Leadership and innovation

McKinsey research reveals a wide gap between the aspirations of executives to innovate and their ability to execute. Organizational structures and processes are not the solution.

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January 2008

Like short skirts, innovation has traditionally swung into and out of fashion: popular in good times and tossed back into the closet in downturns. But as globalization tears down the geographic boundaries and market barriers that once kept businesses from achieving their potential, a company's ability to innovate—to tap the fresh value-creating ideas of its employees and those of its partners, customers, suppliers, and other parties beyond its own boundaries—is anything but faddish. In fact, innovation has become a core driver of growth, performance, and valuation.

Our research bears out this point. More than 70 percent of the senior executives in a survey we recently conducted say that innovation will be at least one of the top three drivers of growth for their companies in the next three to five years.[1] Other executives see innovation as the most important way for companies to accelerate the pace of change in today's global business environment.[2] Leading strategic thinkers are moving beyond a focus on traditional product and service categories to pioneer innovations in business processes, distribution, value chains, business models, and even the functions of management (see "Innovative management: A conversation with Gary Hamel and Lowell Bryan").

Our research also shows that most executives are generally disappointed in their ability to stimulate innovation: some 65 percent of the senior executives we surveyed were only "somewhat," "a little," or "not at all" confident about the decisions they make in this area.[3] What explains the gap between the leaders' aspirations and execution? Even starting to build an organization in which innovation plays a central role is often far more frustrating than most executives ever imagine it to be. Many of those who mimic the approaches of the most successful practitioners have found that path to be ineffective. Sustaining innovation to create real value at scale—the only kind of innovation that has a significant financial impact—is even harder.

There are no best-practice solutions to seed and cultivate innovation. The structures and processes that many leaders reflexively use to encourage it are important, we find, but not sufficient. On the contrary, senior executives almost unanimously—94 percent—say that people and corporate culture are the most important drivers of innovation.

Our experience convinces us that a disciplined focus on three people-management fundamentals may produce the building blocks of an innovative organization. A first step is to formally integrate innovation into the strategic-management agenda of senior leaders to an extent that few companies have done so far. In this way, innovation can be not only encouraged but also managed, tracked, and measured as a core element in a company's growth aspirations. Second, executives can make better use of existing (and often untapped) talent for innovation, without implementing disruptive change programs, by creating the conditions that allow dynamic innovation networks to emerge and flourish. Finally, they can take explicit steps to foster an innovation culture based on trust among employees. In such a culture, people understand that their ideas are valued, trust that it is safe to express those ideas, and oversee risk collectively, together with their managers. Such an environment can be more effective than monetary incentives in sustaining innovation.

This list of steps is not exhaustive. Still, given the limited time and means—as well as the short-term performance pressures that executives constantly face—pursuing innovation with anything other than existing talent and resources often isn't an option. These three fundamentals are a practical starting point to improve an organization's chances of stimulating and sustaining innovation where it matters most—among a company's people.

Leading innovation

While senior executives cite innovation as an important driver of growth, few of them explicitly lead and manage it. About one-third say that they manage innovation on an ad hoc basis when necessary. Another third manage innovation as part of the senior-leadership team's agenda. How can something be a top priority if it isn't an integrated part of a company's core processes and of the leadership's strategic agenda and—above all—behavior?

According to 19 percent of the senior executives, neither growth nor innovation is part of the strategic-planning process, which focuses solely on budgeting and forecasting. Just under half indicated that innovation is integrated into the process informally. Only 27 percent said that innovation is fully integrated into it. But these executives feel more confident about their decisions on innovation and say that they have implemented ways to protect it and to ensure that it gets the right talent.

In a separate survey of 600 global business executives, managers, and professionals, the respondents pointed to leadership as the best predictor of innovation performance.[4] Those who described their own organization as more innovative than other companies in its industry rated its leadership capabilities as "strong" or "very strong."[5] Conversely, those who believed that the ability of their own organization to innovate was below average rated its leadership capabilities as significantly lower and, in some cases, as poor.

As with any top-down initiative, the way leaders behave sends strong signals to employees. Innovation is inherently associated with change and takes attention and resources away from efforts to achieve short-term performance goals. More than initiatives for any other purpose, innovation may therefore require leaders to encourage employees in order to win over their hearts and minds. Our sample of 600 managers and professionals indicated that the top two motivators of behavior to promote innovation are strong leaders who encourage and protect it and top executives who spend their time actively managing and driving it. Indeed, senior executives believe that paying lip service to innovation but doing nothing about it is the most common way they inhibit it. The failure of executives to model innovation—encouraging behavior, such as risk taking and openness to new ideas, places second. Rewarding nothing but short-term performance and maintaining a fear of failure also make it to the top of the respondents' list of inhibitors.[6]

Holding leaders accountable for encouraging innovation makes a big difference. Thirty percent of the senior executives in the survey were accountable for it, through formal targets or metrics, in their performance reviews. They were more likely than the broader group of respondents to view innovation as one of the primary growth drivers, to manage it formally as part of the leadership team or through an innovation council, and to learn from their failures to achieve it.

