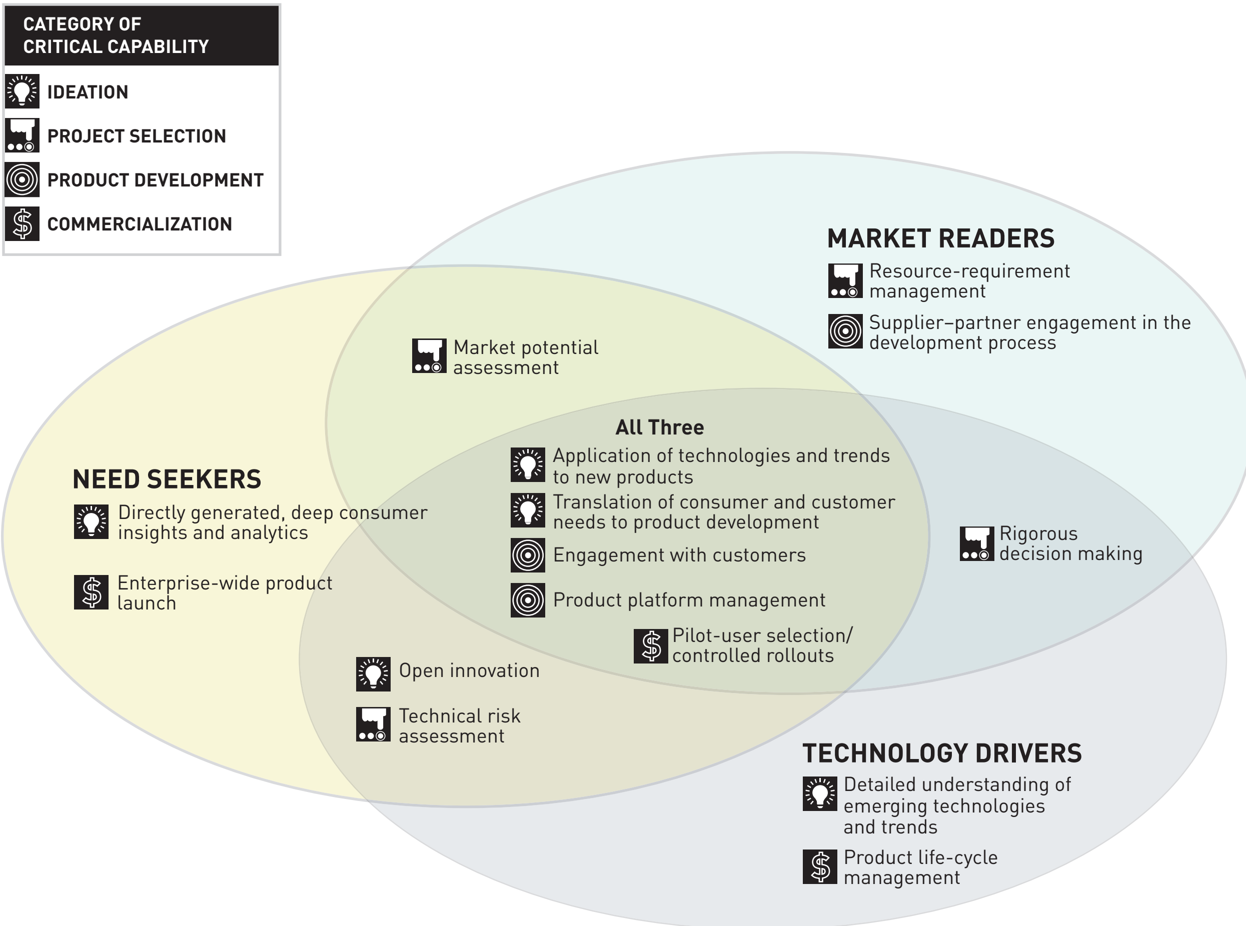
Research suggests that the three strategies deliver comparable financial success if tightly aligned with a company's overall business strategy. But it also demonstrates that each of these innovation models requires a distinct set of innovation capabilities to succeed. (See Exhibit 1, page 3.)

In light of these findings, companies that develop the appropriate innovation strategy must align it with their overall corporate goals and assemble a cohesive set of capabilities to gain a clear financial advantage. The key isn't to be good at everything, but rather to excel at what matters most to your success.

That's why open innovation is a critical capability only for Need Seekers and Technology Drivers. These companies rely on being early to market, with innovations rooted in either the latest technology or new customer insight. Need Seekers are continuously looking for ideas, often from customers, to drive incremental improvements in their products as well as to spur entirely new offerings. Technology Drivers depend heavily on developing new, often untested, technologies that can be converted into products. Their success depends not just on importing fresh ideas from a wide variety of

Exhibit 1: **Critical and Specific Capabilities by Strategy**

The top-performing companies, whether they were classified as Need Seekers, Market Readers, or Technology Drivers, share some critical innovation capabilities. But for each of the three strategies, a distinct set of capabilities — such as resource-requirement management and supplier–partner engagement for Market Readers — rank among the most critical.



