



# FOCUS STUDY

## **Innovation Sourcing: Contributing to Company Competitiveness**

A CAPS Research  
Initiative

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# Foreword

Product, service and process innovation is a critical strategy at companies such as P&G, Whirlpool, Philips, Ford and others worldwide. Important innovations are developed internally, externally or in collaboration with suppliers and customers.

However, firms have not yet fully established how they will most effectively leverage external supplier capabilities to accelerate innovation to the benefit of both buyers and suppliers. Innovation sourcing requires companywide strategies, with strong executive engagement, that are both customer and internally driven. Innovation sourcing is in the early stages of development at most firms.

Numerous articles, private research, and government reports and books emphasize the need for innovation improvements by U.S.-based companies and the country in general. Consulting firms are increasingly focusing attention on innovation strategy and “clean sheet” design of products for emerging markets. There is, however, a need to further develop insights about how companies are achieving innovation and leveraging supplier capabilities, especially in their new product development.

In this and a complementary report, *Implementing Supplier Innovation: Case Study Findings*, CAPS Research studies and explains how leading companies and their suppliers are engaging in supplier innovation. The research examines the strategies and approaches that are in place at a number of companies to accelerate and obtain supplier innovations. Company case examples are used to describe these strategic approaches as well as barriers to success, enablers and overall critical issues.

# Table of Contents

Acknowledgements	2
Foreword	3
Table of Contents	4
List of Figures	6
Executive Summary	7
Recommendations	8
Section I: Introduction, Business and Supply Innovation Strategy	10
Chapter 1 — Introduction and Research Background	11
The Innovation Research Frameworks/Ideas	12
Open Innovation Discussion	12
Research Focus and Objectives	14
Research Approach	14
Report Structure	15
Chapter 2 — Innovation Strategies: Aligning Business and Supply	17
Research Innovation Strategy	18
Innovation Strategy	18
Supply Network Relationships	20
Systems, Processes and Capabilities	22
Results	22
Recommendations Regarding Company Innovation Approaches and Supply Innovation	22
Supply Innovation Strategy: Innovation Sourcing	23
Critical Innovation Elements/Characteristics and Roles	24
Section II: Accelerating & Achieving Supplier Innovation: Supply Strategy & Approaches	26
Chapter 3 — Supply's Innovation Strategy	27
Supply Strategies for Innovation Sourcing	27
Overall Supply Innovation Strategy <b>I</b>	29
Innovation Focused Supply Base Management <b>II</b>	30
Strategic Sourcing with Robust Category Strategy Development and Execution for Innovation <b>III</b>	33
Early Supplier Engagement in New Product Development and Innovation <b>IV</b>	35
Equitable Contracting and Risk/Reward <b>V</b>	36
Strategic Cost Management <b>VI</b>	37
Supplier Relationship Management with Communications and Trust <b>VII</b>	38
Systems and Processes to Acquire, Evaluate and Respond to Supplier Innovations <b>VIII</b>	39
Concluding Recommendations	41

