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Reinventing innovation at consumer goods companies

A range of orthodoxies is making it harder to develop breakthrough products in the consumer goods industry. It urgently needs a reformation.

Article at a glance

For years, consumer goods companies have excelled at product innovation.

Recently, however, their tried-and-true processes for choosing ideas, selecting business models, and making investment decisions have become orthodoxies that hinder the adoption of novel, tailored, and flexible ideas.

Four orthodoxies are particularly ingrained in the consumer goods industry: innovation starts with existing business models and categories, focus groups are at the heart of efforts to generate insights, it's best to rely first on internal resources, and companies should "let a thousand flowers bloom."

Companies must free themselves from these orthodoxies—a tricky task for large, complex, and global organizations, but one that will pay off in spades.

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Reinventing innovation at consumer goods companies

Erik A. Roth and Kevin D. Sneader

For years, consumer goods companies excelled at innovation: the steady introduction of profitable, convenient, high-quality products—ranging from disposable diapers to frozen dinners—that changed the daily lives of consumers. Recently, however, these companies have become increasingly vocal about the poor returns on their investments in product innovation. More new products are being launched, but fewer of them are truly innovative (Exhibit 1).

Paradoxically, little has changed—and that's the problem for the consumer goods sector. As markets have matured, tried-and-true processes for selecting ideas, determining business models, and making investment decisions have become less productive. Existing methodologies have turned into orthodoxies: established ways of doing business that reinforce the status quo and hinder the adoption of novel, tailored, and flexible approaches to innovation. In defining "the way things are done," these orthodoxies also dictate what a company should not do. And because they represent deeply embedded mind-sets shaped by corporate tradition, culture, and values, they are difficult to unwind.

Clearly, not all orthodoxies are wholly undesirable: many of them facilitate the efficiency and predictability that large companies need. Nonetheless, they inhibit the development of breakthrough innovations, which can be six times as productive, measured in terms of the average percentage of sales within a category, as a typical incremental change (Exhibit 2).

Other industries have their own orthodoxies, but four are particularly ingrained in consumer goods, in the form of conventional wisdom:

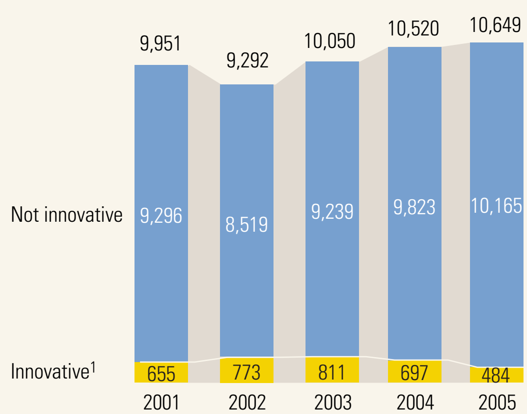
- Innovation starts with existing business models and categories.
- Focus groups are at the heart of efforts to generate the insights companies need.
- Companies should rely on internal resources first for innovation.
- Companies should come up with as many ideas as possible and "let a thousand flowers bloom."

Innovation is an inherently multidisciplinary, cross-functional activity. Eliminating harmful orthodoxies therefore requires changes across business units and throughout corporate hierarchies. Some industry leaders, such as General Mills and P&G, have already begun

Exhibit 1

New but not novel

Number of product launches in US consumer-packaged-goods industry

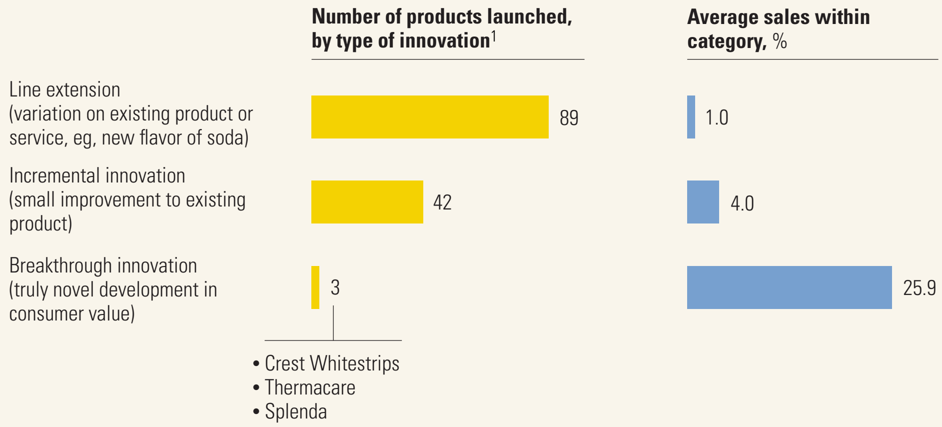


[1] ProductScan defines innovation strictly as products with significant new or added benefits in any of the following areas: formulation, positioning, packaging, technology, meeting previously unmet needs, or merchandising.

