TOMORROW'S INNOVATION LEADERS ARE MADE TODAY

By Michael Ringel, Ramon Baeza, Florian Grassl, Rahool Panandiker, and Johann Harnoss

We are in the midst of a pandemic with still unknown implications for the global economy, and for millions of human lives. For many businesses, managing the current crisis is the sole and immediate focus, whether that means maintaining liquidity to secure survival, pivoting to Covid-19 response, or addressing the impacts of a global downturn.

Over the long term, though, we know that the delivery of value to shareholders, employees, and society requires growth. And growth requires innovation. While it may seem far away right now, the recovery will eventually come, and—as we have seen with previous downturns—the companies that navigate the crisis deftly while positioning themselves for the return to growth will reap disproportionate rewards.

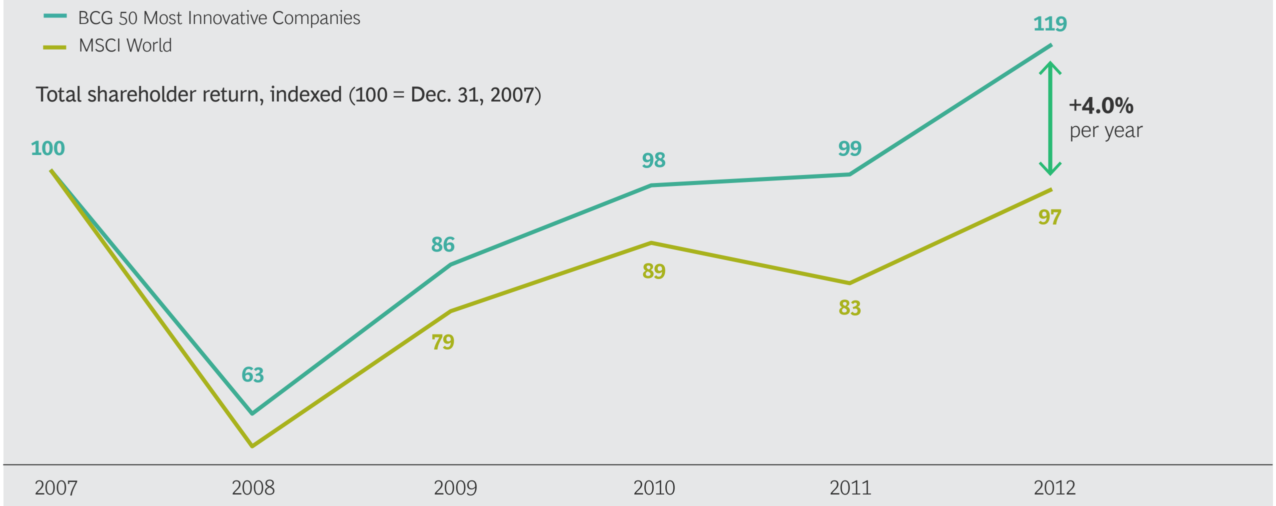
The Mother of All Invention

If the past offers a guide to the future, consider the legacy of the Great Depression of the 1930s. The years following the 1929 stock market crash were years of hardship but also of frantic innovation. They gave birth to inventions as disparate as the helicopter, nylon, radar, and the jet engine, as well as canned beer and sunscreen. As Plato wrote in the *Republic*, "The true creator is necessity, who is the mother of our invention."

And data from the last big economic downturn backs this up. The 50 companies on BCG's list of the 50 most innovative companies for 2007, all of which made significant investments in innovation despite the slowdown, greatly outperformed the market as the economy recovered, delivering total shareholder returns that were 4% higher per year than the market from 2007 to 2012. (See Exhibit 1.)

The good news for large, established organizations is that they often have a relative advantage in times of crisis. Turning that advantage into results will likely require them to play both offense and defense in the short term, while reinventing their capacity for innovation in the long term.

Exhibit 1 | Top Innovators Accelerated Out of the Last Financial Crisis



Sources: BCG Global Innovation Survey; CapitalIQ.
Note: The graph shows the TSR performance of the publicly listed companies on BCG's list of 50 top innovators, starting on Dec. 31, 2007, continuing through the crisis, and ending on Dec. 31, 2012.

In a Crisis, Larger Companies May Be Advantaged

Conventional wisdom has long suggested that when it comes to innovation, smaller companies have an advantage. The data, however, paints a more nuanced picture. Even before the pandemic, recent BCG research had found that the innovation success rates of smaller companies were not higher in any statistically significant way than those of larger companies. (See Exhibit 2.)

