How companies approach innovation: A McKinsey Global Survey

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Not surprisingly, executives say innovation is a top priority for driving growth, according to a McKinsey Global Survey. But respondents point out flaws in how their companies manage and govern innovation. Most companies don't focus on innovations they say will have the greatest effect on performance, for example, and innovation is seldom part of leadership agendas.

Top managers and other executives agree that successful innovation depends on having the right people but disagree when identifying the company's current talent problems.

Executives do agree on a few steps that will help, starting with a different approach by corporate leaders.

In a follow-up online discussion, executives at companies that make innovation a priority say they focus on breakthrough innovation and that innovation counts only if it meets customer needs. Although the goals are clear, executives say they employ a startling range of approaches and practices.

How companies approach innovation: **A McKinsey Global Survey**

Executives say innovation is very important, but their companies' approach to it is often informal, and leaders lack confidence in their innovation decisions. Top managers and other professionals agree that the biggest challenge is talent but disagree on why. Nonetheless, executives agree on some steps to improve innovation.

Executives now firmly believe that innovation is central to a company's strategy and performance, but getting it right is as hard as ever, according to a recent McKinsey Global Survey.[1] Some 70 percent of corporate leaders say innovation is among their top three priorities for driving growth.

But the way companies manage and govern innovation doesn't reflect that importance. For instance, although executives say corporate performance is most likely to be affected by breakthrough innovations, they also say their companies generally focus on innovation in areas such as product or service development. Only 36 percent of top managers—and just over a quarter of other executives—say innovation is part of everything the organization does. Further, although more than a third of top managers (those at the senior vice president level and above) say innovation is part of the leadership team's agenda, an equal number say their companies govern innovation in an ad hoc way.

Top managers and other executives agree that the most important drivers of innovation are culture and people—and that companies face significant challenges with both—yet the two groups have different views of those challenges. Areas of disagreement include whether the company has the right people to innovate and particularly whether top managers adequately protect these people. Similarly, 38 percent of top managers say their organizations encourage learning from innovations that fail, a view shared by less than a quarter of other executives.

Both groups agree on a few organizational and cultural steps that would improve the innovation performance of their companies. The most widely shared idea is making innovation a core part of the leadership's agenda, followed by modeling the right behavior and improving processes for managing innovation risk.

During an online discussion convened to learn more about how innovation is managed at companies that make it a high priority, executives bring to life why innovation has become increasingly central to companies in diverse industries. One participant explains, "*Quality and customer service are no longer differentiators, but rather prerequisites. Innovation is the best strategic decision for sustainable competitive advantage.*" Discussion participants explain that progress of any kind related to innovation is not good enough: their companies focus on breakthrough innovations that meet customer needs and can be commercialized.

[1] *The McKinsey Quarterly* conducted the survey in September 2007 and received responses from 722 executives at the level of senior vice president and above and 736 lower-level executives from around the world and representing a broad range of industries. The data are weighted to reflect a proportional representation of segments in the total population.

Important but not governed

Executives certainly see innovation as an important driver of growth, with some 70 percent of top managers saying it is one of their highest priorities. In addition, more than three-quarters of survey respondents say the huge amount of media attention to innovation has, at the least, raised their companies' awareness of the importance of innovation. Nineteen percent say the attention has caused them to make innovation the main focus.

That importance is borne out in some of the decisions made by top managers. A majority, for instance, say they routinely decide where to focus innovation efforts, where and how to commercialize, or who works on innovation (Exhibit 1). But top managers don't seem to think they have a lot of control over the innovation process as a whole. For instance, less than a quarter of respondents indicate that innovation budgets or targets are decided at the top. Further, many top managers lack a structured approach to making innovation decisions: though 40 percent say they rely on a solid fact base, almost as many, 37 percent, say they depend on a consensus of their peers; only 21 percent rely on intuition.

