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Survival-of-the-Fittest Innovation

by Edward Baker

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Booz & Company Partner Alexander Kandybin on why consumer products companies should look to the power of natural selection to break out of the incremental innovation trap.

by Edward Baker

Despite launching tens of thousands of products every year, the consumer packaged goods (CPG) industry has struggled at length to develop true breakthrough innovations. In the view of Alexander Kandybin, a partner at Booz & Company who regularly advises consumer goods companies on the innovation process, it's because they are caught in a vicious innovation cycle: The industry is mature and investments in innovation typically generate low returns. As a result, companies cut research and development investments, thus giving themselves even less chance of discovering breakthrough innovations. And the fewer big innovation successes they have, the more they cut R&D budgets. Instead, companies focus on incremental innovation, generating necessary but minor line and brand extensions — dozens of different detergent formulations, for instance, or cookie flavors — that keep new products flowing into the market. Yet the competitive advantage they gain with these innovations is soon lost as rivals quickly introduce their own copycat products into the market.

That approach to innovation, Kandybin believes, has led CPG companies to think of innovation as essentially a marketing function rather than as a strategic, competitive advantage. Their risk-averse cultures rely too heavily on customer input, limiting the number of major innovations they are willing to put out into the market. Instead, says Kandybin in this recent interview with strategy+business, CPG companies should take an evolutionary approach to product innovation by introducing more products, allowing more time for them to succeed or fail in the market, and developing products and packaging that are much more difficult to imitate.

S+B: Why does the corporate culture at so many CPG companies seem to be ill-suited to breakthrough innovation?

KANDYBIN: At most CPG companies, research and development is not a strategic function. Rather, it is more of an execution function. CPG companies typically believe that new-product ideation resides in marketing and that R&D is only loosely associated with real innovation. I have heard CPG executives say, "The R&D team just develops what we want them to develop, because we know the market." In fact, research and development should be considered a strategic function and an equal innovation partner with marketing. R&D should be based on the possibilities from a product and technology perspective rather than on marketing's consumer-centric view.

S+B: What's wrong with listening to the customer?

Edward Baker
(baker@edwardhbaker.com), former editor of CIO Insight magazine, is a contributing editor at *strategy+business*.

KANDYBIN: Understanding consumer needs is important in developing many products, but it's a difficult way to come up with truly breakthrough ideas. Dependence on understanding consumers' own perceptions of their needs for innovation ideas will only lead to incremental innovation, and incremental innovations can't, by definition, reap large rewards.

Should we involve the consumer in innovation? Of course. But the question should be, What can you ask consumers? If you ask consumers about something new, they won't know what to tell you, because they don't know what they want. For example, if you had asked consumers in the early 1900s what improvements they wanted in transportation, they would likely have told you a faster, more reliable car and better roads. No one would have thought to ask you for an airplane. If you give consumers a prototype of a new product, they can react to it. But it requires quite a bit of development to get to that point.

S+B: How can CPG companies increase their chances of coming up with breakthrough ideas?

KANDYBIN: This refers back to companies' overdependence on customer input. Breakthrough ideas come from a better understanding of technology development and trend development, and from trying to figure out potential solutions. You can never know if an idea will be successful or not, so companies should develop multiple options as prototypes, and only then involve consumers in the process. The customers will have something to react to. Even at that point, however, if your idea is truly new, consumers may not appreciate all of its benefits.

And even if companies do think up truly breakthrough products, they often decide that they can't afford to fully develop all of them. So they institute processes that kill too many good ideas before they go to market. The better strategy is to create a business model that allows you to test different breakthrough innovations in the market on a regular basis, kill those that don't work early on, and amplify those that do.

Think of it in evolutionary terms. Innovation is really a form of competition. Why do companies innovate? They innovate for only one reason: to outperform their peers, to create something that their peers don't have from which they can gain economic benefits. And because innovation is a form of competition, it's subject to the laws of evolution. If you look at the CPG sector from the macro perspective, what you'll see is lots of companies introducing lots of new innovations, and it will look like many random events. Those that really meet consumer expectations or change consumer expectations survive — those that don't, die. Ultimately, the environment chooses which products work and which don't.

S+B: Given the challenges of the competitive landscape in consumer packaged goods, how can CPG companies distinguish themselves?

KANDYBIN: One big problem with innovation in CPG is that new ideas are so easily copied. A company will launch a product, and within weeks or months its biggest competitor will launch a product that offers almost exactly the same solution in a slightly different shape or form. Sara Lee Corporation recently launched a line of bagged salads that include meat, which was a new product that addressed consumer needs. Soon after, Kraft Foods launched essentially the same product. The result is that there's no market share gain, and the company that first introduced the new product doesn't capture the value of its innovation. One consequence of this is that companies will find that being the fast follower to market is often a more effective and profitable strategy than being a market leader.

Because differentiation in the CPG sector is so difficult, companies should turn their efforts toward innovations that are more difficult for competitors to copy. Focus on product or packaging technologies that require a little bit more advanced science to manufacture; this will at least delay copying by competitors, and may buy you enough time to enjoy an attractive return. When H.J. Heinz Company began selling crispy microwaveable French fries that tasted good, they began to fly off the shelf. That may not sound like a major breakthrough, but it does require some science, in both the product and the packaging, to actually make these French fries microwaveable. No one else has matched them yet, and it's been a while since they launched.

S+B: How can CPG companies get more breakthrough product ideas into their pipelines?

KANDYBIN: One source that CPG companies don't depend on enough is fundamental research. They typically do their R&D and innovation within business units instead of a central organization, and that's another reason their innovation efforts are focused on the incremental. The problem, of course, is that if you create a central organization that is detached from the market, it's likely to end up being a comfortable place for R&D scientists to spend lots of money and time simply thinking.

But such organizations can work well if their efforts are attached to a market mechanism. For example, they might be expected to produce a business plan along with their new ideas and sell that business plan to the appropriate business unit. If none of the business units wants to buy it, they could be allowed to sell it outside the company. Or they could be given the option of developing ideas internally or sourcing ideas from the outside and paying market rates for those ideas. Once you force central innovation groups to develop ways to attach themselves to the market, they begin to work better.

There has also been a lot of talk about looking outside the corporation, to universities and the government, for new ideas and sources of innovation — in part because of CPG companies' lack of fundamental research. That kind of open innovation can work, too, but it has to be handled properly. Too many companies run their open innovation efforts the same way they run innovation in their own departments. It's really a "push" strategy: They create a network of outside scientists, then use those scientists to respond to the same consumer needs their own departments are responding to, and to develop the same kinds of consumer-oriented, incremental ideas.

Open innovation should be thought of the other way around. Rather than paying outside researchers to perform their own work, companies should make it attractive for anyone in the world to come to them with their innovations and ideas. Then, all of a sudden, they increase leverage a thousand times. Procter & Gamble Company is particularly good at this. If a researcher in the Philippines or Australia or Japan comes up with a breakthrough product that relates to oral care, for instance, the best way for him or her to monetize the innovation is to call P&G. Once that happens, a company's innovation leverage increases dramatically. After all, companies still have to have the ability to tell the difference between good ideas and bad ones. +

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