

McKinsey
& Company

Driving innovation at scale

CALSTRS Board Meeting, October 2022

CONFIDENTIAL AND PROPRIETARY

Any use of this material without specific permission of McKinsey & Company
is strictly prohibited



Our focus for today



01

How we define innovation



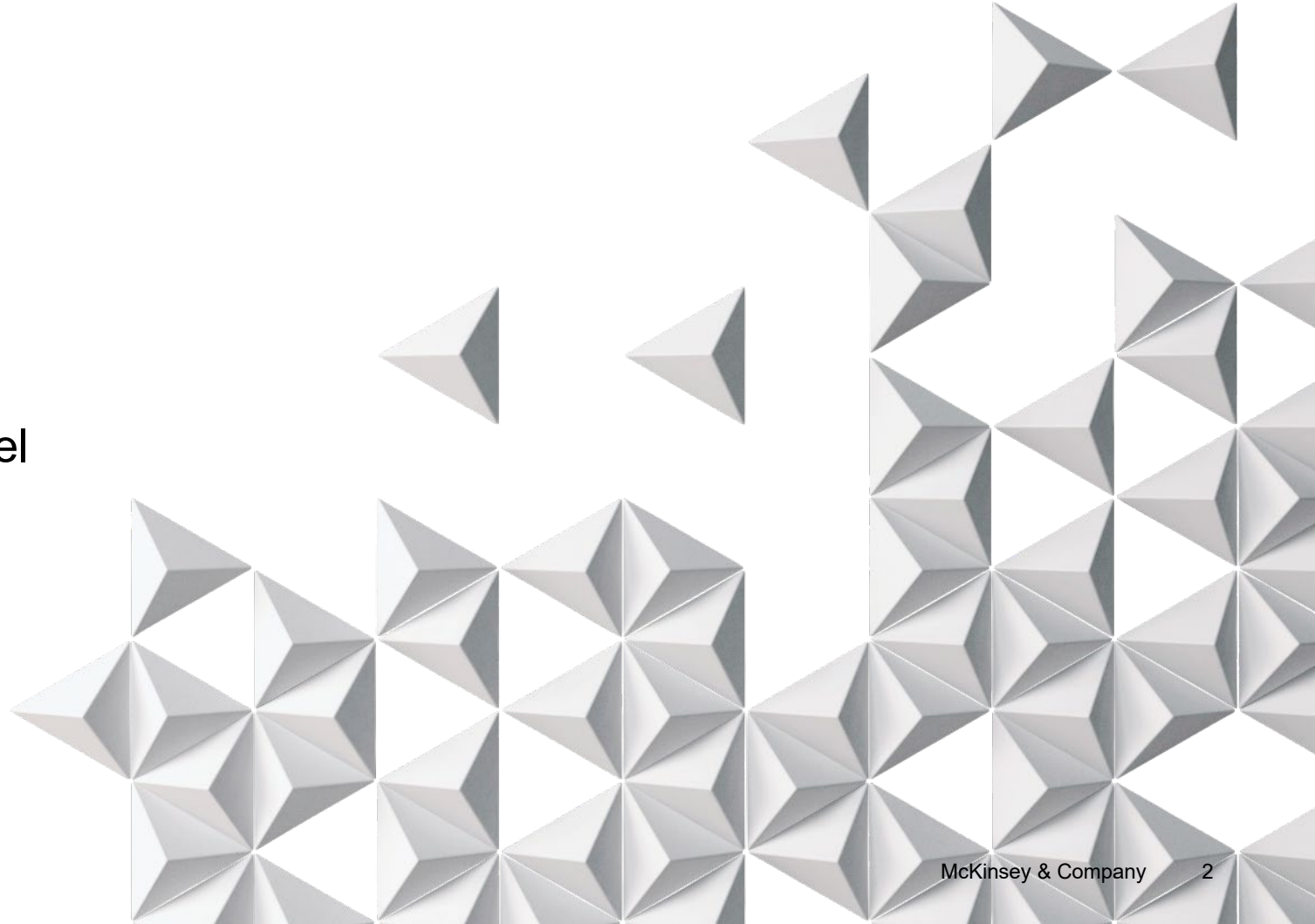
02

Innovation operating model



03

Culture of innovation



Definition:

