Abstract—Innovation is high on every manager’s agenda today. Innovation is seen as a key differentiator in markets that are increasingly hard-fought; it is destined to become ever more so as competitive pressures increase across all industry sectors. Innovation separates the winners from the also-rans. It manifests itself in a variety of forms. Innovation can drive new service and product offerings, but it can also be at the root of new business opportunity creation and the launch of entirely new business models.

Managers across all industry sectors are asking how they can most effectively exploit innovation to improve the bottom-line business result of their enterprises.

Managers of small and medium sized enterprises (SMEs) are not exempt from this challenge. Indeed, SMEs are inherently dependent on their innovation potential for competing successfully against large established enterprises.

A thriving SME sector, on the other hand, is fundamental to the success of any country’s economy. The UK’s approximately 1.2 million SMEs contribute about 40 percent of its GDP and 43 percent employment in the private sector. UK business has been criticised for its lack of innovative performance. This would suggest a deficit in innovation capability across all sectors of the economy, including SMEs. It was this premise that prompted this investigation of the well-being of SMEs.

We asked ourselves, how are SMEs pursuing innovation? How are they approaching it, on what are they placing the emphasis, and where do they perceive the greatest opportunity? Finally, what is working and what is not?

To gain answers to these questions we went to the managers of SMEs. We posed a number of questions that fell broadly into the following categories:

- How important is innovation for the competitive well being of the SME?
- Where are they focusing their efforts on innovation?
- What are the important drivers of innovation for SMEs?
- How much are they spending on innovation – and on what specifically?
- How are SMEs performing on innovation; where are they reaping the greatest benefits?
- What are the obstacles to innovation?
- Who are the competitive benchmarks with regard to innovation for SMEs?

Among the key findings of this study:

- Innovation remains a high-priority strategic focus for the majority of SMEs, with 62 percent of respondents of our survey ranking it one of their top-three priorities.
- Consistent with that finding, 64 percent of respondents indicated that their firms will increase spending on innovation in 2007.

- However, over a third of the managers of SMEs percent surveyed remain unsatisfied with the financial returns on their SME’s investments in innovation.
- The three greatest stumbling blocks to innovation identified are (1) prolonged development times (2) a risk averse culture and (3) limitations on customer insight.
- Respondents ranked Apple, Google, and 3M as the most innovative companies.

I. INNOVATION IN SMES: STATUS and OUTLOOK FOR 2007

A. Innovation is a high strategic priority in the majority of SMEs...

The results of our survey confirm that innovation is a high strategic priority for SMEs. For most SMEs (62 percent) innovation ranks within the top 3 of their strategic priorities. For 20 percent of the SMEs surveyed, innovation even tops the list of strategic priorities. Only 7 percent indicated that innovation is not a priority.

B. SMEs expect a high bottom-line impact from innovation...

87 percent of the SMEs surveyed expect a bottom-line impact from innovation on their business’s profitability in 2007. In fact, almost a third of the SMEs surveyed are expecting the contribution to be high, and 15 percent indicated that their expectation is very high. The majority of SMEs also indicated a growing expectation with respect to the bottom-line business impact. 55 percent expect a moderate increase and 16 percent expect a significant increase.

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1 Source: BERR Enterprise Directorate Analytical Unit (2006) – Private Sector Data
2 Cox Review of Creativity on Business, HM Treasury (December 2, 2005)
C. …and they are increasing their spend on innovation

It doesn’t surprise, therefore, that SMEs are prepared to invest in innovation. Most (64 percent) indicated that their innovation spend in 2007 will be higher than in 2006. 27 percent of respondents indicated that they will increase their innovation spend significantly, that is, with a more than 10 percent increase in spend over 2006.

D. SMEs view innovation as their engine for organic growth...

55 percent of the SMEs surveyed strongly agree that organic growth through innovation is essential for success in their business. Only 6 percent disagree with this assertion.

