# Guidelines for open innovation success with external product development firms

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The rush for innovation as an engine of growth and a source of competitive advantage has accelerated as consumer habits, values and expectations change at breakneck speed and brick and mortar marketplaces, digital commerce and corporate value chains are transformed. A recent McKinsey survey relates that 84 percent of executives say that innovation is important to their growth strategy and 80 percent think their current business models are at risk of being disrupted in the near future.[1]

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## Woeful record of innovation

While most leaders avow that innovation is mission-critical, a way of future-proofing and proactively building competitive advantage, most innovation programs fail regardless of the structure or process deployed. *Forbes* notes that "as many as 95 percent of innovation initiatives can fail to exceed their cost of capital, and other analyses of new product launches (a hazy proxy for innovation) peg the failure rate at 50-90 percent." [2] McKinsey reports that only 6 percent of senior executives are satisfied with their innovation performance – yet believe innovation is critical to their future![3] But at a time when companies are caught between recessionary financial constraints and epic market discontinuity, what approaches actually deliver innovation efficiently and effectively?

The "open innovation" model describes a "a paradigm that assumes that firms can and should use external ideas as well as internal ideas and internal and external paths to market, as they look to advance their technology," as Henry Chesbrough characterized it in one of his seminal books.[4]

## Open innovation with external product development firms

Open innovation holds the promise of cross-pollination, more rapid development cycles and new tools for tackling the challenges of innovation. Many enterprises have embraced a form of open innovation with external product development firms[5] that offers the prospect of being more nimble than internally-managed R&D and less expensive, risky and complex than outright merger and acquisition activity.

Why undertake this approach, a form of outsourcing, for at least part of the innovation process? In the best cases, external collaborators offer:

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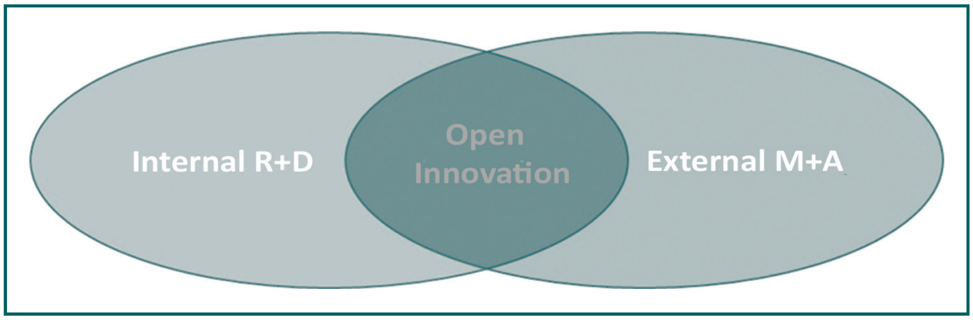
- New toolkits, skills and perspective.
- Speed: to move more nimbly and swiftly through R&D processes, potentially less encumbered by complex internal politics.
- Consumer intimacy and fluency: many smaller, external agencies and product development specialist groups have different, more intimate contact points with consumers, leveraging other recent assignments and harvesting insights from the sea of almost real-time information available through blogs, chat rooms and other digital channels.
- Agility and risk tolerance: external players, operating with less bureaucracy, fewer governance structures and less to lose, often have a greater risk appetite to experiment, iterate rapidly with products as they undergo development and nimbly test and adjust.[6]