Source: ProductScan

Exhibit 2

Breakthroughs sell



[1] For 261 new products, across 18 high-growth categories, launched 2000–04, each with an all-commodity volume >5% (all-commodity volume is measure of distribution, calculated as volume generated by stores where given product is sold ÷ total retail market sales of given product).

upgrading their approaches to innovation. Others should follow because these improvements will pay significant dividends: the ability to innovate at scale and thus to deliver reliable, sustainable returns on investments in product innovation.

Starting with current business models

Consumer goods companies that stick to what they know—business models based on finely tuned business processes, existing facilities, and long-standing relationships with suppliers and customers—believe they can generate predictable results. When companies free themselves from this orthodoxy, they move beyond the development of the latest type of soda or the newest fragrance for soap (incremental moves that run the risk of overextending brands without delivering substantial growth). Instead, they take business-changing steps such as extending brands into adjacent categories, creating "platform" brands that support products across a number of categories, and moving into the white spaces between categories. Consider the following examples:

1. *Extending existing brands into adjacent categories.* For years, P&G's Pampers products focused on a specific consumer benefit—dryness—and overlooked opportunities such as "swimmers" (diapers children can wear in the water). Furthermore, the company categorized both diapers and babies by weight, since it believed that their weight corresponded with their absorbency needs. In 2001, P&G began to see the market differently. Through market research, it discovered that the absorbency needs of babies also correspond closely with their stage of development, as defined by the type and amount of their physical activity. Subsequently, P&G reintroduced its Pampers premium line as Pampers Baby Stages. Realizing that it also could extend the trusted Pampers brand beyond diapers into adjacent, complementary categories, it now offers wipes, disposable bibs, and other products. Since the launch of Baby Stages (which encompasses the product variants Swaddlers, Cruisers, and Easy Ups), P&G's share of the diaper market has risen to 51 percent in 2005, from 41 percent in 2001, and its share of the training-pants market has increased to 18 percent, from 0.5 percent over the same period.[1] Such stellar growth is very rare in a mature and competitive category.

2. *Creating a brand that plays in a number of categories and businesses.* When PepsiCo acquired

[1] Information Resources (IRI), InfoScan Reviews, United States.

Quaker Oats in 2001, the Quaker brand had already managed to refresh its old-fashioned image by moving into value-added categories such as granola bars and cold cereals. Since Pepsi's acquisition, Quaker has reached new levels by viewing its brand as a lifestyle choice rather than as a category. Quaker now stands for wholesome quality, health, and wellness (rather than a specific need state), thus allowing Pepsi to stretch into new product areas such as breakfast cookies, weight control instant oatmeal, and a variety of innovative snacks.

3. *Moving into the white spaces between categories.* Many breakthrough innovations arise in the white spaces between existing categories, because opportunities to introduce or fuse consumer benefits are richest there. Witness the breakfast bar, a product that combines the taste and benefits of traditional breakfast cereals with the portability and packaging of energy bars (themselves an innovation largely advanced by the success of PowerBar). Thanks to changing consumer needs and new delivery technologies, cereal makers have successfully expanded their brands into this new category. Indeed, "on-the-go" nutrition is shaping many product categories.

How can companies increase the odds of making such moves successfully? One tactic is to look assiduously for combinations of brands, techno-logical break-throughs, and insights that help a company address a broader set of consumer needs and so spawn multiple innovations. The artificial sweetener Splenda is a breakthrough product with applications in a number of brands, such as Diet Coke with Splenda and Splenda Brown Sugar Blend.