E. Most SMEs are satisfied with their financial return on innovation...

68 percent of the respondents say they are satisfied with their financial returns from innovation. Indeed, 7 percent are very satisfied. However, this still leaves about a third of the SMEs surveyed who say they are dissatisfied with their return on innovation.

II. INNOVATION RESOURCING

A. Most effort in invested in innovation that targets new products and services for existing customers...

Innovation expresses itself in a variety of forms. Sometimes it contributes to incremental improvement of...
existing products and services. Sometimes it is more radical, targeting a new, category-defining product or service that opens entirely new business opportunities for SMEs. We asked the managers what their innovation targets were.

Using innovation to provide better value for existing customers is highest on the agenda of managers of SMEs, while improving existing products and services was second most important. Neither radical innovation (developing new products for new customers) nor cost optimisation is a priority. Few SMEs are investing innovation effort toward enhancing their Internet presence.

**B. ...while managers of SMEs rely most on their own internal expertise and capability to deliver in those targets**

The clear majority of SMEs ultimately rely on their own internal expertise and capability to deliver their innovation targets. Just over a third indicated that they rely on public research institutions (such as universities) to co-development in the area of innovation. 28 percent said they engage regional and governmental development agencies, and 28 percent bring in traditional management consultancies.

We were surprised to find the low outcome relating to the engagement of governmental and regional development resources. Perhaps it is a lack of knowledge on the part of SMEs of their existence.

**III. OBSTACLES TO INNOVATION**

**Over-run development times and a risk-averse culture hamper innovation most...**

Businesses in seeking to be innovative face many challenges, some externally influenced, others from within the enterprise. Each business will experience a different set of challenges and executives will rate their impact differently. But awareness of the key challenges enables executives to work on strategies and tactics to overcome them.

<table>
<thead>
<tr>
<th>Obstacles for Innovation</th>
<th>Mean score</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Development times that are too long</td>
<td>3.50</td>
</tr>
<tr>
<td>2. Risk-averse culture</td>
<td>3.24</td>
</tr>
<tr>
<td>3. Limited customer insight</td>
<td>3.15</td>
</tr>
<tr>
<td>4. Lack of coordination</td>
<td>3.12</td>
</tr>
<tr>
<td>5. Shortage of suitable talent</td>
<td>3.09</td>
</tr>
<tr>
<td>6. Lack of good way to measure innovation</td>
<td>3.08</td>
</tr>
<tr>
<td>7. Difficulty in selecting right ideas</td>
<td>2.97</td>
</tr>
<tr>
<td>8. Ineffective marketing communications</td>
<td>2.95</td>
</tr>
<tr>
<td>9. Shortage of good ideas</td>
<td>2.71</td>
</tr>
<tr>
<td>10. Lack of access to new technology</td>
<td>2.18</td>
</tr>
</tbody>
</table>

Scoring key: Values range from 1 = not a problem to 5 = significant problem

The greatest obstacle to innovation was seen as development times that are too long. It is not uncommon for firms to be unable to push through innovations as quickly as competitors but also it is quite common for projects to take longer than planned. But failure to deliver ahead of the competition is likely to impact on revenues in the short-term, but more significantly in the long-term. By tying up resources for longer than planned there is likely to be a knock on effect for other projects within the portfolio and other business needs. Lack of co-ordination was seen as a barrier (mean 3.12) by more than 38% of respondents. Improvement to the new product development process along with project management could assist in reducing over-runs. The culture in many organisations does not appear conducive to innovative activity and was seen by 45% of respondents as a major obstacle. Where organisations are risk averse considerable effort is usually needed to change this even if change is seen to be desirable. Alternative approaches to internal development may be easier to achieve, e.g. buying-in new technologies or processes.

Interestingly relatively few respondents believed access to technology as a constraint. Ideas did not appear to be lacking but customer insights and internal talent are more problematic. Several additional obstacles were identified: ‘selling new ideas to your own sales staff’; ‘hard to fight traditional beliefs’; ‘lack of time and manpower’; ‘customers not willing to pay more for innovative products’ and ‘difficulty in demonstrating value of innovation’.

