



# **The Importance of Innovation Management Performance for Financial Investors' Decision-Making**

Lessons Learned from the Survey of German Investors

February 2011

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## **1 Innovation Management as Key Discipline for Value Creation**

Increasing value is a declared aim for financial investors. Different approaches are applied to achieve this goal. Many, like cost cutting, mergers and acquisition, financial engineering are standard. Compared to these, increasing value via Innovation Management is quite young and not yet widely spread among investors. Often there is uncertainty about what innovation is and how it can be management in a manner that it creates value on a sustainable basis. The recent survey, conducted in September 2010, revealed that the presently used instruments to assess Innovation Management capabilities showed only limited effectiveness. However, there are new and already proven approaches which might help investors to achieve the value-creation that they are looking for.

### **1.1 Innovation – More than Just a New Product**

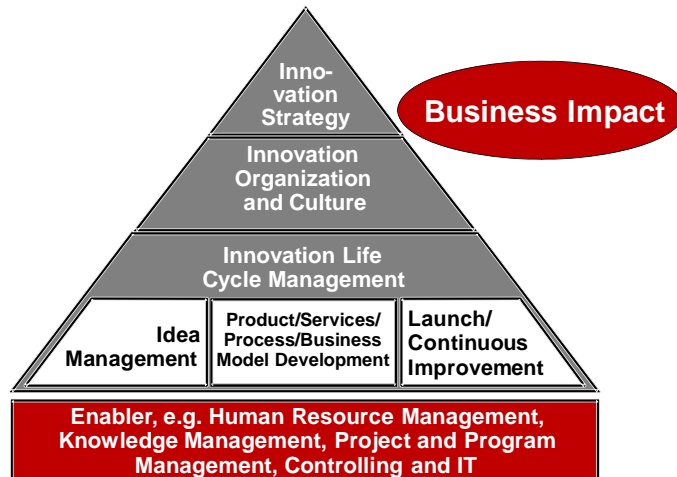
Innovation is still perceived by many investors as a new product only. But most of the companies generate their value not only with new products. They often achieve an increase in value by innovative services, new processes, new organisational structures, and/or new business models. Hence, the simple definition of innovation as a successfully commercialized new idea driving the market to shout “Hurray” is derived. As simple this definition is, as challenging is it to establish a systematic Innovation Management within a company.

### **1.2 Systematic Innovation Management**

A systematic Innovation Management includes the rigid development of the Innovation Strategy in line with the business strategy, the appropriate design and fine emotional balance of the company specific Innovation Organization and Culture, the product, process and/or service specific Innovation Lifecycle Management and the diligent creation and continuous improvement of Innovation Enabling Factors, like measures in HR, controlling schemes to increase transparency of innovation successes etc. All these dimensions need to be geared to business impact. These dimensions with their key performance indicators in each dimension are the basis for the assessment of companies' Innovation Management performance. They are described in the A.T. Kearney “House

of Innovation” and provide for the structure of the IMP<sup>3</sup>rove Innovation Management Assessment<sup>1</sup>.

Companies which are able to generate above average growth in profit, revenues, market share and in the number of employees, due to systematic Innovation Management, are the Growth Champions in the IMP<sup>3</sup>rove Assessment. They set the benchmark for profitable growth from innovations – and thus for increasing value.



A.T. Kearney „House of Innovation“  
Source: A.T. Kearney

Figure 1: A.T. Kearney “House of Innovation“

Numerous studies demonstrate that systematic Innovation Management is a prerequisite for increasing value of companies. This is independent of the size of the company. The comparison of the winners of the annual “Best Innovator Contest” in Germany with the DAX (Germany Stock Exchange Index) confirms this. The Best Innovator Contest is under the auspice of the German Federal Ministry of Economy and Technology.

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<sup>1</sup> IMP<sup>3</sup>rove online assessment of the Innovation Management capability: [www.improve-innovation.eu](http://www.improve-innovation.eu)

