

Forbes
INSIGHTS

HARNESSING INNOVATION TO JUMPSTART GROWTH

LESSONS FROM MIDDLE MARKET COMPANIES



IN ASSOCIATION WITH: **BMO**  **Harris Bank**

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FOREWORD: INNOVATION AND ECONOMIC OUTLOOK ARE LINKED

Middle market executives are split on the future direction for the U.S. economy. But when individual forecasts are coupled with measures of any given particular company’s drive for innovation, something intriguing arises. That is, the more positive the economic outlook, the stronger the innovation focus.

For the moment, leave the issue of which is the cause and which is the effect aside, focusing instead on innovation itself. In general, this survey shows that middle market companies are decidedly innovation-focused. That is, their strategies, products, services, processes and business models tend toward constant evolution.

However, two out of five respondents to the survey run what are referred to throughout the research as “transformative” companies. These are businesses that pursue innovation so aggressively that they tend to execute broader, more disruptive change versus incremental improvement. Accordingly, they are also significantly more likely to display a range of attitudes and processes that enable their more innovation-infused mindset.

Note also, this transformative approach appears consistently across all demographic subsets considered. In other words, the willingness and capacity for pursuing relatively disruptive innovation knows no industry or competitive bias.

In addition, transformative companies are significantly more likely to enjoy a range of associated benefits, including revenue advantage from more updated product/service lines, competitive advantage through breakthrough products and greater gains from efficiency initiatives. And as mentioned, the more transformative the organization, the more positively it views the U.S. economy and its own individual financial performance.

Or is it the other way around? Perhaps a more positive outlook fuels a greater willingness to try something new? More than likely, confidence and optimism are by-products of the willingness to innovate. Transformative businesses place a higher premium on continued evolution and growth, developing tangible business processes to encourage innovation. Perhaps such companies tend to feel greater control and confidence in their destinies.

The economy will likely dominate the conversation in the upcoming presidential elections. As for which direction that will trend, this report offers no obvious consensus. But what it clearly shows is that willingness to innovate and positive outlooks are highly correlated. So is your business feeling anxious about the economy? It might be time to take a closer look at your organization’s willingness and ability to foster innovation.



Bruce H. Rogers, Chief Insights Officer, Forbes Insights

KEY FINDINGS

Change is omnipresent. Middle market executives see change all around. Rating the degree of change perceived in their business environments, executives point to significant evolution in everything from strategies and business models to products, services, processes and talent.

Strategies are fast-evolving. Middle market companies are decidedly innovation-focused. Three out of five say their business strategies are constantly evolving.

Leading edge innovators are confident, aggressive: transformative. Predilection for innovation ranges from a focus on evolution to revolution. So-called transformative companies pursue the latter, accounting for just over two out of five middle market companies. In areas such as strategy, products, services, processes, customer relations or even talent management, these companies are significantly more likely to be willing to take risks to achieve breakthrough competitive advantage.

Innovation boosts the bottom line. Companies that most actively pursue innovation tend to accrue a range of potential financial benefits. For example, they derive revenue advantage from more updated product/service lines, attain competitive advantage through breakthrough products, as well as reap greater rewards from efficiency initiatives.

Innovation works everywhere. No other single category of industry or, for that matter, basic form of competitive model is populated with significantly more or fewer of these transformative businesses. In short, innovation takes root and can be used as a competitive tool in virtually any business in any industry.

Innovation requires enablement. It is one thing to say that a company promotes innovation — or claims it pursues transformative innovation. But it is the evidence of tangible processes for the enablement of innovation that distinguishes the real doers from the wannabes.

True innovators display additional identifying characteristics. Transformative companies tend to be more capable in terms of questioning the status quo, networking, experimenting and drawing connections among unrelated elements (so-called associational thinking).

Innovation correlates with confidence. The survey shows that the stronger a company’s drive for innovation — the more transformative the organization — the more positive its views on not only its own corporate performance, but also that of the U.S. economy in general.

CHANGE IS OMNIPRESENT

Middle market executives see change all around. As Mark Sieron, a group president at Illinois-based, food service manufacturer Middleby Corporation, explains, “You need to be in tune with what’s happening with your customers and constantly adjust and improve what you have to offer.” In short, says Sieron, “you have to be innovation-focused.”

Rating the degree of change perceived in their business environments, executives point to significant evolution in everything from strategies and business models to products, services, processes and talent.

