How Business Services Can Support Today’s Enterprise Innovation Agenda
by The Hackett Group

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How Business Services Can Support Today’s Enterprise Innovation Agenda

By Erik Dorr and Sean Kracklauer

Executive Summary

A shift toward innovation-based strategic growth at the enterprise level has far-reaching implications for business services organizations (i.e., finance, HR, procurement and IT). In addition to continually improving efficiency and taking out costs, these functions must now develop new competencies and reallocate resources to higher-value-added activities to support the enterprise innovation agenda.

Key takeaways:

• Failure to respond to changing demands from the business dictated by an innovation-based growth agenda is a sure recipe for business services to become irrelevant.

• Finance must improve its innovation-related decision support and financial modeling capability.

• HR must implement programs to foster an innovation-oriented business culture.

• Procurement must foster supplier-led innovation.

• IT must reallocate resources away from “run the business” and “improve the business” activities, focusing them instead on “innovate the business” activities.

According to The Hackett Group’s research, innovation of products, service offerings and/or business models is today’s top-ranked business strategy for achieving profitable growth (Fig. 1). This represents a shift away from a focus on expanding existing markets as the primary business growth strategy.

The underlying drivers of the need to innovate in order to grow have major implications for business services functions. These are:

1. Changes in business conditions in emerging markets.

2. Technology-led acceleration in business cycles.
Driver #1: Changes in business conditions in emerging markets

In the aftermath of the global financial crisis, many companies based in developed economies accelerated their expansion into emerging markets for growth. While these will continue to be extremely important, many companies are now recalibrating their domestic-vs.-emerging-market growth profile due to changes in the risk/reward trade-off of pursuing growth in emerging markets. First, economic growth in emerging markets has slowed and is now 4% below pre-crisis levels (Fig. 2). In China’s case, the previous level (10.8%) was unsustainably high, so the decline does not come as a surprise. Further, even though economic growth in emerging markets still far exceeds that of developed markets, competition is intensifying as established companies in developed economies and increasingly assertive local competitors vie for the same customers. Local companies often have a better understanding of their own market’s needs or are advantaged through preferential treatment by regulators.

FIG. 2 Recovery from the global recession, by geography

Source: IMF World Economic Outlook Database, April 2014
In contrast to the slowing pace of growth in emerging markets, growth in North America is now slightly above pre-crisis levels, and Europe is not far behind. However, beneath the surface is a complex reality of shifts in income distribution, consumer preferences and competitive market conditions. To capture a share of domestic growth or just to maintain their market position in this environment, companies are as dependent on the ability to innovate in domestic markets as they are in emerging markets.

Driver #2: Technology-led acceleration in business cycles

The second driver of companies’ need to innovate in order to grow is the accelerating speed of business cycles, which stems from the unprecedented rate of innovation in information technology. Developed economies are in the middle of a transition from an industrial-based economy to a digital economy.1 Not long ago, the post-industrial economy was often referred to as the “information economy.”2 However, the fundamental, technology-driven change taking place in business today is more accurately described as the emergence of “digital business.” Information is still a core element of digital business, and for many unlocking the value of information (including “big data”) continues to be the greatest area of opportunity. However, the business impact of digitization encompasses far more than information, covering a full spectrum of potentially disruptive innovation enabled by digitization of processes, content, assets, products and services (see sidebar).

Digital business is driving a dramatic acceleration of business cycles and indeed the process of creative destruction. As a result, virtually every industry today is more susceptible to disruptive innovation than at any time in history.

Today’s business focus on innovation-based growth must be understood in the context of the above-mentioned drivers. Success in emerging markets will require an ability to fence off competition and create differentiation through innovation. Competitive advantage is more dependent than ever on the ability to “out-innovate” the competition.

Hackett research strongly support this narrative. A new study on innovation found that an astounding 98% of companies believe that innovation will become a more important competitive differentiator in their industry (Fig. 3). For 62% of study participants, creating disruptive innovation is an important part of their business strategy. While high levels of disruptive innovation are to be expected in technology-centric industries, this finding now applies across all industries.

**FIG. 3 The enterprise innovation agenda**

| Innovation will become a more important competitive differentiator in our industry in the next 5 years | 98% |
| Creating disruptive innovation is an important part of our business strategy | 62% | 30% | 8% |
| The company has the right KPIs, processes and incentives in place to meet its innovation goals | 34% | 31% | 35% |

Source: Innovation Study, The Hackett Group, 2014

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1 Emerging economies are also deeply affected by technology-led business cycle acceleration, but often in a different manner than in developed economies. For example, they may lack technical infrastructure or incumbent companies dominating established industries, both of which present different types of previously unexplored opportunities for innovators.