Innovation must
deliver growth in net
new value that is

sustainable

repeatable

substantial

Net New Value

Assets

Members

Engagement

Efficiency

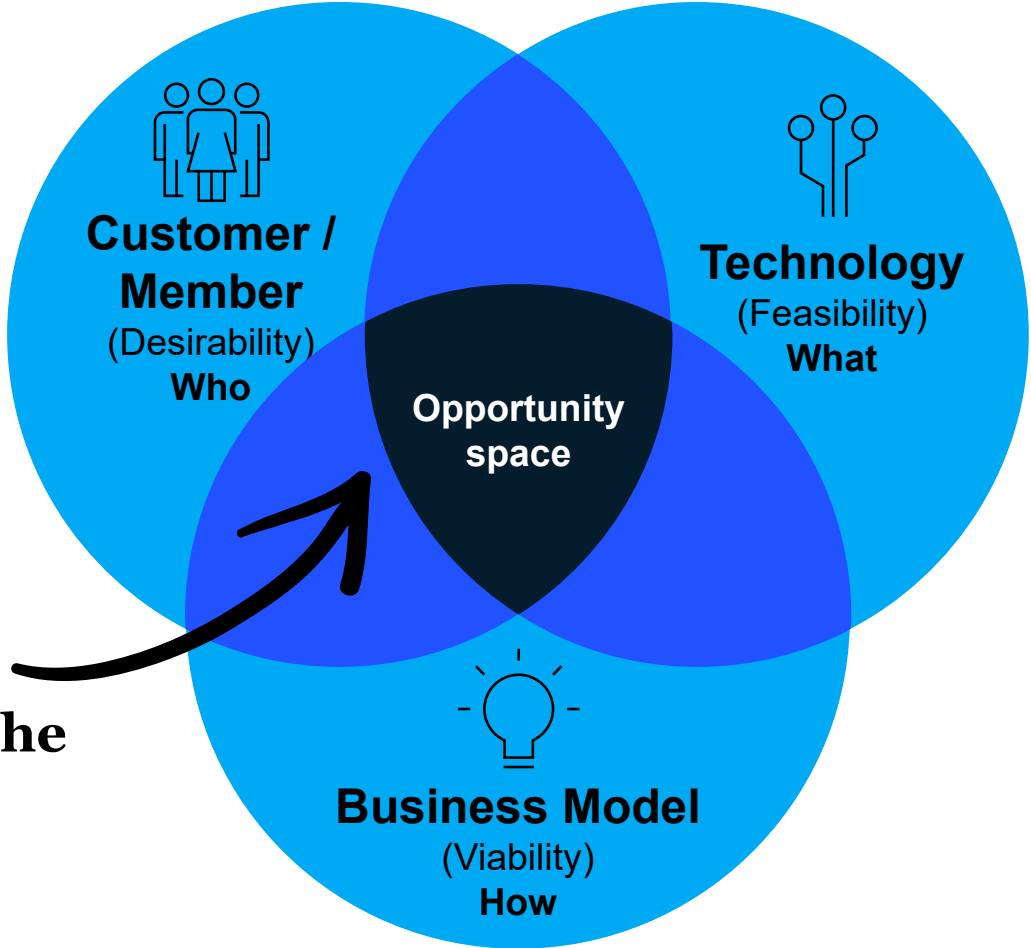
Admin cost

Productivity

Employee Experience



All innovation occurs at the intersection of three things



Opportunities typically lie at the intersection of multiple lens



Customer/member insights, hidden needs
Ethnographic research defining needs & pain points

Does it matter?



Emerging technology and trends
Internal active and latent technologies

Can we build it?



Innovative business models and disruptions in your industries
Market and customer/member segments

Will it win?

What did Edison actually invent?



Inspiration: Life imitates art!

Art as a co-creation activity



Becoming a great innovator is not easy

Although most executives
and Board members agree...

86% Innovation
is a top
priority

80% Business
models are
at risk

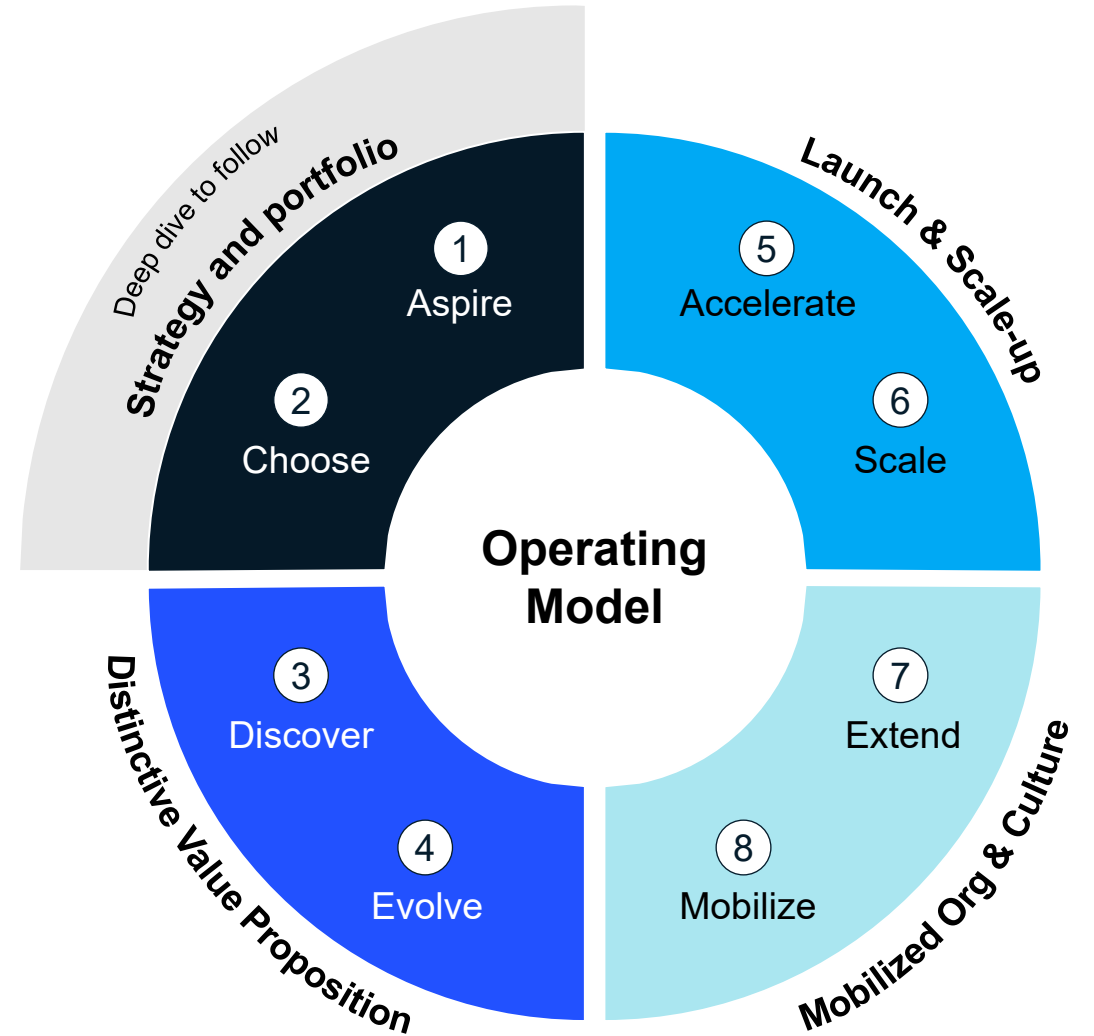


... few are satisfied with results

6% Satisfied with
innovation
performance

2/3 The most
challenging time
in their careers

We have a proven recipe based on work and research with more than 5,000 companies