Chapter 4 — Supplier Perspectives . . . . .	43
Innovation Sourcing: Supplier Perspectives . . . . .	43
Overall Recommendations: The Supplier Perspective. . . . .	45
Chapter 5 — Supply’s Role in Acquiring Supplier Innovation . . . . .	46
Supply’s Role: A Critical Perspective. . . . .	46
Critical Issues Regarding Supply’s Role . . . . .	51
Overall Recommendations . . . . .	52
Section III: Establishing Critical Innovation Sourcing Enablers . . . . .	53
Chapter 6 — Innovation Metrics . . . . .	54
Firm-Level Metrics — Output . . . . .	55
Firm Level Metrics — Input . . . . .	57
NPD Process Metrics . . . . .	57
Recommendations/Actions. . . . .	58
Supply Management Innovation Metrics . . . . .	58
Supplier Innovation Metrics. . . . .	58
Metrics for Continuous Improvement . . . . .	59
Recommendations . . . . .	59
Summary . . . . .	60
Chapter 7 — Intellectual Property . . . . .	61
Buyer Owns and Controls All IP . . . . .	61
Supplier Owns All IP. . . . .	62
IP Developed/Shared by Buyer/Supplier. . . . .	62
Other Considerations Regarding IP and JDAs . . . . .	63
Additional Thoughts Driving Industry Innovation Growth . . . . .	63
Recommendations . . . . .	64
Chapter 8 — Trust and Communications. . . . .	65
Trust and Innovation . . . . .	65
Competency. . . . .	65
Honesty . . . . .	67
Goodwill . . . . .	67
Observations . . . . .	68
Recommendations . . . . .	68
Chapter 9 — Risk/Reward Considerations . . . . .	70
Definitions . . . . .	70
Innovation Risk/Reward Considerations. . . . .	70
Overall Recommendations . . . . .	79
Chapter 10 — Organization and Coordination. . . . .	80
Matrix, Process, Networked Organizations. . . . .	81
Cross-Functional Teams. . . . .	84
Long Term versus Short Term . . . . .	84
The Advanced Purchasing Group in the Matrix/Process Organization . . . . .	85
Organizing the Supply Base . . . . .	85
Recommendations . . . . .	86
Section IV: Innovation Sourcing: Critical Implementation Recommendations . . . . .	87
Chapter 11 — Recommendations: Implementing Innovation Sourcing . . . . .	88
Foundation Strategy Recommendations. . . . .	89
Innovation Sourcing Strategy and Supply’s Role Recommendations. . . . .	89
Observations: Actions to Accelerate Supplier Innovation. . . . .	90
Observations: Actions to Enhance Supplier Collaboration . . . . .	90
Appendix A — Research Methodology. . . . .	91
Appendix B — Implementing Supplier Innovation: Case Study Findings . . . . .	93

# List of Figures

Figure 1.1: Categories of Innovation: Type and Focus. . . . .	12	Figure 3.7: Buyer/Supplier Behaviors Negatively Affecting Trust (and Preferred Status). . . . .	39
Figure 1.2: Type and Degree of Innovation. . . . .	13	Figure 3.8: Development of Supplier Innovation E-Systems and Processes . . . . .	40
Figure 1.3: Open Innovation: A Perspective and Key Players . . . . .	13	Figure 3.9: An Innovation Portal Approach . . . . .	41
Figure 1.4: Innovation and New Product/Service Development . . . . .	14	Figure 5.1: Supply's Role in Acquiring Supplier Innovation . . . . .	47
Figure 2.1: Executive Expectations of Supply are Increasing to Deliver Greater Value Beyond Cost . . . . .	18	Figure 5.2: New Product Development Process . . . . .	49
Figure 2.2: Critical Companywide Innovation Elements/Characteristics. . . . .	19	Figure 5.3: Level of Required Executive Engagement . . . . .	50
Figure 2.3: Critical Supply Innovation Elements/Characteristics. . . . .	23	Figure 5.4: Design-In Workshop Characteristics . . . . .	50
Figure 2.4: Company and Supply Alignment and Linkage Requirements . . . . .	24	Figure 7.1: IP Ownership Range. . . . .	61
Figure 2.5: Critical Innovation Elements and Functional Roles. . . . .	25	Figure 8.1: Dyadic Trust Model . . . . .	66
Figure 3.1: Elements/Characteristics of Innovation Sourcing Success . . . . .	28	Figure 9.1: Risk Assessment . . . . .	71
Figure 3.2: Foundation Enablers/Influencers of Company and Innovation Sourcing. . . . .	28	Figure 9.2: Reward Assessment . . . . .	72
Figure 3.3: Typical New Product Development Stage-Gate Process . . . . .	29	Figure 9.3: Risk/Reward Combinations. . . . .	72
Figure 3.4: Purchase Category Profile for Innovation . . . . .	30	Figure 9.4: Risk and Investment Over Time . . . . .	78
Figure 3.5: Segmentation by Innovation Project/Supplier Size. . . . .	31	Figure 10.1: Sample Matrix Organization Structure. . . . .	81
Figure 3.6: Early Supplier Engagement. . . . .	35	Figure 10.2: Sample Process Organization Structure. . . . .	82
		Figure 10.3: Sample Network Organization Structure. . . . .	83
		Figure 10.4: Competitive Markets Versus Collaborative Communities . . . . .	86