Examples of innovation abound. Consider:

Business models

Luke Norris, CEO of Colorado-based PeakColo, says, “It’s innovation in business models where you often see the most disruption.” PeakColo provides cloud-based computer services, including infrastructure and software. This requires the company to deploy bleeding edge communications and related technology packages. But the disruption is by no means limited to products and services. As Norris explains, “We also find we have to continuously innovate in our service delivery and pricing. As opposed to fixed and relatively inflexible contracts, the company’s customers want true volume-based payment models.” But that, says Norris, “takes a lot of innovative thinking and hard work to enable. It’s an entirely new mindset.”

Products

Middleby Marshall, a division of The Middleby Corporation offers two product lines that deserve to be labeled transformative. These include a conveyor oven, the WOW!, that “revolutionized pizza baking,” says group president Mark Sieron. And today, says Sieron, the company’s CTX Oven,

a device combining a griddle, fryer and char broiler into a single unit, is revolutionizing a broader range of commercial kitchens. “It used to be you needed several line staff to do the cooking. But with this new and innovative oven, one person can handle it all while actually improving the quality and consistency,” says Sieron.

Services

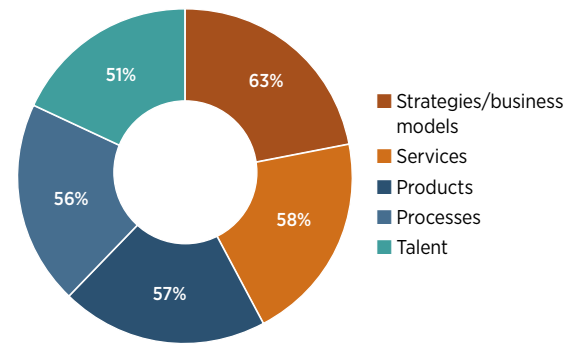
Traditionally, the boating industry featured primarily independent dealers. But Florida-based MarineMax is competing by introducing a scale-based business model. As president, marketing and vacations, Lex Raas explains, “What we do is take on all aspects of boating — from purchase, to storage, upkeep, resale and water-based vacation options — so there’s a single face to the customer and a single standard of high quality.” Innovation in the basic business model is further augmented by an array of service and even product innovation. The company works closely not only with its customers, the boating public, but also its suppliers, the builders of boats, “to continuously innovate with an eye toward improving the whole of the boating experience,” says Raas.

Processes

While transformative products and business models are important, innovation can also mean simply doing more with less. In a chronically weak economy, innovation that leads to incremental improvement in operations is also

welcomed. As Scott Milne, CIO of New Jersey-based Clayton, a \$500 million provider of concrete, block and sand, explains, “Across the board, we’re looking for ways to save time and money — in this economy you have to.” Consequently, the executive gets involved in all manner of projects seeking the means to simplify and automate not only IT operations but also significant business processes. That means “going into the field and seeing what actually goes on.”

FIGURE 1: Middle market executives see significant change in:



¹Figures indicate the number of executives choosing a 4 or 5 on a 5 point scale (where 1 equals stable and 5 equals rapid evolution)

STRATEGIES ARE FAST-EVOLVING

The above are all examples of companies making a conscious effort to pursue innovation. A sense that change is all around drives an orientation toward innovation in strategy and execution. This is a belief that surfaced again and again throughout the survey and interviews.

For example, another key finding is that middle market companies say they are decidedly innovation-focused. Sixty-three percent, for instance, describe their business strategies as either constantly evolving (19%) or evolving (44%). In contrast, only 18% view strategies as stable (13%) or very stable (5%). (See table.)

Those whose business strategies tend toward constant evolution cite a range of underlying motivations. Sixty percent say that it is confidence in their ability to innovate and improve that drives their orientation, while 56% point to an aggressive management team. Nearly half, 47%, say it is a sense that customers want something new that drives their evolution in strategy, while 44% point to business processes and cultures that strongly encourage innovation. Other influences include a belief that competitors are being aggressive or, alternatively, that they themselves are being too cautious.

As for those indicating their strategies are more stable over time, the most often-cited drivers are confidence in current business models (42%) and a relatively stable/transformation-resistant industry or conservative management approach (40% and 40%, respectively). Economic and regulatory uncertainty as well as a commitment to tradition as a corporate value can also contribute to greater stability in business strategy.