The obstacles identified very much reflect the nature of SMEs – resource constrained, short-term needs gaining priority, a lack of systems and procedures and a limited and cost-conscious market-place.

![Obstacles for Innovation](image-url)
IV. RETURN ON INNOVATION

Innovation targeting differentiation in the market place tops the list of innovation returns achieved ...

Our own research has shown that few companies rigorously track their innovation efforts from start to finish, despite the fact that most managers of SMEs recognise the importance of doing so. Among those companies that do have metrics and systems of measurement in place, few are confident they’re doing it as well as they should be.

Measuring innovation is not easy. For one, innovation has many components that need to be measured in order to gain the bigger picture. Ideally, innovation contributes to differentiation. That is, through innovation, the firm creates superior value offering in the form of a product or service, and this endows the firm with a position of competitive advantage in the market – at least for a while.

The second best outcome innovation can achieve is neutralisation. This is important when a competitor has beat the firm to the market. Innovation that neutralises the market impact of the competitors offering can help the firm hold competitive ground if it has already failed to win it in the first place.

But we also know that much of the effort invested in innovation achieves neither of these objectives. It results simply in waste. Failed efforts to achieve competitive differentiation and/or neutralisation fall this category. It is vital that the firm tracks its waste innovation outcomes, though few care to re-enact and debrief failed effort.

There is a fourth possible outcome of innovation that is most often neglected. This is the learning and internal capability development that accompanies, to a certain extent, every innovation activity. Very few companies track this innovation outcome as it is inherently difficult to do so; it is largely intangible in nature and we don’t have appropriate measures in place.

Therefore, we were slightly hesitant to ask managers to assess the distribution of their return on innovation amongst the four possible outcomes described. What we asked and received in the responses is a breakdown that estimates the potential impact of the SMEs investment in innovation without specification of any metric. Hence, one might challenge the rigour of our response outcome. Nonetheless, we do feel that we gain insight into an area of innovation that has traditionally been accessed in the past.

Reported are the means of the responses we received. From these, we see that most of the effort invested in innovation is seen to result in differentiation. Almost 37 percent of the managers indicated that this is the case. Half of the effort invested results in neutralisation, and about a fifth of the effort in waste.

Even though often neglected, we still find that managers appreciate that about a quarter of their investment in innovation does result in organisation learning. This we find encouraging.

V. INNOVATION PERFORMANCE MANAGEMENT

A. Understanding customer needs is highest priority in terms of perceived importance, but also shows the greatest gap to actual performance...

Successful innovation depends on a flow of ideas / concepts connected to the market, an innovation process to take ideas to market adoption, a supportive climate in the organisation and work methods which encourage innovative behaviours. Ideas often come from customers or suppliers and can be the result of links to the science and technology base such as universities. All innovation involves risk and it is the responsibility of executives to be clear about the exposure from the innovation portfolio and manage it accordingly. So in our survey we set out to establish the importance of a series of factors to the company’s innovation performance and the actual level of performance in the view of the executives responding.

From the survey outcomes, we have identified the top 9 out of 17 factors based on the importance rating. We have also shown the gap between performance and importance.

