

SMEs

Unlocking investment value in a 5-year time span through better understanding the role of innovation

Why a 5-year time span? The answer is that private equity investors have this time frame in mind when they look to invest their capital and SMEs need capital sooner or later. More specifically, the question asked is whether the value of the company can be doubled over a time period of 5 years or so through putting in place innovations which will improve growth and profitability¹. Understanding the role and place of innovation in an SME thus becomes critical to good investment decision making on the part of management and investors alike.

The idea is to work with the management team to put in place innovations including those that increase productivity by helping to cut costs or make companies more efficient – or that increase sales and customer service through the development of new or improved products².

“Experience shows that a company must have specific attributes to enable this level of performance – well positioned products and services, growth prospects that exceed GDP growth and a strong management team”

According to Renaud; ‘This potential is usually found in companies that have a culture of innovation rooted in creativity, responsiveness to customer needs, and openness to change’.

Creativity and innovation

What does it take to take advantage of the creative process in most companies? There is no one answer. The starting point is to be aware of the state of development of the SME, understand the spectrum of innovation currently in place, identify the gaps – the non-performing parts of the spectrum, and then take corrective action where possible. Innovation is not just a vague concept but has legs that need to be better understood and articulated by both investors and management.

Summary

- Private equity investment in SMEs looks to a 5-year horizon to bring about innovation-based improvements
- Innovation has a different role to play at various stages in of SME growth
- Creativity is a critical component of some, but not all, aspects of innovation
- Often, some aspects of innovation get lost due to other priorities – only to return later as a problem
- Being innovative has many dimensions. One theme is particularly important and that is creating a climate within which innovation is encouraged to take place.
- Innovation can be hugely influenced by management. Openness and tolerance are keys to encouraging innovation.
- The potential for unlocking value in SMEs can be better understood by examining whether the company has a culture for innovation, the stage of its development, its management practices and, of course, its business strategy.

¹ Innovation prerequisite for investors National Post, October 30, 2012, Productive Conversations

² Paul Renaud, CEO, Omers Private Equity

Innovation is defined here as the full spectrum of new ideas for change in whether in products, processes or business models that will drive the company's growth and profit. It is all about investment not only in terms of spending but even more so in terms of management's commitment to identifying what has to be done and then following through on making sure change takes place.

Spectrum of Innovation

Innovation takes many forms (see chart) and while creativity is important, it is not the whole answer. For example;

- Investment in new and emerging technologies drives new product development and requires creativity.
- Having transparent reward systems along with systems to capture new ideas for improvement to processes (continuous improvement) can contribute significantly to productivity improvement. Creativity, while a factor, is less important than capturing ideas from whatever source.
- Investing in 'common technologies' with the focus of keeping up to date with product line enhancements and modifications draws more on understanding customer's current and developing needs than on creativity per se.
- Seeking to differentiate a product or service from the competition requires investment in new technologies and the creative minds to bring diverse elements together.

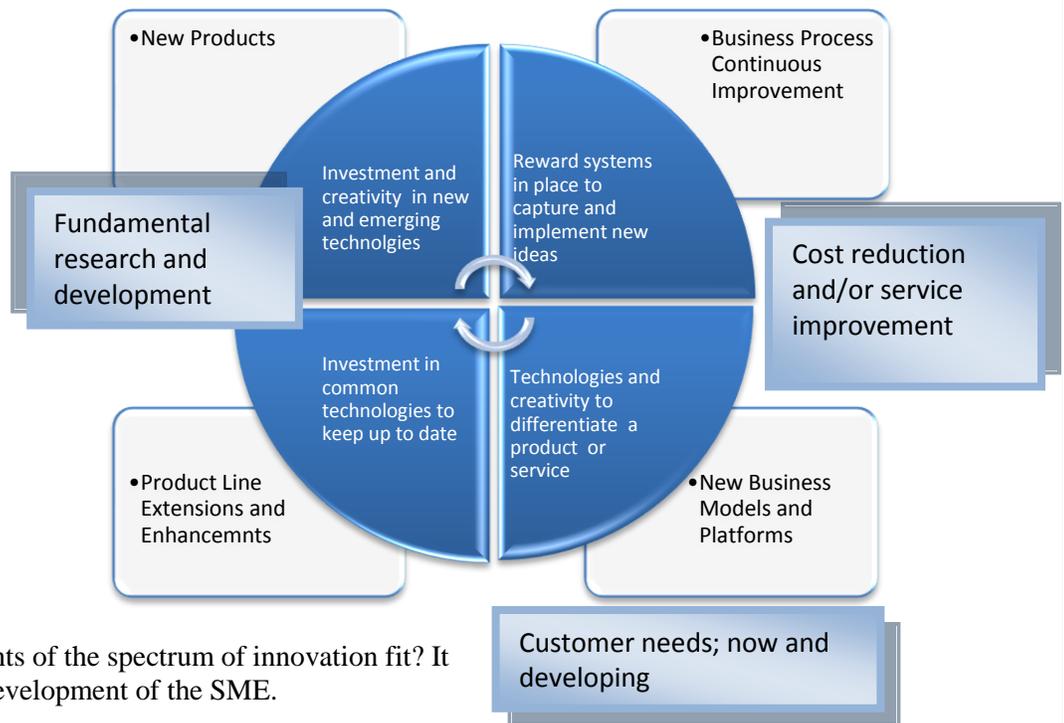
Creativity is the key in two of these four areas; new products and the introduction of new business models or platforms.