Exhibit 1

A top-to-bottom approach to innovation

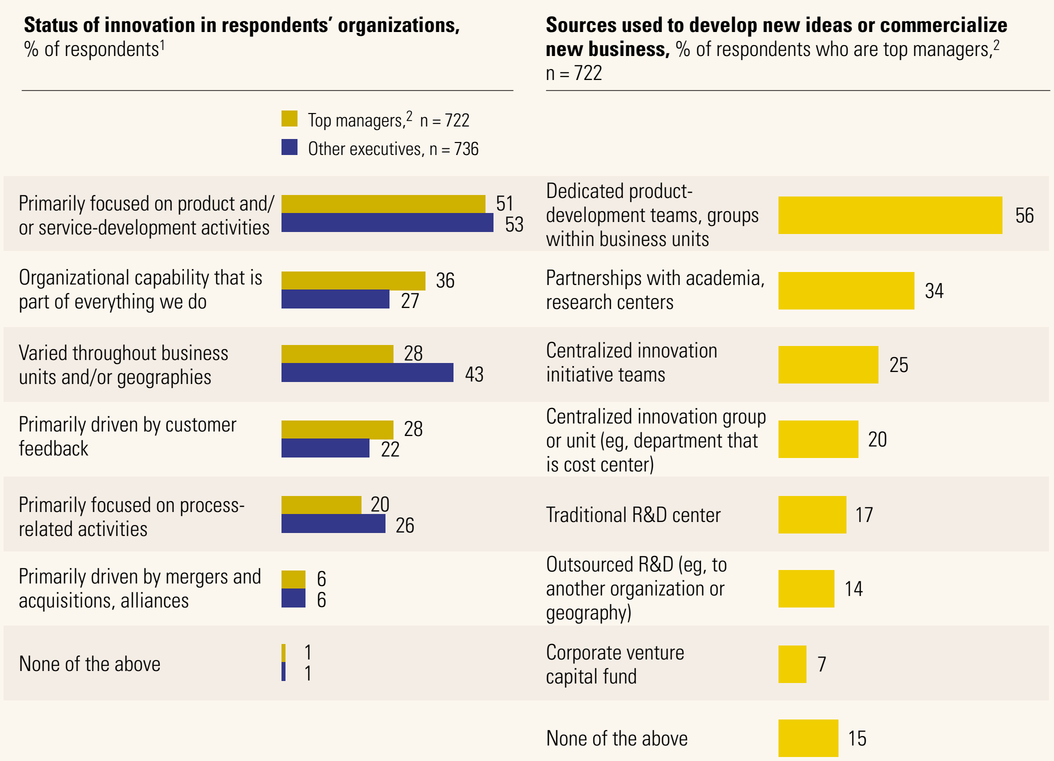
[1]Executives at senior vice president level and above; respondents could select multiple answers; respondents who answered "other" or "don't know" are not shown.

Source: 2007 McKinsey survey on innovation

In addition, companies often seem to isolate innovation projects within business units, even when they see bigger opportunities. When asked where change would produce the greatest improvement in performance, for example, top managers rank product and service innovations much lower than breakthrough ideas. Yet a majority also say innovation at their organizations is primarily focused on developing products or services and that dedicated teams within business units are the most common way they develop and commercialize new ideas (Exhibit 2). Less than half of top managers say they frequently define themes for breakthrough innovations.

Exhibit 2

Developing new ideas



[1]Respondents could select multiple answers; those who answered "other" are not shown.
[2]Executives at senior vice president level and above.

Source: 2007 McKinsey survey on innovation

Similarly, top managers indicate that they are isolated from the innovators within their companies. Most often, top managers get their new ideas from informal, external sources (such as discussions with peers and interactions with consumers), not from the business units or formal teams where innovation tends to occur (Exhibit 3).

Exhibit 3

Where to find the next new idea?

% of respondents who are top managers,[1] n = 722

Sources of new ideas according to organization's leadership

[1]Executives at senior vice president level and above; respondents could select multiple answers; respondents who answered "other" or "don't know" are not shown.

Source: 2007 McKinsey survey on innovation

Finally, most organizations seem to lack consistent central governance that could track the work of the business units on innovation. Only 34 percent of top managers, for example, say innovation is part of their leadership team's regular agenda—and only 22 percent of other executives perceive that to be so (Exhibit 4). Further, only 27 percent of top managers say that their processes for budgeting, strategy, and growth, including innovation, are fully integrated into their annual planning process, although nearly half say there are informal links.

Exhibit 4

Developing new ideas

Ways in which innovation is governed in your organization
% of respondents[1]

[1]Figures do not sum to 100%, because respondents who answered "other" or "none of the above" are not shown.
[2]Executives at senior vice president level and above.

