INNOVATION STRATEGY AND ITS IMPACT ON COMPANY GROWTH

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Abstract

The paper deals with the effects which might have innovation strategy on company growth. The paper also confronts business strategy with innovation strategy and indicates certain disparity between these types of strategies. It indicates that despite having viable business strategy in place, some companies are still puzzled with the incorporation of innovation and innovation processes into corporate strategy. The paper examines how intensively the innovation influence both Real Company Growth (RGR) and Sustainable Company Growth (SGR). By means of Case Study it is exemplified how the company can manage its RGR and SGR through process and organizational innovation on one hand and product and marketing innovation on the other hand. It was found out that the former boosts company growth especially through reduction of the costs and facilitation of processes while the latter drives the company growth preferably through sales increase. Both approaches may complement on each other and generate synergic effects. Both types of growth are compared with the development of real GDP which was the benchmark for the assessment of the innovation process effectiveness.

Key words: innovation strategy, innovation ecosystem, real company growth, sustainable company growth.

JEL Code: L11, L21, L25.

Introduction

Over past decade innovation was put into spotlight because of its potential to provide companies with various economic benefits. Tidd, Bessant & Pavitt (2005) revealed that companies which implemented innovation to improve their processes and differentiated their products were significantly ahead of their competition in terms of market share, profitability, companies´ growth and net income. Lukes & Stephan found out that innovation was a key driver that could guarantee competitive advantage for organizations. They also confirmed that process of innovation related to generating and implementing new ideas, processes and procedures performed tasks in the best, most effective manner and offered the best products and services. Viable innovation strategy is considered underlying element influencing organic company growth. Failures of many well-known companies like Nokia, Yahoo, HP, Sun Microsystems etc. are mainly attributed to the lack of innovation strategy. Despite the companies´ ability to define overall business strategy which promotes alignment among diverse functions they still have a problem with the alignment of innovation effort. A company which resigned to innovation strategy may come to understanding that different parts of an organization can easily wind up pursuing conflicting priorities notwithstanding having business strategy.

1 Methodology

The methodology is based on author´s participating observation, contextual interviews and case studies

1.1 Participative observation

Participative observation (Kawulich, 2005). which comes under ethnographic research was selected as an important research method due to author´s personal engagement in company strategic innovation processes. Participative observation is the method that is based on active participation of the researcher (Hume & Mulcock, 2004). According to DeWalt and DeWalt (2002, p. vii) *"Participant observation is the process enabling researches to learn about the activities of the people under study in the natural settings through observing and participating in those activities"*.

1.2 Case Study research

Case Study research played the fundamental role in the exploration of the impact of innovation strategy on company growth. Case Study is a frequently used research technique which enables creatively explore problems and related circumstances (Yazan, 2015). The aim of the case study is to confront real situation which is supported by the field data with those excerpted from a literature. The aim is to make theory more precise by means of iterative approach. The Case study usually represent typical or unique case (Eisenhardt, 1989). The latter type of the Case Study was applied in this paper. Case study was used to demonstrate the feasibility of boosting company growth by means of innovation-driven strategy.

1.3 **Contextual interview**

Contextual interviews were conducted with five company managers who treated innovation within their management portfolio. The aim of these interviews was the examination of the effects of innovation strategy on the company development and subsequent company growth. Each interview lasted from 40 to 50 minutes and was recorded manually. In addition to the impact of innovation on company growth, the interpretation of interviews help reveal some other benefits that were combined with the execution of innovation strategy like enhancing the company prestige, increase in employee strategic skills or better treatment of uncertainties.

2 Business strategy vs innovation strategy

Company competency to innovate is closely tied with company innovation system which means interdependent set of processes and structures that are conducive to searching for novel problems and solutions, synthesizes ideas into a business concept and product design, and selects which projects get funded (Pisano, 2015).

Needless to stress that innovation strategies are different from many business strategies because of the difficulty to predict next steps, time and impact of the innovation. There are many different types of innovation but using specific type of innovation is dependent on innovation strategy. When developing innovation strategy, it is necessary to consider the level of company maturity, its direction and requested outcome of the innovation.

Basically, innovation strategy should react to what the company wants to get from the innovation. Usually it deals with:

- Development of a new product;
- Protect market share;
- Expand market share;
- Sell or licence to another organization;
- Retain more staff;
- Improve organization efficiency;
- Increase recognition in the marketplace.

Various authors set up their own classifications of innovation strategy. Tidd, Bessant a Pavitt (2005), classified innovation strategies into two groups:

- **Rationalistic innovation strategy** that pays respect to linear innovation model (analysis-decision-implementation). It also takes into consideration trends in environment development, it is long-term oriented and anticipates prospective changes and interconnects goals and activities.