FIGURE 2: Current business strategies

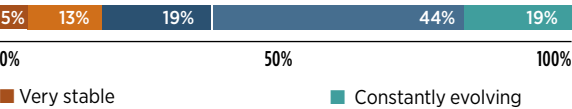


FIGURE 3: Those who change: CONSTANT EVOLUTION



FIGURE 4: Those in repose: STABLE STRATEGIES



FULL-SPECTRUM COLLABORATION

Q&A: Cindy Farach-Carson, Ph.D., Vice Provost for Translational Bioscience, Scientific Director, BioScience Research Collaborative, Ralph and Dorothy Looney Professor of Biochemistry and Cell Biology, Rice University

What do you do? I have a range of roles, but they all eventually focus on translating leading edge science into practical applications.

What is innovation? It's a new way of thinking. It's seeing the same things everyone else is seeing but perceiving something new, different, compelling — and valuable to the world and to the marketplace.

Is innovation an art or a science? You might assume that I view innovation as a highly structured discipline. Well, it very much is, and it also isn't. Yes, there are many organizational elements that need to be in place to enable innovation — that's the formal response. But in the end, it's a lot more like herding cats.

How do you mean? I spend most of my time trying to keep diverse people moving in roughly, rarely precisely, the same direction. Innovators are freethinking, pioneering, opinionated, determined. They're also hardheaded, with their own way of thinking and an instinctual contempt for bureaucracy. Businesses need such people, but their talent needs to be channeled or directed.

How can you channel innovators without throttling their creativity? That's the challenge. And to my thinking, the thing that is most effective is to help them sign on to a common vision and common goals. You want them experimenting, challenging and pursuing their ideas. But at the same time you want them moving in directions that benefit the organization — and you need to be able to recognize the point at which it's time to commercialize the innovation.

When is that — and what needs to be done? In the biosciences, there are points where “endless possibilities” need to be culled to a “more likely to be successful” few. And with that, the pure science has to begin more closely collaborating with the business of bioscience. Scientists don't like that — innovators don't like that — but at some point, you have to begin making fast and early “go/no go” decisions to avoid throwing good money after bad. But there's never a perfect answer because you will never know what might have been had someone continued down a given path.

What advice would you give companies regarding innovation? Very few within any organization will be true innovators. So you need to listen. Create an atmosphere where people really feel free to express themselves. And from there, you need what I call full-spectrum collaboration: researchers, engineers, clinicians, statisticians, computer scientists, attorneys. The days when one person on their own can truly capture the value of innovation are long gone. You need a team. And that's why this is cat herding, because so many creative and capable people are moving in different directions for different reasons. But ultimately, you have to balance business with innovation.

Relative to larger enterprises, do mid-size companies have a leg up on innovation? It depends on the large company — is it a monolithic organization or is it being run in a decentralized manner? Generally speaking, absolutely, mid-size companies have a built-in set of advantages in that they have fewer legacy impediments and can be more nimble. They also tend to have a purpose and can be more dedicated — say to immunotherapy or a heart device as opposed to the whole of medicine.

What inhibits larger companies from being more innovative? They can have too many committees requiring too many reviews and approvals. They have internal politics — this or that product line or that customer belongs to “my” division, not yours.

ACTIVE, CONFIDENT, AGGRESSIVE: TRANSFORMATIVE

As a group, middle market executives are heavily predisposed toward innovation. Nonetheless, individual companies differ dramatically in their approach, with some pursuing evolution, others revolution and still others somewhere in between.

The heftiest segment, 43%, tends to favor revolution: a larger, more comprehensive and generally bolder brand of innovation. Throughout this survey, this group is referred to as transformative. Note that in nearly every instance examined, relative to other segments, members of this “transformative” group are seen to be more active, confident and even aggressive in their pursuit of innovation.

In every instance examined, transformative companies are significantly more likely to err on the side of creative destruction. In areas such as strategy, products, services, processes, customer relations or even talent management, these companies are significantly more likely to be willing to take risks to achieve breakthrough competitive advantage.

A good example of a transformative innovator is Middleby Marshall, a division of The Middleby Corporation. Its WOW! conveyor oven revolutionized the pizza industry some 25 years ago. Today its CTX Oven is a highly efficient infrared broiler, gaining widespread acceptance by the so-called casual dining industry.

Group president Mark Sieron believes there are a number of drivers enabling his company's innovative posture. Foremost, “we have a chairman who is very engaged with customers, and he's always listening to needs.” This led to development of the WOW! Oven: “Customers were saying they needed to cut labor costs and energy costs as well as speed up the cooking process,” says Sieron. So the chairman directed the company's research teams “to find a way to address those needs.”