Source: 2007 McKinsey survey on innovation

Too little talent or too many barriers?

It is often said that a company's main challenge with innovation is finding enough talented people. In this survey, top managers agree that identifying the right people and aligning them for innovation is their single-greatest struggle and that the most important drivers of innovation are the organization's culture and people. The survey also suggests, however, that companies discourage talented staff from pursuing innovation by offering limited incentives, being risk averse, and having no plan for dealing with failure. And the survey shows that top managers and other executives have different perceptions of the struggles related to finding and aligning their people.

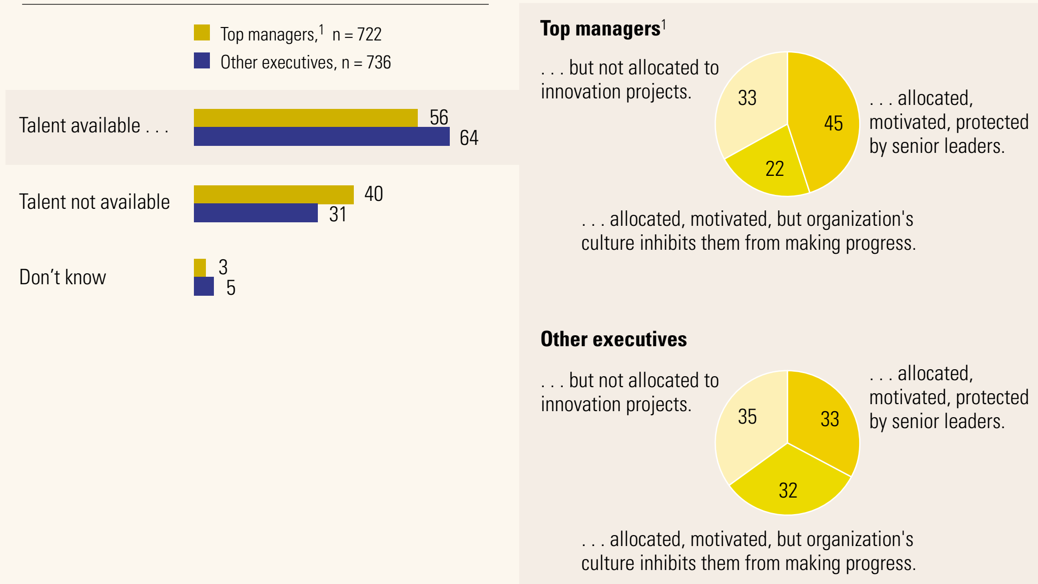
Some 40 percent of top managers say that they do not have enough of the right kind of employees. Among top managers who do say enough people are available, however, nearly half say the right employees are in place, motivated, and protected by senior leadership, and only 22 percent say the organization's culture inhibits them from making progress (Exhibit 5).

Other executives take a different view. Only 31 percent say the problem is that they don't have enough of the right kind of people. Among those who say the organization does have the right employees, almost one-third say the company's culture inhibits progress. Only a third say innovators are protected by senior leaders.

Exhibit 5

The talent problem

Status of talent for innovation projects in respondents' organizations, % of respondents



[1]Executives at senior vice president level and above; figures may not sum to 100%, because of rounding.

Source: 2007 McKinsey survey on innovation

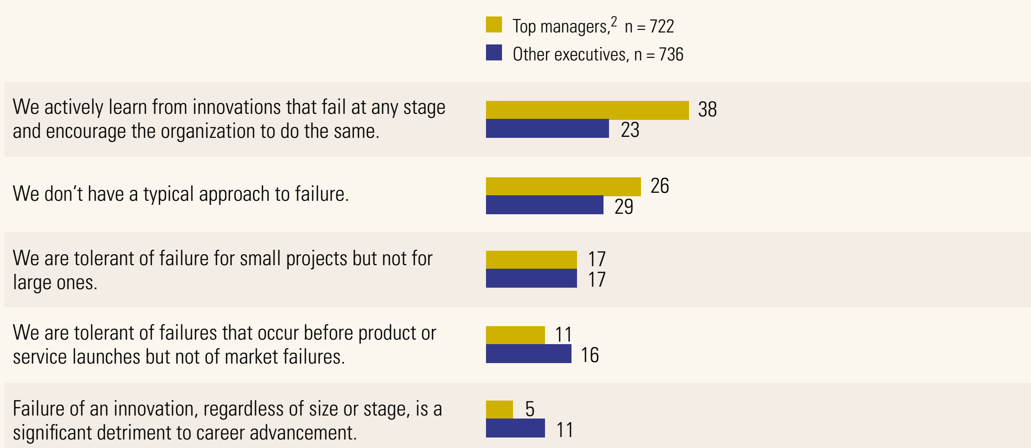
There are also disparities in executives' perceptions of how their companies react to failure in innovation. Far more top managers say they actively encourage the organization to learn from failure, for instance, and far more other executives say any kind of failure is a significant detriment to career advancement (Exhibit 6).