02

Innovation operating model



Most important dimension: ASPIRE

**Do you accept innovation-led growth as absolutely critical?
Do your targets and accountabilities reflect this?**



Clear
innovation
vision and
“destination”



Required growth
contribution from
innovation



Cascaded
targets and
accountabilities

Board can:

Inspire! (Collaborate to shape vision)

Are we being bold enough? (Make it bigger, better)

Are we appropriately balancing risk? (3 horizons)



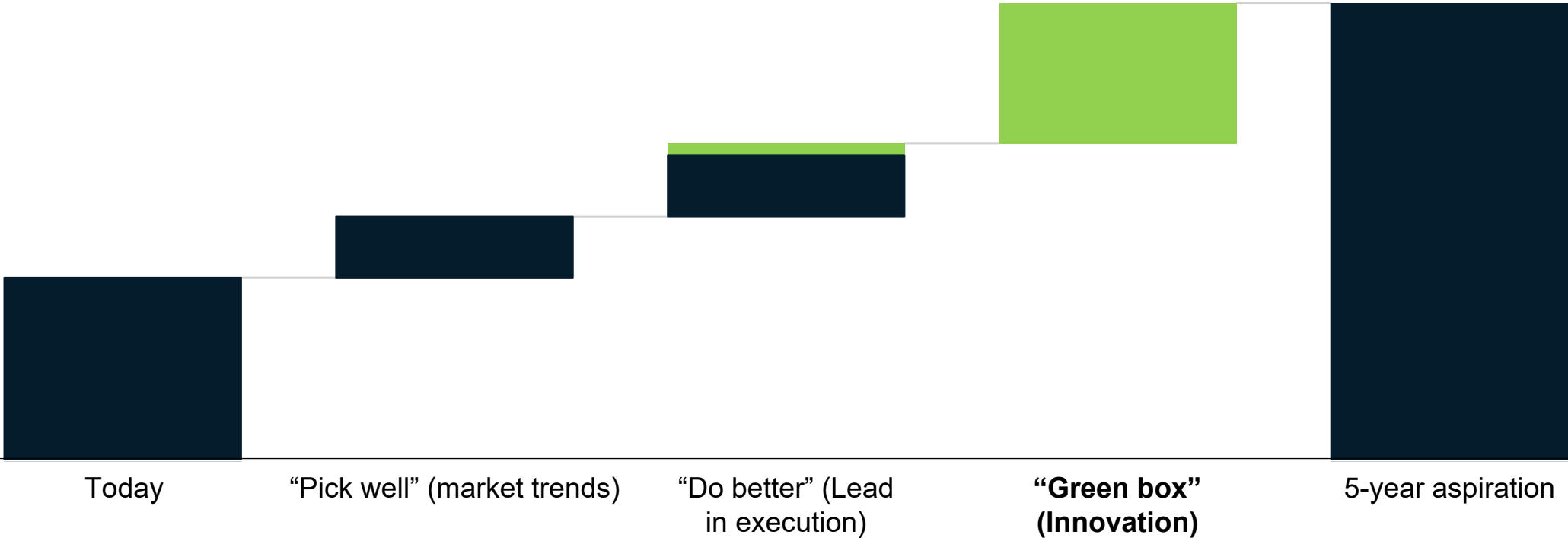
Aspiration: Setting a bold but plausible Destination

“I believe that this nation should commit itself to achieving the goal, before this decade is out, of landing a man on the moon and returning him safely to the earth”

President John F. Kennedy,
Address to Congress on Urgent National Needs, May 25, 1961



It starts by establishing a “Green Box”



Without a measurable aspiration that requires innovation to attain, leaders don’t actively commit funds and resources to innovation, and instead rationally pursue other near-term priorities

Another critical dimension: CHOOSE

Do you invest in a coherent, balanced portfolio of initiatives that are resourced to win?



Clear innovation themes to pursue



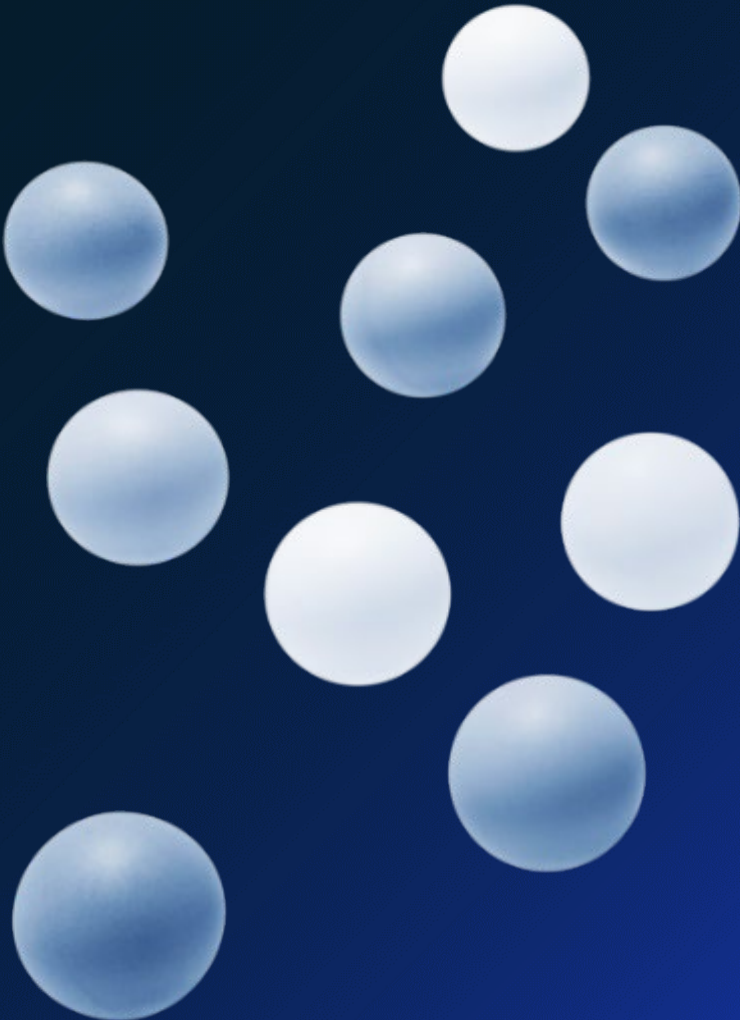
Rigorous portfolio governance and prioritization