Next, “there's not a lot of management layers — we're very nimble that way,” says Sieron. Yet another key is the way the company collaborates across business units.

For example, Middleby maintains a technology center “where customers can come in for the day, and we'll demonstrate the products and technologies we're developing.” Recently, a major national company sent in its national account group with one set of needs in mind but wound up leaving with agreements to run a 60-store test using products with a completely different focus.

Finally, no matter the economic climate, the company never fails to invest in innovation. “If sales slip, we may cut back a little on R&D spending,” says Sieron. “But we have enough experience to know that if you're going to cut, cut somewhere else. To let go of R&D, that's mortgaging your future.”

For another example, consider MarineMax. The group's overall business model is itself an innovation. In an industry characterized by small, individually owned dealerships and/or repair shops, the company competes by presenting a single face to the customer across all aspects of boating. But its innovations don't stop there. In products, for example, the company worked closely with one of its manufacturers, Sea Ray, “to develop a 37-foot boat with the outboard motors completely hidden.” The advantages, says Raas, “include greater safety and improved ergonomics,” to name a few.

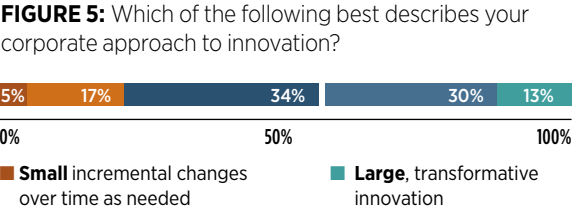
Regarding service innovation, the company also offers a range of classes and events designed to enhance both knowledge and enjoyment. It also organizes group boating excursions, for example from Florida to Bimini. And now, responding to customer demand, the group offers a charter service and is even working with engineers “to develop better designs for charter boats.” All told, says Raas, “we are constantly looking to innovate in everything we do to enhance the boating experience.”

The incremental approach

At the opposite end of the spectrum, about one in five middle market executives (22%) say their companies prefer smaller, incremental changes over time. Here, innovation is approached more cautiously. As opposed to implementing bold moves, such “incremental” businesses are more likely to move slowly and cautiously, implementing change only as needed or required. About a third of the sample, 34%, described their orientation as dead center on the continuum from incremental to transformative change.

But this is not to say that incremental change isn’t valuable. CIO Milne of Clayton says the IT function at his company is a prime example of continuous, incremental innovation. As for the function itself, “in this economy, there’s pressure to keep costs down, particularly in cost centers.” As such, “we work with vendors to do whatever we can to stay lean.” A good example is the company’s adoption of leading edge software and server technology. The company recently went through a process of consolidating and streamlining. Working with vendors, says Milne, “we took advantage of the innovations they could provide to reduce costs and improve efficiency.”

In addition, Clayton’s IT group also pursues innovation on its own. “In finding and improving software tools, it’s really important to get out into the field,” says Milne. A real eye opener was a day spent observing the company’s delivery processes. “You want to talk about a short shelf life — concrete for delivery is good for about 40 minutes,” says Milne. “So we were just amazed at how much shouting and re-routing and doing whatever needs to be done to keep things moving takes place on a daily basis.” Ultimately, Milne was able to work with his dispatchers to develop IT tools to improve associated processes. Nonetheless, “there’s no substitute for seeing the challenges through the eyes of your end-users.”



INNOVATION BOOSTS THE BOTTOM LINE

The differences between transformative-minded and more “business as usual” approaches by no means end there. One compelling set of findings is that companies that more actively pursue innovation tend to accrue a range of potential financial benefits. For example, transformative companies are also significantly more likely to:

