8 | 2014
workspan
The Magazine of WorldatWork©

Fostering and Rewarding Bright Ideas

Sparking innovation may mean recognizing employees just for trying.

It's rare these days to scan a business journal or newspaper without reading mention of innovation as a, if not the, key success factor for businesses today. Innovation is so top-of-mind for today's business leaders that it ranks as one of the top five CEO challenges in 2014 — along with human capital, customer relationships, operational excellence, and corporate brand and reputation — according to "The Conference Board CEO Challenge 2014: People and Performance."

Most companies believe innovation is important and even mission-critical to sustainable, profitable growth. And while innovation is often most tangible when thinking of products and services, it is also very important in terms of processes — innovation can occur throughout the organization, in every function and at every level. Think of efficiency gains on the manufacturing line — elimination of scrap, an innovation that often comes from line workers; use of robotics to speed assembly

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and increase production. Or think of the HR function, for which companies are now sourcing more candidates than ever using online tools and information.

Recognizing the importance of innovation, some companies are paying for it — most frequently referencing innovation as one of a few measures to qualify/adjust core financial results in the annual incentive program. At some level, these companies are asking the question: If innovation is mission-critical, why not measure and pay for it directly?

The answer to this question, of course, is not so simple. Focusing on innovation in the pay program makes good sense for some companies. But for others, rewarding for innovation explicitly in the pay program can be ineffective and, at worst, it can actually get in the way of real breakthroughs. The question to then ask is, "What works best and when?"

In Theory

There are two paths that a company can take to encourage innovation. The first approach is to incorporate innovation in the pay program, and the second is to focus on the organizational culture itself. The right approach for many companies will be somewhere in between — for which the pay program reinforces a culture already strong with innovation or for which the pay program ignites a spark within a culture hesitant with innovation. And in determining this right approach for their company, leaders need to consider their company's history with innovation, its product offerings and its future goals. A keen sense for where the organizational culture most naturally orients itself is also critical.

Path 1: Encouraging Innovation With Pay

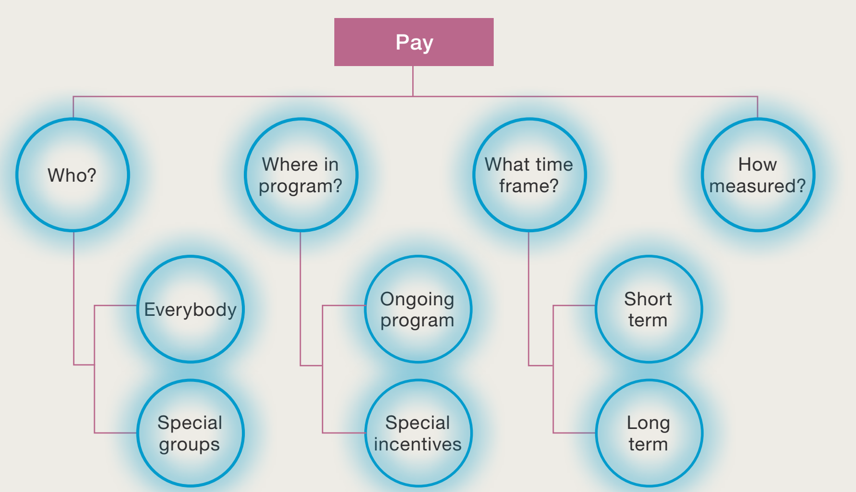
When thinking about how to incorporate an innovation-type metric into the pay program, companies face many of the same questions as with any other metric: To whom should innovation apply? Or those functions closest to innovation, such as research and development and marketing? Where should it be included in the program? And over what time frame? Of course, the new and challenging question here is: How should innovation be measured? (See Figure 1.)

Many companies tend to focus primarily, if not exclusively, on output-/outcome-related innovation metrics. These can cover quantitative and qualitative metrics and are generally related to success of the end product/service in the market (e.g., percentage of revenue from new products/services; product launch success; customer feedback specific to new products/services).

As with most singularly or narrowly focused measurement frameworks, there are natural limitations and potential unintended consequences to focusing only on outputs/outcomes. (See Figure 2.)

Given the potential for unintended consequences with output/

Figure 1 | Decisions Regarding Pay Metrics



Source: Semler Brossy

outcomes-only metrics, a more comprehensive framework helps to fully capture the whole innovation process. Like any good story, innovation has a beginning, a middle and an end. (See Figure 3.) The beginning focuses on resource allocation (i.e., time, money and people). The middle addresses the pipeline and the processes that come before the launch of any new product or service, including process speed and pipeline balance (i.e., are there sufficient early-stage ideas to feed later-stage concepts, and ultimately go-to-market products/services?). And the ending is where the greatest focus is today — naturally, because the story is most clear at its end (i.e., outcomes and results are comparatively simple measurements).