**Exhibit 1** Innovation Model Continuum



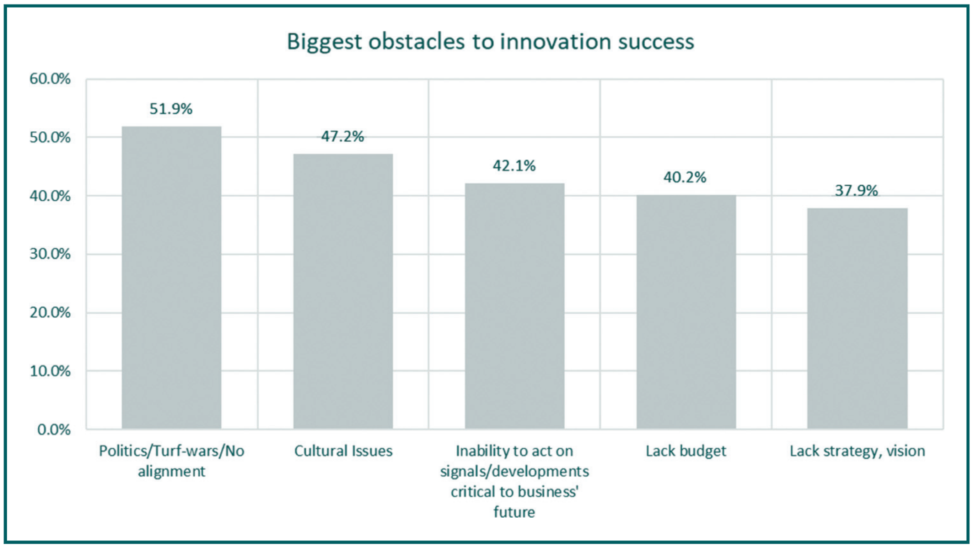

As a senior innovation executive from a multinational consumer packaged goods company puts it: "We recognized early on that the market is moving faster than our ability to capture and create a response." She engaged an external product development firm as part of a corporate commitment to "build an innovation ecosystem that can move from insights to concepts to design-for-manufacture solutions in six months."

Open innovation partnerships may have a competitive advantage: a 2018 BCG study of "the most innovative companies" proposes that "strong innovators" use the "open collaboration" model 77 percent of the time, compared to just 23 percent for the average performers.[7] A recent Gartner survey reports that virtually half of the best innovation comes from the outside.[8]

## Institutional barriers

But open innovation in itself is not a panacea: teams steered by external collaborators may be just as difficult to manage well as fully internally-sourced and led initiatives. Open innovation engagements oblige organizations to share confidential information, bridge culture differences and hand over the reins during critical, defining stages of the initiative. Given the differences in points of view and culture between corporate leaders and innovation entrepreneurs, and mounting pressures to deliver, these engagements can be challenging to sustain.

**Exhibit 2** Top barriers to innovation success




A recent innovation benchmarking survey[9] highlights the top barriers to success. Clearly culture and strategic misalignment are central issues.

Partnering with external teams to drive for breakthroughs offers an alternate path that can circumvent the internecine squabbles that often erupt between corporate divisions and functions.

From my own experience, both on the corporate sponsoring side of innovation initiatives and also on the outside, running a contract R&D/innovation firm, I have tracked why some engagements sputter or achieve only marginal success. The common pitfalls can be grouped in two broad categories:

- Strategy blindspots: weak links to core business, systems and strategy; fuzzy or meandering scope; the wrong metrics.
- Process management blindspots: the wrong team members, fatally slow pace, poor communication and storytelling, resulting in poor internal buy-in; inadequate C-Level championing.

Any innovation team that launches an initiative without a clear strategic brief and strong support from other internal clients is likely to lose its way over time. They often shed key sponsors – from marketing/brand and business unit teams – as market dynamics and investment priorities change. And as seen from the outside, working as a contract R&D innovation manager, my teams have often been stranded on programs that meander and drift because corporate politics shift, decisions are opaque and strategic communication breaks down.

## Designing for success

How to do it right? A co-founder of a medical device innovation agency wisecracked, “Can’t they just brief us then leave us alone? We’ll bring back the goods in three months!” Sadly, this is the rare engagement model – and it brings risks of its own. Here are some suggestions/guidelines, hard-won by experience, for innovation sponsors and their collaborators:

> **"When companies are caught between recessionary financial constraints and epic market discontinuity, what approaches actually deliver innovation efficiently and effectively?"**

### *1. Validate and justify the need and fit, based on customer evidence*

The strongest impetus for an innovation imperative is a signal of urgent, unmet need from the marketplace. For example, at Boston Children's Hospital, long-regarded as the country's top performer in terms of medical care, the Director of Food Services was aware of a growing interest in healthier food choices, including more plant-based options. But it wasn't until patient-family advisory groups voiced their desires – and a group of physicians actually rented city billboards demanding healthier food[10] – that his innovation agenda secured significant internal funding: "The voice of the customer really trumps internal opinions and paved the way for big change," he observed.