Source: Booz & Company; adapted from "The Global Innovation 1000: How the Top Innovators Keep Winning," by Barry Jaruzelski and Kevin Dehoff, *s+b*, Winter 2010

sources, but also on ensuring that the products that they do go on to develop will ultimately succeed in the marketplace.

And Market Readers? These companies have built their strategy around a fast-follower model. They should focus on being strong in other capabilities, particularly in the stages of product development and commercialization.

Establishing Open Execution

Few companies have the wherewithal to develop enough new products and services to keep growing in an increasingly competitive business climate. One thing is certain: A scattershot approach to open innovation will not succeed. If you are seriously interested in open innovation, you will need to establish a systematic process for capturing the best ideas, whether from within or outside your company, and focus on the specific set of capabilities needed to capture, develop, and commercialize the good ideas that surface. Open innovation, like any key capability, can keep you one step ahead of the competition, but only if it is approached with rigor and seriousness of purpose.

Reaping the full benefits of open innovation is no easy task, especially for companies that have yet to venture into this often complex and tricky domain. We typically divide the effort into five activity areas, which are addressed concurrently: organization, external relationships, culture, processes and tools, and incentives.

• **Organization.** No open innovation effort will succeed without the involvement of a senior-level executive to champion the program. An innovation office with access to a dedicated innovation fund should be established under his or her auspices. The office's mission should be to seek out new ideas, and the office should put together two kinds of teams: some dedicated to developing and managing relationships with external partners; others, chosen from different business units, to organize cross-functional innovation processes.

• **External relationships.** The key to successful open innovation lies in establishing strong relationships with outside partners — whether they be universities, other companies, or even independent inventors and consumers — and developing systematic processes for surfacing and vetting ideas. Adequate intellectual property (IP) policies must be agreed on, policies that allow for the proper licensing of external ideas and make clear the conditions under which external partners can use that IP. But it is critical to ensure that such protections are not allowed to become legal handcuffs that restrict opportunities via an excessive aversion to risk.

• **Culture.** Promoting open innovation may present a set of internal challenges. Companies that struggle to innovate, especially Technology Drivers, tend to lack a truly collaborative cross-functional environment. Success depends on fostering a culture that expects and rewards the free exchange of ideas across divisions and geographies, making it easy to disseminate ideas and gain access to ideas from other groups. You can't do this by fiat; a decree that "from now on, we will be open to new ideas and experimentation" will be ignored. To build a collaborative culture and move away from the not-invented-here syndrome, start by changing behaviors; attitudes will follow. Companies that do this well have typically established a team for designing new practices. For example, the team might design and establish an active internal venture capital investment scheme, to review ideas quickly and then move right away to vetting and acting upon them if they are worthwhile. This in itself will give innovators better reasons to share their ideas.

• **Processes and tools.** Companies that make the most of open innovation are highly disciplined in their own use of technology, and in their process innovation. They communicate frequently and use consistent processes, backed up with simple, flexible IT tools, to track new ideas, select the best ideas, manage the development stage, and link R&D with other functions such as marketing and manufacturing. Some companies are turning to social media tools to promote internal and external collaboration.

• **Incentives.** Once discovered, good ideas need to be captured effectively. Creating solutions that benefit both you and your partners is critical to successfully developing external ideas. Internal budgets for divisions and functions should be tied in part to those areas' innovation efforts, as should individual incentives. This will require a process for developing and tracking key innovation metrics.

Each of the three types of companies has its own approach to these activities, and gains leverage from them in a different way. For example, Need Seekers may convene cross-functional groups that can integrate their separate ideas into common innovation practices. That might not work so well for Technology Drivers, which are typically working with highly specialized and intensive R&D practices, and which may need intensive ways to train their marketing teams and bring them on board (and which may have outsourced manufacturing altogether). Although the details will vary, the basic message is clear: Companies have an enormous amount to gain from open innovation. They will, however, realize those gains only if they think of this new approach as an innate part of their distinctive R&D skill — a capability that, in the end, gives them a distinctive edge. +

strategy+business magazine
is published by PwC Strategy& Inc.
To subscribe, visit strategy-business.com
or call 1-855-869-4862.

For more information about Strategy&,
visit www.strategyand.pwc.com

- strategy-business.com
- facebook.com/strategybusiness
- http://twitter.com/stratandbiz

101 Park Ave., 18th Floor, New York, NY 10178

pwc | strategy&
Formerly Booz & Company