

OPTIMIZING R&D FOR LONG-TERM SUCCESS – INCREMENTAL VS. BREAKTHROUGH INNOVATION

Sustaining innovation in public markets requires more than increasing R&D budgets. Companies that innovate successfully balance incremental and breakthrough innovation across governance, incentives, engagement, and metrics levers.

Lever	Instead of...	Do this...
Governance	Focusing board and executive management on oversight of core business and returns	Create dedicated governance structures (e.g., innovation committees, ring-fenced units) with longer time horizons (8+ years)
	Cutting long-horizon R&D projects during a downturn to “beat EPS guidance.”	Protect long-term R&D budgets during downturns, avoiding reactive cuts that undermine future competitiveness
Incentives	Linking compensation solely to operational and financial KPIs (margins, ROIC, earnings growth)	Tie incentives to long-term (8+ year) value creation, innovation milestones, and outputs
	Evaluating investments through traditional DCF or NPV frameworks	Recognizing that transformational innovation can follow a different timeline, and use scenario-based or options-based valuation frameworks
	Integrating all innovation within the existing enterprise-wide framework or structure	Create separate or hybrid structures to protect innovation from short-term pressures
Engagement	Emphasizing predictability, capital discipline, and steady returns to shareholders	Set expectations on time horizon, risk, and asymmetric payoff potential of breakthrough innovation
	Treating your shareholder base as a given, which you have no control over	Cultivate anchor shareholders who understand the company’s innovation strategy and can provide stability during periods of investment
Metrics	Tracking R&D spend all in one bucket	Bucket innovation into incremental and transformational based on horizon and impact
	Prioritizing projects with clear ROI and shorter payback periods	Adopt an options-based portfolio approach to assess innovation, recognizing that a small number of breakthrough projects often generate most of the long-term value