Initiatives sufficiently resourced to win



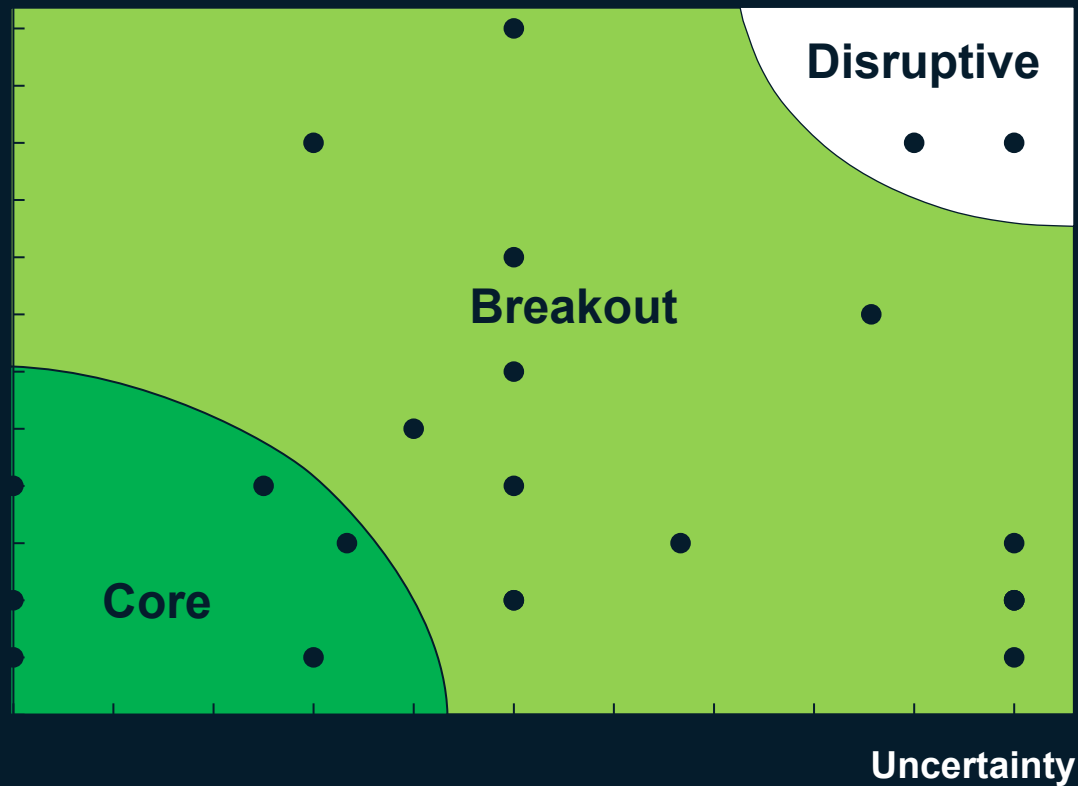
Resource alignment and balance across time and risk



The “Green Box” defines the magnitude and risk of the portfolio of innovation initiatives

Illustrative

Potential impact



Horizon 1

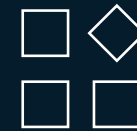


Core

Accelerate

Assets and capabilities close to today's business

Horizon 2



Breakout

De-risk & accelerate

Predictable risks, often in an adjacency or pocket of growth that uses existing assets and/or capabilities