Equally important, internal "customers" need to embrace the proposed innovation. At a multinational maker of over-the-counter pharmaceuticals, the Open Innovation Head reported having scouted an intriguing new consumer-friendly constipation drug-delivery system. It checked the boxes that market research had identified as "emerging megatrends": hand-held portability, patient-friendly dosing, a new form-factor. Moreover, it offered additional features that clearly differentiated it from competitors – making it a high-potential candidate for an open innovation development collaboration. But decades of experience had taught the Head not to proceed until the brand teams articulated the need for such a product in a formal internal brief. "I was confident this technology was on target, but actually held back presenting it for months, until they were very clear about the product/market fit and were aligned in their motivation." While clear voices from the customer, either internal or external, are no guarantee of innovation success, they provide critical support and can serve to catalyze engagement and buy-in across departments and functions.

### *2. Scope the innovation assignment/engagement in three strategic steps*

Step 1. Define the playing field, the scope of the innovation your organization seeks. Is it:

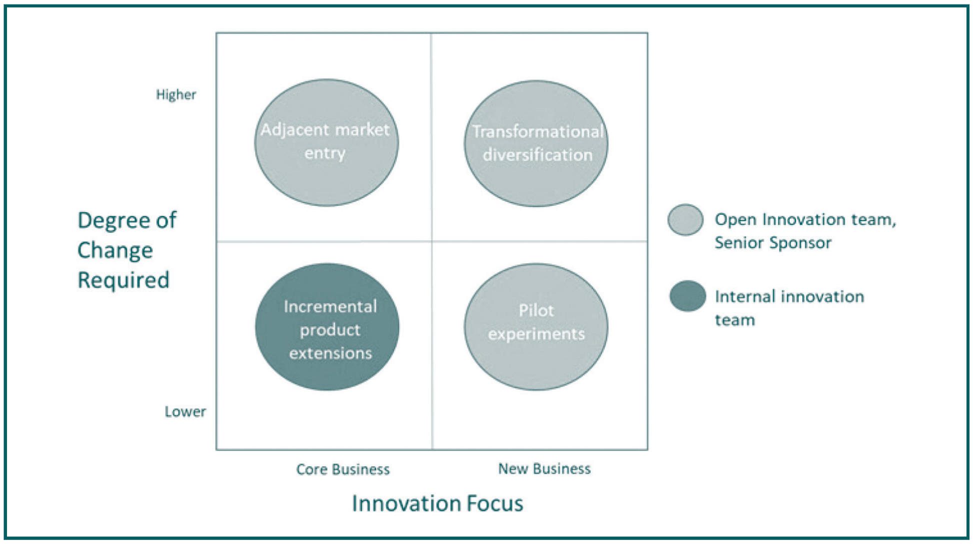
- Incremental, focused on modifications to current products, services in current markets?[11]
- A push into adjacent markets, leveraging existing assets?
- Transformational – a stretch into entirely new terrain, with radically different products/services/business model?

The scope of the innovation program often determines both the level of resources required and the appetite for risk required. Higher risk profiles require a higher degree of corporate sponsorship to navigate the politics and turf-battles (see Exhibit 3).

Step 2. Pick the right challenges to "outsource collaboratively" to external innovation partners.

One rule of thumb: partner externally when the defined challenge is something your team cannot effectively tackle—for example, new spaces, channels, materials, processes or supply chain. Outsourcing to experienced innovators can reduce internal competition, accelerate organizational learning and counteract internal turf battles.

**Exhibit 3** Example Innovation Foci/Staffing Map




**Step 3.** Carefully delineate the boundaries for the innovation solution.

Does the innovation team have permission to explore outside of current systems – supply chain, brand architecture, distribution channels or business model? What are the hard and fast rules that govern onboarding new solutions? Often open innovation teams share what they believe is an exciting proposition with corporate management, only to run into a wall. As a case in point, at a multinational pharmaceuticals company, an innovation team and twelve internal "clients" invested eleven months in conducting due diligence on a technology, building a compelling case for a new brand that would bolster a shift away from generic products, potentially delivering higher margins. A business case identified the investment and time required to commercialize the technology and corroborating national market research confirmed the rationale – the credible promise of a healthy ROI, starting three years post-launch. But when the final presentation was made to senior management, the program was abruptly shuttered. "We took too long, and the judgment from Leadership was that it was dead-on-arrival –we couldn't move forward," reported the innovation project lead. The diagnosis? Too much risk, too many shifts in current operating procedures, too little internal support for stretching beyond "business as usual." The antidote: proactively clarify the strategic parameters for innovation and take pains to highlight potential stumbling blocks such as shifts in legacy supply chains or channel relationships.