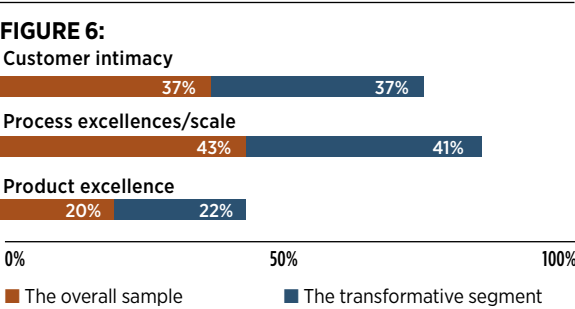
- **Derive revenue advantage from a fresher product/service line.** Over half of middle market executives in the survey, 55%, say 16% or more of their sales come from products or services developed over the past three years. However, this figure rises to 69% among transformative companies.
 - **Develop competitive advantage through breakthrough products, services or processes.** Overall, 57% say they have been the first to develop a product generally viewed as a breakthrough over the past five years. But among transformative companies, the figure rises to 77%.
 - **Reap greater rewards from efficiency initiatives.** Twenty-four percent of businesses at large obtained 16% or more of their cost savings from improvements in strategies. But that figure increases to 38% among transformative businesses. In general, the more transformative the orientation, the more effective the cost-saving initiatives.
- Zeroing in still further, approximately one-third of the overall sample, 31%, say relatively new products and services account for 20% of sales or more. Again, the figure rises to 42% among transformative companies. Such statistics are an indication that for the middle market overall, innovation is an important element of the business model. Nonetheless, transformative organizations tend to derive, significantly greater percentage of their revenues from new products and services than those from the general sample at large.

INNOVATION WORKS EVERYWHERE

A surprising finding is that no other single category of industry or, for that matter, basic form of competitive model, is populated with significantly more or fewer of these transformative businesses. In short, innovation can take root and be used as a competitive tool in virtually any business in any industry.

It is also striking that innovation is taking place at nearly the same pace regardless of the fundamental business model. The Treacy-Wiersema¹ model suggests that companies tend to compete primarily in only one of three competitive axes: customer intimacy, process excellence/scale or product excellence. The idea is that a focus in any one of the three areas limits the degree to which a company can build its strategic core in either of the other two.

Participants were asked to isolate their core capability based on this model. Surprisingly, the distribution of “transformative” companies also precisely mirrors the distribution of competitive models of the sample at large.



¹The Discipline of Market Leaders, Michael Treacy and Fred Wiersema

CUSTOMER-DRIVEN REVOLUTION

Q&A, Martha Rogers, Ph.D., Founding Partner, Peppers & Rogers Group

What is the linkage between customers and innovation? An innovation by itself is of no value unless it appeals to a customer. What businesses create has value only if a customer buys it. So another way of thinking about this, if you’re not engaging with customers in your product or service development or the fundamental way you do business, you could be missing the whole point.

How should mid-size companies engage with their customers? There are limitless ways. I believe the best way to approach it is to ask yourself, what interactions are taking place and how is the learning from each of those being captured and disseminated? You’re trying to at all times identify customer needs and preferences. And in today’s world, you need to be able to respond incredibly fast, because if you don’t, someone else will. So if you’re smart, you’re not listening to solely your own customers — you’re also listening to your competitors’ customers.

And the tools are? Also limitless. There are call center and website interactions. Sales and service calls. Data mining. And increasingly, mobile interaction and social media. Leading companies are looking for ways to recognize what’s going on with their customers and their competitors’ customers earlier on so that they can respond more rapidly. And I believe if we’re discussing innovation that’s driven by customer insight, the real action is not in specific products or services — there will always be innovation in those areas. The real topic you want to explore is innovation in business models.

What’s going on with business models? Think about how Blockbuster was overtaken by Netflix. You had to drive to a physical location to get your movie, and if you then brought it back late, you paid a late fee. Netflix listened: Driving is a hassle; late fees are bad. Identifying and addressing customers’ core needs resulted in a completely new business model. That same dynamic is playing out in just about every business you can think of. Right now, somewhere, there are customer needs that are perhaps not being perceived but are certainly not being addressed. Your company will either step up and develop the needed new wrinkle, or a competitor will.

What other innovations in business models are you seeing? A really vital set of innovation is taking place in customer intimacy or, more specifically, trust. A growing number of companies are paying attention to individual customer transactions and then taking action that benefits the customer.

For example? One thing you’ll probably hear is that cellular customers are always confounded by the complexity of billing. They never know if they’re on the right plan or not. One European carrier is now saying, go ahead, use your phone, browse, text and call and then at the end of the month we’ll analyze your activity and put you on the most cost-effective plan for you. Then there’s USAA, a U.S. banking and insurance company. USAA proactively looks out for its customers’ best interests. After many of their customers served in Iraq during the first Gulf War, USAA sent refund checks to them for time the cars were not being used. “We know you were serving your country, we know your car was in the garage and not being used, so we are reimbursing you for that time.” Over 2500 of those checks came back from the customers, uncashed, with heartfelt thanks and good wishes for the company. That’s innovation, if not revolution. And you can be certain moves like that will attract attention, stimulate new sales, spread goodwill, and improve customer loyalty.

