

Innovating for growth

A guide to approaching innovation for small and midsize businesses

Rapidly changing markets — fueled by fierce competition, changing customer requirements, accelerating technological advancements and an uncertain economy — have left CEOs with two choices for their business: innovate and grow, or stick with the status quo and face the threat of becoming obsolete.

- High-growth companies are 37% more likely to rely on radical innovations than no-growth companies.
- 74% of companies depend on incremental innovation more than they depend on radical innovation.
- CEOs of small and midsize businesses report that “lack of time” is their No. 1 barrier to innovation.

Companies need to continually innovate to stay competitive.

CEOs from small and midsize businesses seem to have made the right choices as 70% project increased revenue growth for their businesses this year, according to a Vistage CEO Confidence Index survey. They also report that this growth is fueled by expansion tactics such as acquisitions, developing new products, entering new geographic markets, and gaining new customers through sales and marketing efforts.

Innovation is playing a role, based on data collected from 1,432 CEOs in a recent Vistage survey.¹ Experts from Vistage, Optimize Inc. and the University of Southern California found that high-growth companies² are significantly more engaged in innovation than no-growth companies.³

“The fastest-growing companies are the ones most capable of adapting to a rapidly changing environment, so innovation and growth are clearly linked,” says business strategist **Marc Emmer**, president of Optimize Inc. and one of the study’s co-authors.

“Clearly, the companies that are growing and succeeding are the ones that are innovating. In a hyper-competitive marketplace, competitive advantage is often fleeting and temporary,” adds Emmer. “The most successful entrepreneurs I know demonstrate a relentless pursuit of improvement.”

This report draws on both survey data and expert insights to identify the innovation practices of small and midsize businesses, explore the barriers and facilitators of innovation, and offer guidance on how CEOs can optimize their innovation practices — not just to improve their business, but to grow it.

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¹ Q2 2018 Vistage CEO Confidence Index

² High-growth companies are defined as those that achieved 10% revenue growth last year and forecast revenue growth greater than 10% this year.

³ No-growth companies are defined as those that experienced flat or declining revenue growth last year and forecast the same results for this year.

Part I

Understanding innovation

Innovation is the act or process of departing from the status quo. Innovation is breaking the status quo in search of something better — it's not just about being different. It's an effort that results in some kind of measured improvement, such as more efficient workflow or increased market share.

Innovation requires an intentional commitment of energy (i.e., people, time, money, resources) to achieve an advantage or possibly even to disrupt a market. In some situations, it is triggered by an event. For example, a new entrant in your market might threaten your competitive position, or a key employee might depart from your company. In these instances, innovative tactics are required to maintain the performance of your company, return operations to the status quo, or simply ensure its ongoing sustainability.

Technology, as much as anything, is forcing businesses to innovate. Whether it's the implementation of new customer relationship management (CRM) or enterprise resource planning (ERP) systems, or embracing social media to connect with customers, markets and potential employees, technology is the change agent of our generation. Failure to adapt to the unrelenting speed of technological change is a fast path to obsolescence.

**“For companies,
the goal of
innovation is
not to become
a different
business; it’s to
become a better
business.”**

Joe Galvin
Chief Research Officer,
Vistage Worldwide

Broadly speaking, there are two types of innovation that companies can employ in efforts to improve: incremental innovation and radical innovation. Distinguishing between these two categories can be difficult because they blur together at the margin, but the differences are real.

“They have important implications for organizational design and performance management,” says **Shelley Xin Li**, assistant professor of accounting at the University of Southern California. “People may have different understandings of what ‘incremental’ or ‘radical’ means. For this study, we had to break down incremental innovation and radical innovation in concrete terms.” Further analysis then verified those terms through responses collected from CEOs.

Focus: The process of improving existing products or services

Focus: The process of creating novel products or services or major technical breakthroughs

Incremental

Status Quo

Radical

Goal:

- Serve new customers or markets
- Develop new processes of making or providing existing products or services

Goal:

- Provide new products or services
- Develop new technologies

“Innovation is usually very incremental in small and midsize companies,” says Emmer. “For example, a company might try to use innovation to increase their productivity 2-3% in a year. The problem is, if all of your competition is also seeking a 2% productivity improvement every year, you won’t achieve differentiation with that approach.”