Horizon 3



Disruptive

De-risk

New to the industry or world ideas often supported by a new business model



03

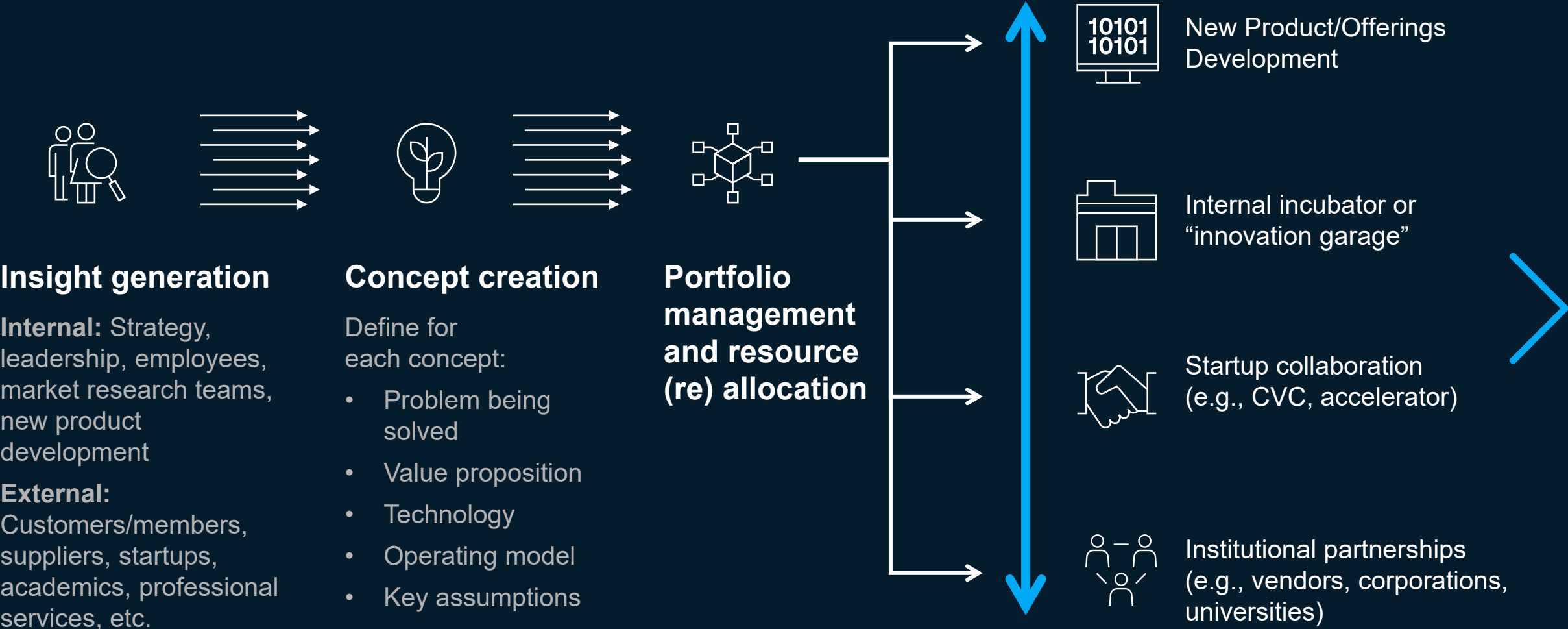
Culture of innovation



Moving from activities to outcomes



An operating model and delivery system is needed to sustain, repeat and scale value creation



Insight generation

Internal: Strategy, leadership, employees, market research teams, new product development

External: Customers/members, suppliers, startups, academics, professional services, etc.

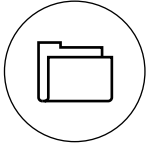
Concept creation

Define for each concept:

- Problem being solved
- Value proposition
- Technology
- Operating model
- Key assumptions

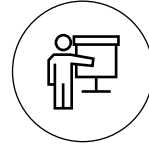
Portfolio management and resource (re) allocation

Why incumbents struggle to innovate at scale



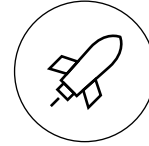
Strategy and portfolio

- Despite best efforts, management views the world through the lens of current products, brands and business lines
- Planning systems struggle with the volatility, return horizon, and pace of innovation



Distinctive value proposition

- The “urgent” demands of the next quarter displace innovation - in both resource allocation and leadership mindshare
- Ideas are not rooted or validated in truly valuable customer/member problems to solve



Launch and scale-up

- Innovation processes often mandate success and don't allow for learning early enough to surface and resolve key risks
- Channels, assets, and capabilities are wired to deliver today's business, not scale new ones



Mobilized org & culture

- Incentives (financial and non-financial) do not reward risk taking
- Required hard and soft skills are in short supply
- Missed opportunities to use external partners

**Innovation culture is
not created or
determined by a widely
followed “playbook”**

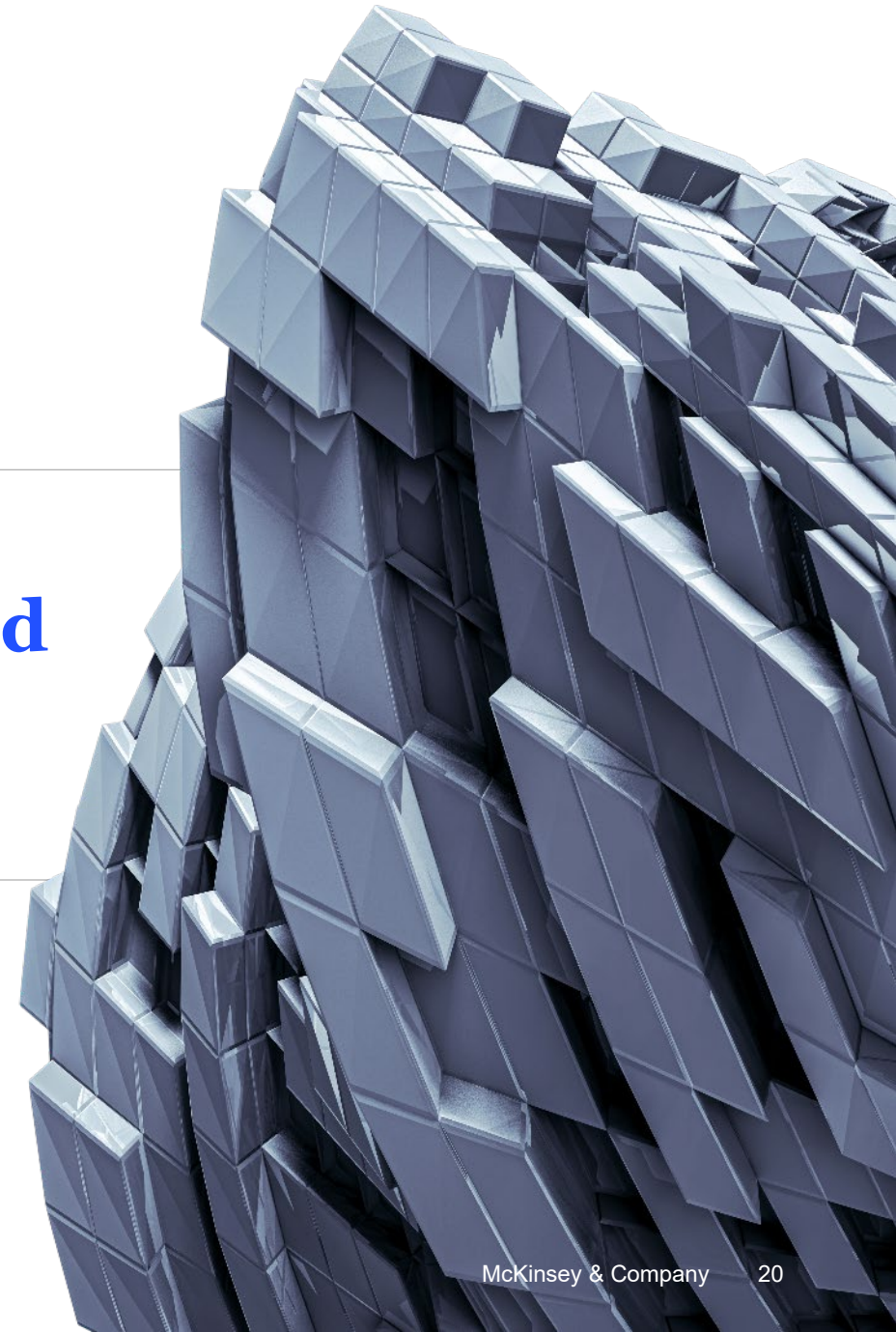


“We have eight ping pong tables, eleven foosball tables, and 135 bean bag chairs. I can’t understand why innovations performance isn't up”

Overall, **85%** of innovation leaders report that **fear often or always** holds back innovation.

