



**INNOVATION
FOR GROWTH**

WHY IS INNOVATION IMPORTANT?

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Innovation is important on a number of levels. It is important for nations and regions, for economic growth and it is important for firms for survival and growth.

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As stated above, innovation is important on different levels and is also important for different reasons. For nations, (and regions) innovation is an important driver of economic growth and improvement. For firms, there are a number of reasons, including survival, growth and shareholder return. This article will look at the importance of innovation from the perspective of the nation and the firm. From the individual perspective, we constantly innovate. We change our route to work to become more efficient. We change how we do something (process innovation). We train to broaden our skills (to gain competitive advantage).

Nations see innovation as important. It is a driver of economic growth. It is linked to increased welfare, the creation of new types of jobs and the destruction of old ones. In a recent book, Baumol noted that “virtually all of the economic growth that has occurred since the eighteenth century is ultimately attributable to innovation.”¹ The Economist Intelligence Unit undertook a survey in 2007² which noted that “long-run economic growth depends on the creation and fostering of an environment that encourages innovation. Innovation is considered an important driver of long-term productivity and economic growth. It is argued that countries that generate innovation, create new technologies and encourage adoption of these new technologies grow faster than those that do not.”

Innovation Nation³ states that “innovation is essential to the UK’s future economic prosperity and quality of life. To raise productivity, meet the challenges of globalisation and to live within our environmental and demographic limits, the UK must excel at all types of innovation”.



Why do we say that innovation is important? There are a number of surveys that have recently been published which confirm this. For example, respondents to The Boston Consulting Group for their report “Innovation 2010. A Return to Prominence – and the Emergence of a New World Order” ranked innovation as a strategic priority with 26% citing it as a top priority and a further 45% ranking it as a top-three priority. Research undertaken by McKinsey⁴ during 2010 supports this with their survey reporting that “84 percent of executives say innovation is extremely or very important to their companies’ growth strategy.”

For firms, there are a number of reasons as to why innovation is important, and can be briefly summarised as follows:

- Market
 - To survive adverse changes in operating circumstances;
 - To make life easier for their customers and help them improve their businesses;
 - To gain competitive advantage;

- To protect market share;
- To reposition an organisation and raise its market profile;
- To lead the market and reinforce a reputation as market leader;
- To open new horizons so as to get out of a rut or avenues with limited potential;
- External Forces
 - To comply with legislation (actual or anticipated);
 - To reduce competition and/or the influence of competitors;
- People and Organisation
 - To stimulate staff with interesting and challenging work;
 - To attract and retain higher calibre staff;
 - To provide stability for the workforce;
 - To encourage those with good ideas to approach the company;
 - To attract alliance partners;
- Financial
 - To attract extra funding;
 - To raise margins and profitability;
 - To drive total shareholder returns.

Box 1

The Boston Consulting Group undertakes an “annual global survey of senior executives on their innovation practices.” Titled “Innovation 2010. A Return to Prominence – and the Emergence of a New World Order”, the latest report sets out the world’s most innovative companies. These are identified by the survey respondents. “Rankings are based on a combination of survey responses (80 percent weighting), three-year TSR (10 percent), three-year revenue growth (5 percent), and three-year margin growth (5 percent).”

Rank	Company	Headquarters
1	Apple	United States
2	Google	United States
3	Microsoft Corporation	United States
4	IBM Corporation	United States
5	Toyota Motor Corporation	Japan
6	Amazon.com	United States
7	LG Electronics	South Korea
8	BYD Company	China
9	General Electric Company	United States
10	Sony Corporation	Japan
11	Samsung Electronics	South Korea
12	Intel Corporation	United States
13	Ford Motor Company	United States
14	Research in Motion	Canada
15	Volkswagen	Germany

Virgin Group, identified as the UK’s most innovative company, was ranked 24th, and there were only 3 other UK companies in the top 50 (British Sky Broadcasting 37; Vodafone Group 38; and HSBC Group 49).

When considering this list of reasons, it is interesting to note the two lists of innovative companies set out in Boxes 1 and 2. Both Apple and Google take the first two

Box 2

Research undertaken by Booz & Company has identified the 10 most innovative companies, as voted by the companies they surveyed. The following data is extracted from "The Global Innovation 1000. How the Top Innovators Keep Winning." strategy + business Issue 61 p 12.

