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Innovation champions: How CFOs can keep companies vital

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In this series of white papers, PwC and faculty at Wharton focus on how CFOs can build high-performing finance teams. Topics include attracting and motivating the right talent; leveraging all parts of the finance organization; and what it means to be a high-performance CFO today.

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In today's fast paced and constantly changing market, continuous innovation is critical to any company's success. Timely innovation boosts market share, sharpens competitiveness, lifts earnings and propels careers. CFOs can play a critical role, but for them, supporting innovation presents a particular challenge. According to PwC, faculty at Wharton and top-performing finance executives, embracing innovation requires monitoring risk closely without smothering ideas. For finance executives who have spent the past five years cutting costs and managing cash flow, the balancing act is as formidable as it is essential. The finance department should shed the perception that it bogs down new ideas, and should ensure that companies have the processes and expertise to decide when to invest, and where.

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Cautionary tales about companies that resist innovation fill the annals of business history. Many of these buttoned-down, detail-oriented company cultures possessed formidable bench strength and a tireless commitment to high performance. This enabled these firms to manage well, given foreseeable circumstances. However, they learned the hard way that markets, economic climates, technology and competitive scenarios shift constantly—and now, more than ever, companies need to be able to innovate.

"The speed at which innovations are changing business models in many industries means approaches to innovation need to change," a 2012 PwC CEO Survey report notes. Indeed, as a nation, the U.S. is playing innovation catch-up, according to the 2012 Global Innovation Index Rankings published by INSEAD, which weighs such factors as human and capital research, market and business sophistication, and knowledge and technology inputs and outputs. The U.S. garnered only tenth place on the innovation index, behind Switzerland, Sweden, the United Kingdom, Hong Kong and Ireland, among others.

To drive the most efficient innovation in such a competitive climate, CFOs need to jettison preconceptions about what innovation means. "Managers in all industries need to define innovation as more than just the products and services they create," says PwC partner and U.S. technology sector leader Tom Archer. "They must learn how to deliver products and services in new ways that customers can use, enjoy or derive underlying value from."

The goal is not necessarily to set the world on fire. "Two thirds of what you do in innovation is to maintain market share," says Don Allan, CFO of Stanley Black & Decker, a tool, hardware and security products manufacturer. Of the key factors that differentiate value propositions in global markets, innovation trails only brand power, according to Allan. "Without innovation, brand power becomes outdated."

Companies like Blockbuster and the handset division of Motorola (which eventually became Motorola Mobility and was sold to Google) illustrate the consequences of slipping behind the innovation curve. Both former leaders in their respective sectors, they fell off the pace. Failure to challenge online rivals drove Blockbuster into bankruptcy; its remains were sold to DISH Network Corporation in 2011. Motorola, once a leader in the mobile industry with its clam-shell phone design, has scrambled to keep up with innovation in the sector since the modern smartphone was introduced.

Aligning the organization

In order to foster innovation in a company, an innovation mindset should take root from the shop floor to the executive suite, including the office of the CFO. "Finance can kill innovation," warns Allan. "You can easily justify that these investments don't make sense in the short term." Instead, CFOs should help operating executives understand the potential of new projects. "Helping the business to understand what innovation could lead to from a finance, revenue and profitability aspect—that's a CFO's role," says PwC Partner Ed Ponagai.

Growth-minded CFOs make innovation a priority everywhere in the company. They align their organizations with new innovation models and forge partnerships with strategic business units where innovations typically begin. A recent client meeting demonstrated for PwC's Archer how innovation resides in collaboration and cross-fertilization between finance and other parts of the company, rather than exclusively in the silos previously dedicated to it (i.e., R&D or Advanced Development). At the meeting, *"Many of the most powerful sources of organic growth come from pathways other than the invention of new products."*

– George Day, Wharton marketing professor and the co-director of the Mack Center for Technological Innovation

Archer notes, executives from the company's service side joined the CFO and product executives for a cross-portfolio strategic planning discussion—an indication that in this particular client's view, innovation encompasses much more than just products. It involves input from all parts of the company, from finance through fulfillment.

According to Allan, Stanley Black & Decker routinely dispatches "swat teams" that spend time with customers on job sites. Time spent observing someone else doing work generates no immediate tangible return, but the results can be invaluable. For example, while observing workers using hammers for hours on end, a swat team noted the excessive strain on workers' arms that comes from pounding nails repeatedly. Seeing those consequences up close triggered a lucrative idea: The swat team proposed making hammers that mute vibration. In the end, the process yielded a breakthrough in hammer design that supported a premium price.

Pathways to innovation

As companies seek new ways to promote growth, mounting evidence calls for innovation outside of the usual research and development space. "Many of the most powerful sources of organic growth come from pathways other than the invention of new products," says Wharton marketing professor George Day, who is co-director of the school's Mack Center for Technological Innovation. For instance, innovations can arise from mapping complex customer interactions; every visible bottleneck and sticking point offers an opportunity for innovation.

Snack-maker Frito Lay seldom introduces new products, Day points out. Its innovative strength lies instead in improving product design, packaging and positioning on a national level. The video gaming industry illustrates yet another approach to innovation. While there is obviously a key technology dimension, successful innovation and mass adoption also hinge on overcoming costs and introducing customers to the new skills required for sophisticated video games.

Christian Terwiesch, Wharton professor of operations and information management, believes companies that focus innovation exclusively on new products throw too much money at them. They spend lavish amounts in pursuit of marginal gains. Additional dollars aimed at breakaway hits go to potentially weaker and weaker projects. In an arena where outstanding innovation should yield ten-fold returns, companies arguing over initiatives with a 150% return versus 160% have lost the battle before it begins, Terwiesch says. "Once you're fighting in those areas, it's a losing proposition."