Just **25%** of organizations **understand** that fear is a barrier to innovation.

And fewer than **11%** are **doing something** about.



There are fear-more and fear-less innovation cultures



1 Low/high fear innovation cultures as measured by Five Fundamentals of innovation culture
Source: McKinsey survey and analysis

Leadership behaviors in fear-less cultures



Believe & Value

- The Board, CEO and top team authentically hold innovation as a core value in their organization.



Frame & Champion

- The Board, CEO and top team frame and champion innovation on repeat.



Signal & Symbolize

- The Board, CEO and top team use the power of symbols to communicate innovation's importance.



Show & Ritualize

- The Board, CEO and top team routinely role model innovation norms and rituals.



Shield & Empower

- The Board, CEO and top team destigmatize failure and empower experimentation.

Aha moments: inspiration from other innovators



Singapore

Integrated myriad fragmented public services into a one location through a smart-phone app

Digitized parking payments app to create a paperless experience and enabled per-minute based payment

Co-created with citizens re-designed primary school exit exams with wider scoring bands, enabling shift to nurturing well-rounded individuals



US Digital Services

Gave technologists a seat at the table, enabling a more user-centric experience

Cloud-based thinking to enable scale and adaptability: reduced CMS update time from 4 weeks to a few days

Enabled third-party innovation through API systems, resulting in Blue Button, a consolidated patient medical history platform



Capital One

Constant iteration and generation of new ideas: 95-97% of ideas generated annually shut down

Launched developer portal with open APIs, shifting to creation of a "banking platform" for consumers



Consumer Finance Protection Bureau

Hires PhD social scientists from different disciplines that design and conduct research on consumer finance behavior to drive product innovation



Set a "paperless" aspiration and is digitizing core offerings (e.g., vehicle registration, drivers license)



Michigan Economic Development Corporation

Utilized crowdgranting (i.e., funding from the community) to direct development based on community preferences

What are your top questions about innovation?



Appendix

History repeating itself in new ways

Parking lots became drive-in-movies which become parking lots become drive in movies....

Walmart 
Drive·in

You're invited to an amazing drive-in family movie tour.

Find a location below and sign up for free tickets today.

[Get free tickets](#)

Walmart  Drive-in

Walmart  Drive-in

Pursue multiple pathways of growth to increase chances of outperforming peers



Core

80%

of growth comes from core industries and segments¹



Breakout

20%

more likely to outperform peers when businesses grow into adjacencies



Disruptive

50%

of revenues expected to come from new products/services through 2030²

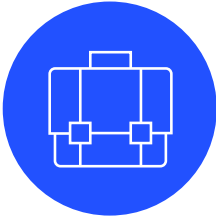
97%

Companies growing in all directions are 97% more likely to outperform their peers

1. Varies by industry, growth measured from 2005-2019

2. Based on Survey of Innovators from McKinsey '2021 global report: The state of new-business building'; N=1,178

What kind of fears are we talking about?