Facilitating the out-of-the-box thinking required to identify innovation platforms is often difficult for consumer goods companies, whose managers and employees are organized by geography, business unit, brand, category, or customer. Specialized teams with discrete resources, incentives, processes, and directions—including a mandate to focus on innovation—may be needed to foster cross-functional activities, such as the systematic fusion of consumer, technical, and industry knowledge to transform seemingly unrelated ideas into feasible product concepts. Researchers gather and brand marketers interpret data on profitable consumer segments. Together with R&D, the team explores current, developing, and even hypothetical technologies. Finally, strategists share relevant analyses of market dynamics and other contextual issues to help refine ideas (for instance, by modifying the positioning of a product or creating customer-specific variants to better meet the needs of channel partners).

The rewards of this approach are unique insights that can be translated into differentiated new products and businesses. A food product company, for example, conducted a weeklong workshop to generate new ideas by combining consumer, technical, and industry knowledge. An internal team developed go-to-market plans for two new business units with separate structures, leadership teams, and income statements. One of the resulting products eventually became the second most profitable in the company's entire portfolio.

Relying on focus groups

Orthodoxies also reinforce the reliance that consumer goods companies place on established tools for generating insights about consumers. It's easy to understand the survival of popular traditional techniques such as syndicated market research, simplistic quantitative surveys, and focus groups: they are well understood, and some of them—particularly focus groups—are quick and cost effective.

Yet so many companies use the same tool kit to scrutinize consumers that the resulting insights are undifferentiated. What's more, conventional research methods often gather incomplete information. Because they rarely make it possible to experience the full benefits of new or hypothetical products, they often fail to predict accurately whether consumers will understand the technologies that underpin truly innovative products. Consumers are notoriously poor at articulating needs or benefits beyond those they have already experienced: when asking them to imagine true innovations, companies get mixed results at best. Even an industry standard such as simulated test marketing (which often emphasizes historical consumer reactions to new products) reinforces incremental thinking and can give top scores to innovations that subsequently fail the market test. In short, traditional methods can describe past consumer behavior but rarely uncover the white-space opportunities between existing product categories or the kinds of insights that lead to breakthrough innovations.

Companies should diversify both the techniques for gathering consumer insights and the way these insights are used. Many have succeeded with ethnographic or anthropological research approaches such as in-context interviewing and "living with consumers": observing people buying and using products in stores, at work, in restaurants, or at home. Leaders are pushing the envelope further by creating new environments—computer simulations, mock stores, model "homes of tomorrow," and more—to observe purchases and consumption. In this way, managers develop a deeper understanding of the motivations that shape consumer behavior. Consider these examples:

1. General Mills observed its target market—children—playing in school yards when it developed Yoplait's Go-Gurt, one of the fastest-selling yogurt-based products in the United States. The company realized that children, given their active lifestyles, would prefer a convenient on-the-go product that could be opened quickly and held in one hand. The solution, a packaging innovation, gave rise to Go-Gurt: yogurt, in a squeezable tube, that kids can eat without a spoon.

2. Nike marketers, armed with next-generation athletic-shoe prototypes, visit inner-city neighborhoods in major urban areas to interact directly with target consumers. The company can borrow much of its style, attitude, and imagery directly from its customers while simultaneously gauging reactions and building buzz around upcoming products.

3. Dove's recent Campaign for Real Beauty created a vibrant online community that encouraged women to debate the concept of beauty. By monitoring these forums, Dove gathered information critical to developing products that challenge existing paradigms (such as the female consumer's desire for "flawless" skin) in the skin care and cosmetics industries.

Relying on a company's own resources

Most consumer goods companies need to change their interactions not only with consumers but also with other external parties. Historically, these companies have relied primarily on their internal capabilities to manage innovation. But a recent analysis across major consumer goods categories demonstrated that the overwhelming majority of US patents arose outside the top seven global consumer goods companies (Exhibit 3). In the laundry and home care category, for example, 95 percent of the patents filed from 2002 to 2005 did not originate within them.[2] Indeed, the leading companies constitute only a tiny fraction of the world's consumer goods innovators.

Yet our research suggests that few companies look beyond their advertising agencies, to the many alternative external sources of insights: suppliers, venture capital firms, entrepreneurs, and inventors. This oversight may prove costly, since external partners can spot trends, create competition for complacent in-house teams, share technologies and manufacturing processes (in some cases developed for other purposes), and even craft fully developed product concepts. Consider a few examples.

