



Fostering an innovative culture

Sustaining competitive advantage

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Fostering an innovative culture

Sustaining competitive advantage

To sustain competitive advantage, companies must institutionalize their innovation process by creating an environment in which creative thinking is central to their values, assumptions, and actions.

Growth challenge

Constant innovation is a hallmark of successful growth companies—staying ahead of the competition requires inventiveness at the individual, group, and company levels. As companies grow, market demands and competition can force them to maintain a culture of nonstop innovation. Growth, however, also creates a need for structure and control, which can make a culture of innovation difficult to sustain.

Organizational complexity erodes flexibility

Sustainable growth requires increased operational scale, but companies cannot scale its operations effectively without implementing formal structures, processes, and controls. Growth can strain the entrepreneurial philosophy that has driven a company's success. More importantly, it can erode corporate flexibility—as management layers increase, they create islands of data, knowledge, and intelligence that can complicate a company's decision-making processes.

A company's tolerance for risk and uncertainty reduces as it grows

Developing new ideas is a risk-intensive process that requires significant resources. As companies grow, their risk profile must become more conservative as shareholders will expect them to stabilize operations and manage their business to financial expectations.

New and old corporate cultures collide

As companies grow, they require people who can guide them through each stage of their organizational development. However, companies also have to evolve to meet changing internal and external priorities. As a result, a company's corporate culture is pulled between two poles: established employees who are used to a stable and familiar environment, and newer employees who have a different mindset, a higher tolerance for risk, and place less value on organizational structure. Left unchecked, this dichotomy can cause a company's culture to be dictated by employee self-interest rather than corporate objectives.

Addressing the challenge

Sustaining an innovative culture requires companies to create environments where creative thinking is central to corporate values, actions, and assumptions. Innovative companies require employees who seek new opportunities, accept risk, collaborate well with others, and commit themselves to the organization. Innovative companies also require leaders that will work to create those kinds of environments and will guide and promote innovative behavior.

1. Create the required foundation

Companies need to assess the role of innovation within their organizations, make the necessary adjustments to their goals and their corporate culture, and redefine the responsibilities of their leaders.

2. Enhance operations to foster innovation

By creating an environment that empowers employees, companies will promote the collaboration required to generate and implement new ideas.

3. Manage the ongoing change

Companies must create teams to guide them through periods of change, manage their employees' anxieties, and set small milestones to be used to gauge enthusiasm.

1. Create the required foundation

As companies grow, their leadership teams must manage increasingly complex organizations while maintaining a commitment to innovation. To do this, companies need to assess the state of their innovation and find means to enhance and foster it.

Assess the state of innovation

The goal of innovation is to develop products that generate above-average returns. These returns allow companies to re-invest in activities designed to give them a competitive advantage in the marketplace. When the innovation cycle is disrupted, companies do not have this incremental capital base and, therefore, have to fund innovation-related activities with capital initially allocated for other purposes.

“Strong culture enhances performance in two ways. First, it energizes employees by appealing to their higher ideals and values, and by rallying them around a set of meaningful, unified goals. Second, it boosts performance by shaping and coordinating employee behavior.”¹

Companies must understand the role innovation plays in influencing their business goals, organizational structure, and employee behavior and use this knowledge to decide how and where improvements should be made (see Figure A).

Define the elements of culture

“Culture consists of the values, beliefs, and norms that are exhibited in the way that people in the organization accomplish their work, relate to one another, and solve the problems that confront them on a daily basis: ‘The way we do things around here.’”²

Companies need to focus innovation-related activities around the three principal elements of corporate culture: core values, beliefs, and norms. Core values are principles that help employees make decisions about what is important for the company. Beliefs are the shared views of what is right and wrong. Norms are the operating rules that determine acceptable employee behavior. A single set of core values, beliefs, and norms will focus the entire workforce on a set of common goals.