Part II

Practicing innovation

Small and midsize companies don't all approach innovation the same way. In the survey, CEOs were asked to rate these activities based on how critical they were to their company's success.

"In our analysis of the data, we looked at respondents that agreed or strongly agreed to the statements provided," explains **Anne Petrik**, senior director of research at Vistage Worldwide. "We then used those "agree" percentages to rank the activities to see which rose to the top."

Company success is based on:	Agree %
1. Operational efficiencies that reduce time/cost	67%
2. Incremental improvements in existing products/services	60%
3. Serving new customers and markets	60%
4. New processes for making or providing existing products	46%
5. Providing new products or services	38%
6. Radical innovations and technological breakthroughs	16%
7. Developing new (patentable) technologies	15%

Source: Q2 2018 Vistage CEO Confidence Index, n= 1,432

Again, the majority of these activities (No. 1-4) centered on incremental innovation rather than radical innovation (No. 5-7).

"Small businesses — relative to big corporations — are more likely to serve a 'niche' market where the innovation tends to come from continuous improvement of the product or service through deep knowledge of the customers," explains Li.

Why do small and midsize businesses favor incremental innovation?

"Incremental innovation is easier to fund and much less risky. Generating radical innovations often requires large investments of resources in exchange for uncertain returns that will probably be far into the future. Most small businesses have grown past the entrepreneurial, startup stage. Their managers are less willing to make these investments, some of which might put the survival of the company at risk, even if they had the required capital."

Kenneth Merchant

Deloitte & Touche LLC Chair in Accountancy and Professor of Accounting
University of Southern California

“The focus is not to develop completely new technologies or general solutions, but to apply base technologies or general solutions developed by others in a specific setting to solve specific problems.” By contrast, radical innovation not only requires more financial resources, “but also more human resources — in terms of time and expertise,” Li says. “It is unlikely that the same people who have to worry about meeting the targets on their existing business also have enough time or expertise to think about meaningful radical innovation ideas.”

“The research suggests that high-growth companies are making bigger bets on innovation and using a blended approach to innovation and growth,” observes Emmer.

“These findings show that companies must develop and implement something new to grow rapidly,” says **Kenneth Merchant**, the Deloitte & Touche LLC Chair in Accountancy at the University of Southern California. “That means making investments and taking risks. But growth has its rewards; it is one of the major drivers of entity value creation.”

According to the data, high-growth companies are:

39%

More likely to develop new processes for making/delivering existing products and services

50%

More likely to provide new products and services

37%

More likely to rely on radical innovations

58%

More likely to develop patentable technologies

Source: Q2 2018 Vistage CEO Confidence Index

“It is well understood that innovation is a major driver of economic growth. These findings show how the economy-level relationship between innovation and growth also plays out nicely in small businesses. Sustainable success depends on not only executing today’s strategy well, but also adapting for future’s changing needs.”

Shelley Xin Li

Assistant Professor of Accounting
University of Southern California

Case Studies

Innovation in action

How two CEOs grew their companies through different approaches to innovation

If you want to grow your business, should you pursue incremental innovation or radical innovation?

There's no wrong answer, as both approaches can effectively lead to growth. Just ask Vistage members Margaret Mitchell and Frank Sciarrino. Both drew on concepts from the Vistage-Stanford Executive Leadership Program to drive incremental innovation and radical innovation, respectively, to transform their businesses in different but powerful ways.



“Without spending more, we’ve seen revenue increase.”

Margaret Mitchell

CEO, The Epi Center MedSpa

For years, **Margaret Mitchell**, CEO of San Francisco-based The Epi Center MedSpa, ran her skincare clinic like most others in the industry. She offered a wide range of quick procedures and treatments, such as Botox. But Mitchell had a nagging feeling that there was a way to provide skincare that was more personalized and effective.