The full spectrum of innovation comprises everything from fundamental research through to continuous improvement. Investment in innovation is not just about budget dollars but also needs to include recognition of time spent by management and staff as well as management's emotional commitment.

Innovation stages

Where do all these elements of the spectrum of innovation fit? It depends on the stage of development of the SME.

While **fundamental research, applied science and development** are exceedingly important for the medium and long-term future of most corporations, it is less important for the struggling-to-survive SME. Keeping in touch with fundamental developments in technology is important, however, and can be accomplished by maintaining close and meaningful contact with research institutions, universities and bright individuals. Early collaboration can build relationships which may prove useful at a later stage of development for an SME.



| Innovation Stages | | | | | |
|---------------------------------------|--|--|--|---|--|
| ← SME Focus → | | | | | |
| Innovation management | Start Up | Rapid Growth | Growth | Mature | Aging |
| Management's overall attention | Establishing credibility Entrepreneurship Survival | Developing a strong competitive position Market share | Maintaining a strong competitive position | Maintenance of profit and market position | Exiting the business Ongoing survival |
| Innovation effort | Specific new product development tasks Setting in place the seeds of a culture for innovation | Business model establishment New product quality and support Customer feedback for success | | Product enhancements and modifications Search for innovation | Opportunistic only |
| Innovation management systems | Non existent Reward is skewed to share value appreciation | Simple idea management system Rewards migrate to other forms of recognition | Full-fledged idea management system Sophisticated reward system for full range of innovation spectrum | | System maintenance |
| Management structure | Loose and informal, lack of definition of responsibilities Individual performance | Some organizational definition required Individual and group performance | Group performance Decentralized Well defined responsibilities and accountabilities | | |
| Management's innovation style | Open and ad hoc | Bordering on participative | Open and non-hierarchical | Formal, delegation and control | |
| Collaborative initiatives | Virtually none outside the enterprise | Mainly Internal effort | Seeking outside collaborators; research institutions etc. for new ideas | Managing outside collaboration | |
| Likely casualty during stage | Cost reduction and continuous improvement, cost containment | | Risk profile shifts from risk taking to more conservative | New products | No new products |

Best innovation management practices are thus dependent upon the stage of development of the SME. Investors may look to accomplish their mandate in a period of 5 years; from start-up through rapid growth and into a solid growth period at which point, investor interest shifts to selling their share participation to an industry participant, another equity investor, or through launching an IPO.