Any other business model innovations we should consider? Another example of increased intimacy is social media. And here, the key point I would share is that companies need to stop thinking about social media as yet another new method to be exploited to sell more stuff but instead view it as a means to identify and solve customer needs and problems. One of my favorite stories is the case where a gentleman was having a really rough day and then encountered a long line in his bank. While in line, to vent, he tweeted about his predicament. Moments later, because the bank was monitoring social media, a bank representative walked right up to the gentleman, both apologizing and expediting the visit. That’s a new way to serve customer, create a better experience, and generate long-term loyalty.

INNOVATION REQUIRES ENABLEMENT

It is one thing to say that a company promotes innovation — or claims it pursues transformative innovation. But it is the evidence of tangible processes for the enablement of innovation that distinguishes the real doers from the wannabes. In this regard, those describing themselves as transformative tend to exhibit key processes for innovation with far greater frequency than the sample at large.

For example, among the overall sample, 59% of executives say their organizations provide recognition for innovation. But among transformative businesses, the figure rises to 77%. Similarly, recruiting a diverse workforce is a key objective for 59% of the sample at large. But the frequency rises to 77% among transformative companies.

Other key mechanisms for promoting and enabling innovation include providing means for young workers

to learn from more experienced colleagues as well as the reverse. Companies can also provide training in techniques to promote innovation, can more aggressively and intensely collect and analyze data in order to identify opportunities, and can fund unconventional research or even enable/encourage informal networking. Again, in every instance, the most transformative companies pursue these strategies to a categorically greater degree than the overall sample.

TRUE INNOVATORS DISPLAY IDENTIFYING CHARACTERISTICS

Transformative executives also have greater confidence across a range of attributes described by various consultants as essential elements of innovation. The authors of *The Innovator's DNA*¹, for example, suggest there are five key skills that can lead to disruptive innovation. Moreover, the authors argue that each of these skills, which may reside in individuals, an organization or both, can be developed and improved.

Again, transformative companies are significantly more likely to report greater capacity than the sample at large in each of these key skills. Specifically:

Questioning allows innovators to challenge the status quo and consider new possibilities. Fifty-four percent of the overall sample say they are either satisfied (36%) or very satisfied (17%) with the degree their organizations exhibit this behavior. However, the figure rises to 73% among the most innovative businesses, composed of 42% satisfied and 31% very satisfied.

Observing helps innovators detect small details — in the activities of customers, suppliers and other companies — that suggest improvements in processes, products and services. Again, transformative businesses are significantly more likely

to report greater satisfaction with their performance in this area — 72% versus only 56% for the overall sample.

Networking permits innovators to gain radically different perspectives from individuals with diverse backgrounds. Experimenting prompts innovators to relentlessly try out new experiences, take things apart and test new ideas. Finally, associational thinking — drawing connections among questions, problems or ideas from unrelated fields — is triggered by the aforementioned activities of questioning, observing, networking and experimenting. In each instance, relative to the sample at large, transformative organizations are significantly more satisfied with their performance in each of these areas.

¹*The Innovator's DNA*, by Hal Gregersen, Clayton M. Christensen and Jeff Dyer.

INNOVATION CORRELATES WITH CONFIDENCE

Perhaps most intriguing of all the findings is the degree to which a stronger commitment to innovation correlates with higher levels of confidence and optimism. The survey shows that the stronger a company’s drive for innovation — the more transformative the organization — the more positive its views on not only its own corporate performance, but also that of the U.S. economy in general.

The most transformative companies are indeed significantly more bullish on the U.S. economy. Overall, the consensus outlook is mixed, resulting in no clear guidance on the future. Specifically, a bit more than a third (37%) of the overall sample sees the economy as weak (28%) or very weak (9%). Roughly another third, 35%, remain neutral in their outlooks, predicting neither recovery nor further decline. And just under a third, 29%, describe the condition of the U.S. economy as strong or very strong.