<table>
<thead>
<tr>
<th>Key challenges facing companies seeking to innovate</th>
<th>Means Importance</th>
<th>Performance</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Understanding customer needs</td>
<td>4.54</td>
<td>3.33</td>
<td>1.21</td>
</tr>
<tr>
<td>2. Senior management sponsorship</td>
<td>4.37</td>
<td>3.53</td>
<td>0.85</td>
</tr>
<tr>
<td>3. Providing sufficient funds for projects</td>
<td>4.05</td>
<td>3.12</td>
<td>0.93</td>
</tr>
<tr>
<td>4. Leveraging customer relationships for ideas</td>
<td>3.89</td>
<td>3.01</td>
<td>0.88</td>
</tr>
<tr>
<td>5. Encouraging experimentation with new ideas</td>
<td>3.87</td>
<td>3.12</td>
<td>0.75</td>
</tr>
<tr>
<td>6. Sustaining marketing support beyond launch</td>
<td>3.79</td>
<td>2.92</td>
<td>0.86</td>
</tr>
<tr>
<td>7. Providing an innovative culture that regards honest failure</td>
<td>3.78</td>
<td>2.89</td>
<td>0.90</td>
</tr>
<tr>
<td>8. Clear innovation process for moving from idea generation to sales</td>
<td>3.77</td>
<td>3.00</td>
<td>0.77</td>
</tr>
<tr>
<td>9. Providing project team support</td>
<td>3.71</td>
<td>3.06</td>
<td>0.65</td>
</tr>
</tbody>
</table>

Scoring key: 1=minimum score; 5=maximum score
Two areas stand out as very important, understanding customer needs and senior management sponsorship. There is a large gap in between importance and need on the level of understanding of customer needs. Given the high emphasis placed on new product and service offerings for existing customers this gap is a cause for concern. Also whilst breakthrough innovation may be seen as the result of reframing customer demand it is unlikely to be successful without deep insights into user needs and application. So long-term success may be hampered unless the gap is closed.

Senior management support is considered important but is generally seen as less of a problem. But when we examine views at different organisational levels we find that executives see it is important (mean 4.53) but the gap (0.78) is much less than that reported by senior managers (importance 4.53, gap, 1.12). It is probably this senior group who are most influential in making innovation happen and their perception of a lack of support may be telling.

An innovative culture is often considered to be a differentiator of effective innovative performance. Once again we see the responses of executives and senior managers varying whilst they both emphasise the importance (executives mean 3.80 and senior managers, 3.94), the gap is 0.79 for executives and 1.18 for senior managers. It would appear that executives are presenting a rosier picture than senior managers of the suitability of the culture to support innovation.

One area, which would be expected to afford greater importance, particularly by executive management, is the measurement of innovation performance. Whilst both senior and middle management rated this higher than executive management, it was middle management, which showed the greatest gap (1.32 compared to 1.06 for senior management and 0.95 for executives). So it appears that more senior levels see the measurement as more appropriate for their purposes than middle managers (mean 3.32 compared to 3.68).

B. Almost half of the SMEs view their innovation performance better or significantly better than their competitors; but only a quarter do when compared to the leading innovators in the industry...

Whilst these companies will be unable to match the innovative capabilities of their most admired companies, one would expect them to draw comparisons with leading innovators in their industry.

When asked to compare their own innovation performance 37% of respondents reported inferior performance to industry innovators leaders. Only 23% saw their performance as superior. But when asked about innovation performance against leading industry competitors, 49% of respondents reported superior performance with only 20% being inferior. So whilst comparatively less innovative than leading innovators this does not appear significantly to impact on their innovation performance compared to their competitors.

C. Customer demand is the strongest driver and determinant for innovation in SMEs...

Customer demand is seen to be the strongest driver. This reinforces the need for understanding customer needs, customer insights, and leveraging of customer relationships as influencing innovation performance.

Responding to the environmental signals, leaders are seen as having a key role in driving through innovations but without an organisation switched on to innovation the changes may well not result.

External factors are seen as much less influential in terms of the drive for innovation. Of course this will vary between sectors, e.g. new legislation often creates opportunities for innovations, environmental concerns opens up new markets and a growing preference on the part of consumers for organic produce. But many of our respondents appear less impacted by such developments.
VI. THE INNOVATION CHAMPIONS

A. Apple leads the pack in innovation in the eyes of most respondents...

Many companies manage to display brilliant innovation over short stretches of time or in specific business or product service lines. But few appear to have institutionalised innovation to the extent where it is a continual source of value creation. Our respondents were asked to identify those companies they thought had achieved that stage – the innovation champions.