Figure A. Understanding the role of innovation in your company

| Factors | Key questions | Actions | Key steps |
|--------------------------|---|--|---|
| Company goals | Does innovation play a critical role in your success? For example, does innovation drive revenue, cost savings, or both? | Analyze performance to determine what is driving revenue, growth, and cost savings. | <p>Understand and define what role innovation can play in the company's financial performance (e.g., Will reduced time-to-market affect revenues? Will innovation increase production efficiency and lower costs?).</p> <p>Understand how competitors are innovating. Do they outperform your company in time-to-market, cost efficiency, customer service, and return on investment?</p> <p>Determine if you need to re-examine your objectives.</p> |
| Organizational structure | Is innovation pervasive, or is it confined to specific groups? What is causing this? Who are the star performers? Why? | Create criteria to aid the measurement of achievement, degree of communication, appropriate rewards, and training. | <p>Compare the achievement of various groups within your organization.</p> <p>Understand what is unique about the groups that innovate. Understand why certain groups do not innovate (e.g., Are these groups facing barriers in making decisions? Do they need a champion? Do they have inappropriate members or an inappropriate structure?).</p> |
| Employee behavior | Do your employees recognize your company's innovative culture? Are their views consistent? Are the company's values, beliefs, and norms driving your employees' behavior and decision-making? | Consult employees across the organization. | <p>If you determine that an innovative culture does not exist, understand the underlying reasons (e.g., Do employees understand the company's goals? Is there low employee morale, corporate bureaucracy, or weak leadership?).</p> |

3M's original pacing rule was that 25 percent of sales should be derived from products that were created within the last five years. 3M's culture enabled it to successfully meet this target. Its corporate values—"thou shalt not kill a new product idea," "make a little sell a little," tolerance for failure, and bias for action—are relied upon to empower innovation.³

Redefine the role of leaders

An important role of a company's leaders is to communicate and reinforce the core values, beliefs, and norms of corporate culture. Company leaders also serve as role models to the employees who look to them to provide inspiration, support for their ideas, and the guidance required to excel.

“If you ask, ‘What really makes VeriFone different?’ the answer is simple: We practice what we preach. People see constant reinforcement, on a day-to-day basis, of what we stand for.”⁴

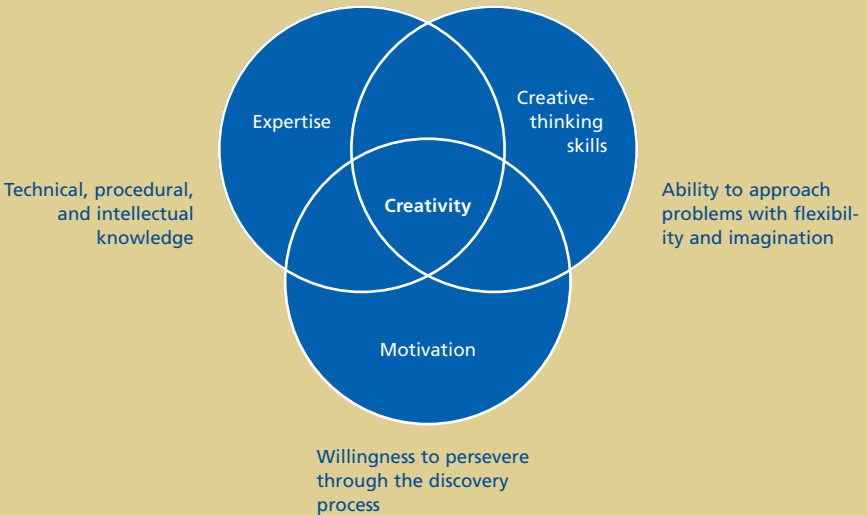
2. Enhance operations to foster innovation

A change in culture necessitates more than just a unified vision and strong leaders—it requires a structural change in a company’s recruitment practices, its methods of assigning responsibilities, the way groups within the organization interact, and the way achievements in the company are rewarded.

Develop the employee base

Creativity is the force behind innovation (see Figure B). Innovative achievements are the product of employees who have the right expertise, can think creatively about problems that arise, and are motivated to persevere through the discovery process.