Interestingly, however, slightly more top managers than other executives (33 percent compared with 28 percent) say leaders hinder innovation by maintaining a fear of failure in the organization. There are other notable differences in how executives rank the importance of various failures by leadership teams. For 60 percent of top managers, the biggest hindrance these teams present to innovation is their failure to follow communication with action. Only 48 percent of other executives choose that response, just below the number of those who choose failure by leaders to model behavior that encourages innovation.

Exhibit 6

When innovation fails

Leadership team's reactions to failure in innovation,
% of respondents[1]



[1]Figures do not sum to 100%, because respondents who answered "other" or "none of the above" are not shown.
[2]Executives at senior vice president level and above.

Source: 2007 McKinsey survey on innovation

When innovation is the number one priority

A small share of companies seem to have figured out how to foster and govern innovation: 35 percent of top managers say they are "very" or "extremely" confident in the innovation decisions they make. (An additional 40 percent say they are "somewhat" confident.) At organizations where executives are confident and top managers say innovation is their single most important priority for driving growth (11 percent of the total), there are some notable organizational and cultural differences.

One key organizational difference is the use of innovation-related metrics in performance reviews. Although only 29 percent of all companies include these metrics in reviews of C-level executives and business unit heads, 47 percent do so at organizations where innovation is the top priority and 50 percent at organizations where executives are confident in their innovation decisions. Both kinds of organizations are also likelier to make innovation an integral part of the organization's annual planning process—the practice at 40 percent of companies where innovation is the top priority and 45 percent of companies where the executives are confident. Also, at companies where innovation is the number one priority, top managers say they define the themes for the crucial breakthrough innovations as frequently as they determine where to focus innovation among existing products and processes.

Although these executives also say talent is the biggest challenge to successful innovation, less than 5 percent of respondents at companies where innovation is a priority say the right people are available but not allocated to such projects; nearly three-quarters of those who have the right employees say that those people are allocated, motivated, and protected by senior leaders. Notably, less than a quarter of executives who are confident in their innovation decisions say their companies lack the right people to innovate, perhaps indicating that this confidence is based at least partly on the perceived competence of the organization.

Source: 2007 McKinsey survey on innovation

Making innovation work

Respondents agree on some steps that will help them improve the innovation performance of their companies, many of which are aligned with the steps already being taken by confident companies.

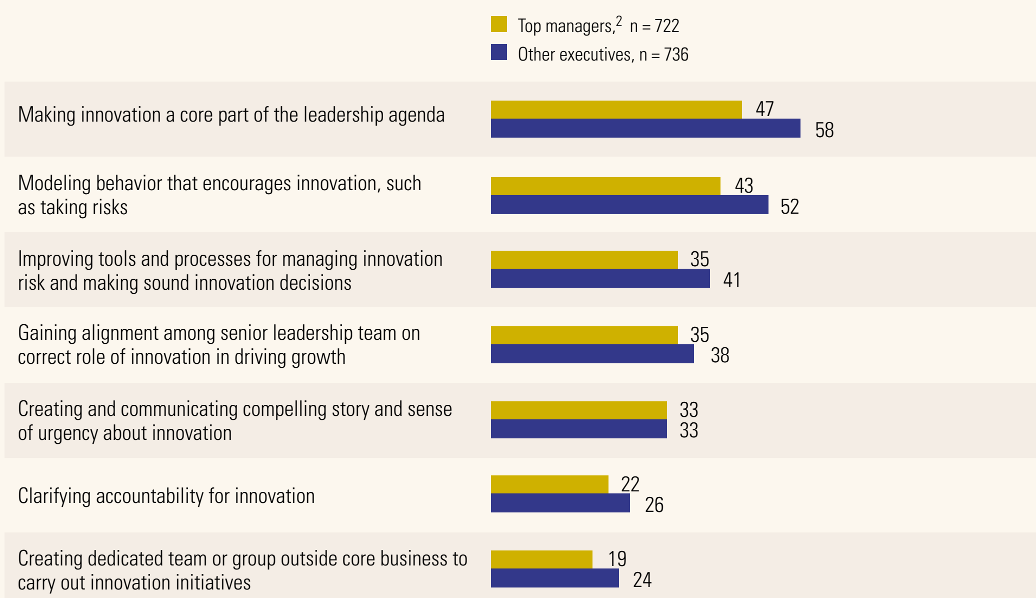
Those steps start with leaders. Respondents say ensuring that innovation is a core part of the leadership agenda is central to improving innovation (Exhibit 7). Other systemic changes recommended by many executives directly address organizational issues they identify, such as the failure of top managers to model behavior that encourages innovation and the neglect of innovation risk (just over a quarter of companies today focus on this risk). Some tactics often perceived as important to successful innovation, such as creating a compelling story to help communicate it, are seen as less effective.