**Fear of negative
impact on career**

3.6x

More pronounced amongst
average innovators compared
to leading innovators



**Fear of uncertain
outcomes**

2.7x

More pronounced amongst
average innovators compared
to leading innovators



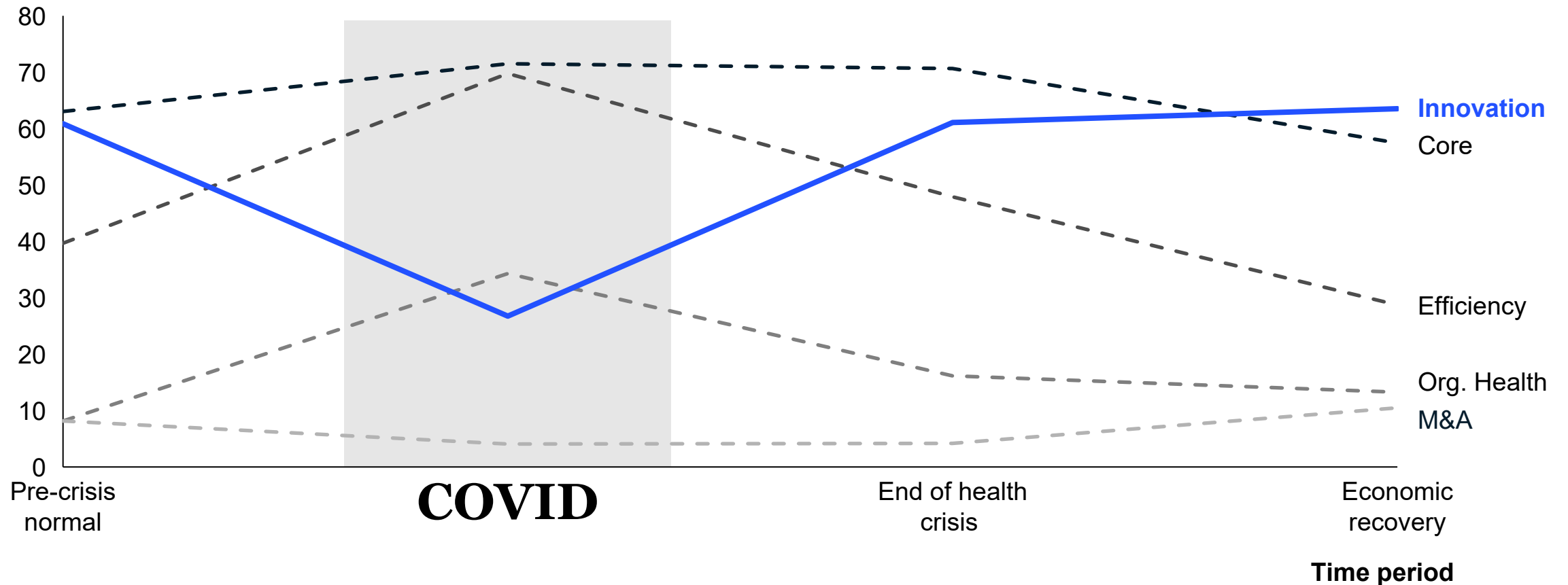
**Fear of
criticism**

1.5x

More pronounced amongst
average innovators compared
to leading innovators

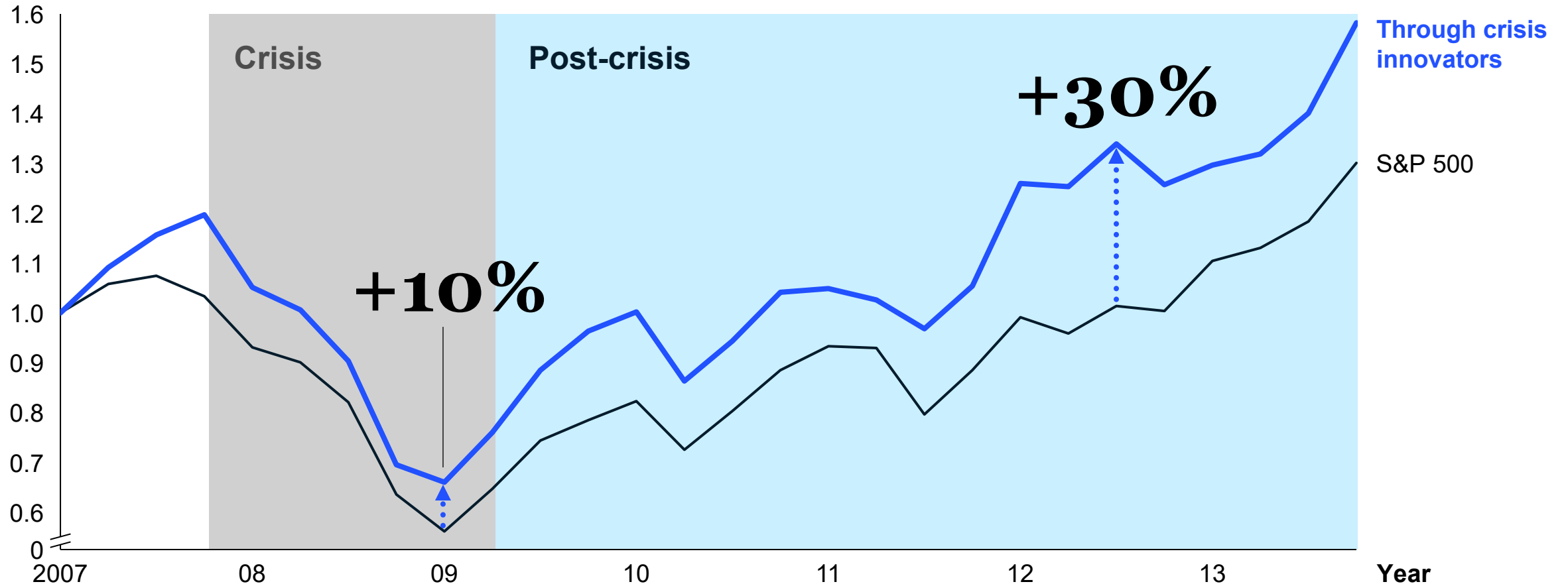
Many companies have put innovation on the back burner during the crisis

% of executives who list each action as the #1 or #2 priority pre and post COVID-19