If size is not an impediment to innovation in good times, it cannot be an excuse for underperformance in times of crisis. There are many reasons why larger companies can have an edge over smaller rivals in times like these. They may have more resources, a more balanced risk profile due to diversification, and consequently a greater ability to fund investments from their own cash flows. And their size and reach may make them more attractive partners to smaller companies seeking to gain a stronger foothold in an uncertain market.

Of course, these advantages are not evenly distributed. For example, some industries are being hit very hard by the pandemic, and not every large incumbent company is destined to come out of this crisis stronger. But for many companies it is worth asking whether the crisis presents an opportunity for new strategic moves.

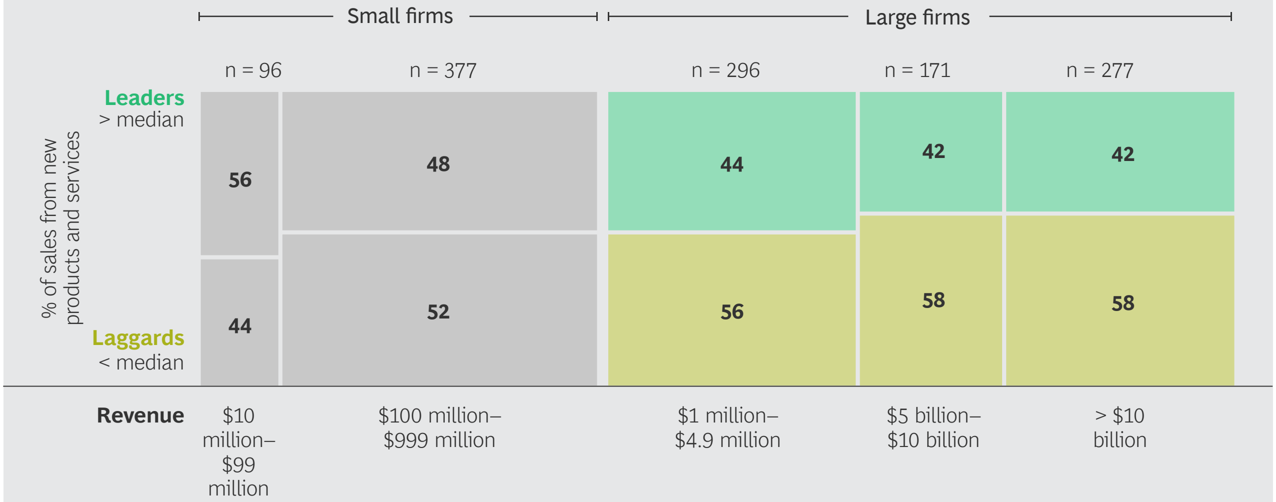
For Those That Can: Play Defense and Offense

Even before the current crisis, many organizations were remarkably fuzzy about their commitment to innovation. Our research found that 65% of corporate leaders called innovation a top-three management priority, but only 45% of companies actually walked the talk and put the required resources behind that claim. We also found that another 25% of companies failed to align their innovation ambition with their spending. This was wasteful at the time, but it is unforgivable now.

To wield your advantage successfully today, we suggest six urgent moves, the first three defensive and the rest offensive.

De-average, don't just divest. It's critical to rethink the portfolio. Stress test all businesses, value propositions, and projects in light of the current situation—and then

EXHIBIT 2 | Large and Small Firms Innovate on a Relatively Even Playing Field



Source: BCG Global Innovation Survey.
Note: Innovation leaders are defined as those that generate more output in percentage of sales from products and services launched within the past three years than the industry peer median; n = 1,217.

reorient investment toward the opportunities that you identify. For which initiatives is the economic argument most strong and consistent, and which can be delivered in the current operating model? Wherever possible, don't just cut your budget but also deploy it to accelerate the most promising efforts in light of the postcrisis reality. Then assess the growth impact of these portfolio shifts and their impact on your previous growth ambition and provide clear guidance to the capital markets. BCG research shows that companies that shifted—or even grew—R&D spending in the last crisis created more shareholder value.

Change culture, now. Most companies are going through huge changes with the widespread shift to remote working. Introducing digital tools is essential to support collaboration and teaming, but it's not enough. Teams need to be energized, empowered, and aligned. Regular "all hands" meetings can help strengthen community despite distance and maintain a sense of urgency and purpose. New team norms should allow for more decentralized decision making and autonomy, such as by introducing a "default to yes" logic for many noncritical decisions. Some of these new norms may persist once you return to more established ways of working. Many executives see this moment as the biggest opportunity for culture change in a long time.