- **Gradualist innovation strategy** which is more commonplace in current managerial practice. This type of strategy assumes that understanding complexity of changes is quite impossible. This restrained capability to understand complexity and dynamics of the environment development refers both to presence and future.

Dodgson, Gann & Salter (2008) presented the classification of innovation strategies. According to them innovation strategies can be categorized as follows:

- **Proactive strategies**. This strategy is applied by companies that effectively operate their R & D, they are able to pioneer their technologies and can be technology leaders. Within proactive strategy companies usually execute both radical and incremental innovation.
- **Active strategies.** This type of innovation encompasses defending existing technologies and markets, while being prepared to respond promptly once technology and markets are proven. Companies that pursue this strategy are rather cautious to accept significant risks. These companies usually opt for incremental innovation and applied research accomplished in internal R & D. As examples companies like Microsoft, Dell or British Airways can be mentioned.
- **Reactive strategies**. This type of strategy is used by companies that are (i) followers, (ii) operations-driven, (iii) low-risk takers and right-opportunity waiting. Companies which pursue this strategy are focused on copying proven innovation and use almost exclusively incremental innovation. AS an example, low-cost airlines Ryanair, that copied service model of Southwest Airlines can be mentioned
- **Passive strategies** – This type of strategy is used by companies which wait until the customers raise demand for new or innovative products or services. Typical examples are automotive suppliers which are obliged to supply spare parts of exactly defined specification.

Nowadays so-called agile approaches to strategy management attracted a great deal of attention. These approaches accentuate dynamic approach to strategy, typically the ability of strategy to react on ongoing basis to sudden changes in environment. Doz and Kosonen (2008) put in spotlight their concept of fast strategy. Other authors emphasized the incorporation of external knowledge to increase the effectiveness of innovation strategy (Linder, 2019).

2 Innovation strategy and company growth

Wu & Lin (2011) examined the influence of innovation strategy and organizational innovation on innovation quality and performance. They arrived at conclusion that innovation strategy positively influenced both innovation quality and innovation performance. This conclusion was also corroborated by the research conducted by Brodzicki & Ciolek (2016) who found out that companies with high innovation performance were not only more focused on innovation, but also more aware of the need to implement changes.

2.1 Corporate growth and how to measure it

Corporate growth can be approached from two different standpoints. The first expression refers to **Real Growth Rate – RGR** which is understood as percentage increase in sales compared to previous period:

$$RGR = \frac{T_1 - T_0}{T_0} \tag{1}$$

The other approach is through **Sustainable or Equity Growth Rate – SGR** which stands for the relative percentage increase in equity compared to previous period. Sustainable growth rate is such an increase during which the company is able to finance its growth (measured by relative sales increase) by the increase in own financial resources (measured by relative increase in equity). As long as the company grows by SGR it doesn´t need any additional foreign financial resources.

$$SGR = \frac{E_1 - E_0}{E_0} \tag{2}$$

SGR can be then express as follows:

$$g = ROE \times \left(1 - \frac{D_0}{EAT_0}\right) = \frac{EAT_1}{R_1} \times \frac{R_1}{A_1} \times \frac{C_1}{E_0} \times \left(1 - \frac{D_0}{EAT_0}\right) \tag{3}$$

Where:

ROE = Return on Equity;

D = Dividends paid to shareholders;

EAT = Earnings after taxes;

A = Assets;

C = Capital;

R = Revenues.

From the equation (3) it is apparent that company growth is strongly influenced by the dividends paid. Supposing that the company pays off entire taxed profit to shareholders SGR is 0. On the contrary if the company doesn´t pay any dividends the SGR squares ROE.

Interpretation of formula (3) leads to conclusions that the innovation is conducive to sustainable company growth (SGR) only then if it boosts profit margin, accelerates transformation of assets into revenues and uses leverage effect.

The impact of innovation on company growth is executed through the increase in net profit which may be achieved either by revenues increase or costs decrease. The former is usually tied with product innovation which, based on the level of radicalness, can boost company sales either by launching brand new products or supplying innovative product that delivers higher customer value. The latter is quite often combined with the process innovation which can involve new technologies, process reengineering, SCM improvements, quality standards implementation etc. Needless to stress that the effects obtained from new products launch are often delayed because of protracted time-to-launch (TTL). TTD is tightly dependent on the category of business (e.g. for IT innovation is typical shorter TTL than that for drug development). On top of that there are links to complexity of innovation where demanding and time-consuming radical innovation requires longer TTL that simple incremental innovation.