Figure B. The three components of creativity ⁵



Guiding principles for recruitment

- Recruit people who are willing to challenge the status quo and seek out new trends and directions.
- Attract individuals who can communicate and defend their ideas.
- Hire talented agitators, even if they make you uncomfortable.
- Complement creative optimists with pragmatists.
- Attract productive workers who have the stamina to recover should an initiative fail.

To sustain a positive and productive corporate culture, managers must be mindful of the personality and beliefs of the employees they hire. Also, companies must be aware that, while recruiting the right individuals is important, an ability to integrate new employees into the organization will ultimately determine the company's success. New employees can change the dynamics of a company, and existing employees may perceive an erosion of a familiar identity. To ease the integration of new employees, companies should involve existing employees in the hiring and integration process. Companies must also communicate their reasons for recruiting new employees and the roles these employees will play in guiding the success of the company.

“Culture gets revealed to new employees by their immediate surroundings and the behavior of the people around them ... companies should ensure adequate interaction between new employees, the people that will carry the culture forward, and existing employees, the keepers and creators of the culture.”⁶

“It is difficult to maintain culture through periods of rapid growth. New people bring new ideas, but there is a risk that these new ideas will overwhelm the established culture of the organization. We tried to mitigate this risk by increasing corporate communications and internal marketing when we doubled in size.”⁷

In order to foster a culture of innovation, companies need to motivate their employees with rewards, recognition, and empowerment. (For further information on how to build an exceptional employee base, please refer to the “Attracting and retaining talent” management brief within this series.)

“Hiring from within allows us to shape the culture and succession for the organization while strengthening commitment and long-term potential. When hiring from outside, we place people at a level where they can understand the culture, be evaluated by their peers, and build respect/rapport with the members of the target team.”⁸

Empower employees

Creating a true feeling of empowerment among employees is vital to fostering a culture of innovation. Assigning ownership of activities and giving employees the authority to make appropriate decisions are key motivational tactics. Companies can empower their employees by encouraging divergent thinking, listening to them and being open to new ideas, and ensuring that they have the information and resources they need to follow through with their ideas.⁹

“I empower all employees by encouraging them to better understand their importance and role within Redknee and rely less on me to provide guidance. A company has to be bigger than any one employee. This is the only way to create a scaleable organization.”¹⁰

Empowerment does not mean simply handing over control. Freedom and authority must be complemented with accountability, management discipline, and feedback. To be effective, a corporate culture must be focused on achieving the results outlined in the business strategy. Also, a consensus on the qualitative and quantitative metrics that will govern success must also be created.

“For each department, we determined the critical success factors required to meet the company objectives. Those became the foundation of the parameters that I monitored on an ongoing basis, and thus held my managers accountable for.”¹¹

Organizational structure will have a critical bearing on how decisions are made throughout a company, and it will define the network of relationships and interactions that contribute to the execution of the company's strategy. The organizational structure has to evolve to deal with changing priorities and increased business complexity. Growth inevitably leads to a buildup of management layers, which in itself creates islands of responsibility, authority, and influence. This proliferation can complicate decision-making processes and hinder innovation.

“The larger and more complex a company becomes, the more important it is for senior managers to train employees throughout the organization to make independent decisions about priorities that are consistent with the strategic direction and the business model of the company.”¹²

Foster collaboration

Innovative ideas, by definition, rarely confine themselves to a single group, but instead require support throughout the company. Taking an idea from concept to reality requires a high degree of trust and communication, so it is important that leadership teams be at the forefront of activities that require collaboration.