As with so many CEOs, the demands of day-to-day operations were preventing Mitchell from spending as much time as she needed on strategic planning. She recognized the need to dig into the critical question: What innovation would put her business ahead of her competitors?

Mitchell started analyzing her industry and plotting her company and competition using a framework called the Cost-Quality Frontier. The answer came to her immediately: She needed to slow down when working. Mitchell reasoned that The Epi Center MedSpa could increase profits by devoting significantly more time to each visit. The clinic

would see fewer customers, but by learning more about each customer, clinicians could recommend a tailored sequence of therapies that would encourage repeat business. This would push The Epi Center MedSpa to a leading position on the Cost-Quality Frontier.

“I needed to understand our customers better by deeply immersing myself in their experience,” says Mitchell, “which really reinforced that our customers wanted greater intimacy, and that it was worth our time to take longer with each visit.”

Since implementing this innovation, The Epi Center MedSpa has seen dramatic growth. “Without spending more, we’ve seen revenue increase,” says Mitchell. “This past January, for example, ended 40% higher than any other January on record. People are so happy here that they’re referring their friends.”



“The kitchen and bath industry is a \$131 billion market that has not kept up with consumers’ shopping habits.”

Frank Sciarrino | COO, Quote Countertops

Innovation had always been a part of European Wholesale Countertops, a California-based family business that has pioneered new approaches to countertops marketing, materials and fabrication for more than 40 years.

In spite of this success, Chief Operating Officer **Frank Sciarrino** — part of the next generation of family leadership — recognized that one facet of the business had stagnated: marketing and sales. Countertops, and home remodeling more generally, were stuck in brick-and-mortar showrooms, while other customer-facing industries had already moved sales online. “Our customers couldn’t do this basic thing: shop online, preview a product, and see what it was going to cost,” says Sciarrino. “I wanted to solve that problem.”

When his software development partner approached him with an in-store countertop quoting tool, the solution became clear. Together, they launched Quote Countertops, a software-as-a-service (SaaS) app that allows customers to preview countertop materials in virtual interiors and get a price quote in 90 seconds.

“Consumers have changed. They want instant gratification. They’re on their phones. They want to know how much it’s going to cost, what it’s going to look like and why they’re going to choose you,” explains Sciarrino.

The need Sciarrino identified proved to be real and widespread throughout the home remodeling industry. After launching Quote Countertops, the team discovered demand far exceeded their expectations, and they have responded by expanding the scope of their software and business. Quote Countertops now showcases a wide variety of home-interior products with plans to add more. It has been adopted by everyone from big box stores to mom-and-pop home interiors firms, who can deploy the app without having either computing knowledge or equipment. Sciarrino says he’s especially proud that the app is getting

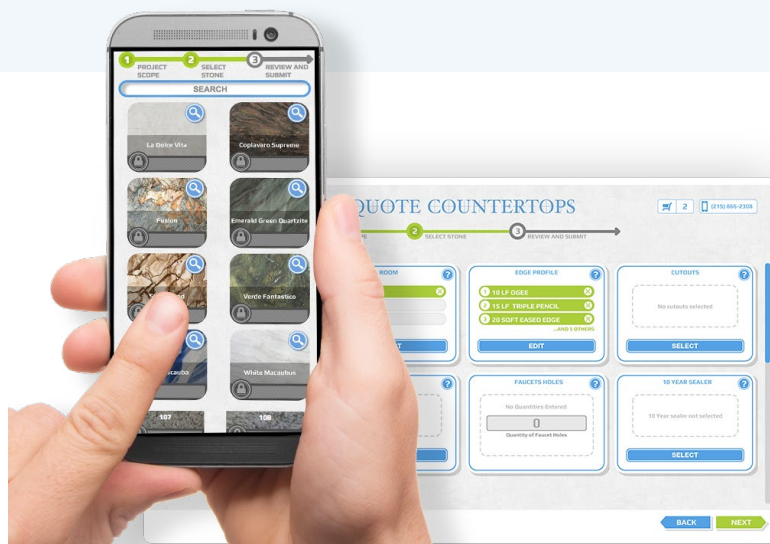


Image courtesy of Quote Countertops

adopted by “old school” retailers who’d resisted online sales. “The Quote team aren’t just software developers. We’re coming from the business community we’re serving. This isn’t innovation for innovation’s sake — we’re solving a real problem.”