2 Another term commonly used for the fundamental changes in the nature of business was “Enterprise 2.0.”
For many, translating recognition of the importance of innovation into actual strategy and execution will pose major challenges. While companies recognize the growing importance of innovation, only about one-third of them believe they have the right KPIs, processes and incentives in place that are necessary for meeting their innovation goals, while another third say they lack these fundamental components of success.

The Role and Readiness of Business Services in Enterprise Innovation

Three-quarters of study participants view business services as an integral part of the innovation cycle (Fig. 4). This is a far cry from the perception of business support functions in pre-digital days as a cost center or an administrative activity. However, 80% of participants believe that business services need structural transformation to adequately support enterprise innovation.

Business services functions are almost unanimously planning to expand their role in supporting enterprise innovation (Fig. 5). However, their self-assessed capability to do so varies widely. Human resources is by far the most deficient in terms of having the KPIs, processes and incentives needed to support innovation of the core business as well as innovation in the HR function itself. Procurement and finance score the highest (i.e., the least self-perceived deficiency). The IT function is somewhere between the two extremes.
Finance focus: Providing decision support

The role of the finance function in enabling enterprise innovation is generally limited to providing decision support and advice. Business cases underpinning strategic investments and R&D funding need to be based on financial modeling, financial assumptions and risk analysis. Our research shows that finance is highly effective in this kind of decision support, but adoption of these techniques is relatively low (Fig. 6). The finance organizations that have not developed decision-support capabilities specific to innovation-related decisions are still providing analytical support for traditional capital expenditures and business-case prioritization. Going forward, they must develop models for decision support specific to innovation-related capital expenditures and business cases.

FIG. 6 Adoption vs. effectiveness of innovation practices, by function

Source: Innovation Study, The Hackett Group, 2014

It should be noted that finance’s ability to support innovation as reflected in Fig. 6 is biased toward sustaining innovation, which is usually based on traditional financial modeling methods using metrics such as internal rate of return (IRR) and net present value (NPV). Finance’s ability to support decisions about capital allocation for disruptive innovations (which have longer planning horizons and higher levels of risk) is much less mature.

Fostering an innovation culture

Many leading organizations have programs designed to foster innovation and instill an innovation-oriented culture. At Google and 3M, a certain percentage of employees’ time is dedicated to the generation of new ideas, which is tied to individual performance results and rewarded. Alcoa’s program to encourage idea generation among employees is resulting in a continuous stream of fresh ideas and initiatives.

HR focus: Leading cultural change and providing training

The human resources organization may directly enable enterprise innovation by acquiring or developing the talent necessary to execute an innovation agenda. However, our research indicates that HR is most effective with indirect support of enterprise innovation. First, it can promote organizational values related to innovation by driving cultural change. This possibly includes the design of programs fostering employee innovation (see sidebar). Second, HR may provide training on innovation and creativity. Both practices have adoption levels below the 50% mark, and just 60% of companies rate these practices as effective, leaving much room for improvement.
Procurement focus: Fostering supplier-led innovation
Procurement organizations’ most effective innovation-enabling practices are integral to the innovation cycle itself, as opposed to the mainly supporting practices in HR and finance. Suppliers are deeply entwined in enterprise innovation and in some cases are the main source of product innovation in globally integrated supply chains. Managing supplier involvement is ranked as the most effective of all innovation-enabling practices in our study. While fewer than 50% of procurement groups have adopted this practice, close to 80% of those groups consider it to be effective. Examples of large enterprises with processes in place to engage suppliers in innovation abound. For example, in the very early stages of a new project, Honda invites guest designers from its external supplier organizations to set up operations within its facilities and work side by side with its engineers, designers and technologists. National Grid organizes supplier events to help identify and understand the capabilities of its suppliers, which helps procurement identify the best suppliers for new projects.

IT focus: Defining the function’s role in enabling enterprise innovation
The main driver behind the strategic focus on innovation at the enterprise level is the unprecedented innovation occurring in information technology. Most enterprise innovation involves one or more of the following: content digitization, process automation, process and data integration, mobile technology, or application of advanced analytical techniques (including mining large amounts of data). Clearly, information technology is squarely in the center of the innovation cycle. Much less clarity exists about the role the internal IT organization should play in this process.

Many IT organizations are bogged down by “run the business” activities. Additionally, they must work through a growing backlog of change requests aimed at improving the business. They simply have no resources to support initiatives that are designed to create competitive advantage through innovation. With the IT organization mostly sidelined by basic “run the business” activities, ownership of critical technology components of enterprise innovation is effectively residing elsewhere in the business.