### *3. Secure C-level/senior sponsors/champions whom you update along the way*

While there are no guarantees that having a C-level sponsor bulletproofs your innovation project, it can certainly help. Different from a project or functional leader, a C-level sponsor can fly at the right altitude to transcend petty turf-wars and routine political constraints. Your sponsor can find new resources, link your project to emerging shifts in strategic direction and provide the social capital required to compel internal collaboration. At Boston Children's Hospital, the "food with purpose" innovation program has now expanded to encompass a major "reinvention" of the in-patient meal experience, which will require a reconfiguration of the operating systems within production kitchens. One key to the program's momentum: the appointment and sponsorship of a new Chief Culture Officer, whose mandate includes broad-based improvements to the patient and family experience.

### 4. Forge and engage a talented, nimble, innovation team

Four in ten internal innovation teams are small – less than ten people.[12] While not always politically feasible, smaller has proved to be more nimble and more effective, causing Amazon's innovation teams to establish the "two pizza" rule.[13]

Great innovation teams include talented technical and process specialists with high energy and an inherent can-do orientation. Some process tips:

- Successful open innovation teams empower both "scouts" and "architects" – people who can imagine new technology and business models and anticipate building bridges back to the home base.
- Designate a primary relationship contact with open innovation collaborators to enhance and compress communication loops. The best project leads speak the internal, corporate dialects and translate them for the outside open innovation team. They also narrate what they see or don't see in the outside world and share their insights with their colleagues. And they religiously keep track of decisions made along the way – through a "diary" or running transcript – that helps keep collaborators aligned and honest, an essential defense against strategic drift.
- Strive for team continuity to boost learning. Rapid turnover hampers progress and threatens the retention of institutional knowledge.
- Share more, not less, with external innovation partners. Transparency fosters intimacy and collaboration, enabling the team to navigate together.

### 5. Seek synergies as opportunities to bolster rationale, relevance and alignment

Talented open innovation program leaders watch for unexpected synergies that increase the value of insights gained from innovation exploration. These can include:

- The discovery of new customer and competitor insights.
- The capture of new consumers/segments/channels that can be grown over time, to the benefit of multiple internal teams.
- The creation of new intellectual property: patents, know-how.
- The establishment of new capacity – technical partners, supply chain partners, service providers, sources of talent.

For example, in a project for a pharmaceutical development company, the initial technology focused on an alternative approach to colonoscopy preparation. The open innovation team uncovered unique manufacturing techniques and fresh consumer insights that revealed a new adjacency: a product/market opportunity focused on a different patient set and channel of distribution. "We got two for one, a new product line that may be even bigger than what we set out to capture – leveraging the same intellectual property," the CEO noted. These serendipitous insights opened up a range of new strategic partners and sources of funding.

### 6. Frame the open innovation program as a strategic investment in a portfolio

As the retail giant Target's CEO exhorted, "Don't just innovate for innovation's sake."[14] When innovation is framed as merely experimental – an annual expense – not a sustained investment in assets, it tends to get marginalized. Experienced innovators seek authorization to manage their initiative as a portfolio of projects: instead of isolated stabs at innovation, they create a diversified array of programs, with different risk/reward ratios and different foci. By managing an open innovation portfolio, the sponsoring organization improves the likelihood of developing partnering muscles that support sustained collaborations. They also reap the benefits of the upfront learning by applying insights and techniques over multiple engagements.

### *7. Boost alignment with innovation partners*

How best to deepen alignment and motivate innovation teammates, particularly in extended collaborations? Currently, less than 15 percent of corporations offer bonuses based on innovation performance and only a very few – less than 4 percent – offer equity or financial stakes.[15] Outside Innovation partners typically sign fee-for-service R&D contracts. A modest proposal to stimulate the commitment of innovators: consider creative compensation schemes, especially for outside collaborators, that might include a success fee, phantom equity or a royalty on future product sales. "With more potential upside," cites one innovation agency CEO, "we'd wake up with this collaboration at the very top of mind, every single day." A pharmaceutical development firm has awarded a series of stock options to its open innovation partner: "We wouldn't be here today without their insights, and want to keep them highly focused on where the puck is going."