He adds that they’ve discovered that web-based shopping serves a much more diverse audience than they’d originally thought. “We leveraged the best practice of calling our end users to learn their story. On one call, the customer informed me he was in his 90s! This completely changed how we define our demographic.”

Retailers and wholesalers who’ve adopted the software are seeing substantial increases in sales volume and spending per customer. Brick-and-mortar stores are now able to convert traffic from social media and organic search directly into sales. Customers who shop with the app spend approximately \$1,000 more than customers who only visit the showroom, as they are exposed to a greater variety of high-quality materials options and can better align these options with their budget.

Deeper dive: Sciarrino on innovation



How can CEOs overcome these barriers to innovation?

Emmer and Galvin share the following perspectives:

CEO challenge: We don't have enough time or resources for innovation.

Expert perspective: No one has time or money for innovation. You have to make time for it. You have to choose to invest in it. Since most small businesses don't have dedicated teams for research and development, we recommend carving out time for your management team to meet once a month and discuss innovation initiatives. These conversations and activities need to aim for goals that go beyond continuous improvement. Set ambitious goals related to launching new products, winning new business and rethinking your business model.

CEO challenge: Innovation feels like an overwhelming task.

Expert perspective: Sometimes, this stems from thinking about innovation in a limited sense, such as in the context of creating new products. In fact, innovation has much broader applications: It can transform everything from services to financials to operations in ways both large and small. For example, a company might adopt a unique monetization method that disrupts its industry; it might integrate automation tools to innovate workflow; it might transform its production line to accelerate the delivery of goods.

CEO challenge: We don't know how to get started with innovation.

Expert perspective: Create a task force that is in charge of innovation and clarify who is responsible for the outcomes of that task force. The team should include at least one senior leader. Put someone in charge who isn't already managing daily operations so they can focus on new opportunities instead of putting out fires.

CEO challenge: It's difficult to get my team engaged in innovation.

Expert perspective: Create incentives for innovation that are not governed by your company's EBITDA or measured by its financial returns. In addition, work with your human resources team to make innovation a core competency of your employees. Start asking candidates about innovation as part of your interview process. Train your employees on innovation practices and strategies. Review the innovation capabilities of your senior leadership team.



Within the distinct categories of the Vistage Decision Model, CEOs should consider the following goals and recommended actions to optimize their innovation.

Category	Goal	Recommended actions
Leadership	Create a culture that promotes innovation.	<ul style="list-style-type: none"> • Communicate openly with your employees and share data and KPIs at all levels of the company. • Encourage ideation and experimentation and seek opportunities to learn from mistakes. • Articulate a “growth portfolio” in your strategic plan that identifies how much growth comes from your core business versus market adjacencies or diversification. • In the strategic plan, identify your long-term vision and objectives for innovation, along with related incentive strategies and employee goals.
Customers	Engage with customers and listen and respond to market needs.	<ul style="list-style-type: none"> • Develop a continuous and formal way of listening to your customers, whether via social media, focus groups, or one-on-one meetings. • Reverse engineer how and why customers behave the way they do to come up with new ideas for offerings. • Constantly re-evaluate your service model.
Talent	Get the right people involved in innovation and keep them motivated.	<ul style="list-style-type: none"> • Listen to your employees — especially those that are closest to customers. • Include a wide range of views throughout the innovation process. • Make innovation a core competency of employees; recruit employees skilled in this area, build innovation competencies through professional development opportunities and consider whether innovation expertise is represented on your leadership team.
Financials	Focus on long-term performance rather than short-term gains.	<ul style="list-style-type: none"> • Don’t become overly dependent on metrics, because this can hinder your ability to innovate. • Promote the idea that transformative innovation takes time and will not necessarily deliver a return on investment within a year or two. • Separate operating budgets from innovation budgets. • Dedicate sufficient resources to innovation.
Operations	Implement structured project management processes.	<ul style="list-style-type: none"> • Apply formal processes to product development, such as stage-gate processes or the agile method. • Ensure oversight for the entire product management lifecycle, including sunsetting old or dated products.