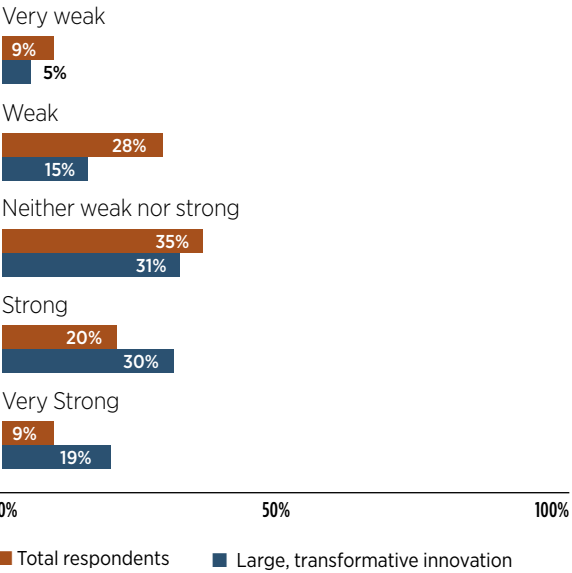
But viewed through the eyes of the most transformative-minded companies, the economic outlook changes dramatically. Half, 49%, view the U.S. economy as strong (30%) or very strong (19%). Meanwhile, only one in five innovation-focused executives, 20%, see U.S. economic well-being as weak (15%) or very weak (5%).

The relative uptick in optimism among transformative businesses carries over into survey participants’ outlooks for their own performance. For the overall sample, 66% view their own company’s financial well-being as strong (46%) or very strong (20%). But again, for innovation-focused executives these figures rise to 82%, composed of 48% indicating strong and 34% very strong.

It is also worth noting that in general, middle market executives have more confidence in themselves than in the surrounding environment. This includes views of their own industries and customers as well as their own capabilities in innovation.

This is a realization that also permeated the prior

FIGURE 7: How would you characterize the relative financial well-being of the U.S. economy?



report in this series, “Inspired for Growth: Lessons from Middle Market Companies.” These companies are by their nature entrepreneurial, and those gravitating toward management of such enterprises tend to be a confident lot. Nonetheless, in every instance cited, the most transformative-minded are also significantly more confident.

FIGURE 8: How would you characterize the relative financial well-being of your company ?

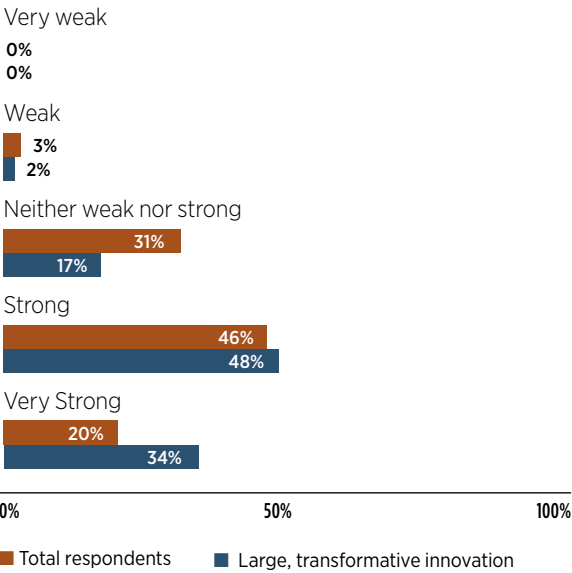
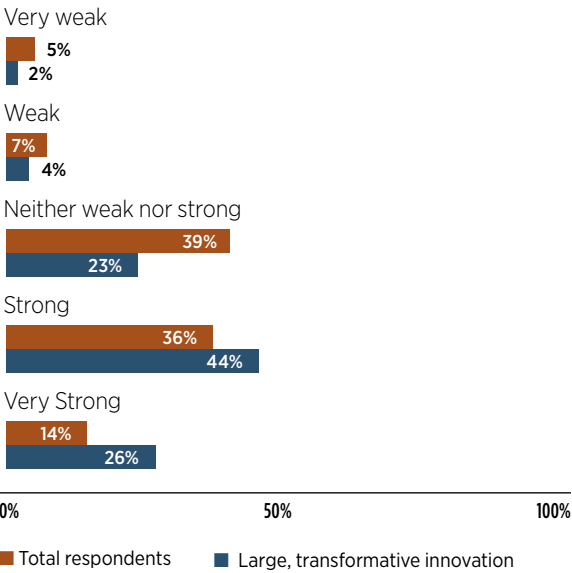


FIGURE 9: How would you characterize the relative financial well-being of your industry ?



IF WE CAN'T BUILD IT, WE'LL BUY IT

Q&A: Chief Development Officer (from a Fortune 250 acquirer)

What is your role? My job is to scour the landscape looking for opportunities, assessing the competition and addressing risks to our business at large. I work closely with our senior executives and business managers to assess the right paths for our company and help us get the organization where it needs to be.