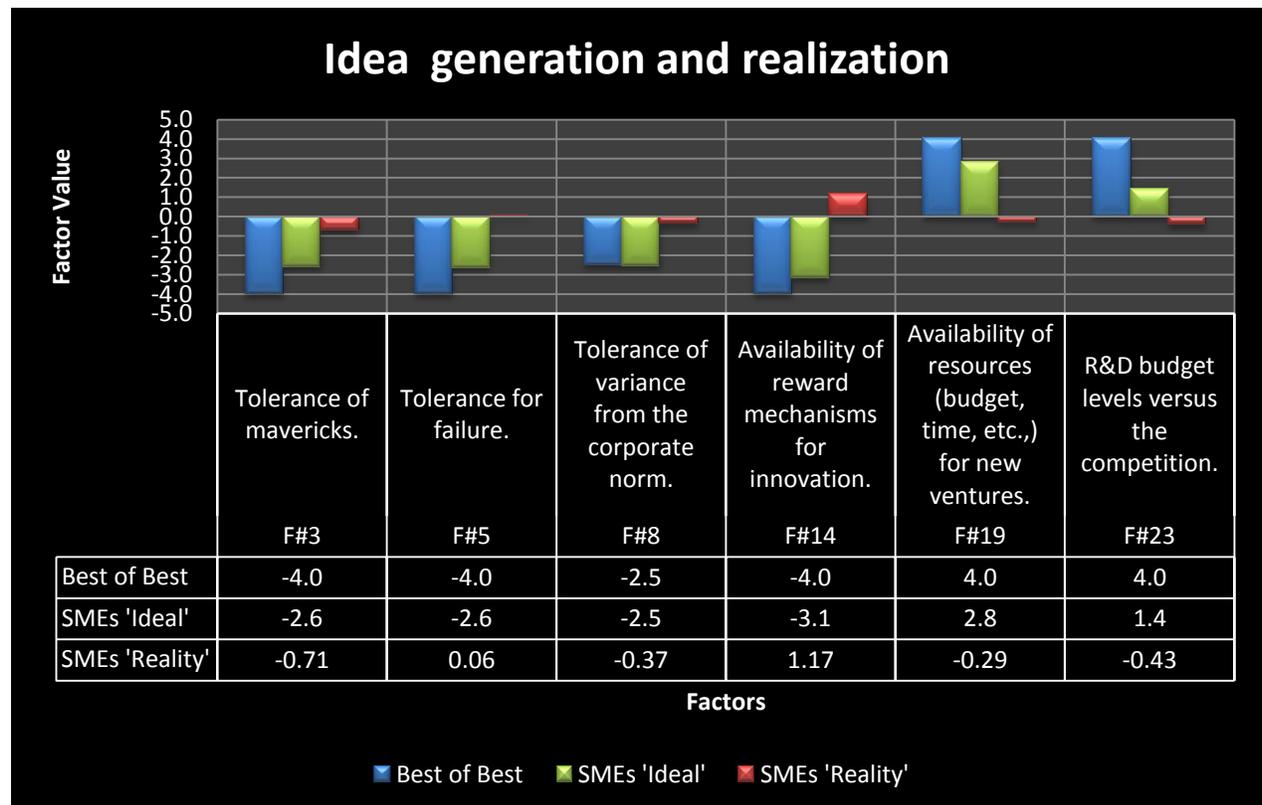
Having a strong management team is a first priority but some sort of orderly process for managing innovation efforts soon becomes essential to ensure that activities which are productive are fast-tracked are those which are non-productive are eliminated or minimized. Thus having a system in place which can capture and manage the creative and implementation process (**idea generation and realization**) is an important contributor to accomplishing tasks in a 5-year period. An early focus on the importance of innovation can also plant the seeds that this organization has a 'culture of innovation'.

Highly-innovative companies have a breadth and depth to their innovation practices which starts early on in their history and is, we have found, much influenced by the founder's attitudes and values. Typically, however, a start-up struggles with just one aspect of innovation; a new product or a new business model.

Seldom is a start-up concerned with continuous improvement. Our research also indicates that companies which undergo rapid expansion invariably forget about continuous improvement. Management's attention is focused on growth. Different aspects of innovation come into play at various cycles of a company's growth.

Dimensions of the culture for innovation

Our on-line survey respondents, those employed by SMEs, provides some insight into the values – culture – that they hold regarding 'idea generation and realization'; one of three key themes of innovation. SME's 'Ideal' is very close to our benchmark; the Best of the Best³.



The message is reasonably clear and that is that tolerance for a number of issues is a key to creating a proper climate for innovation; in this case with the purpose of encouraging ideas. Reward mechanisms; both monetary and non-monetary, also play a key role in generating ideas and in their implementation. Having this at least some of these Factors in place and recognized by all is a measure of the presence of a 'culture of innovation'.

For more on respondents' opinions regarding 'leadership' and the 'organization and management of day-to-day affairs' please visit the web site; <http://www.corporateinnovationonline.com> There you will find additional information on management practices which impact corporate innovation.

³ Best of the Best is a benchmark arising from our researching the management practices of highly-innovative companies, in this case a collage built on results from 3M, P&G, and John Deere. For more information visit the web site; <http://www.corporateinnovationonline.com>

Conclusion

The potential for unlocking value in SMEs can be better understood by examining whether the company has a culture for innovation, the stage of its development, its management practices and, of course, its business strategy.

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