Our research implies that most senior executives do not actively encourage and model innovative behavior. If they did, they could give employees the support needed to innovate. They can also take a number of other practical steps to advance innovation.

1. Define the kind of innovation that drives growth and helps meet strategic objectives. When senior executives ask for substantial innovation in the gathering of consumer insights, the delivery of services, or the customer experience, for example, they

communicate to employees the type of innovation they expect. In the absence of such direction, employees will come back with incremental and often familiar ideas.

2. Add innovation to the formal agenda at regular leadership meetings. We observe this approach among leading innovators. It sends an important signal to employees about the value management attaches to innovation.
3. Set performance metrics and targets for innovation. Leaders should think about two types of metrics: the financial (such as the percentage of total revenue from new products) and the behavioral. What metrics, for example, would have the greatest effect on how people work? One company required that 20 percent of its revenue come from products launched within the past three years. Another established targets for potential revenues from new ideas in order to ensure that they would be substantial enough to affect its performance. Leaders can also set metrics to change ingrained behavior, such as the "not invented here" syndrome, by requiring 25 percent of all ideas to come from external sources.

Senior executives say that the top three ways they spend time making decisions about innovation involve determining what types or strategies to focus on, who gets to work on the resulting projects, and how to commercialize the fruits. Few spend time on targets, metrics, and budgets for innovation. That is telling, since executives whose companies do have such targets and metrics feel the greatest confidence in their decisions.

Designing innovation networks

Chances are your organization has some people who are passionate about innovation and others who feel uncomfortable about any topic related to change. Recent academic research finds that differences in individual creativity and intelligence matter far less for innovation than connections and networks—for example, networked employees can realize their innovations and make them catch on more quickly.[7]

Since new ideas seem to spur more new ideas, networks generate a cycle of innovation. Furthermore, effective networks allow people with different kinds of knowledge and ways of tackling problems to cross-fertilize ideas. By focusing on getting the most from innovation networks, leaders can therefore capture more value from existing resources, without launching a large-scale change-management program.

Social-network analysis can help executives to diagnose existing networks in order to ascertain their characteristics, such as the frequency of collaboration and the degree of cross-functional interactions among members, and to identify people who broker information and knowledge. This kind of information can also serve an essential role in the creation of effective innovation networks by clarifying the mind-sets of individuals and groups.

In one company, for example, we found three groups with distinct perspectives on innovation. One believed that the company was innovative, but the other two, with 57 percent of its employees, thought that it wasn't—indeed, that it was actually bureaucratic, slow moving, inefficient, and stressful. A separately developed network map highlighted the company's hierarchical structure but also showed that cross-functional departments were well connected.

When we combined the analysis of personal perspectives on innovation with the network map, we found opportunities for improvement. Paradoxically, the analysis revealed that those employees, largely middle managers, with the most negative attitude toward innovation were also the most highly sought after for advice about it. In effect, they served as bottlenecks to the flow of new ideas and the open sharing of knowledge. A further analysis of the people in this group highlighted their inability to balance new ideas with current priorities and to behave as leaders rather than supervisors. We have observed that middle managers pose similar challenges in many organizations.