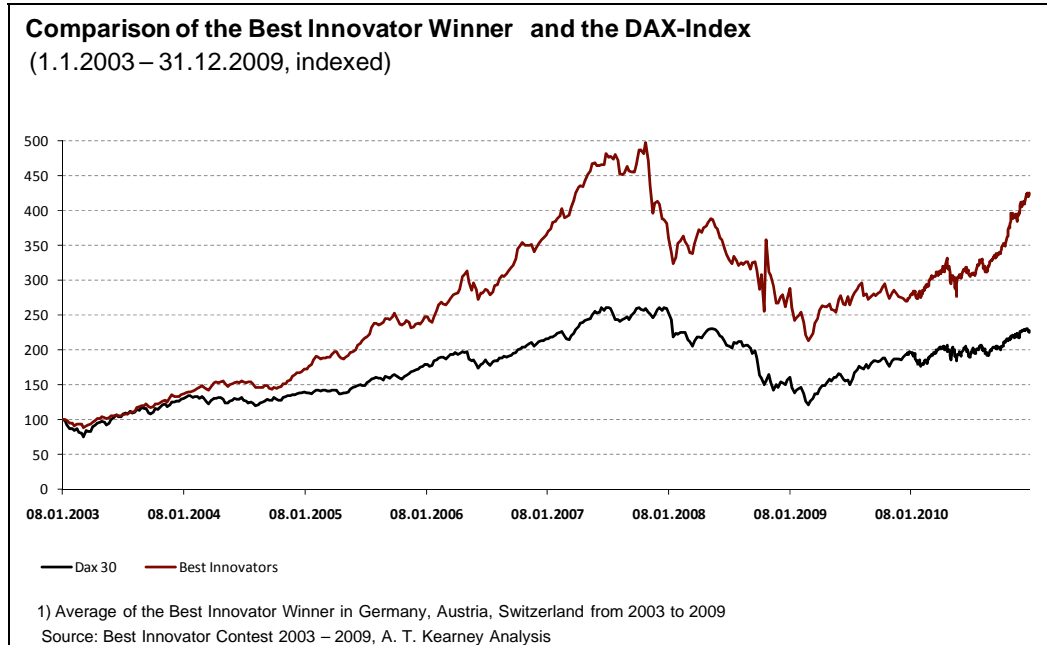
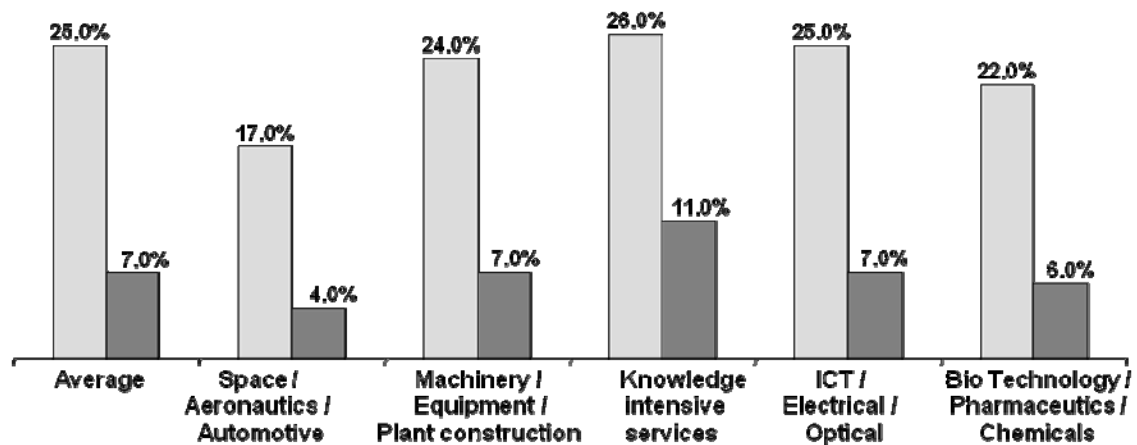


Figure 2: Comparison of the winners of the Best Innovator Contest and the DAX

In the same way, the comparison of European small and medium sized enterprises shows to what degree Growth Champions outperform their competitors.

**Annual growth in revenues of the last 4 yaers (median)**



Source: IMP<sup>3</sup>rove, March 2008; N=1324; [www.improve-innovator.eu](http://www.improve-innovator.eu)

Figure 3: Comparison of the growth champions with the average

For financial investors the challenge and also opportunity is to identify those companies, which have significant potential for improvement in Innovation Management, and therefore a high potential for value-added.