When it comes to desired outcomes from innovation, instead of lumping innovation under a single heading, Terwiesch urges CFOs to assign every proposed innovation to one of three "Horizons" with suitable expectations and commensurate investment. Horizon One features products and services that increase revenues from known sectors in familiar markets. Horizon Two initiatives seek growth from products or services adjacent to existing sources of revenue.

Horizon Three represents the game-changer—the brand-new idea that vaults beyond the competition. In most cases, Terwiesch advises, "if the long term is too risky, let others resolve that uncertainty." When an idea really takes off, big companies then have the muscle to embark on innovation imitation, or to purchase or license the product. However, it makes more sense for large companies to assign the bulk of innovation to Horizon One, where expected returns far outweigh the prospects of losses, he notes.

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Innovation within finance

One of the most potent ways for a finance team to foster company-wide innovation is to model a culture of innovation within its own ranks. Improvements in such classic functions as working capital management and time-to-close not only free cash for innovation elsewhere within the company, they also free finance executives to spend time on other projects.

While finance departments in many companies have adopted such practices as shared services, outsourcing, leadership programs and automation, this is often not enough. In Stanley Black & Decker's finance department, for example, short-term fixes are out; system-wide solutions are in. A new finance regime champions functional efficiency throughout the company. An ambitious goal aims to shrink time spent on routine transaction processing to 50% from a norm of 75%, freeing Allan and his finance team to spend more time analyzing performance data, partnering with business management, driving talent development and performing value-added activities that boost top and bottom lines.

Allan has gone one giant step beyond the standard "better practices" to a program called Foundations of Financial Excellence (FFX). This program, explains PwC partner Mike Boyle, pulls individuals from the finance organization into a dedicated transformation group. Each member of the group is asked to identify and spearhead an initiative that will significantly improve either operating profit or cash flow. Most of the projects are expected to drive, at a minimum, hundreds of thousands of dollars in financial returns, Allan recently told CFO.com. This can be a career-making exercise.

Participants in the FFX program are asked first to develop business plans for their initiatives, which may involve working capital management, productivity improvement, reduction of fixed assets or introduction of new products and services. During the first weeklong session, they present their business plans to Allan. Four months later, after working on their projects with other Stanley Black & Decker employees, they present their results in another weeklong session.

In one initiative, an employee based in the U.S. developed a plan to reduce days sales outstanding (DSO) in the company's European operations from 70 days to 65 days. Working with finance and commercial teams in Europe, he focused on overdue payments from smaller customers. By changing payment terms, he and his colleagues have so far dropped the European DSO figure down to 66 days. They hope to drop it still further, but as Allan notes, "Already the project has driven more than $1 million in receivables benefits."

Another project involved pricing. In this instance, an employee compared Stanley Black & Decker's pricing on electronic security products with that of its competitors and devised a new pricing structure for some products. Overall, the adjustments resulted in a revenue gain of $4.5 million—a 1.5% increase for a business generating roughly $300 million a year.

The keys to making these projects work? According to Boyle, who has worked with Stanley Black & Decker for a number of years: real commitment from the top; willingness to dedicate time and resources to these initiatives; and a culture that rewards employees for taking on a challenge to innovate while offering them the structure they need to succeed.

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– Mike Boyle, PwC Partner

Lessons learned

As the FFX program illustrates, finance departments can move beyond their reputations for stifling innovation without sacrificing their ability to rigorously evaluate potential projects. Finance can better facilitate interdepartmental communication, helping other functions and units ensure that the value and benefits of innovative investments are formulated and presented effectively in business cases. "Knowing when and how to apply the appropriate analytics is crucial", says PWC's Boyle. "While it's important to benchmark and measure outcomes, overly regimented, rigid metrics can stifle innovation. Measuring progress must include taking into account all of the benefits of an innovative project, even those that are difficult to quantify."

Even so, companies face "go or no-go" decisions all along the way, from initial green lights to mid-course adjustments. Once projects are underway and not meeting expectations, knowing when to pull the plug is a tough call," Stanley Black & Decker's Allan says. However, some fixed rules apply. At Stanley Black & Decker, new initiatives must meet objectives within firm time frames. "If you can't find a way to produce it in six months," says Allan, "it goes back on the shelf." But what about gray areas, where projects reach only 75% of their goals in the allotted time, or, for example, a viable innovation finds consumers but can't sustain a sufficient price premium? In that case, the product would get a bit more time to prove itself, but only to a point, according to Allan. "We don't tend to let things drag on beyond 12 months. If it hasn't come to fruition by then, it gets shelved until technology or the market changes."

For CFOs, the challenge is to steward, rather than stifle, innovation. Stanley Black & Decker has innovated through strategic acquisitions quite successfully, and developed an integration playbook to ensure they add value. But Allan also aims for more topline-focused projects in the FFX program to help the company grow organically. In the competitive global marketplace, innovation is a necessity, not an option. "You have to be the innovation leader in your industry," he says, "just to make sure that you maintain market share and create the opportunity to gain share."

Key takeaways:

- The CFO has the role of steward when it comes to company-wide innovation.
- The CFO is responsible for leading by example, by innovating within the finance function.
- Innovative cultures take vital cues from finance departments that don't get in the way. Encouraging and investing in innovation requires a different way of thinking and a rethinking of standard metrics.
- As key factors that differentiate value propositions in global markets, innovation trails only brand power. Work on both in tandem to boost performance.
- Finance teams should shrink time spent on transaction processing to gain more time for valued-added financial analysis that supports innovation.
- CFOs should frame innovation initiatives based on three horizons where investment and potential returns are commensurate.

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