3 Case study PharmaComm, s.r.o

Pharma Comm, s.r.o. is Czech based pharmaceutical company aimed at the research and development, production and sales of generic versions of Active Pharmaceutical Ingredients (API). Nowadays the company operates modern technologies and currently employs approx. 140 employees. Ten years ago, the company that suffered from the lack of innovation considered boosting company growth by embarking upon innovation. Due to scarcity of resources (financial, human, expert and technology) the company decided to start with process reengineering consisting in removing non-value added processes, slashing the staff by 25%, reinforcing R&D etc. This company reconstitution was intended to improve financial performance and helped collect financial resource inevitable for supporting new products development. In the wake of reengineering three new product developments were initiated. These developments which were rather costly and time consuming were believed to ensure annual company growth which would keep the company growth abreast with real GDP.

GDP was calculated by known formula (4):

$$g(\%) = \frac{GDP_t - GDP_{t-1}}{GDP_{t-1}}.100 = \frac{\Delta GDP_t}{GDP_{t-1}} \tag{4}$$

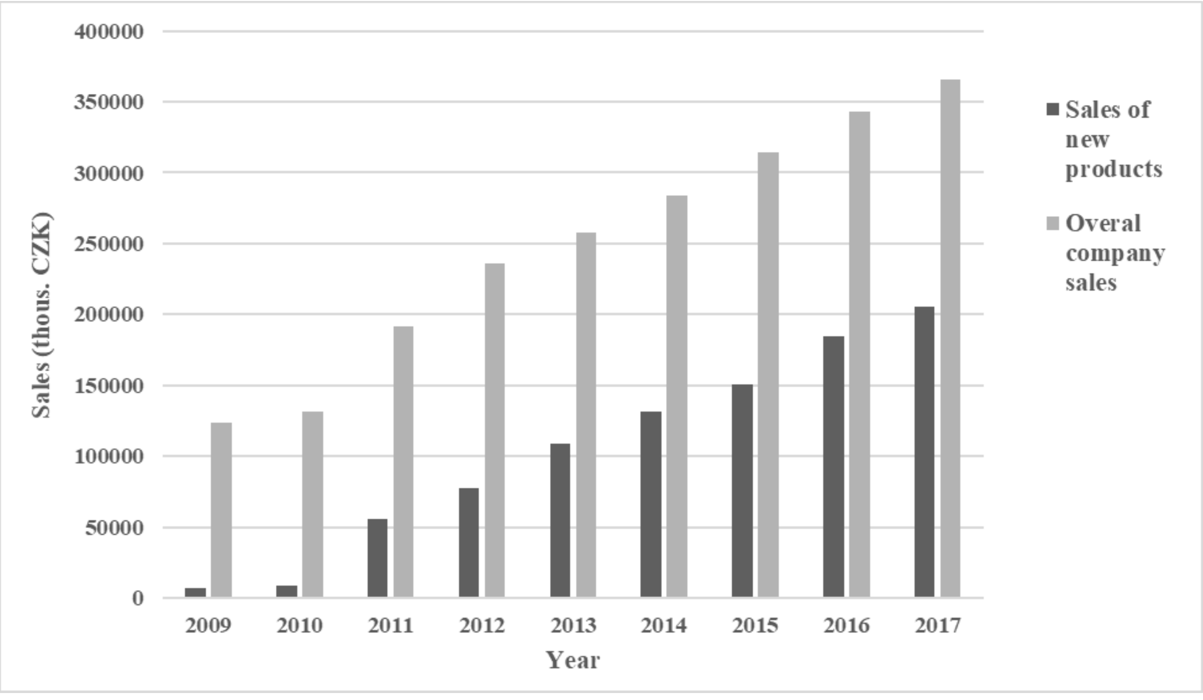
3.1 Process and organization innovation and its impact on company sustainable growth

The company executed Business Process Reengineering which preferably referred to process innovation. The company terminated non-value-added processes and established completely new or significantly improved process. The main benefit was reaped from scaling up the production that enabled to generate the same output with lesser headcount. The other benefit was derived from organizational innovation. The company carried out outsourcing of several supporting processes like maintenance services, apparatuses qualification and calibration, payroll accounting etc. This innovation not only saved the cost but also made the processes more transparent. The company was charged for those services only that were actually consumed.

3.2 Product and marketing innovation and its impact on company growth

Between 2004-2009 the company finished development of three generic products epoprostenol, latanoprost and travoprost. The first one is dedicated to the treatment of Pulmonary Arterial Hypertension (PAH) while the remaining two to glaucoma treatment. All three new products had significant impact on company sales which was multiplied by 2017. The contribution of these products to company sales is shown in Fig. 1.