In the current study the relevance of Innovation Management in investment decisions and for the value increase of portfolio companies was examined. In a first step, focus

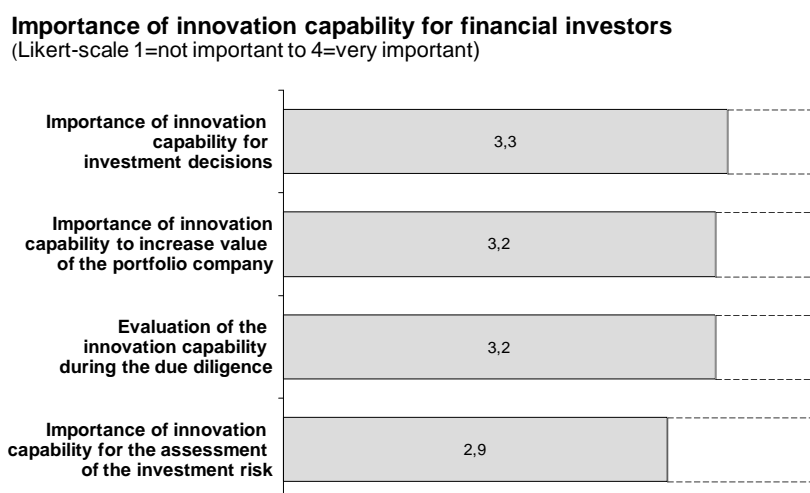
was put on the German market. Venture capital and private capital investors were included in the survey. The innovation capability of companies is - according to their feedback - important. However, particularly smaller investment firms are often lacking effective assessment tools.

New assessment tools – such as the European IMP<sup>3</sup>rove benchmarking approach – can lower the investment risk and at the same time contribute significantly to the value-creation by the portfolio of companies by providing guidance to the right levers to unlock innovativeness.

IMP<sup>3</sup>rove offers financial investors valuable additional information about the potential of value-added of their targets during the Due Diligence and – even more important – for sustainable value creation of the portfolio companies.

## 2 Innovation Management as Important Criterion for Investment Decision

For financial investors the innovation capability of a company plays a key role in different phases of the investment. Most important it seems to be for the investment decision. The answers of the investment firms in the sample show an average score of 3.3 on a scale from 1 (no role at all) to 4 (very important role). Slightly lower is the score of the importance of innovation capability for value-added of the portfolio companies. The average is 3.2 on a scale from 1 (unimportant) to 4 (very important). The question how often the innovation capability of a company is evaluated during a Due Diligence resulted also in an average score of 3.2 on a scale from 1 (never) to 4 (always).



Source: A.T. Kearney, Study "Bedeutung des Innovationsmanagement für Finanzinvestoren 2010"; N=55

Figure 4: Innovation Management as important criterion for financial investors;

The importance of innovation capability during the assessment of the investment risk is valued with 2.9 on a scale from 1 (unimportant) to 4 (very important). Here nearly 30% of the investors in the survey indicated “low importance”. While for less than 10% of the investment firms in the survey, the innovation capability for the investment decision is of low importance.

Remarkably high is the score for the benchmarking of Innovation Management. 70% of the surveyed firms consider this at least as “important”. Only for 1.9% the benchmarking of the innovation capability is unimportant.

### **3 Effective Assessment Instruments for the Innovation Management are Needed**

While the importance of Innovation Management for financial investors is high, they are sceptical regarding the effectiveness of their own tools for assessing the innovation capability.

#### **3.1 Scepticism Regarding the own Assessment Tools**

Just one third of the companies in the survey consider their tools for assessing the innovation capability as effective or very effective. The majority of the financial investors have doubts about the effectiveness of their own assessment tools. However, there is a difference between those financial investors who complete more than 10 due diligences and those who complete less than 10 due diligences per year.

Within the more active financial investors, 12.5% of the companies in the survey believe that their tools for assessing the innovation capability are effective. At the same time 12.5% from the sample think that their tools are not effective at all.

From the less active financial investors, just 4.4% consider their tools to be very effective. Nearly 70% of the less active financial investors are convinced that their instruments are of limited effect at the most.

Financial investors take a risk where they could reduce it if they used assessment tools that have proven their effectiveness.

### 3.2 More Effective Assessment Tools

If benchmarking of Innovation Management plays an important role for investors – 70% of the sample rated this with “important” – and more effective tools for the assessment of the innovation capability are needed, then the IMP<sup>3</sup>rove Assessment should be used. In the IMP<sup>3</sup>rove Assessment the Innovation Management capabilities of the company are benchmarked against a database of more than 2,800 companies. The IMP<sup>3</sup>rove benchmarking report offers insights in the company’s Innovation Strategy as well as in the innovation life cycle processes, innovation culture and organisation, and innovation-enabling factors. Most important is the contribution of the Innovation Management to the company’s value-added – the Innovation Results.