While the root cause of IT’s inability to support the enterprise innovation agenda is an efficiency gap that ties up its resources with everyday activities, the opportunity cost of the commensurate effectiveness gap is typically an order of magnitude higher (Fig. 7). This is because the opportunity cost of the inability to support business improvement and innovation far exceeds the direct cost of the resources involved in these activities.

FIG. 7  IT’s efficiency and effectiveness gaps

Source: Innovation Study, The Hackett Group, 2014
However, at some companies, IT organizations are integral to the innovation cycle. Close to 50% are actively involved with the business in enterprise innovation, but only half of these organizations rank the practice as effective. Educating the business about technology-related innovation opportunities has a lower adoption rate but is judged to be very effective in supporting enterprise innovation.

IT’s contributions to enterprise innovation at a time of unprecedented opportunity to innovate through the application of technology is a signal that IT organizations are at a critical juncture. In one possible scenario, the formal IT organization is relegated to the status of a utility, and responsibility for technology innovation is migrated to the core business. Another is that formal IT organizations will develop a partnership with the business and thereby make themselves essential to the enterprise innovation cycle, a topic we will explore in future research.

**Action Items**

The ultimate measure of the effectiveness of business services functions is their ability to help the company execute its growth strategies. As these strategies increasingly center on innovation, IT, finance, procurement and HR organizations need to develop very different sets of capabilities. While each organization has business demands and priorities, there are a number of recommendations with cross-functional implications. These include:

- **Communicate and ensure strategic alignment.** As business services organizations go through a strategic transformation, the risk that they will fall out of alignment with the business strategy increases. CIOs, CFOs, CPOs and CHROs have a responsibility to ensure that changes in the strategic priorities of the enterprise are met with corresponding adjustments in operational priorities, resource allocation and transformation objectives.

- **Adopt advanced modeling techniques pervasively.** Finance organizations historically have led the charge in developing decision support models for traditional investments, including modeling of financial and operational risk. Innovation-related investments are often of a different nature, which must be reflected in innovation-oriented financial models.

- **Foster a culture of innovation and manage knowledge-worker productivity.** Establishing an organizational culture is an enterprise issue, not just an HR responsibility. Leaders at different levels in the company’s hierarchy need to start encouraging risk taking, creativity, and collaboration with other internal functions as well as across the extended value chain of the enterprise. Far from being a distraction from transactional efficiency, the availability and application of these skills maximizes the productivity of today’s knowledge workers.

- **Innovate across the entire value chain.** Both the demand side and the supply side of the extended value chain can be rich sources of innovation. The most successful innovators galvanize the creative energies of internal staff, obtain improvement ideas from their customers, and strengthen the innovative capacity of their suppliers. This happens by design, starting with the development of end-to-end process capabilities. Procurement must play a key role in driving supplier-led innovation.

- **Mobilize technology skills across the entire enterprise.** The technology skills that are essential to innovation are not the exclusive domain of the IT organization. Because the demand for technology skills will outpace supply for the foreseeable future, companies must search every corner of the organization to locate technology talent or risk being out-innovated by competitors. While this trend is most visible in industries where business and technology are rapidly converging, it is no less true in more traditional sectors, where the traditional separation between IT and the business is still deeply entrenched.
Related Hackett Research


“2014 Key Issues: Reinventing Business Services to Support Innovation-Based Growth,” January 2014

“2014 Key Issues: Recalibrating Finance to Deliver Greater Value,” January 2014

“2014 HR Agenda: Recalibrating HR to Deliver Higher Value,” January 2014

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Mr. Dorr has over 20 years of experience in consulting, research and advisory roles in information technology strategy, enterprise application suites and business process reengineering. Before being named to his current position, he was Senior Enterprise Research Director. Prior to joining The Hackett Group, he held a number of senior management positions, including Vice President of IT at a global manufacturing company, where he was also a member of the executive leadership team.

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Over the past 20 years, Mr. Kracklauer has advised Global 1000 businesses on strategy, organizational structure and process redesign. He has worked extensively in finance strategy, business performance management, planning and budgeting, financial reporting compliance, and functional design for business intelligence systems. His fields of expertise include leading large-scale cross-functional projects to improve the effectiveness and efficiency of general and administrative service delivery by identifying the optimal strategy, structure, sourcing and enabling technologies to achieve the business objectives. Mr. Kracklauer has served clients ranging from $5 million to over $100 billion in revenues in the financial services, technology, pharmaceutical, telecommunications, energy, health care, retailing, consumer packaged goods, software, broadcasting and manufacturing sectors.