By capturing the full story of innovation, companies can help avoid unintended consequences, engender a more holistic view of innovation among employees and thereby increase the chances of generating and successfully executing truly innovative ideas.

Path 2: Encouraging Innovation in the Culture

Companies that take the second path, choosing to lever innovation in the culture itself, also have many tools to encourage innovation — many of which can be just as, and even more effective than, pay. To best focus their efforts, companies should first take stock of significant barriers to innovation today: fear of failure? Anchored in the past? Not enough resources? Too few ideas? Situations in which the innovation competes with/threatens an existing product or service?

After these barriers are identified, companies can better determine which of the available cultural levers to pull. Some more traditional, "inside-the-box" cultural tools include:

- **Using career tracks** whereby roles/positions closest to innovation can travel distinct career paths, focused more so to individual contributions than management of others
- **Offering recognition** — both formal (e.g., letters of acknowledgement or award ceremonies) and more informal (e.g., special access to development opportunities)
- **Embedding innovation in the job itself** — with specific skills, competencies and other requirements direct to innovation, for which these job elements are then assessed and developed over time. Others have extended this to the recruiting process and screen candidates for innovation — here, past experience or exposure to innovation is the price of admission to the company.

Some of the more "outside-the-box" ideas include:

- **Introducing innovation-oriented contests** whereby employees are invited to submit ideas for new products or new uses for existing products. Ideas are advanced through different rounds in a contest format, and winners are chosen for development and/or funding. This serves as a way to generate new ideas, as well as create a process for vetting ideas
- **Increasing awareness of innovation through classic techniques,** such as innovation fairs, during which innovators test their ideas on colleagues in a setting that harkens back to grade-school science fairs. Others use traditional schooling methods, putting select employees through coursework tailored to innovation — from creative ideation through operational execution
- **Using office space** in innovative ways to bring people together and encourage new thinking (e.g., free lunches, open office plans, housing different departments on the same floor) — in other words, using the office

Figure 2 | Potential Unintended Consequences With Output/Outcomes Metrics

Output/outcomes metrics	Potential unintended consequences
Measuring the percentage of revenue from new products ...	... may more naturally encourage close-to-the-core, lower-risk innovations, than breakthrough, higher-risk innovations. An example of this comes from the consumer products industry where innovation can manifest as modest extensions to existing product lines — different attributes for existing products (e.g., strawberry-flavored toothpaste), or combination-packaging of complementary products (e.g., shaving cream with razors). These sorts of innovation are certainly close to the core, and while they may drive incremental sales, they likely fall short of the gains that can come from breakthrough, more game-changing innovations (e.g., launching an entirely new teeth-whitening category).
Product launch success ...	... may help institutionalize a "fear-of-failure" culture, where employees are hesitant to take risks, focusing more on the downside risks for their careers.
Success measures ...	... can slow the pace of innovation — as individuals work to cover all bases — and companies can ultimately lose out to faster-moving competitors.
Customer feedback as a metric ...	... may focus employees too much on the end consumer, so much so that they too narrowly view who the consumers might be or miss the ability to see unmet customer needs (i.e., new opportunities that end consumers haven't yet conceived).

Source: Semler Brossy

And many companies will factor in innovation **when assessing an individual's performance,** particularly for those roles closest to important innovation activities.

space itself as a tool to promote collaboration, interaction between different team members and/or business units, and idea generation

- **Encouraging — and even requiring — employees** to take time away from their normal work and providing them with tools/equipment to experiment with new aspects of their jobs or just the time to think about presenting problems or new opportunities. Highly innovative companies will also provide funding and other resources to help make the most of this time that is dedicated to employee innovation.

In combination, these tools can be effective at breaking down some of the common barriers to innovation and actively encouraging it within the organizational culture.

Where Theory Meets Reality

In reality, of course, these two paths are not so distinct. Companies will want to walk both paths at times, looking to pay and culture as mutually supportive in encouraging innovation. For example, some companies include innovation as an element in the pay philosophy or as a screening criteria when developing the pay peer group. And many companies will factor in innovation when assessing an individual's performance, particularly for those roles closest to important innovation activities.