“The innovative culture thrives on the free exchange of ideas. Be communicative and train managers and supervisors to allow the free flow of information among them, their subordinates, and their superiors.”¹³

“The primary engine for innovation at IDEO is its distinct approach to brainstorming—the only part of company life where strict rules do apply ... To help maintain the right spirit, IDEO’s five principles of brainstorming are emblazoned on the walls: ‘stay focused on the topic,’ ‘encourage wild ideas,’ ‘defer judgment,’ ‘build on the ideas of others,’ ‘one conversation at a time.’”¹⁴

Activities that instill a sense of collaboration

- Have structured brainstorming sessions that are open to all employees. During these sessions, ensure that all ideas are heard and duly evaluated.
- Allow job rotation. For example, have a research engineer spend time in the field with your sales team to experience direct customer interaction.
- Implement a mentorship program to connect senior personnel with new employees.
- Create cross-functional teams to complete tasks of strategic importance. In each team, include individuals from different groups, geographical locations, and, if possible, cultural backgrounds.
- Create a regular schedule of mini-conferences where internal groups present their ideas to one another.
- Use events, such as sporting activities, charity events, or lunchtime lectures to promote inter-departmental interaction.

“We made a decision to incorporate a policy whereby each individual is systematically rotated into different groups for a specified period of time. The initial reaction from employees was not overly positive. They realized later, however, that the interactions and knowledge from this experience have helped to solidify the foundations of open communication and trust within our company.”¹⁵

Encourage employees and create reward programs

A company's reward system must be designed to encourage innovation. Employees will be apprehensive of innovative activities if they perceive that they will be exposed to considerable personal risk. A truly innovative culture must make employees aware that the failure of a new idea or initiative to fulfill all expectations will not affect their position within the firm. In cases where expectations are not realized, it is important to emphasize the lessons that were learned.

“Leaders need to let employees know that they are prepared to support people who have taken up initiatives that have gone against the grain of the organization but have failed to deliver on the first or second try.”¹⁶

When structuring formal and informal reward schemes, it is important for companies to understand what their employees value. Individuals that are attracted to creative activities are generally driven by the excitement of seeing their ideas transformed into something of value. These people need to be rewarded through the use of intrinsic rewards, such as peer recognition. It is also important to publicize these rewards, as employees learn from the success of others. To further reinforce innovation, individuals' incentives should include both financial and intrinsic incentives linked to achieving agreed-upon performance targets.

To reinforce knowledge sharing and collaboration, group-based incentives should be used to reward teams when appropriate. These rewards should be based on the performance of the team in achieving its goals (see Figure C).

“Innovation is a people process. It happens when people work together on a challenge that energizes them in an open environment of trust and respect in which mistakes are considered learning events and everyone understands what value is being created and for whom.”¹⁷

Figure C. Structuring reward programs*

| Individual incentives | | Group-based incentives | |
|--|--|---|--|
| Financial <ul style="list-style-type: none"> • Bonuses and rewards linked to individual and company targets | Intrinsic <ul style="list-style-type: none"> • Individual awards • Peer recognition • Increased responsibilities • Carry through projects (ownership) | Financial <ul style="list-style-type: none"> • Bonuses and rewards linked to group goals | Intrinsic <ul style="list-style-type: none"> • Group awards • Peer recognition • Senior management recognition |
| Base compensation packages | | | |
| Compensation | | Soft benefits | |
| <ul style="list-style-type: none"> • Base salary • Bonus • Pensions • Cars, computers • Healthcare and insurance • Stock options | | <ul style="list-style-type: none"> • Work-life balance • Training • Career development • Challenging assignments • Recognition • Promotions | |

* (For further information, please refer to the “Attracting and retaining talent” management brief within this series.)

“In addition to being a really tough, results-oriented culture, we are also a culture of caring. I’m not talking about grand gestures. I’m talking about the day-to-day realities—being generous with acknowledgment, always making people feel important, always communicating. More than anything else, these informal methods of recognition are what stick. A private e-mail, a private telephone call—the spirit that [these] create is incredible.”¹⁸

“Do not wait until the completion of the innovation process to reward an employee. For example, move the employee onto the project full-time, commit additional resources to the project, or grant promotions. Such reward programs will not determine a project’s fate, but your commitment to the idea will encourage your workforce to take chances.”¹⁹

3. Manage the ongoing change

Promoting a creative culture may require adjustment to a company's internal and external operations. Companies need to create a management team to oversee innovation and to communicate expectations to employees. It is also important to create a series of milestones to be used to gauge the progress toward a more innovative culture.

