

Revenue Driven Resource Allocation: Funding Authority, Incentives, and New Product Development Portfolio Management

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The first step in transforming strategy from a hopeful statement about the future into an operational reality is to allocate resources to innovation and new product development (NPD) programs in a portfolio. Resource allocation and NPD portfolio decisions often span multiple levels of the organization's hierarchy, leading to questions about how much authority to bestow on managers and how to structure incentives for NPD. In this study, we explore how funding authority and incentives affect a manager's allocation of resources between existing product improvement (relatively incremental projects) and new product development (more radical projects). Funding may be either fixed or variable depending on the extent to which the manager has the authority to use revenue derived from existing product sales to fund NPD efforts. We find that the use of variable funding drives higher effort toward improving existing products and developing new products. However, variable funding has a subtle side effect: it induces the manager to focus on existing product improvement to a greater degree than new product development, and the relative balance in the NPD portfolio shifts toward incremental innovation. In addition, we highlight a substitution effect between explicit incentives (compensation parameters) and implicit incentives (career concerns). Explicit incentives are reduced as career concerns become more salient.

Key words: innovation; new product development; authority; incentives; resource allocation; portfolio

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