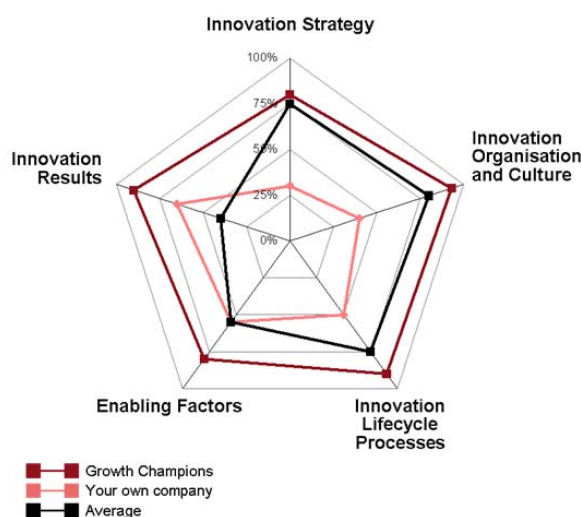


Figure 5: Benchmarking results of the IMP<sup>3</sup>rove Assessment;  
Source: IMP<sup>3</sup>rove Benchmarking Report

The IMP<sup>3</sup>rove benchmarking report reveals at a glance how the company benchmarks along the dimensions of the A. T. Kearney “House of Innovation” compared with the Growth Champions and the average. The detailed benchmarks reveal the areas where improvements should be initiated for increasing the company’s business performance. This is an effective approach for investors to systematically develop value-creation of their portfolio companies.

### 3.3 Relevance for Investors in Europe

Discussions with investors indicate that most value of the IMP<sup>3</sup>rove Assessment is expected for Private Equity firms investing in more mature companies rather than in start-ups. Our hypothesis is that the key lessons learned from this survey conducted in Germany will not differ very much from other countries. However, this needs to be proven.

Two main learnings became obvious from the follow-up discussions with investors that participated in the survey:

1. There is the need for investors to better understand the wide variety of innovations. It is not yet common understanding among investors that innovation includes more than just product innovation. Companies in all industry sectors can and have to leverage Innovation Management to increase their value and their competitiveness on a sustainable basis. Case examples demonstrate that not only product innovation is an innovation that generates value<sup>2</sup>. In discussions, investors were skeptical about the need of companies in the low-tech industry sectors to innovate. A small company running a gravel pit was not considered to be able to innovate at all. However, examples show that there are more successful gravel pits than others. They either developed better services or identified new market segments that they can serve.

In the discussion it became obvious that even these “low-tech” companies have opportunities to innovate – and that they need to exploit these opportunities for their profitable growth. Thus, they can improve their competitive position, when technologies change or their cost structure deteriorates due to the increase e.g. of energy cost or due to new competitors entering the market.

2. Investors need to better understand the levers in Innovation Management that create value. They then can apply the tools that most effectively address these levers and increase the value-added of their portfolio companies.

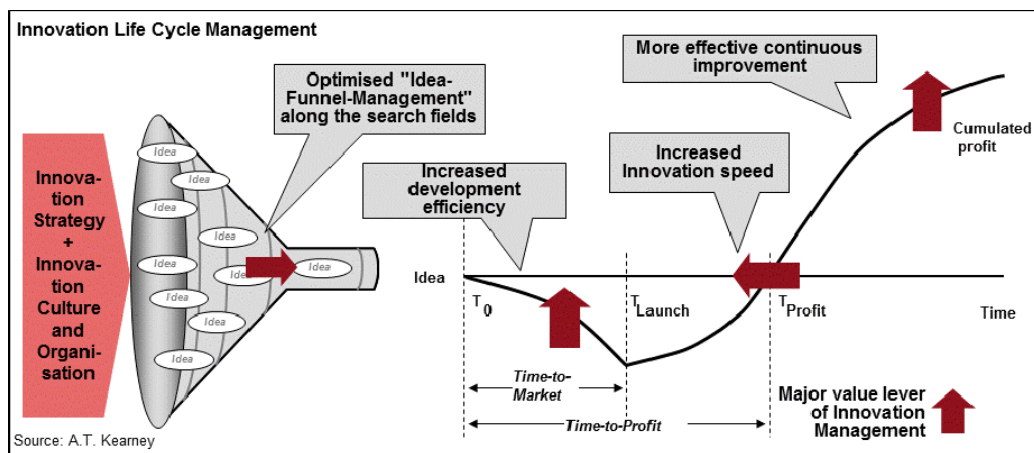


Figure 6: Management of the Innovation Life Cycle Process

<sup>2</sup> IMP<sup>3</sup>rove – A Project with Impact. 50 Success Stories on Innovation Management. Europe INNOVA paper No. 14, 2010

Especially in managing their portfolio investors can focus the company's management activities on the key levers.

