strategy+business

ISSUE 78 SPRING 2015

Creating What Consumers Want

A new approach can help CPG companies introduce products with the right features, price, and packaging.

BY DAVID MEER, EDWARD LANDRY,

AND SAMRAT SHARMA

REPRINT 00304

Leading Ideas

Creating What Consumers Want

A new approach can help CPG companies introduce products with the right features, price, and packaging.

by David Meer, Edward Landry, and Samrat Sharma

Consumer packaged goods (CPG) companies have a big problem: They have almost no idea which of their new products will end up being popular with consumers. Despite big data, despite a decade of heavy investment in innovation, despite chief innovation officers and efficient R&D, failure rates for new products have hovered at 60 percent for years. Two-thirds of new product concepts don't even launch.

One reason is that the retail environment has become far more complex. E-commerce continues to upend long-established business models, and consumers are shopping less at supermarkets and hypermarkets and more in convenience stores, at discounters, and online.

What's more, although CPG companies are extremely good at the early stages of innovation—identifying promising areas of growth and creating new product ideas in those areas—and at the later stages of testing concepts and commercializing them, there's a conspicuous hole in the middle of the process. They don't have a clear grasp of which combinations of features, packaging, price, and even labeling will persuade consumers to make a purchase. They're like triathletes who are world-class at swimming and running, but terrible at cycling.

There's a way to fill that hole, but it won't be easy. Based on our experience, we think it will require progress in three key (and intertwined) areas. None of the three will work without the other two, and all will compel CPG executives to rethink aspects of their traditional business model.

First, companies need to adopt dynamic modeling to gauge various combinations of features. When companies test a product concept today, they're limited by the relative primitiveness of the tools available to them, such as consumer concept testing and market structure analysis. Testing a preset combination of options (for example, the cinnamon-flavored cookies, in six-ounce individual packages, at 79 cents per pack) produces a basic thumbs-up or thumbs-down assessment as to whether the product will be financially viable. However, the results apply only to that combination. If you change one element, the test results become much less useful. Worse, the testing is expensive and time-consuming, with turnaround times that are measured in months, which makes testing every single combination impossible.

Ideally, companies should be able to test various combinations more dynamically, adjusting the flavor profile, pack size, price, labeling, distribution channel, and any other aspect of the value proposition—even the brand name. Developing a simulation model that can evaluate a wide range of scenarios by altering the various elements and seeing how each factor affects the outcome while the product is still in the development stage is an effective way of doing so.

How much more would consumers pay for low-calorie cinnamon cookies? Would they prefer eight-ounce packs? And should the cookies be sold at a convenience store, a big-box retailer, a warehouse store, or online (or all of the above)? The right model would break such product propositions into their component parts, reassemble them in novel ways, and estimate demand for the new combinations. This in turn would require detailed data on which features consumers value, how much they're willing to pay for those features, and where they're willing to make trade-offs.

In addition, simulation models need to deliver more actionable results. Rather than providing just a basic yes or no, the results must break down revenue, volume, and margin contribution. If a new product is going to take market share from another player, the model should let the company know where that share will be coming from, at what price, and through which channels. Importantly, the model should also indicate how much volume is incremental and how much is simply cannibalizing the company's other offerings in the same category.

Illustration by Mitch Blunt

Although similar models are already being used in industries such as financial services and technology, CPG companies have been slow to embrace the new analytics. In fact, the reverse has happened: In response to cost pressures, CPG companies have systematically disinvested in analytics and insights teams. The limited resources CPG companies seem to have are being spent in areas such as social media and mobile marketing. But firms that are serious about innovation have to start the process by investing in foundational tools. And they will likely find that these investments pay for themselves over time.

Second, companies have to develop priorities based on their capabilities. Companies don't start product development with a blank sheet of paper. They have critical advantages in areas where they focus their investments and attention; other areas can be either outsourced or set aside. Once a company has clear insights about which features consumers value, and how much they value those features, the next step is to figure out which of those insights it can actually implement, based on its capabilities and resources.