Apple and Google are both ranked number 1 in their sector in the Fortune 2006 survey\(^3\). But interestingly neither Apple nor Google features in the top 5 most admired companies in Business Week’s list which is headed by General Electric. Beaten by both Starbucks (2nd) and Toyota (3rd) Apple is placed at 7th. 3M appears at 14th and IBM does not appear in the list\(^4\).

B. Most admired innovators

<table>
<thead>
<tr>
<th>Rank</th>
<th>Company</th>
<th>% of total mentions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Apple</td>
<td>12%</td>
</tr>
<tr>
<td>2</td>
<td>Google</td>
<td>7%</td>
</tr>
<tr>
<td>2</td>
<td>3M</td>
<td>7%</td>
</tr>
<tr>
<td>3</td>
<td>Microsoft</td>
<td>4%</td>
</tr>
<tr>
<td>4</td>
<td>Virgin</td>
<td>3%</td>
</tr>
<tr>
<td>5</td>
<td>BMW</td>
<td>3%</td>
</tr>
</tbody>
</table>

VII. SUMMARY OF INSIGHTS

Where does this study leave us then? The research findings provide us with a good overview on how managers of SMEs are thinking about and approaching innovation in their firms.

The findings confirm that, indeed, innovation is a strategic priority in most SMEs today. In those SMEs innovation is viewed as an important element in achieving success compared to their industry competition. Consistent with that view, we find that SMEs are prepared to invest in innovation. In fact, the majority of firms indicated their intention to increase their spending on innovation in 2007.

Innovation makes a difference to profitability, yet a significant number of SME managers are not satisfied with their financial return on innovation. If innovation remains a point of contention; its measurement is an even greater one.

SMEs flagged a number of other areas of concern with respect to innovation: Development times that are too long, a risk averse culture, and limited insight into what customers really want appear at the top the list. We find it interesting that while existing customers are the focus of most innovation effort, SMEs feel they don’t really have the customer insight they need. And, while many SME businesses depend upon their own internal capabilities to achieve innovation, the organisational culture in many SMEs is not seen to be particularly conducive to innovation.

Finally, respondents ranked Apple, Google, and 3M as the most innovative companies. Innovation leaders differentiate themselves not only by generating an abundance of good ideas, but also by their organisational capability to translate these into a differentiated customer value offering. That is to say, the real innovators view innovation not only as an outcome to be tracked, but much more importantly, as a strategic capability to be nurtured and deployed.

Undoubtedly, this requires deliberate and purposeful management of the innovation capability across all its dimensions. Getting innovation to achieve a greater return on investment is a major and complex task. Sometimes it is difficult to know where to initiate the task. Most important is that SMEs do, in fact, rise to the task, where even small but decisive steps can be important stepping stones to becoming an innovation leader.

We hope the findings of this research will help SMEs’ on that journey.

VIII. SURVEY METHODOLOGY

In early summer 2007 Henley Management College sent the Henley SME Innovation 2007 survey electronically to SMEs in the UK and Continental Europe. Participation was voluntary and anonymous, though specific information relating to enterprise size, turnover, industry sector and comparative performance within that sector was solicited.

The survey queried managers in the following key areas:

- Innovation Spend
- Strategic Positioning of Innovation
- Innovation Focus
- Innovation resourcing
- Obstacles to Innovation
- Innovation Returns
- Innovation Performance Management
- Innovation Benchmarks
- Innovation Drivers and Determinants
- Innovation Outlook

In total, 156 managers responded to the survey from, in a total, 26 countries but predominantly within the EU.

\(^3\) http://bwnt.businessweek.com/interactive_reports/most_innovative/index.asp?chan=innovation_special+report+-+2007+most+innovative+compaines_2007+most+innovative+comanies

The responses by industry broke down as follows:

Whilst all levels from junior management up to executive and director were represented by far the greatest proportion were from director/executive levels.