Experience shows that many small and medium sized companies lack strategic focus. For developing a clear Innovation Strategy a set of proven tools are available.

- Analyzing the impact of trends on the company's markets and business
- Identifying the most promising search fields in which the company should develop their innovations
- Assessing the own capabilities to which degree they match already the needs required to effectively address the search fields
- Developing and managing the innovation portfolio and pipeline
- Developing the innovation roadmap that integrates trend analysis, search field definition, capability assessment and innovation portfolio management

## **4 Outlook**

Based on the results of the survey of German investors, the IMP<sup>3</sup>rove Approach offers valuable services for investors in Europe and beyond.

- The IMP<sup>3</sup>rove online benchmark supports the identification of the Innovation Management performance gaps of portfolio companies
- A well trained infrastructure of tools and service providers with proven track record is ready to step in to drive the change needed within the portfolio companies.
- The IMP<sup>3</sup>rove – European Innovation Management Academy provides both, investors and managers with state of the art insights and case examples on Innovation Management and how it needs to be geared to sustainable and profitable growth.

Investors interested in enhancing the value-creation of their portfolio companies and CEOs of portfolio companies who are looking for approaches how to exceed the growth targets of their investors can leverage IMP<sup>3</sup>rove – the European approach to improving their portfolio's Innovation Management performance with sustainable impact.

## 5 Appendix

### 5.1 Framework of the Study

The survey was sent to financial investors with an equity investment volume from 10 mil. € to 200 mil. €. The focus was on financial investors located in Germany. The study was executed by A. T. Kearney based on a survey conducted in September 2010.

### 5.2 Questionnaire of the Study

The Importance of Innovation Capability for Investment Decisions

|   |   |   |                                    |  |   |
|---|---|---|------------------------------------|--|---|
| 1 | How important is the innovation capability of a company for your investment decision?                     | very important <input type="checkbox"/> | important <input type="checkbox"/> | limited <input type="checkbox"/>           | unimportant <input type="checkbox"/>          |
| 2 | How often do you assess the innovation capability during the Due Diligence?                               | always <input type="checkbox"/>         | often <input type="checkbox"/>     | rarely <input type="checkbox"/>            | never <input type="checkbox"/>                |
| 3 | How important is the innovation capability of a company for the assessment of the investment risk?        | very important <input type="checkbox"/> | important <input type="checkbox"/> | limited <input type="checkbox"/>           | unimportant <input type="checkbox"/>          |
| 4 | How important is benchmarking of Innovation Management?   | very important <input type="checkbox"/> | Important <input type="checkbox"/> | limited <input type="checkbox"/>           | unimportant <input type="checkbox"/>          |
| 5 | How effective do you think your tools are to assess innovation capability?                                | very effective <input type="checkbox"/> | effective <input type="checkbox"/> | limited effective <input type="checkbox"/> | not effective at all <input type="checkbox"/> |
| 6 | How important is the improvement of the innovation capability of your portfolio for increasing its value? | very important <input type="checkbox"/> | Important <input type="checkbox"/> | limited <input type="checkbox"/>           | unimportant <input type="checkbox"/>          |
| 7 | How many companies will you probably assess in a due diligence in the next 12 months?                     | 1-5 <input type="checkbox"/>            | 6-10 <input type="checkbox"/>      | 10-20 <input type="checkbox"/>             | > 20 <input type="checkbox"/>                 |

Which further aspects are important for your investment decisions?

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## 6 Contact

More detailed information on the survey and future activities of the IMP<sup>3</sup>rove – European Innovation Management Academy please contact the IMP<sup>3</sup>rove Core Team Members:

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IMP<sup>3</sup>rove offers the platform for **IMP**roving **I**nnovation **M**anagement **P**erformance with sustainable **IMP**act.

Are you looking for solid benchmarks on Innovation Management? Or would you like to improve your knowledge in Innovation Management? Are you interested in European studies on Innovation Management at small and medium sized enterprises (SMEs)? Or would you like to join the international IMP<sup>3</sup>rove network of Innovation Management professionals?

IMP<sup>3</sup>rove offers you proven approaches to improve Innovation Management for sustainable growth and competitiveness.

IMP<sup>3</sup>rove is an initiative of the European Commission, Directorate General Enterprise and Industries. For further information on IMP<sup>3</sup>rove and the activities of the IMP<sup>3</sup>rove – European Innovation Management Academy please visit:

[www.improve-innovation.eu](http://www.improve-innovation.eu)

[www.europe-innova.eu/innovation-management](http://www.europe-innova.eu/innovation-management)