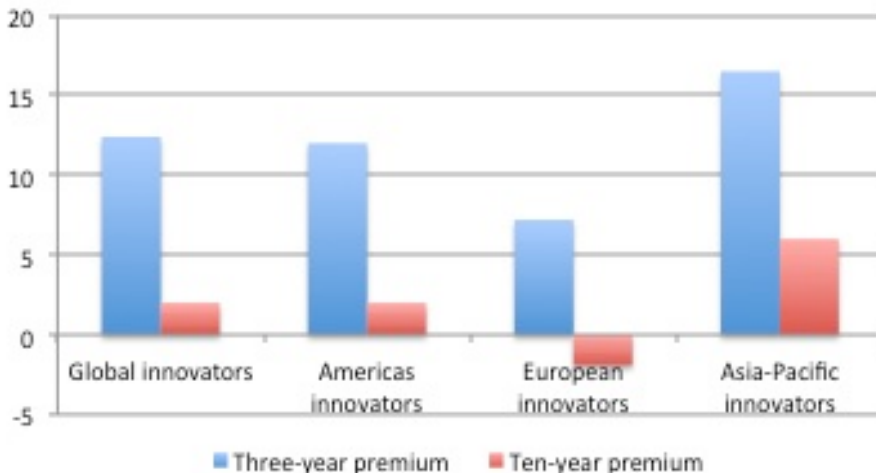
Company	R&D Spending 2009		Sales 2009	Intensity
	\$US mil.	Rank	\$US mil.	(Spending as % of sales)
Apple	1,333	81	42,905	3.1
Google	2,843	44	23,651	12.0
3M	1,293	84	23,123	5.6
GE	3,300	35	155,777	2.1
Toyota	7,822	4	204,363	3.8
Microsoft	9,010	2	58,437	15.4
P&G	2,044	58	79,029	2.6
IBM	5,820	12	95,759	6.1
Samsung	6,002	10	109,541	.55
Intel	5,653	13	35,127	16.1

According to the research report, "Apple...leads the Top 10, capturing 79 percent of the vote; it is followed by Google, with 49 percent; 3M is in third place, with 20 percent." It is evident from this, that R&D spend does not necessarily determine success at innovation. "Success in innovation is determined not by how much you spend, but rather by how you spend it."

Chart 1

The Boston Consulting Group, as part of their annual innovation survey⁴ calculate the three- and ten-year annualised total-shareholder-return premiums of innovative companies compared with their industry peers. The TSRs account for price appreciation and dividends.

Annualised TSR premium (%)



slots, probably not a surprise.

Innovation Management and the Knowledge-Driven Economy⁵ notes that "in the knowledge-driven economy, innovation has become central to achievement in the business world. With this growth in importance, organisations large and small have begun to re-evaluate their products, their services, even their corporate culture in the attempt to maintain their competitiveness in the global markets of today."

Research undertaken by the Boston Consulting Group supports the business case that innovation boosts performance – see Chart 1. Business Week also regularly features lists of top innovative firms and found that the median profit margin of the top 25 firms was 3.4% in the period 1995-2005, whereas the average for other firms in the S&P Global Index was only 0.4%. The median annual stock return was 14.3% and 11.3% respectively. Research undertaken by Innovaro⁶ reports that "half the companies identified in January 2005 as innovation leaders subsequently demonstrated an increase in share price of at least 50% over the following two years and, as a portfolio, over the same period Innovation Leaders delivered a return of 48.6% - significantly better than that of the FTSE, NASDAQ or Dow Jones." The report (2008) also notes that "the top five performers over the past year have been:

- Apple 135% (increase in share price);
- Nokia 91%
- Google 52%
- Adidas 36%
- Reckitt Benckiser 25%"



To conclude, innovation is important both nationally and also to individual firms. For the former, it is an important driver of economic growth, and all the benefits that this brings to individual nations. For firms, it can mean survival at one extreme to outperformance at the other.



1. Baumol W (2002) *The Free Market Innovation Machine: Analyzing the Growth Miracle of Capitalism*. Princeton University Press. Princeton
2. Economist Intelligence Unit (2007) *Innovation: Transforming the way business creates* EIU sponsored by Cisco Systems
3. Department for Innovation, Universities and Skills (March 2008) *Innovation Nation* Crown
4. McKinsey Global Survey 2010
5. European Commission Directorate-general for Enterprise (2004) *Innovation Management and the Knowledge-Driven Economy* ECSC-EC-EAEC Brussels-Luxembourg
6. Innovaro 2008 *Innovation Briefing, Innovation Leaders 2008*, www.innovaro.com

Founded in 2010, Innovation for Growth is a business consultancy firm that specialises in the provision of advice to small and medium sized enterprises. We work with companies from all sectors undertaking innovation audits, and providing innovation advice so our clients can achieve their growth aspirations. We also undertake desktop, business research, enabling our clients to concentrate on running their business.

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