# Executive Summary

Innovation of products, services and business models is increasingly identified as an important strategy to achieve competitive advantage. Apple, Cisco, Ford, IBM, Philips, Procter & Gamble and Whirlpool, to name a few leading companies, have identified “innovation” as a critical strategy that will enable their future growth and profitability.

“Open innovation”<sup>1</sup> is a strategic approach being implemented by firms across multiple industries. Procter & Gamble popularized the open innovation approach through its “Connect + Develop” efforts, whereby it established a goal of attaining 50 percent of its revenues through external innovations over a five-year period.<sup>2</sup> Open innovation maxims include:

- Smart people work at our own as well as other companies.
- External R&D can create considerable value and internal R&D enables capture of some of the value.
- Research does not have to originate internally to profit, and establishing better business models is more important than getting to market first.
- Companies that make the best of both internal **and** external ideas will win.
- Companies can profit from others’ use of their intellectual property (IP) and companies should buy others’ IP whenever their own business model can be advanced.

In addition, The Boston Consulting Group, in conjunction with Bloomberg Business Week, recently

completed its seventh annual global survey of senior executives about their company innovation strategies and practices.<sup>3</sup> Three key findings stand out:

1. “Innovation is again becoming a top priority at companies, after the great recession, and more resources are being spent on innovation and satisfaction with the innovation return is slowly increasing.”
2. “The innovation focus is still cautious, with the focus being incremental innovation, based on existing products and services vs. breakthrough new products and innovations. However, the innovation focus is broadening in rapidly developing economies to include product development and idea generation.”
3. “Three areas of weakness limiting innovation are; (a) risk adverse corporate cultures, (b) lengthy new product development cycle-times, and (c) inadequate measurement practices for innovation.”

Furthermore, C.K. Prahalad and R.A. Mashelkar<sup>4</sup> argue that, following the severe economic downturn, innovation is making a comeback as a high-priority corporate strategy. However, traditional approaches to and views about innovation are changing dramatically. Innovation strategies built around affluent consumers and abundance may be giving way to more inexpensive, value-to-customer or money-driven products and services. In addition to the value focus, consumers worldwide are also demanding environmentally friendly products and services, further shifting the focus of innovation.

<sup>1</sup>Chesbrough, Henry. “Open Innovation: The New Imperative for Creating and Profiting from Technology.” Boston: Harvard Business School Press, 2003.

<sup>2</sup>Huston, Larry and Sakkab, Nabil. “P&G’s New Innovation Model” *Harvard Business Review*. March, 2006.

<sup>3</sup>Arndt, Michael and Einhorn, Bruce. “The 50 Most Innovative Companies” *Bloomberg BusinessWeek*. April 15, 2010.

<sup>4</sup>Prahalad, C.K. and R.A. Mashelkar. “Innovation’s Holy Grail” *Harvard Business Review*. July-August, 2010.

Within this changing environment, CAPS Research undertook research to determine how buying companies and their suppliers were able to collaborate in order to further innovation and the development of new products and services.

The research was aimed at answering three fundamental questions:

1. What company strategies and approaches can be used to achieve supplier innovation?
2. What supply strategies can be used to identify, select and effectively collaborate with suppliers to accelerate and achieve supplier innovation?
3. What is the specific role supply management can play in achieving supplier innovation across the stages of product, service and process innovation?

The primary source of data was in-depth interviews with five leading worldwide companies, eight of their SBUs and their suppliers with a focus on innovation and companywide approaches to achieving supplier innovation. Extensive interviews were conducted with more than 70 key leaders representing innovation, engineering, technology, sales, product development and purchasing. The business units were from the automotive, industrial manufacturing, electronics, food and beverage, and telecommunications industries.