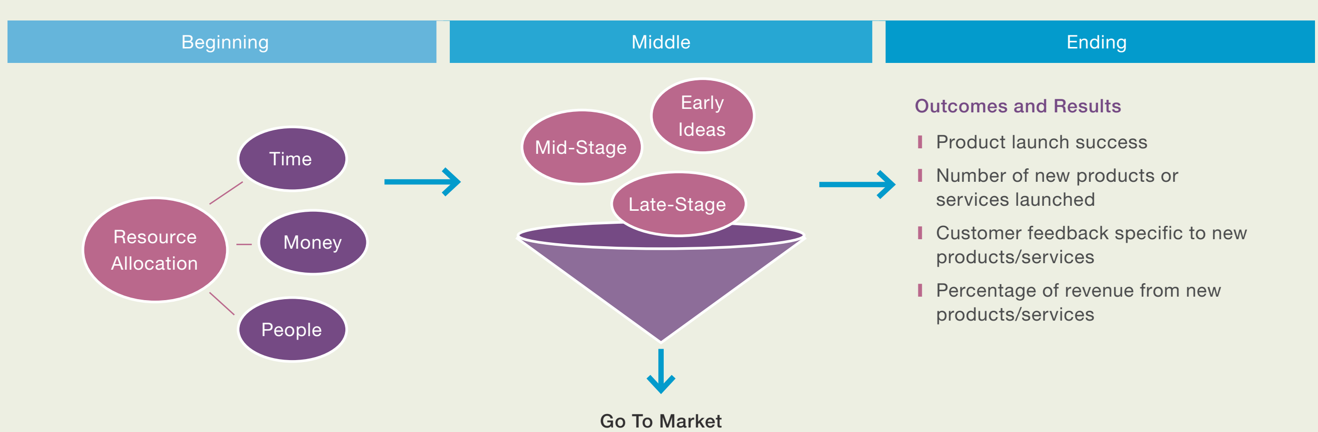
Many companies will actively avoid penalizing individuals for failed innovations. And there are even those that will reward risk taking, even where that risk taking does not pay off. This can work to reinforce a culture that acknowledges the reality of innovation — some new ideas will work and others won't. Failure is a natural and therefore acceptable outcome within truly innovative companies. Where high-potential employees swing and miss, the right response may be to reward them for trying — not as much as if they had a hit, but enough to acknowledge the effort and keep them for the next at-bat.

What companies want to avoid is a culture in which failure is not tolerated. This can stifle innovation and could result in good money going to bad ideas that should otherwise be abandoned. In other words, rewarding employees for trying may help encourage employees to recognize — and accept — failure early on, thereby saving significant money in wrong research-and-development and launch costs.

Conclusion

The theory behind incorporating innovation as an incentive metric

Figure 3 | **Comprehensive Innovative Framework**



Source: Semler Brossy

is sound: Employees should be rewarded for innovation, which is key to long-term growth and sustained high performance. In fact, a recent study, "Why it Pays to Be a Category Creator" published by the *Harvard Business Review*, found that while "category creators" comprised only 13 percent of Fortune 100's list of fastest-growing companies, these innovative companies drove roughly 50 percent of the incremental revenue growth and 75 percent of the incremental market capitalization growth for the entire group. As you consider innovation at your company, the first question becomes: Do you measure it today?

If yes, then reflect on current measurement framework. Are you measuring performance only at the end of the innovation story? How might the story read differently if you also captured the beginning and the middle? Could it lead to: more thoughtful allocation of research-and-development dollars? More and better feedback on interim product designs? Shorter time from an initial idea to the go/no-go decision? Greater success rate overall? And, ultimately, higher return on investment on innovation efforts?

If no, then another question presents: How effective is your company today as it relates to innovation?

- *If effective, then take special care before measuring innovation explicitly in the pay program.* What you don't want to do is turn a good thing bad. Some companies shy away from defining and measuring innovation, wary that this sort of structure may stifle innovation. If you do choose to pursue, step lightly at first — consider a pilot program for a small group — perhaps a group focused on a new area, away from the core business. And remember the full story of innovation when developing the measurement framework — the beginning and middle metrics can help set aside concerns that can arise with outcome-based measures alone.
- *If not so effective today, then innovation in pay may be the way forward.* Again, prudence is the path when introducing anything new as it relates to pay. Step lightly at first (e.g., moderate weighting in the overall incentive calculation and allow for subjective assessments, in addition to objective). Those caveats aside, measuring and rewarding for innovation directly may be exactly the jump-start the company's innovation engine needs — measurement in the pay system can help define and articulate innovation objectives, thereby clarifying the needed behaviors, and, ultimately, successes or failures. ws

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