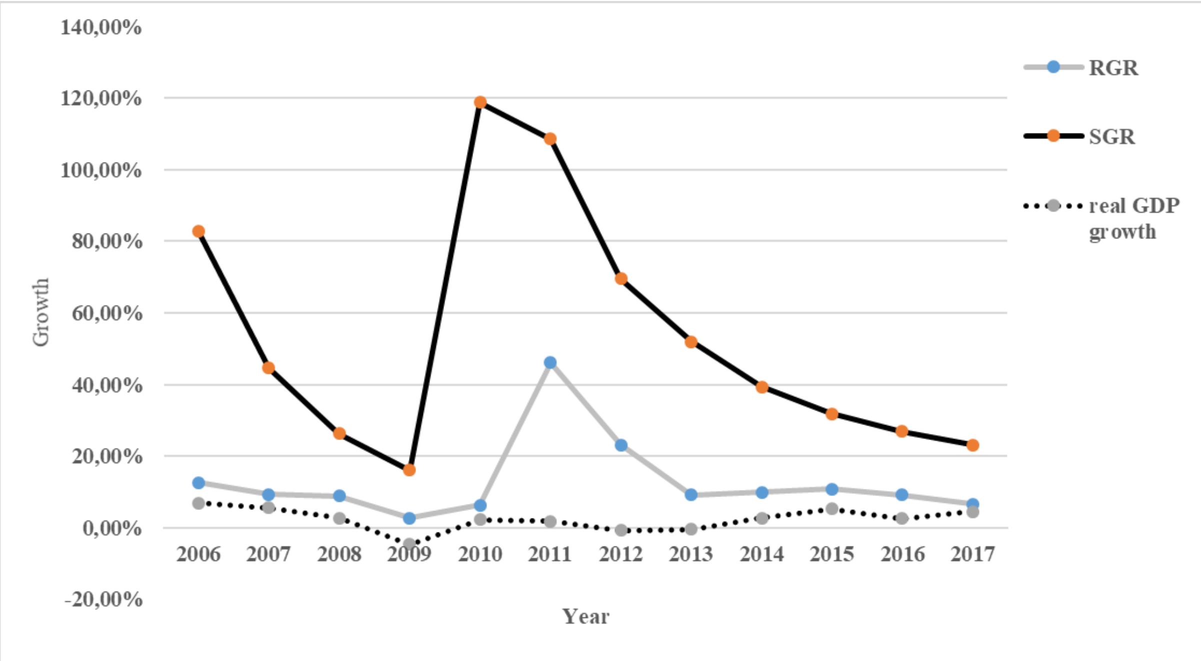
Fig. 1: The contribution of new products sales to overall company sales



Source: PharmaComm

Fig. 1 shows the importance of new products contribution to overall company sales. Depending on successful drug registration process that is key legal barrier to any drug sales the company boosted the sales of new products which achieved more than 56% of total sales by 2017.

Fig. 2: Comparison of real GDP growth in the Czech Republic to PharmaComm SGR and RGR



Source: own calculation

Fig. 2 shows the development of company SGR and RGR as compared to real GDP growth in the Czech Republic. During the whole

4 Results and discussion

From Fig. 1 and 2 it is apparent that innovation may significantly influence both real (RGR) and sustainable (SGR) company growth. The growth was observed during the period 2009-2017 based on obtaining marketing approval from regulatory bodies. As pointed out in Fig 2 both RGR and SGR exceeded the real GDP growth that was the benchmark for company management to measure success of company growth. On top of that SGR exceeds RGR during the observed period. It means that the company in question propels its growth not only by the sales but also by the improved effectiveness of other main and supporting processes. The company started to benefit from economy of scale and principles of lean management.

The company in question decided to solve its problem by means of two-phase innovation process. The first phase being dedicated to process and organizational innovation while the second to product and marketing innovation. The first phase dealt with Business Process Reengineering (BPR) and outsourcing of supporting processes. This phase was preferably dedicated to costs cutting and facilitating operation processes. The second phase was dedicated especially to new product development and their placement to the market. For this reason, the company launched new business model which incorporated customer into development of new products. PharmaComm eliminated sales brokers from the logistic chain and contracted for the product directly with end users. Customers themselves defined the qualitative parameters of the products including impurity profile of the drugs. They also participated on the analytical testing methods which were furthermore exploited by both parties.

Conclusion

The impact of innovation strategy on company growth is quite fundamental because the company growth is the main driver of shareholder value creation. Even if the role of innovation strategy is believed to positively influence company growth some companies are still puzzled with the incorporation of innovation in their strategic plans. There are several different ways how the company may benefit from the innovation. The company can either boost the sales by means of product and marketing innovation or the cut the costs by means of process and organizational innovation. The case study presents the way how the company may combine all approaches and generate reasonable sustainable growth through innovation. The company in question combined all four types of innovation which led to excellent sustainable growth that exceeded annual GDP rate.

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