Create a change management team

A company's leadership team has an important role in advocating the organizational changes required to sustain innovation. Employees need to understand that change is routine. Therefore companies need to create a change management team dedicated to the change process.

“Sustaining innovation requires treating everything, including teams, organizations, procedures, and product lines, as temporary.” ²⁰

The change management team's primary responsibility is to obtain company-wide support for the change effort. This begins with clearly communicating the need for change. The team then needs to ensure that all projects are aligned with any changes in direction, and make sure that there are no inconsistencies in the practices expected and those performed. The change management team should also be given the authority to allocate resources to specific strategic areas and to terminate projects that are deemed unnecessary.

“You cannot sell change, or anything else, without genuine conviction, because there are so many sources of resistance to overcome. Especially when you are pursuing a true innovation, as opposed to responding to a crisis, you've got to make a compelling case.” ²¹

Manage employee anxieties

The change management team will need to manage employee's expectations and anxieties. When people are placed in an environment of change, resistance naturally occurs. Employees may be unsure of the outcome of the change, or they may be worried about the impact it may have on their positions and careers. These feelings can be mitigated by

- Creating dissatisfaction with the status quo: Make employees understand why change is required. Highlight a credible reason for change that is simple, realistic, and is communicated frequently.
- Encouraging participation: Involve employees in the implementation process (e.g., task forces, planning committees). This increases individual ownership and excitement for the changes and decreases resistance.

- Providing time and opportunity to disengage: Help employees disengage from the status quo by using simple gatherings such as lunches and ceremonies to communicate the change and to generate excitement about the future.²²

Set small milestones

Transforming a company into an engine of innovation is a time-intensive process. By articulating clear short-term goals and measuring progress companies can communicate evidence of success to help maintain momentum behind the change effort.

“A renewal effort risks losing momentum if there are no short-term goals to meet and celebrate ... without short-term wins, too many people give up or actively join the ranks of those people who have been resisting change.”²³

Given the unpredictable nature of innovation, companies may find it difficult to meet their objectives (see Figure D). Companies may have to invest more time or money than expected into activities before their full benefits can be realized. Companies must be prepared to modify their plans and communicate setbacks and adjustments as required.

Figure D. Dealing with setbacks to change²⁴

| Potential setbacks | Counter measures |
|---|--|
| <p>Forecasts fall short: When attempting to innovate, it is difficult to predict how long something will take and how much it will cost.</p> | <ul style="list-style-type: none"> • Understand and communicate reasons for any shortfall • Propose and implement new plans |
| <p>Roads curve: There may be unanticipated events that change priorities.</p> | <ul style="list-style-type: none"> • Be prepared to respond, troubleshoot, and adjust plans as necessary • Communicate changes and their impact to employees |
| <p>Critics emerge: Critics, skeptics, and cynics will challenge the change initiatives.</p> | <ul style="list-style-type: none"> • Use tangible results, supporters, and acknowledged experts to respond to criticism |

An executive's diagnostic

Creating the required foundation, enhancing operations to foster innovation, and managing change are important steps in transforming your company into an engine of innovation. The following 20 questions will assist your organization in ensuring that key aspects of this transformation have been articulated and addressed.

Create the required foundation

Yes | Somewhat | No

| | | |
|---|--|--|
| 1. Does innovation continually contribute to revenue generation and cost savings within your company? | | |
| 2. Is innovation pervasive across the company, or is it isolated to specific groups? | | |
| 3. Do your employees understand how innovation relates to the corporate vision and goals? | | |
| 4. Have you created a set of core values, beliefs, and norms in order to guide the development of your corporate culture? | | |
| 5. Have you redefined the roles of your company leaders to encourage and champion creative activities? | | |

