

Estimate your Innovation Opportunity Cost

Introduction

Cost of opportunity = the resources required to pursue a selected opportunity.
Opportunity cost = the foregone value of a deselected opportunity.
Innovation is often funded, but neglected in favor of other projects or diminished by conservative financial analysis, and so the actual project pursued is degraded. These unintended consequences can be massive and executives rarely appreciate the full potential of innovation. This worksheet will help you estimate the opportunity cost, identify the hidden value in your portfolio, and inform better investment choices.

Select a innovation project that you feel is somehow degraded or neglected.

Project Name: _____

Estimate Level of Focus:

Estimation

How wounded is the project?

Think of the full resources required (\$, FTE) to reasonably overcome the innovation obstacles.

Compare to the actual level of resources deployed.

What % of the full resources does the project actually have?

100% = fully resourced
0% = not resourced

How distracted are executives and key resources?

Think level of critical, strategic and creative thinking required by the project. How much of the required attention is available?

100% = adequate attention
0% = no attention

The **Level of Focus** is the product of these two estimates.

Product of above

Focus Level

Estimate Upside:

Assume the project overcomes its obstacles and starts delivering returns. Think of several reasons that would cause this project to drive towards its upside. List them here:

Thinking of these factors, how much bigger could the upside be than the current business case? Be optimistic.

1x = there is no upside
2x = upside case is equal to twice the base case

Upside Level

Analyze your Innovation Opportunity Cost

Opportunity Factor:

Find your Opportunity Factor from the table below. This factor is the multiplicative improvement in risk-adjusted NPV of your example project from making different portfolio choices.



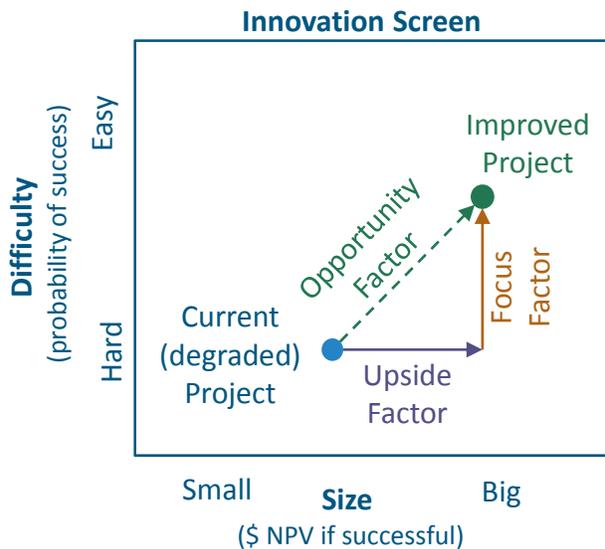
Opportunity Factor

See below for commentary on levels, factors, errors and pressure.

Analysis

		Upside Level							Upside Factor	
		1	1.25	1.5	2	4	8	16		
Focus Level	100%	1.0	1.1	1.1	1.3	1.8	2.8	4.8	Efficiency Pressure	
	80%	1.3	1.3	1.4	1.6	2.2	3.4	5.9		
	60%	1.7	1.8	1.9	2.1	2.9	4.6	7.9		
	40%	2.5	2.7	2.8	3.1	4.4	6.9	11.9		
	20%	5.0	5.3	5.6	6.3	8.8	13.8	23.8		
Focus Factor										
		Estimation Error			Innovation Error					Danger Zone

The Model



Upside Factor: Financial analysis and operational processes are inherently conservative, usually based on delivering a reliable promise. Consequently the credible business cases used to represent the size of a project are conservative. The upside is rarely considered systematically or in any detail. This becomes a self-fulfilling prophecy that creates a kind of mediocrity or low aspiration, as focus on delivering the conservative business case severely reduces the ability to drive the upside.

The Upside Factor is a measure of how much value is in the upside of the business case. On the table, it is the first row, where the focus level is 100%.

If the upside is relatively small compared to the base case, then the error in using the base case to understand value is a mere “estimation error.” However, if the upside level is large, then using the base hides the upside and prevents teams from seeking it. This becomes a more damaging “innovation error”.

Focus Factor: Innovation is difficult, with many obstacles to success. It can require concentrated resources and serious critical thinking to learn, pivot and bend the rules on the way to success. Yet many projects suffer from neglect due to the clutter of many projects in the portfolio:

1. Wounded projects. Innovative projects can get short shift, with resources well below the level they need to drive effectively forwards.
2. Distraction. Innovation requires attention from executives and key people who are so busy with other things that they cannot bring their creativity and power to the project.

The Focus Factor is a measure of how much a project could improve if it got the proper focus. On the table above, the focus factor is the first column, where there is no upside (upside case = 1x base case).

Some pressure on budgets and resources can be good, motivating efficiency, so a focus level a little below 100% might be OK. However, if the pressure gets too high, then project teams change their aspirations and plans, and the pressure creates neglect.

Opportunity Factor: Improving Focus increases your ability to creatively overcome the obstacles in innovation and thus improves the probability of success. Visibility to the Upside increases the potential for driving the business result above its conservative business case, improving the NPV. The product of the Focus Factor and the Upside Factor measures the total increase in risk-adjusted value available, the Opportunity Factor. Achieving this requires a portfolio decision making perspective, decluttering to increase focus and systematically creating visibility to upside.

When the pressure and the innovation error gets too high, the compound effect can be catastrophic, creating an unintended danger zone and dramatically undermining innovation in the organization.