## Some takeaways

Innovation is an imperative, but success requires sophisticated leadership. Open innovation is not a good match for every innovation challenge and organization. But guided by experience won through past failures and successes it can deliver breakthrough, timely results – if it's structured, resourced and managed well. Some guidelines:

- Frame and guide open innovation programs strategically, just as you manage any critical corporate initiative.
- Create a portfolio of innovation bets, and vigilantly capture new value produced, which may extend beyond a single product or technology solution.
- Pay close attention to communications within and across teams and organizations; strive to secure at least one senior-level sponsor.
- Align with providers/collaborators/partners to build long-term commitment.

## Notes

1. McKinsey Global Innovation Survey, 2018: www.mckinsey.com/business-functions/strategy-and-corporate-finance/how-we-help-clients/growth-and-innovation#
2. Quinn, Brian "You Can't Outsource Innovation," *Forbes magazine, 9-22-2016* www.forbes.com/sites/brianquinn/2016/09/22/you-cant-outsource-innovation/#134136ff5ccb
3. McKinsey Global Innovation Survey 2018: www.mckinsey.com/business-functions/strategy-and-corporate-finance/how-we-help-clients/growth-and-innovation#
4. Chesbrough, H, *Open Innovation: The New Imperative for Creating and Profiting from Technology* (Harvard Business School Press, 2003. See also Allio, R.J. (2005), "Interview with Henry Chesbrough: innovating innovation," *Strategy & Leadership*, Vol. 33 No. 1, pp. 19-24. https://doi.org/10.1108/10878570510572617
5. Chesbrough's scholarly citations have held steady at about 8,000 per year over the past 5 years; see Google Scholar: https://scholar.google.com/citations?user=1-kDZb0AAAAJ&hl=en
6. Airbnb co-founder Brian Chesney invites new hires to "ship on the first day" – to dive in and put their fingerprints on product refinements within their first 24 hours on the job. https://firstround.com/review/How-design-thinking-transformed-Airbnb-from-failing-startup-to-billion-dollar-business/
7. BCG January 2018 report: "The Most Innovative Companies: 2018." In this context, "open" meant having organizational structures that allowed for easy collaboration with both internal and external partners. www.bcg.com/en-nor/publications/2018/most-innovative-companies-2018-organizing-digital.aspx

8. In Gartner's annual "Innovation Survey 2019" of 393 Chief Marketing Officers, participants reported that almost half of the most valuable innovation comes from outside. https://www.gartner.com/en/marketing/research/innovation-survey-2019

9. KPMG 2020 Innovation Benchmarking Report: https://info.kpmg.us/content/dam/info/en/innovation-enterprise-solutions/pdf/2019/benchmarking-innovation-impact-2020.pdf

10. Russom, Perry, "'Protect Patients From Hazardous Hot Dogs!': Billboards in Boston Target Menus at Local Hospitals," NBCBoston.com, 11/28/19. The Physicians Committee for Responsible Medicine, a non-profit comprised of 12,000 doctors who advocate for a plant-based diet, is the group behind the billboards. www.nbcboston.com/news/local/boston-hot-dog-billboards-target-hospitals/1951180/

11. About half of innovation projects focus on "incremental" innovation, according to KPMG's 2020 Benchmarking report. This is typically a reflection of short-term performance metrics, tight budgets and a diminished appetite for risk. KPMG 2020 Innovation Benchmarking Report: https://info.kpmg.us/content/dam/info/en/innovation-enterprise-solutions/pdf/2019/benchmarking-innovation-impact-2020.pdf

12. *Op.cit.*, see KPMG.

13. Cane, Aine, "Every team should be small enough that it can be fed with two pizzas." *Inc. Magazine*, June 7, 2017. www.inc.com/business-insider/jeff-bezos-productivity-tip-two-pizza-rule.html See also Jeff Bezos, 2003 Annual Letter, Amazon. "Great innovations, large and small, are happening everyday on behalf of customers and at all levels throughout the company. This decentralized distribution of invention throughout the company — not limited to the company's senior leaders — is the only way to get robust, high-throughput innovation."

14. *Fortune* magazine video interview with Target CEO Brian Cornell, July 18, 2017. www.youtube.com/watch?v=mctP1n2oElA).

15. *Op.cit.,* see KPMG.