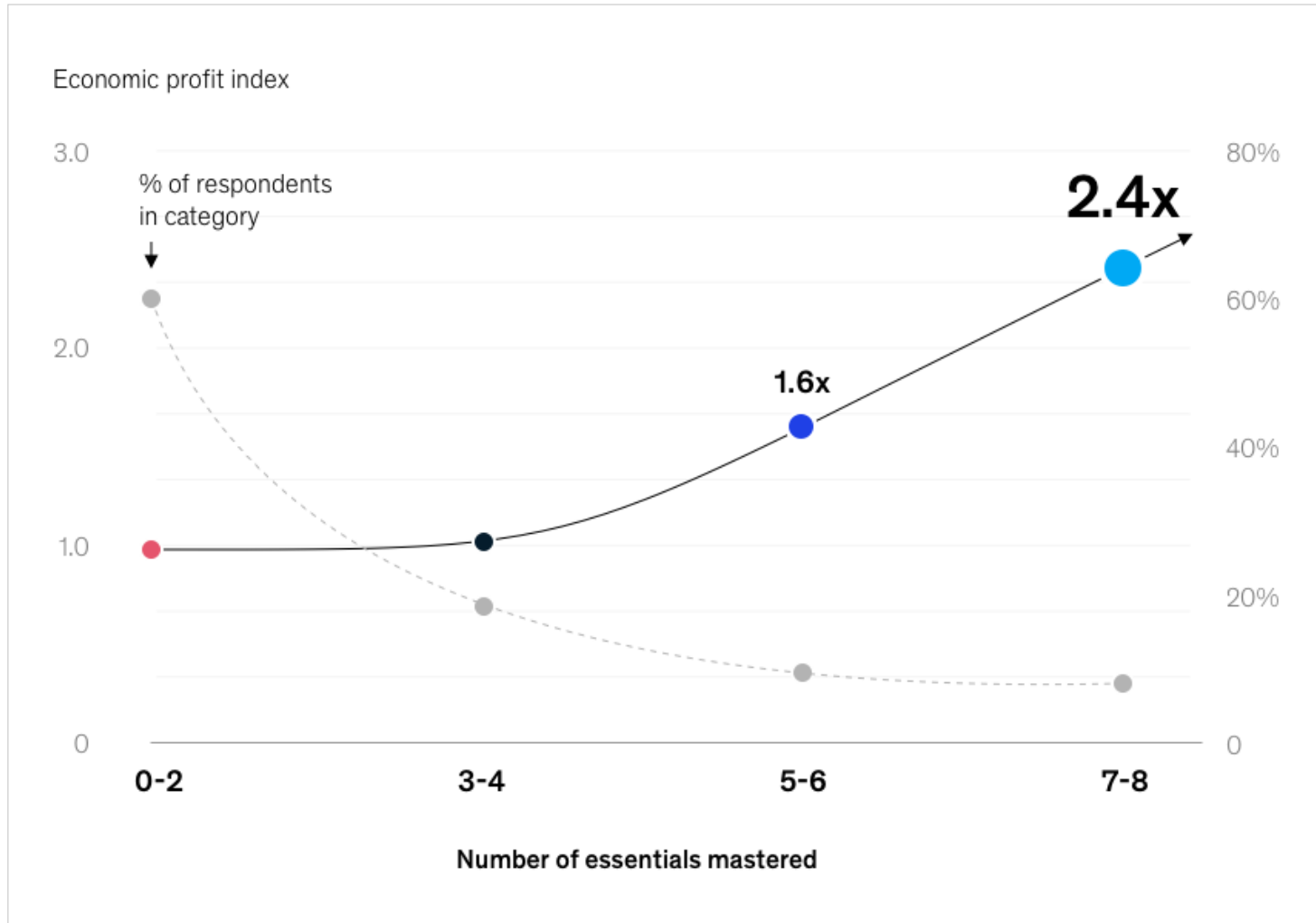


History suggests that companies that invest in innovation through a crisis outperform peers during the recovery

Normalized market capitalization



Companies following the recipe generate higher economic profit



Companies gain a significant competitive advantage by mastering the greatest number of Innovation Essentials

Mastering 'Aspire' and 'Choose' drive the most incremental value

In a crisis, we believe this shifts to 'Discover' and 'Evolve' as the most immediate needs

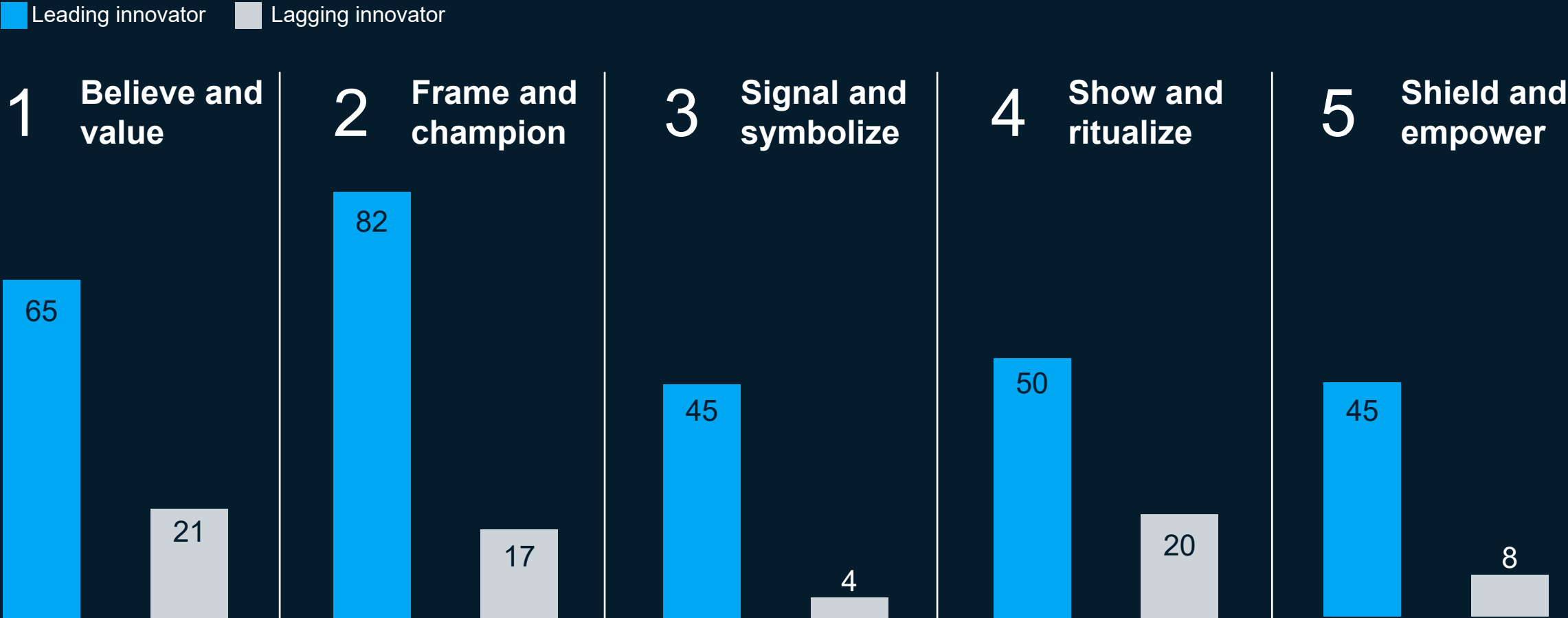
Do you know your iQ?

Diagnostic to assess innovation maturity and determine areas of focus to deliver greatest potential for accelerating and enhancing impact



What does the data say?

Adoption of Five Fundamentals, % of respondents



1 Question: To what extent is each cultural fundamental present in your organization?
Source: McKinsey survey and analysis