For example, some companies are good at developing new flavor profiles, and can easily launch spin-off products (adding toffee to the cinnamon cookies, for instance). Others are good at packaging innovations or cost reductions that lower prices. Still others have strong distribution capabilities, and can get products into new store formats quickly. Whatever its strengths, a company should prioritize its innovation ideas accordingly.

Concurrently, this step provides companies with valuable insight into which areas they should concentrate on developing next. Coming up with ideas that are hard to implement because of a lack of relevant capabilities should influence a firm's future investment priorities, enabling it to build new capabilities that would ensure competitive advantage in the future.

Finally, companies need to make organizational shifts to put these insights into action. CPG companies need to reorient their org charts so that the innovation function collaborates more directly with marketing, sales, and the supply chain during product development. Many companies think that these four functions collaborate already. But the truth is that they work from different perspectives, with varying definitions of success and incentives, and at different stages in a product's development. Innovation wants to get new products from the drawing board to market, while marketing is busy trying to get consumers to open their wallets. Sales focuses on persuading retailers to give new products shelf space, which in turn can help stimulate consumer demand. And the goal of the supply chain is to maximize efficiency and minimize process proliferation. The objectives overlap, but they're not identical. As a result, products in development can travel far down the tracks before problems surface.

CPG companies would do better to use the insights they generate in the first step (through dynamic modeling) and the priorities they establish in the second (understanding their capabilities) to create a common set of facts and objectives that all four functions can agree on. In some cases, this will mean restructuring lines of authority, incentives, and other aspects of the organization. A dramatic step? Yes. But it is necessary if companies are to make sure that these critical functions are working together.

Some leading CPG companies have started to implement this new approach to innovation. For example, one packaged-food company had spent 18 months working on a preservative-free version of a product. One of its competitors had already introduced a similar product, and the company feared market share losses. But with the official launch date only months away, the company learned that two major grocery chains had decided they would not carry its new product, in part because the competitor's preservative-free version didn't appeal to their customers. Firm leaders scrapped the product, treating their investments as a sunk cost.

To avoid repeating that mistake, the company shifted away from trying to innovate by following the competition, and toward an approach based on a richer understanding of consumers' desires.

It started by running a dynamic analysis of several product options. It found that although "preservative-free" wasn't a sufficiently attractive incentive for consumers to open their wallets, "natural" (meaning no artificial ingredients) would be. R&D had originally said the natural product would take two years to develop, but a deeper look at the company's capabilities and priorities revealed that the team could actually complete the product's development in just six months.

In fact, a discussion between the R&D team members and their counterparts in sales and marketing revealed that R&D had been receiving so many new product ideas that it used "two years" as the default timing for all of them. The company was able to identify other innovations with clear potential—including a superpremium line and new packaging—that could be brought to market quickly. In the aggregate, these innovations enabled the company to grow sales at a faster rate than the competition and to improve profitability in the category for the first time in three years.

R&D had been receiving so many new product ideas that it used "two years" as the default timing for all of them.

If this example shows anything, it's that CPG companies can't afford to throw ideas at the wall and hope one of them will stick, even if they are trying to imitate a competitor. Chances are, your rivals don't have any more insight into what consumers want than you do. This new approach should go a long way toward fixing that. +

Reprint No. 00304

David Meer
david.meer@strategyand.pwc.com
is a partner with Strategy&'s consumer and retail practice based in New York.

Edward Landry
edward.landry@strategyand.pwc.com
is a partner with Strategy&'s consumer and retail practice based in New York.

Samrat Sharma
samrat.sharma@strategyand.pwc.com
is a partner with Strategy&'s consumer and retail practice based in Cleveland.

strategy+business magazine
is published by PwC Strategy& Inc.
To subscribe, visit strategy-business.com
or call 1-855-869-4862.

For more information about Strategy&,
visit strategyand.pwc.com

• strategy-business.com
• facebook.com/strategybusiness
• twitter.com/stratandbiz
101 Park Ave., 18th Floor, New York, NY 10178

pwc | strategy&
Formerly Booz & Company