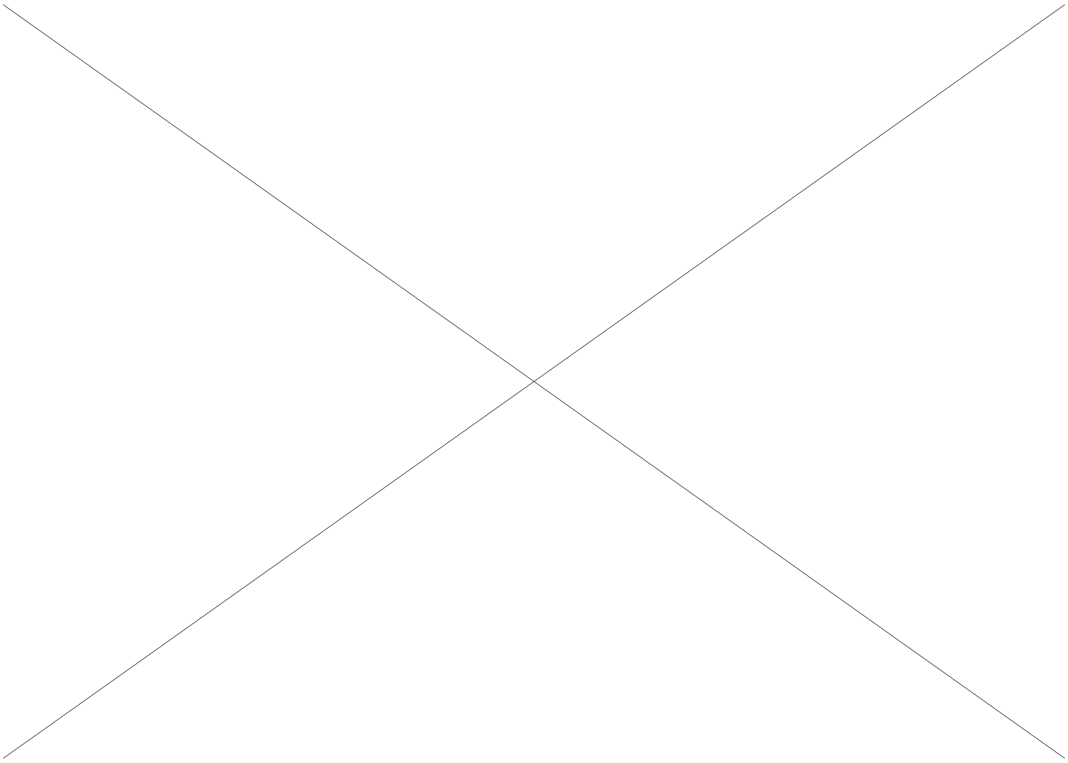
Senior management used this analysis to create a network of middle managers who were encouraged to generate newer and bigger ideas. Members of the network regularly discussed new ideas with senior executives, and these ideas were evaluated collectively by mutually agreed-upon criteria.

Shaping innovation networks is both an art and a science. Any network is unpredictable and, in the end, impossible to control. Focusing on the replacement of one or two ineffective members has less impact than establishing the conditions for vibrant networks and taking advantage of the connections through which they flourish.

Making networks more decentralized is another way to improve collaboration and performance (Exhibit 1). Consider the case of two geographically separate units that undertake the same activities. A larger leadership group with an open and positive mind-set is a distinguishing feature of the higher-performing unit. Its information network is also more decentralized, with a larger number of connections. Hierarchy is still evident in the higher-performing unit, but its information and knowledge network is more distributed, and more of the members participate actively. The lower-performing unit has just one leader, who controls most of the interactions and has a negative mind-set about openness and collaboration, and there are far fewer connections. The network design is more centralized.

The four critical steps in designing, implementing, and managing an innovation network are presented in Exhibit 2. In addition, executives can fine-tune the network’s goals by identifying the appropriate mix and balance of employees. Innovation networks, like cross-functional teams, require different skills and attitudes. In our experience, they include combinations of several archetypes:

- Idea generators prefer to come up with ideas, believe that asking the right questions is more important than having the right answers, and are willing to take risks on high-profile experiments.
- Researchers mine data to find patterns, which they use as a source of new ideas. They are the most likely members of the network to seek consumer insights and to regard such insights as a primary input.
- Experts value proficiency in a single domain and relish opportunities to get things done.
- Producers orchestrate the activities of the network. Others come to them for new ideas or to get things done. Producers are also the most likely members of the network to be making connections across teams and groups.



This kind of staffing is clearly an inexact science. A team or network in need of more ideas might get additional idea generators to fill the gap. If the challenge is commercializing the right ideas, management might opt to add producers and experts. In our survey of professionals, respondents who regarded their companies as more innovative than competitors in the same industry were also more likely to work for companies that had larger numbers of producers.

Cultures of trust

Senior executives say that making top talent available for projects to meet innovation goals is their single biggest challenge in this area. Some 40 percent of them also believe that they do not have enough of the right kinds of talent for the innovation projects they pursue. A different view emerges from below, however. Employees are more likely to believe that their organizations have the right talent but that the corporate culture inhibits them from innovating (Exhibit 3). We, for our part, believe that defining and creating the right kind of culture, however elusive, greatly increases the prospects for successful and sustained innovation (see sidebar, “Many paths to success”).

Managers and employees broadly agree about the attitudes, values, and behavior that promote innovation. Topping the list, in our research, were openness to new ideas and a willingness to experiment and take risks. In an innovative culture, employees know that their ideas are valued and believe that it is safe to express and act on those ideas and to learn from failure. Leaders reinforce this state of mind by involving employees in decisions that matter to them. Respondents to our survey of 600 executives and managers indicated that trust and engagement were the mind-sets most closely correlated with a strong performance on innovation. In the same survey, 46 percent of the professionals surveyed said that they were far more likely to seek out a trusted colleague than an expert or manager to get new ideas and feedback on their own ideas.