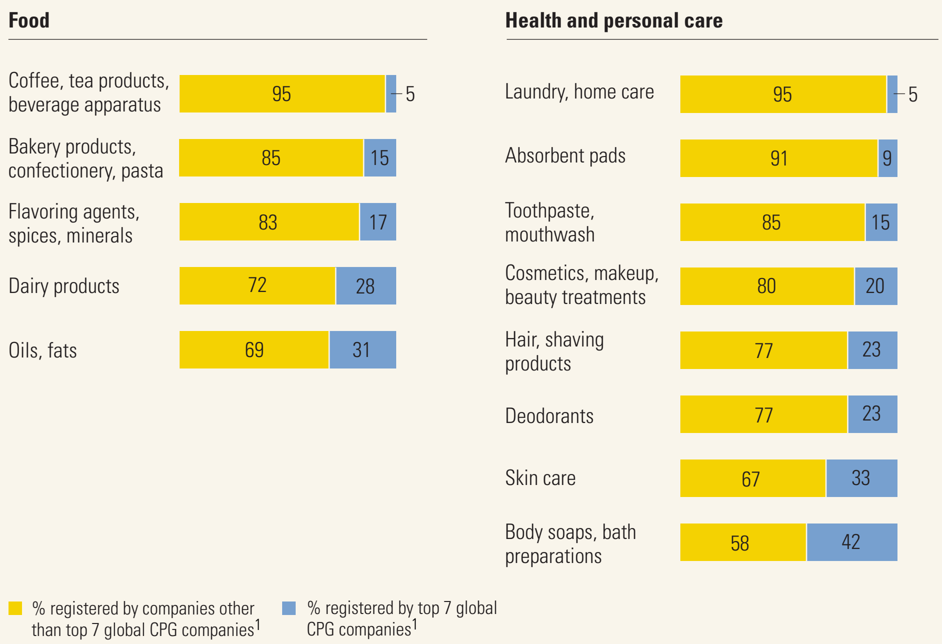
1. Through a joint venture, Clorox (which acquired Glad Brands in 1999) gained access to a critical patented plastics technology that archrival P&G

[2] We conducted this analysis using data from Delphion, an online data source for finding and viewing information about patents.

Exhibit 3

Less innovation at the top

Share of US patents registered by consumer-packaged-goods companies, 2000–05, %



[1] Danone, Kraft, L'Oreal, Nestle, P&G, Reckitt Benckiser, Unilever.

Source: Delphion; McKinsey analysis

had developed for its baby, feminine-care, and paper businesses. The result of this unlikely marriage was Glad's groundbreaking product Press'n Seal, whose distinctive technology improved the underlying margins of Clorox's business and allowed P&G to generate income from its intellectual property.

2. Coca-Cola and Alcoa observed that consumers store most sodas at home in pantries and have only a few cold ones in refrigerators at any given time. Warm cans limited consumption. With this insight, the companies used Riverwood International's (now Graphic Packaging) packaging technology to create a cardboard case—the Fridgepack—that fits in refrigerators more easily. Incremental volumes rose dramatically, benefiting all three companies.

3. P&G's Connect+Develop program is well recognized as one of the most outward-looking efforts in the whole industry. The company's CEO set clear metrics and targets, such as boosting to 50 percent the proportion of innovations incorporating external ideas, from 35 percent today and 15 percent in 2000. In addition, P&G introduced incentives so that its business units receive credit for sales and profits generated through external relationships. It has also pioneered the use of collaborative online communities, which have become fruitful sources of innovation. P&G now systematically combs the world for innovations it can improve through its own technology, marketing, or distribution. The company uses its extensive external network—academics, alumni, suppliers, technical communities, consumer communities,

[3] For additional information on such networks, see John E. Forsyth, Nicolo' Galante, and Todd Guild, "Capitalizing on customer insights," *The McKinsey Quarterly*, 2006 Number 3, pp. 42–53.

creative agencies, bankers, and venture capitalists—both to generate ideas and to complete deals.[3]

Helpful as external relationships can be, collaboration does have its perils. In particular, commonly tapped external partners—creative agencies and design studios, in the case of consumer goods companies—can become insiders over time and lose the external perspective necessary to challenge conventional wisdom. Best-in-class innovators avoid this problem by creating external boards of industry thought leaders who meet periodically to supply objective, outside-in perspectives on the company's direction. Given the power of outside ideas, companies should experiment with various approaches for sourcing, jointly creating, and commercializing intellectual property with external partners.

