Finding the Right Mix: What is the Appropriate Combination of Innovation Types in Your Portfolio?

by Jamie Lahiere and Sean Klein

It can be difficult to find the right balance of innovation types in your portfolio. The mix with the highest overall return varies by industry, competitive position, and most importantly, by the company's business strategy. Your portfolio will rely heavily on the strategic goals of the organization and should naturally evolve and adapt to changing environmental needs and company direction.

The goal is for management to arrive at a ratio that will maximize innovation ROI in the form of revenue growth and increased market capitalization. As in financial investing, you want to construct a portfolio that produces the highest overall return that's in line with your company's tolerance for risk, or “innovation ambition” (Nagji, 2012).

The innovation portfolio’s mix of investments should align with:

- Corporate strategy
- Growth goals
- Tolerance for risk
- Company mission and values

The first step to balancing the portfolio is to understand innovation types, determine how you will classify initiatives, and assess the level of risk your innovation strategy requires.

Understand Innovation Types: Not All Innovation is the Same

Strategically classifying your projects by innovation type will communicate valuable insights regarding the state of your portfolio and reveal discrepancies between business growth priorities and initiatives receiving funding. There are three primary innovation types: core, adjacent, and new platform.

These three tiers are distinguished by potential returns and how much they deviate from core business competencies and associated levels of risk.
Determine How You Will Classify Innovation Initiatives

Here are some examples and additional detail on how to classify your innovation initiatives into these three types.

**Core Innovation Projects** - Low risk initiatives that leverage core competencies and stay within the organization’s comfort zone.

Line extension project types typically fall within this bucket. Line extensions are incremental improvements made to existing products or services. These innovations replace yesterday’s offerings with today’s and are often referred to as incremental or sustaining.

**Adjacent Innovation Projects** - Initiatives that leverage existing competencies to deliver offerings to a new customer base.

This type of innovation initiative allows companies to strategically expand from existing business into new territories with moderate risk. Projects classified under adjacent typically leverage existing capabilities but require new insight into market variables such as customer needs, market structure, competition, and technology trends. Channel innovations that deliver existing offerings through new channels also fall within this category.

**New Platform Innovation Projects** - Long-term investments that call on capabilities beyond core competencies.

Breakthrough innovation initiatives are designed to create new offers - if not whole new businesses - to serve new customer needs and markets. These innovations are often referred to as radical, transformational, game changing, and new-to-the-world because they are the engines of blockbuster growth.

Disruptive innovation describes a process by which a product or service takes root initially in simple applications of niche markets and then relentlessly expands into more lucrative markets, eventually replacing established competitors and technology. These are often referred to as growth innovations.

There are three additional strategic portfolio classifications that many companies use. These classifications either a) consume shared resources with the innovation portfolio, or b) highlight specific corporate initiative goals. These strategic buckets are process, business model, and support.

**Process Innovation** refers to manufacturing or process changes that enable an organization ability to produce an offering more efficiently.

- Efficiency innovations focus on reducing the cost of making and distributing existing products and services.
- Cost saving innovations free up cash for other uses while enabling the same amount of work to be done faster or with fewer resources.

**Business Model Innovation** redesigns the way an organization delivers value to customers, often involving the creation, or reinvention, of a business itself. While the previous types of innovations are in the form of new product and service offerings, business model innovation results in a new value proposition.

**Support Initiatives** include any type of project work that consumes development resources. Projects in the support bucket are often post-launch fixes to offerings, new product development capability building, and regulatory compliance efforts.
Assess Risk and Strike a Balance

A company’s portfolio should strike a balance between short-term growth and long term bets that target strategic growth areas. Many companies pour the majority of their investment into core innovation initiatives such as line extensions, packaging changes, and process improvements. According to Harvard Business Review, high performers that invest in all three primary classifications typically invest 70% core, 20% adjacent, and 10% new platform. Interestingly enough, these same high-performers see an inverse return on their portfolios with total revenues resulting from 10% core, 20% adjacent, and 70% new platform (Nagji, 2012).

The right balance will vary from company to company based on strategic factors as well as development stage, competitive position and specific industry. Core innovations and new platform projects have substantial differences in risk levels, time frames, and potential payoff. It’s important for management to employ portfolio thinking techniques to view ongoing innovation initiatives in terms of overall risk and return characteristics. After establishing a clear understanding of innovation characteristics, you can begin to shape the portfolio to achieve your goals.

Reference:

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