Pull external partners closer and fill capability gaps. This is a time of extreme hardship for many smaller suppliers, innovation partners, and freelance providers, many of which are critical sources of fresh ideas and capabilities. Consider selective moves you can make to reaffirm or expand commitments for mutual long-term benefit. Offer lifelines to mission-critical resources such as top engineering freelancers—by extending contract commitments, for example. And if you have the economic flexibility, consider targeted hiring to shore up critical capabilities and build new, strategically important ones. For example, we have yet to meet a company executive who does not look for leading talent in the areas of data science/analytics or product management. Now is the time to fill longstanding skill gaps with exceptional talent. If you can afford to, think even bigger, such as by scanning the market for attractive "acqui-hire" opportunities to bring small, effective teams onboard.

Build resilience through business model innovation. Whether inspired by necessity, such as the urgent need for retailers and restaurants to design and launch new delivery options, or simply driven by insights into new customer needs, innovating at the level of the business model is increasingly essential for both resilience and growth. We are already seeing that digital-first, asset-light ecosystem players have been able to adapt more rapidly to the current crisis than more traditional asset-intensive, vertically integrated companies. Leaders can significantly accelerate the process of business model innovation by acquiring ventures that are already using novel business models—particularly at a time when valuations are low. The new streaming service Disney+, for example, leverages capabilities and talent brought in through targeted acquisitions of technology provider BAMTech and streaming platform Hulu.

Look for new opportunities. We don't suffer from a shortage of predictions as to how the world will be different post-COVID-19. In truth, nobody knows yet. But that should not stop you from asking "what if." What if the crisis permanently lifts a regulatory or cost constraint that previously stopped you from pushing into a new field? For example, consider relocalization of core parts of your supply chain, either to shore up your own resilience or to comply with new regulatory demands. What if your customers discover new needs that you can support with a new offering or business model? Education and health services have so far been largely shielded from disruptions to their established business models. Will people be willing to engage more remotely in the future? If so, what are the second-order effects and what new opportunities will emerge? What if you have skills or intellectual property that can be deployed to accelerate the response to the pandemic? This might mean entering entirely new sectors or partnering with companies in those sectors—a good way to test your ability to build, orchestrate, and keep growing external ecosystems. Bosch, the German tier one automotive supplier, recently partnered with Randox, a UK-based medtech company, and they were able to develop a promising new rapid diagnostic test for COVID-19 in just six weeks.

Reimagine your innovation system. The crisis offers an opportunity to reimagine the way you innovate for long-term success. In our experience, top performers look at innovation as a system—a system built to help teams invent, market fit, and scale ideas to impact, all embedded in and supported by an operating system that protects teams from the running business, guides them with an effective strategy, and channels resources to the most promising endeavors.

BCG's research shows the significant upside of getting innovation right. We looked at more than 1,200 innovation leaders and laggards and found robust quantitative evidence that innovation performance fundamentally comes down to getting five factors right: an inspiring ambition with concrete innovation goals; a single system of decision making, processes, and rules; the ability to attract and retain talent and assign it to the most important tasks; a rigorous approach to the project portfolio to ensure a steady stream of innovations that deliver on the ambition; and cross-functional teams working in an agile manner and supported by the right digital tools. (See Exhibit 3.)

Our benchmarking database that assesses innovation maturity on a five-point scale indicates that a one-step improvement in a company's maturity level on all five of these factors can drive an increase in innovation output (the percentage of revenue from products, services, and business models created in the past three years) of 3.4 percentage points. Companies that move from clear laggard to clear innovation leader on these dimensions can see output gains of up to 20 percentage points.

If there was ever a moment to reconsider the status quo, this is it. Smart moves to achieve innovation excellence today can help companies navigate the current crisis and will pay dividends down the road. Of course, every crisis is different, but the strongest innovators are in the best position to accelerate out of the crisis when conditions improve. Tomorrow's innovation leaders will be made today.

EXHIBIT 3 | Five Capabilities Boost Innovation Output by 3.4 Percentage Points

Source: BCG Global Innovation Survey.
Note: Exhibit shows the predicted impact of a one-step increase in maturity level on the percentage of sales from products or services launched in the past three years.

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