Letting a thousand flowers bloom

Unless companies manage their portfolios effectively, they cannot rationally determine which projects to invest in and which to discard. In fact, our recent research confirmed that consumer goods companies have more ideas than capacity to develop them.[4] Top innovators in consumer goods meet this challenge by aligning their innovation strategies with their portfolio decisions.

Many other companies, however, are over-burdened by a principle of orthodoxy: letting a thousand flowers bloom, or creating portfolios loaded with less risky, incremental ideas. To be sure, a few lucky companies play in subcategories, such as yogurt and gum, that are growing rapidly enough to absorb large numbers of incremental ideas. And incrementalism can serve certain purposes, such as maintaining market share or achieving short-term financial goals. However, most companies must actively prune their pipelines, place bets, and back winners.

Few do, however. Some risk-averse consumer goods companies believe that packing their pipelines with projects, however small and derivative, will help them avoid prematurely discarding winners or, worse, the "next big thing." Incremental projects are also taken up for alleged strategic reasons (one of which is that they are the pet projects of powerful people). Industry convention also plays a role: the average brand manager has only two years to earn a promotion and isn't likely to invest in risky ideas that will take longer to realize.

Unfortunately, traditional evaluation tools (such as returns on investment and net present value) increase the likelihood of prematurely eliminating potential breakthrough ideas and of adopting incremental ones. To predict the performance of incremental innovations, companies analyze various characteristics (say, the most important customer segments) of similar products. By contrast, a company's projections for potential breakthrough ideas, even with historical data for more or less similar products, will be less accurate. Such inaccurate projections can lead companies to underestimate the sales and profits from such projects, which are then killed. Of course, the opposite could happen—profits could be overestimated—but that isn't likely in risk-averse consumer goods companies, given the number of unknowns.

Some companies defend their tendency to let small projects proliferate: they claim that a constant stream of more predictable ideas makes them better able to forecast revenues and profits. And it does, but at a price. First, companies fail to consider the opportunity costs of failing to pursue breakthrough innovations systematically. Second, they underestimate the cost of complexity, typically in the form of insufficient resources for ballooning numbers of projects. (The more projects a company attempts to push through, the more likely it is to have less than optimal operations, which could even strain its relationships with channel partners.)

Finally, these problems become worse as companies grow. Even if the average value of each

[4] Over 75 percent of the companies in McKinsey's 2005 consumer-packaged-goods survey cited an imbalance between the number of ideas and the resources available to develop them.

project stays constant, the number of projects required to sustain high growth rates increases substantially, thus making the effort more complex and less fruitful. Recently, we worked with one senior executive who realized that an almost exponential increase in the number of initiatives would be required to meet his company's growth goals during the next five years, given the ever smaller average expected value of each innovation. Another client discovered that his company's growth goals remained beyond reach, despite the hundreds of innovation projects under development.

Rather than treating all projects equally, consumer goods companies should recognize that they can't develop incremental innovations and breakthrough ideas in the same way. Because the former are usually derivative products targeted at some large group of core customers, they tend not to change as they move through the development process. With such incremental ideas, companies primarily need to confirm that the product is feasible and that current consumers are interested in it. They can develop such products effectively through a standard stage-gate process, which evaluates a product at predetermined intervals. If a project does not meet certain criteria, such as the estimated sales volume, it is abandoned.

By contrast, potential breakthrough ideas aim to offer new sets of consumers substantially novel benefits and unproven technical features. They would therefore benefit from an iterative, learning-based evaluation with many market check-in points, similar to those that venture capital firms and high-tech companies use.[5] Such approaches might, for example, include iterative rapid prototyping, which uses product concepts to create an ongoing dialogue with consumers whose comments shape the design throughout the development process.

Consumer goods companies, once regarded as pioneers of innovation, are now bogged down by the very practices they hoped would keep bright ideas coming. To kick-start growth and rejuvenate ailing innovation engines, these companies must break free of orthodoxy—a tricky task for large, complex, and global organizations, but one that is sure to pay off. Q

The authors wish to acknowledge the contributions of their colleague Lindsey Pippel.

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[5] For more information about stage-gate and iterative product development processes, see Richard Holman, Hans-Werner Kaas, and David Keeling, "The future of product development," *The McKinsey Quarterly*, 2003 Number 3, pp. 28–39.