Enhance operations to foster innovation

Yes | Somewhat | No

| | | |
|--|--|--|
| 6. Does your workforce consist of people who have the ability to approach problems in an unconventional manner? | | |
| 7. When hiring new employees, do you look for people who are willing to challenge the status quo and pursue new trends and directions? | | |
| 8. Do you involve employees in the hiring process? | | |
| 9. Do you have programs and activities that allow for meaningful interaction between new and existing employees? | | |
| 10. Do you encourage your employees to be divergent thinkers and ensure that they have the right information and resources to follow through on their ideas? | | |
| 11. Have you assessed your company's organizational structure to identify and remove decision-making bottlenecks? | | |
| 12. Is there a high degree of trust and open communication between various groups in your company? | | |

| | | |
|--|------------|-----------------------------|
| 13. Do you balance empowerment with accountability by creating a set of metrics for your employees to work toward? | | |
| 14. Do your employees feel secure enough to believe that should their ideas fail to realize the desired result it will not affect their position within the company? | | |
| 15. Does your company have a reward system that fosters behavior that contributes to innovation? | | |
| Manage the ongoing change | Yes | Somewhat No |
| 16. Do you have a team of dedicated individuals, composed of representative employees, that lead and champion the changes required to sustain innovation? | | |
| 17. Does this team monitor the activities of the company and ensure that there are no inconsistencies in the practices expected and performed? | | |
| 18. Does this team use dialogue and consensus-building to garner support for the changes at the departmental level? | | |
| 19. Do you manage the expectations and anxieties of your employees by communicating why change is important, involving employees in the implementation process, and providing the time and opportunity to disengage from the status quo? | | |
| 20. Do you articulate clear short-term goals and objectives, measure progress, and communicate evidence of success to maintain the momentum and enthusiasm of your employees as changes are implemented? | | |

Scoring key:

If more than 75 percent of your answers (16 of 20) are “Yes,” then your company is addressing the challenge of fostering an innovative culture. If 50 to 75 percent of your answers (10 to 15) are “Yes” or “Somewhat,” there is more work to be done in order to foster an innovative culture. If less than 50 percent of your answers are either “Yes” or “Somewhat,” your company needs to re-evaluate its approach towards fostering an innovative culture.



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Davenport, Thomas H. et al. "Who's Bringing You Hot Ideas (and How Are Your Responding)?" *Harvard Business Review*, February 2003.

Duck, Jeanie D. "Managing Change: The Art of Balancing." *Harvard Business Review*, January 1993.

How can Deloitte help?

Deloitte can assist senior management throughout the process of fostering an innovative culture. We can provide expert and independent advice that is practical, proactive, and designed to help stakeholders achieve their objectives in as efficient and effective a manner as possible.

Deloitte can assist in the process of fostering an innovative culture through the following services:

- Addressing all the people-related factors that contribute to an organization's success, including culture development, team building and facilitation, and workforce transition.
- Developing and implementing communications strategies.
- Searching for the right executives to join your growth efforts.
- Designing and implementing integrated performance and pay programs.
- Planning and implementing reorganization and restructuring efforts.
- Designing and assisting in change leadership programs.
- Selecting and implementing enterprise software solutions to enhance collaboration and information flow.

About Growth, The Executive Series

How do companies achieve value-creating growth? More importantly, how do they sustain it? Deloitte understands the issues companies face as they grow and can help your business meet and exceed its objectives. Deloitte has undertaken research to uncover the secrets of successful growth companies. The result of this research is The Growth System—a strategic framework to sustain value-creating growth that consists of three cornerstones: Strategy, Capability, and Commitment. Growth, The Executive Series, is a set of 13 briefs that explore a selection of key success factors within The Growth System that can help a company sustain growth. These success factors are addressed in each of the following 13 briefs:

Strategy

1. Developing strategic plans
2. Pursuing and managing alliances and acquisitions
3. Core competencies and strategic outsourcing
4. Developing winning products
5. Strategic marketing

Capability

6. Attracting and retaining talent
7. Attracting capital
8. Leveraging technology
9. Managing business risks
10. Global expansion
11. Designing the right organization

Commitment

12. Creating the right leadership
13. Fostering an innovative culture

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