Innovation remains a difficult challenge. While many of these suggested improvements are consistent with the approach taken by companies where innovation is the top priority—and with much management advice—most companies clearly find them difficult to implement. The reasons likely lie in what members of the leadership team identify as their top challenges: finding the time to focus on new topics, closely followed by taking risks on new initiatives and changing processes. Meeting those challenges will no doubt help companies with far more than innovation.

Exhibit 7

Improving innovation performance

Processes that would have the greatest impact on improving innovation performance,
% of respondents[1]



[1]Respondents could select multiple responses; those who answered "other" or "none of the above" are not shown.
[2]Executives at senior vice president level and above.

Source: 2007 McKinsey survey on innovation

Respondents' discussion

We convened an online discussion[1] with senior executives who participated in the original survey and whose companies put a high priority on innovation to learn more about how innovation is managed at their companies, what they're doing to innovate, and what their biggest challenges are.

Finding the innovations that matter

At companies where innovation is a priority, not just any progress is good enough. Breakthrough innovations that are marketable matter most. One participant says, *"While we have what is in essence an R&D team, their time and energy can be easily consumed by existing product. Keeping them and the product teams focused on growth beyond what is already in the market creates significant and not always pleasant tension."*

Not surprisingly, collaboration across R&D and marketing is often seen as essential to success. Another executive describes his company's transition to market discipline: *"In the past,"* he says, *"it seems that innovation was handled by the research folks, and it was a gigantic black box where if all went well some technology would come out and marketing would go sell it. This, of course, was a recipe for failure."*

Although participants generally see customers and the market more broadly as the arbiters of successful innovation, they note that ideas come from all over. Some companies focus largely on external ideas: *"Some inside, some out, more from street level than the tower,"* says one. Other companies, however, find their best ideas primarily internally. *"The executive team strives to implement innovation as a core element in the way we do business,"* a participant says. *"We truly embrace an 'open-door' policy to new and creative ideas from our research and development process through product management, sales, and customer service."*

Some discussion participants also point to a hierarchy of ideas, often driven by organizational structures, that can hinder useful innovations. One explains, *"Functional units drive more little 'i' innovation, and the size of the 'I' tends to grow as we move higher up the organizational ladder. This leads to tension because senior-generated ideas may have momentum that gets in the way of immediately practical [little] 'i' innovation that is needed to ensure longer-term success."*

Getting—and keeping—people on board

One theme that runs through the discussion, whether the topic is best practices or challenges, is the importance of ensuring that innovation is clearly understood and employees throughout the organization are engaged, to varying degrees. One participant sums up the risk companies face when the whole organization isn't engaged: *"When colleagues complain or resist innovation, the spark will be snuffed out."*

But executives are dubious about how much they can really do. Many agree that getting everyone to innovate isn't realistic. One executive explains, *"Mentoring people into becoming more open minded is a long process. We sometimes find it's a necessary investment, not so much to make them innovators but to get them to accept innovation and prevent them from becoming innovation antichampions."*

In managing innovators, one of the biggest challenges for many companies is measuring the contributions of these people. Business practices vary particularly widely here. One executive says,

[1] Twenty-three senior executives, including CEOs and directors, participated in the discussion, which took place over three days in October 2007. Participants were from around the world and work in industries such as food and beverages, freight, and high tech.