Research perspective

5 innovation lessons from top-performing companies

1 Never stop improving. High-performing companies are relentlessly focused on improving their performance through innovation, whether that's aimed at accelerating processes, tightening workflows or clarifying communications. How do they succeed? By creating a culture that encourages exploration and experimentation, facilitates open communication with customers and employees, and drives innovation from both the top-down and bottom-up. At a higher level, the company's senior team recognizes innovation as a key source of competitive advantage.

2 Seek out radical innovation on a smaller scale. What makes an innovation "radical" has nothing to do with size and everything to do with impact. Radical innovation is about breaking through perceived limitations to fundamentally change the game. For example, introducing a new product or capability, along with a new message to market, can serve as radical innovation on a smaller scale. Driving disruption can lead to tremendous rewards, but it requires tough decision-making and strong leadership on the part of the CEO.

3 If something breaks, use innovative thinking to fix it. All companies have to cope with the reality that, at some point, some part of their business is going to break or go wrong. What separates the high-performing companies from the pack is how they react to that challenge. They assess the situation quickly. They pivot rapidly to an innovative solution. They rally teams around the goals of that solution. By contrast, low-performing companies are quick to assign blame. They wait for others to fix the problem. They use outdated solutions to address new challenges.

4 Picture your worst-case scenario. What would you do if Amazon announced a solution that targeted your customers and made your go-to-market model irrelevant? More likely, what would you do if a competitor acquired a smaller player and boxed you in? What if they launched a new product or hired a superstar from your best region? Prepare for these worst-case scenarios by working through them in advance with your team. Set up a one-day offsite exercise where you proactively address these scenarios and brainstorm innovative solutions.

5 Leverage the relentless pace of change. Respect the fact that there is no status quo anymore, and that everything changes all the time. As a CEO, the question you must ask yourself is: Do I recognize, anticipate and leverage the current pace of change, or do I wait for a crisis to hit that will force me to innovate under pressure? In either case, innovation is required for survival and growth. Better to choose the former.

Contributors


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Marc Emmer is president of Optimize Inc., a growth consultancy specializing in strategic planning. Marc speaks, writes and consults throughout North America and is a recognized thought leader on strategy. Marc's second book, "Momentum, How Companies Decide What to Do Next," was covered online by Yahoo Finance, Business Insider, CBS and NBC. Marc has crafted strategic plans for over 140 organizations, including more than 60 Vistage members. Marc is a regular contributor to the Vistage Research Center, Inc.com and Forbes.com.


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About Vistage Worldwide

Vistage is the world's leading executive coaching organization for small and midsize businesses. For more than 60 years, we've been helping CEOs, business owners and senior executives solve their greatest challenges through confidential peer advisory groups and one-to-one executive coaching sessions with accomplished business leaders. Today, more than 23,000 members in 20 countries rely on Vistage to help make better decisions for their companies, families and communities. The results prove it: Vistage member companies grow 2.2 times faster than average small and midsize U.S. businesses, according to a 2017 study of Dun & Bradstreet data.

Learn more at vistage.com.

About our research

Vstage Research curates subject matter from the Vistage community and collaborates with top thought leaders to create unique content. Vistage executives access actionable, thought-provoking insights from the Wall Street Journal/Vistage Small Business CEO Survey and Vistage CEO Confidence Index results, as well as national and local economic trends. Since it began in 2003, the Vistage CEO Confidence Index has been a proven predictor of GDP, two quarters in advance. Vistage Research provides the data and expert perspectives to help you make better decisions. Visit vistage.com/ceoindex and vistageindex.com to learn more.

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