Deep-dive on innovation in Consumer Products

New insights on how innovation leaders are creating value despite industry headwinds
Despite industry headwinds, Consumer Product companies with strong innovation portfolios and capabilities can generate more value for their shareholders.

Consumer product (CP) companies face an ongoing set of challenges to performance, from slowing industry growth,¹ to declining brand loyalty,² to the rise of unconventional competitors who play by different rules.³ While virtually all companies in the world pursue “innovation” as a key driver of growth (CP companies are no exception in this regard),⁴ very few are actually creating new, viable business offerings that drive value for their customers and shareholders. There are, however, exceptions to the rule. In a recent analysis we conducted across 44 leading CP companies, representing over $900 billion in revenue, we found that a small number of companies are driving disproportionate performance from innovation. Based on this insight, we set out to understand what separates innovation leaders from everyone else, and analyze what these leaders are doing to drive greater returns from innovation.⁶ What did our analysis reveal? Simply put, the companies that drive disproportionate returns and performance from their innovation investments are companies that do three things well:

1. They systematically innovate beyond product
2. They design for consumer behavior
3. And they develop systemic capabilities to drive their innovation activities

What we have found may appear deceptively straightforward, but – as our analysis shows – only a select few companies have been able to put these principles into practice successfully. What follows is a more detailed assessment of what these innovation leaders do differently.

New Deloitte research shows that there is a small group of CP companies who generate above-average returns from their innovation investments by doing three things:

Innovate beyond product: Use multiple types of innovation to improve profitability and consumer experience. Companies that apply multifaceted innovation to support product differentiation demonstrated a better hit rate for innovations launched in the market.

Design for consumer behavior: Break through consumer paralysis and stimulate trial and adoption by leveraging “on the ground” realities of consumer decision-making. Deeper understanding of consumers’ cognitive and behavioral tendencies can help companies heighten consumer engagement and prevent off-ramps to action.

Develop systemic capabilities: Build robust organizational structures that enable repeated innovation performance. Companies that systematically consider innovation strategy and intentionally structure to support and fuel innovation with the right leadership, talent, and funding mechanisms, can more reliably design, launch and scale innovations over time.

Key Takeaway: The CP landscape is rapidly changing and companies that maintain the status quo will likely increasingly face negative consequences. The historical industry playbook in CP is not working; traditional CP companies are already quickly losing share to smaller, more nimble, and more innovative companies who are successfully capturing the attention of brand-agnostic consumers in an increasingly crowded playing space.

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Our study reveals that CP companies who are innovating beyond product, designing for consumer behavior, and leveraging capabilities in a systematic and repeatable fashion are seeing substantially greater returns from their innovation investments in the following ways:

- **Substantially greater shareholder value creation:** CP innovation leaders experienced 14% annual stock price growth over 5 years, compared to zero growth for laggards.6

- **Significantly greater economic value creation than the average CP company in our sample:** CP innovation leaders created an EVA spread7 of 7 percentage points over 5 years, versus 1 percentage point for all other CP companies in our study.

- **Improved consumer brand perception:** Leaders develop and launch products that are more valued by consumers, compared to “easily replaceable” products of the average CP company in our study.8

**What are leading CPGs doing differently?**

1. **Innovating beyond product**

   **The Status Quo**
   Many CP companies equate “innovation” with developing new products or new product extensions—according to recent Nielsen research, there were more than 20,000 product launches since 2008, yet only a whopping 74 of these have been blockbusters.9 Moreover, a Deloitte analysis of successful innovations launched by 44 top Consumer Products companies revealed that nearly 90% of CP innovations are either product performance or product systems or line extensions. While core for most CP companies, product-based innovation can be easily identified and copied, and is rarely sufficient to enable a sustainable competitive advantage in the market. To successfully navigate the changing industry landscape, it is imperative that CP companies consider innovation outside of products alone.

**Ten Types of Innovation**

The good news: there’s more to innovation than product improvements. In Deloitte’s leading book *The Ten Types of Innovation: The Discipline of Building Breakthroughs*, Deloitte explained that the world’s leading innovators systematically innovate “beyond product” by leveraging ten distinct types of innovation.10 These innovations range from configuration innovation in the form of partnerships or business models that change the economics of offerings, to enhanced consumer experiences and alternate delivery channels. Most importantly, research conducted for the original publication of the Ten Types of Innovation book, as well as the more recent research we conducted on the 44 Consumer Products companies described in this paper, both showed that companies that combine multiple types achieve greater success and higher hit rates. A few examples demonstrate how different kinds of innovation can be combined to produce greater value:

- **Building a network or ecosystem of partnerships**
  Companies don’t have to do it all alone; increasingly, open platforms are seen as a novel way to develop unconventional partnerships and leverage the collective intelligence of employees, outside experts, and consumers. Colgate, for example, uses an online platform to leverage the collective intelligence of the public to help solve specific consumer challenges in dental care. GE’s FirstBuild program has enjoyed success using crowdsourcing and crowdfunding tools for product innovation and development, coupling the unconventional insights and early feedback available through these approaches with the company’s traditional advantages in manufacturing at scale.11

- **Investing in next generation consumer experience for the “segment of one”**
  Personalization and curation are not new ideas in service industries, but applying them in CP to satisfy unmet consumer needs for individualization and customization and to simplify...
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Key Takeaway: Successfully innovating beyond product means building robust ideas that cut across multiple types of innovation, making them difficult for competitors to copy.