There is also widespread agreement about the cultural attributes that inhibit innovation: a bureaucratic, hierarchical, and fearful environment. Such cultures often starve innovation of resources and use incentives intended to promote short-term performance and an intolerance of failure. Only 28 percent of the senior executives in the survey said that they are more likely to focus on the risks of innovation than on the opportunities, but only 38 percent said that they actively learn from innovation failures and encourage the organization to do so as well. Even more alarmingly, only 23 percent of the employees believe that their organizations encourage them to learn from failure. To make a corporate culture friendlier to innovation, managers must acquire new skills to engage and lead the staff. Many fall under the heading of leadership skills, such as coaching (as opposed to ordering) subordinates and facilitating collaboration across silos.

Corporate-wide change programs not only are daunting and time consuming but also often have only a limited impact. Our experience helping companies to change and become more innovative suggests that they can make progress without such programs. We have described a number of leadership role-modeling and formal organizational mechanisms to promote innovation. When top management reinforces them with commitment and energy to build capabilities for specific tasks, the combination can yield impressive results. Top teams can help build a more innovative culture in several ways:

1. Embrace innovation as a top team. It’s not enough for the CEO to make innovation a personal goal and to attend meetings on innovation regularly. Members of the top team must agree that promoting it is a core part of the company’s strategy, reflect on the way

their own behavior reinforces or inhibits it, and decide how they should role-model the change and engage middle management.

2. Turn selected managers into innovation leaders. Identify managers who already act, to some degree, as network brokers and improve their coaching and facilitation skills so that they can build the capabilities of other people involved in innovation efforts more effectively. The goal: making networks more productive.
3. Create opportunities for managed experimentation and quick success. Not surprisingly, this approach is typically the best way to start any change effort in large organizations. Quick success matters even more with innovation: people need to see results and to participate in the change. To get going quickly and learn along the way, select an innovation theme or topic area and then create small project teams. While you try out topics and ideas, test the most effective leadership and organizational approaches for your organization. The goal isn't to get it right the first time but to move quickly to give as many influential employees as possible a positive experience of innovation, even if a project doesn't generate profits immediately. A positive experience will make all the difference in building the organization's capabilities and confidence.

Innovation is a big idea with a big potential. But it is wise to approach it in small steps, implementing just one or a few of the ideas we propose and building from there. For many companies, the initial steps on this value-creating journey are the most critical of all.

Many paths to success: Excerpts from a McKinsey online discussion on innovation

To learn more about how innovation is managed at companies where it is a priority, we identified senior executives who, in our fall survey, had described their company that way and invited them to join an online discussion. One major topic was how leadership groups manage innovation. Discussion participants describe a wide variety of approaches to innovation ownership, the degree to which it is part of their leadership agenda, how to motivate innovators, and how innovation-related performance metrics are applied to leaders and to innovators.

One company has a structured approach to managing innovation 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 says, "*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, another participant says that, at his company, leaders 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 rat holes 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!*"

Beyond the leadership team, discussion participants stress the importance of ensuring that innovation is clearly understood and employees are engaged, to varying degrees, throughout the organization. A senior executive explains, "*We are trying to get the communication [about innovation's importance] to originate from the employees themselves. We can speak about it a lot but we want the conversation to continue after the meeting, without us around.*" Another participant sums up the risk companies face when the whole organization isn't engaged with innovation: "*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 says that, at his company, "*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 anti-champions.*" Another observes, "*Some [business unit leaders] realize the importance of being innovative and spend considerable time to generate new ideas. Others find it quite difficult and frustrating, especially those who have worked in the company for many years. One of our greatest challenges is to make the process constantly evolving.*"

In managing innovators, one of the biggest challenges for many companies is measuring the contributions of these people. Companies' practices vary particularly widely here. One executive says, "*We do not have specific innovation targets. We do have continuous improvement targets [for business units] that clearly generate innovation. We are good and getting better at moving thoughts to plans to projects to production.*" Another says, "*Innovation is part of our key factors for success. So you cannot be successful if you do not manage innovation right. Ultimately this translates in sales and EBIT*[1] *or targets to develop new markets. But it is true that I can hardly remember any specific innovation target in our target portfolio.*" A third has an even stronger view: "*I see innovation to be evaluated in long-term business success. Hard criteria—for example, time spent on innovation thinking—is not feasible in my eyes.*"

At another participant's company, the approach is quite different: "*The leadership team has a target to achieve around innovation, the results are measured, and actions are taken to achieve the results on a quarterly basis.*"

And at yet 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 way 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.*"

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