The main recommendations from the research “Innovation Sourcing” follow. Detailed results of the study are presented in the body of the report.

## Recommendations

### **An Established and Clearly Communicated Company Innovation Strategy Is Required for Innovation Sourcing to Succeed**

To drive open innovation, a clearly defined and articulated innovation strategy must be established. The strategy will require a holistic approach with a number of elements that include a companywide innovation strategy with executive engagement, a culture of innovation from any source, clear-cut definitions of innovation and metrics that accurately measure the success of the innovation effort.

Supply network relationships will also have to be established that include both a focus on customer innovation needs and the ability to translate and communicate these needs to suppliers when appropriate. Equitable buying company and supplier risk/reward agreements that spur supplier innovation on behalf of the buying company combined with high

levels of trust and positive supplier working relationships must also be achieved.

The right systems, processes and capabilities also have to be in place to speed innovation ideas to commercialization. These include robust innovation and new product development stage-gate processes, as well as internal and external ideation workshops.

### **Specific Strategies**

Specific recommendations for company and supply policy, strategy and practice that directly impact on the acquisition of innovation from suppliers, all derived from this research, include:

- The companywide innovation strategy should be more “open” than “closed,” with a company culture that values and emphasizes innovation from suppliers and other external sources.
- An executive position for innovation should be established, with responsibility for enhancing the rate and quality of innovation from all sources, including suppliers.
- Innovation definitions and metrics should be established to measure innovation implementation and innovation results.
- To enhance supplier innovation efforts focused on company needs, clarity around company innovation needs should be established and communicated to suppliers.
- Equitable risk/reward agreements should be established with suppliers.
- Executive support and engagement should be established to develop strategic and positive working relationships with those suppliers most likely to be able to provide future innovation.
- Innovation and new product development stage-gate processes should be reviewed to enhance speed to commercialization and segment risk/reward scenarios.
- Executives should establish budgets for:
  - Innovation workshops
  - Internal and external innovation training
  - Innovation idea portals
  - Working with universities and other third parties to find new innovations
- Strategic supply strategies should include supplier innovation as a measurable objective.
- Company innovation needs should be clearly communicated throughout supply management and to suppliers.
- Methods to assess supplier innovation capabilities and ability should be established.
- Approaches to obtain and assess supplier innovations ideas should be established.

- A culture should be established that emphasizes achievement of supplier innovation through equitable risk and reward, IP ownership and joint development efforts.
- Supplier innovation should lead to overall strategic objectives of competitive costs, asset utilization, and revenue and margin enhancement.
- Supply base segmentation that identifies strategic suppliers for innovation, with a focus on positive supplier working relationships and collaboration to achieve important innovation needs, should be established.
- Appropriate levels of information transparency with strategic suppliers should be established.
- Executives should engage with buyers and suppliers to establish working relationships conducive to innovation.
- Supplier communications and trust-building efforts should be developed to become a customer of choice for innovation.
- Highly innovative suppliers should be rewarded with ongoing business.
- An advanced supply group, focused on achieving supplier innovation early in the new product/service development process, should be established.

### **Required: A Holistic Approach to Achieving Innovation Sourcing**

As is evident from the long list of recommendations above, there are a number of critical elements that are required to drive and achieve supplier innovation. The elements are focused on innovation strategy, supply network relationships, systems, processes, capabilities and results. For supply to be effective in its innovation sourcing efforts, a holistic company and supply approach to achieving supplier innovation is required along with effective implementation of the critical elements. The interrelationships between company and supply innovation strategy and innovation sourcing need to be clear and communicated throughout the company and out to suppliers and other third-party providers.

### **Innovation Sourcing Assessment is Enabled**

The detailed recommendations in Chapter 11 provide the basis for a company to assess its' company and innovation sourcing efforts. A leadership group can rate the implementation of each of the recommendations on a scale ranging from not implemented, somewhat implemented to fully implemented. A consensus can then be reached by the executive group regarding priorities and possible improvements.