How does innovation factor in to your role? As a large organization — as a very large organization to be precise — it's very easy to get caught up in bureaucracy, turf battles, inertia and other forces that make it harder to identify opportunities for innovation. Part of my role is to do what it takes to help the organization avoid those pitfalls.

So are you unable to innovate? To the contrary, we are consummate innovators, employing a range of tools and processes. We invest heavily in R&D — which is actually one of the advantages we enjoy over small companies. We have built-in distribution ready to go, and so we are willing to invest more to develop and deliver products ourselves. We have very close relationships with customers and are attuned to their needs. We have relationships with universities and research labs all over the world. And with a global footprint, we are able to take innovation gleaned in one country or region and leverage that worldwide. We also invest heavily in joint ventures, partnerships and alliances and throw out seed capital in minority investments. And we are in constant touch with investment bankers and PE firms who apprise us of promising innovations.

How do you view midsize companies? They are competitors. And surprisingly often, they are able to latch on to innovations in processes, products, services or technologies that would be far more valuable to us — again because of our scale — than they are to the current owners. But they are also potential allies. And that's part of what drives our corporate development initiatives, a willingness to pay a premium over the value of what someone owns because of the ways we can leverage that asset.

Do midsize companies have any advantages in innovation over your organization? To some extent, yes, they do have less getting in the way of fundamental change and they do tend to focus. And a lot of these midsize companies were launched right of the garage of grad students who are on the cutting edge in some key area. But we are also cutting edge in many areas. And what I always say is that the reason there are so many attractive startups is because — there are just so many startups, so some of them are bound to be successful.

So you prefer startups to midsize companies? We do like to get in closer to the ground floor. But an attractive innovation, something that we can't build or replicate on our own, could appeal to us no matter the size of the owner. We are always looking for great opportunities to invest or acquire.

CONCLUSION: IS IT THE CHICKEN OR THE EGG?

Which came first: their more positive outlooks and stronger performances or their more innovation-minded approach to business?

Two out of five middle market company executives say their business models are transformative — exhibiting a degree of agility that both larger companies and less innovation-capable peers often view with admiration and envy. These same businesses, meanwhile, also tend to hold a significantly more positive outlook for the U.S. economy as a whole as well as for the fortunes of their own individual companies.

More than likely, confidence and optimism are by-products of the know-how and willingness to innovate. Indeed, the research shows that a greater focus on innovation tends to translate into more breakthrough products and services, more revenue from new products and services, and greater returns from cost-saving initiatives. But regardless of which is the cause and which is the effect, the inescapable conclusion is that the willingness to pursue innovation and greater

confidence in the achievement of success are intertwined.

As for the pursuit of innovation, the research highlights an array of enabling elements. These can range from something as basic as tolerating well-intentioned mistakes to the provision of innovation training, all the way to a carefully orchestrated model of full-spectrum collaboration. But generally speaking, the more transformative the business, the more innovation-enabling tools and processes are in evidence.

In the end, confidence and optimism are more than likely the by-products of the ability to innovate. Companies with greater capabilities in terms of driving transformative change tend to feel more in control of their own destinies. Such businesses place a higher premium on continued evolution and growth, developing tangible business processes to encourage innovation.

METHODOLOGY

The insights and commentary found in this report are derived from both a survey instrument and personal interviews.

Partnering with BMO Harris Bank, Forbes Insights conducted a survey in July 2012 which was completed by 313 executives. Key demographics include:
Executive title: CEO/President (32%), SVP/VP/Director (20%), CFO/Treasurer (15%)
Company size: \$250 million to \$499 million (27%), \$100 million to \$249 million (38%), \$50 million to \$99 million (34%)

The sample features a wide spectrum of industries, albeit with several notable concentrations, including professional services (16%), retail and wholesale trade (14%), banking/finance (12%), and engineering and construction (11%). Respondents were also relatively evenly distributed throughout the U.S.: Northeast (33%), Southwest (24%), Midwest (20%), Southeast (18%) and Northwest (5%).

Interviews were conducted with seven senior executives including:

- Cindy Farach-Carson, Ph.D., Ralph and Dorothy Looney Professor of Biochemistry and Cell Biology
Vice Provost for Translational BioScience, Rice University
- Lex Raas, President, marketing and vacations, MarineMax
- Luke Norris, CEO, PeakColo
- Mark Sieron, Group President, Middleby Corporation
- Martha Rogers, Ph.D., co-founding partner, Peppers & Rogers
- Scott Milne, CIO, Clayton Company

Forbes Insights extends its gratitude to these executives.

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