"We do not have specific innovation targets. We do have continuous-improvement targets [for business units] that clearly generate innovation." Another says, *"I see innovation to be evaluated in long-term business success. Hard criteria—[for example,] time spent on innovation thinking—are not feasible in my eyes."*

At another company, innovation targets are used throughout the organization. This company's executive explains that, in the short term, her company uses an *"internal point system, which might be weak and in some ways subjective."* But, she adds, *"On a long-term view, we try to replace people who don't take part in our permanent innovation process and tell people to look for another company to work for."*

Processes vary

Managing the innovation process is critical to making it work. Some companies focus on managing just a few of its elements. One participant, for example, says, "The two biggest questions by far are how to get innovative people in[to] the organization and how to assess ideas. Everything in between is just an attempt to formalize and complicate the innovation process."

At another company, the approach is almost the complete opposite—very structured and formal: *"You must have folks who are committed, [and] the company must have systems in place so everyone can communicate. We place a stage gate system around the projects and then use a collaborative management tool so that the projects can be accomplished smoothly. We compare data from those projects in order to find best practices and then have Six Sigma teams work on implementing those best practices across the different stages of a project. Just as the e-mail system is organized to create maximum efficiency, we believe that our system does the same, so that innovation can flourish and not be bogged down in wasted work."*

The management challenges don't stop with developing ideas and innovations. One participant notes, *"Hand in hand with innovative ideas is the ability to remain consistent in our delivery process to ensure we don't compromise the integrity of our company and the success of the customers we serve."* Discussion participants generally agree that their companies have a disciplined approach to managing the financial uncertainty that tends to accompany innovation. An executive at one company explains, *"We go in estimating there will be a lot of failures. Our structure has been to collect numerous ideas and find low-cost, low-risk ways of testing their potential, knowing that most will fail, but at a time when there is a small financial cost. The few successful ones rise to the top, and by the time they require large financial investments, we have enough feedback to be reasonably sure they are going to work."*

Leaders and innovation

Leaders at the companies of participants in this discussion have a wide range of approaches to owning innovation and degrees to which it is part of their leadership agenda. One company has a structured approach that includes the whole leadership team: *"We take very good care that the innovation topics are on our watch list and recur as important topics in our regular meetings. . . . Our leadership team starts the day with the discussion of innovation. Some topics are discussed over months again and again, to check if our first decision on it is still OK or if we need to make a change."* An executive at another company says, *"There is a split [on our leadership team] between abstract thinkers and pragmatic operators. The pragmatists understand the value of reaching for new, creative solutions but want measurable improvements. In our company that balance seems to be effective in guiding the conversation."* And a third says there is *"very little sustained discussion"* among leaders at his organization, adding, "*Innovation [is] generally handled by one or two leaders while the rest focus on operations.*"

There isn't even agreement on whether innovation should be discussed formally. One executive says, "*Innovation can be seen as another thing on the corporate agenda or as streamlined into business as usual, as one of many avenues for agenda-setting initiatives. The latter approach tends to work better for us, by keeping innovation active and real as opposed to [being] a separate thing.*" Another comments, "*There are quarterly meetings internally to see how the businesses are performing versus their innovation targets, and there are meetings every six months to dissect the innovation pipeline.*" In contrast, one participant says that leaders at his company generally have "*lengthy, informal discussions*" about innovation, while another says, "*We do not plan specific times to spend on innovation as an executive team.*"

Several participants actually caution against too much discussion. One explains, "*Ten percent of our time is well spent driving innovation and 10 percent of our time is lost in the debate about whether new ideas are innovations or product enhancements.*" Another says, "*Our discussions are quite lively! . . . That said, we recognize the potential to dive into ratholes or digress into too much detail. We try to be careful to keep our discussion on track and meaningful. . . . All talk and no action is not a recipe for success!*"

Contributors to the development and analysis of the survey include **Joanna Barsh,** a director in McKinsey's New York office; **Marla Capozzi,** an associate principal in the Boston office; and **Lenny Mendonca,** a director in the San Francisco office.