2. Designing for consumer behavior
Companies can de-risk innovation by using behavioral design to increase the rate of initial trial and ongoing adoption of offerings, building solutions that address common behavioral and cognitive tendencies. By combining principles from behavioral economics with user insights and business experience, leading innovators leverage behavioral design to take solutions that seem smart on paper and actually make them “stick” with consumers by considering how their sense of identity, incoming preconceptions, and perceptions of possible options impact decision-making. CP companies can learn from others that have successfully leveraged these tactics effectively, for example:

Sparking initial trial
Convincing customers to try a new product or choose one amongst many remains a fundamental challenge in CP, particularly in a “more is more” world in which the sheer number of available alternatives makes selection increasingly difficult. Speaking to consumers’ existing “mental models” can help cut through the noise to get at what really matters. For example, recognizing the need to readjust their approach to make up for lost market share during the 2008 economic downturn, P&G conducted user research to determine core feelings behind shampoo selection to bolster sales of their Pantene line. The findings from this research were surprising: the proliferation of hair care options was more overwhelming to consumers than delightful. This informed a new strategy, in which the company restructured the hair product’s line-up around a limited number of attributes—Fine, Normal/Thick, Curly, and Colored—to address the fact that less choice, not more, was desirable to consumers. Consumers overcame “analysis paralysis” and Pantene increased market share.

Motivating ongoing adoption
Tactics such as building on existing habits, leveraging feedback loops, and crafting experiences where value increases over time can be successful approaches for getting customers to come back; “set it and forget it” options—like subscription services—provide even more stickiness. As an example outside of CP, Allianz’s “Save More Tomorrow” retirement savings program used behavioral design to help people with long-term
Reducing consumer off-ramps
Whether consumers are just trying something for the first time, or for the hundredth, CP companies should consider designing for three key moments in decision-making when consumers are especially susceptible to behavioral tendencies:

1. Understanding the consumer mindset: Aligning offerings with consumers’ “sense of self,” and framing options to help people internalize the value of possible choices

2. Heightening perceived ability: Supporting decision-making with structure and “front of mind” presence to make the path forward seem achievable and relevant

3. Supplying compelling prompts to action: Reducing friction to decision-making and action, such as instilling a sense of scarcity to make the risks of inaction feel stronger than the risks of action

Key Takeaway: Multi-faceted innovation in itself is not enough. Smart, advanced solutions don’t sell themselves; solutions with compelling value propositions that people will actually use. Applying lessons from behavioral economics can help drive consumer trial and adoption to help ensure market success of innovations by designing for consumers in ways that demonstrate meaningful value, and make sense within consumers’ existing mental modes.
3. **Developing Systematic Innovation Capabilities**

Without systemic capabilities, you can’t consistently repeat innovation to maintain competitive advantage. Leading innovators build well-designed, self-reinforcing innovation systems that yield increased marketplace performance, streamline organizational processes, increase clarity and motivation for their people, and foster internal and external collaboration. Components of a balanced, well-developed innovation system include:

**Setting the strategy:** Innovating in the absence of a strategy puts the company at risk of supporting disjointed efforts. We have seen this play out in practice with countless companies in both the CP sector and beyond: while innovation is prized and declared as a strategic priority by many, only a small minority of firms we have encountered have executive alignment around their innovation ambition and intent. In the absence of a joint vision for innovation, innovation efforts are fragmented and – very frequently – the right hand ends up unaware of what the left is doing. Articulating and communicating a compelling vision, supported by specific themes, is therefore a critical starting point for an effective innovation system that can galvanize an organization behind common goals, metrics and priority opportunity spaces.

**Managing the portfolio:** Actively monitoring, measuring and managing innovation initiatives against well-defined criteria, and providing clear governance and decision rights, are core principles for repeatedly achieving innovation. A portfolio approach, in which innovation efforts reflect different levels of ambition and risk, allows for continued progress toward closer-in core improvement while also supporting big-bet transformational initiatives.

**Constructing, building, and scaling innovation:** Developing breakthrough innovations requires equipping teams with different processes and perspectives than used in day-to-day business or more traditional innovations. The right kind of structure, methods, tools and development pathways help organizations to effectively build and scale innovation ideas. Depending on the kind of innovation that a company aspires to undertake, this may require new processes—based in iterative development rather than strict stage-gate structures—as well as new collaborative models that connect talent across the organization or through external partnerships.

**Fueling innovation:** Supplying the right resources, at the right times, is critical to successfully accelerating and amplifying key innovation initiatives. While structure and processes are important, talent, tools, and funding provide the fuel for nascent ideas to take form and get traction. Without the support of meaningful incentives—which can also attract external players to bolster innovation development—and leadership from above, innovation systems run the risk of being smart on paper but inert and ineffective.

**Key Takeaway:** *In order to better achieve repeated innovation success and a sustained competitive advantage, a company must develop the right innovation capabilities and organizational competence that provides the right kind of structure, processes, incentives, and leadership models.*
4. Putting it all together: four types of CP innovators

Each of these components—innovating across multiple types beyond product, designing for consumer behavior and experience, and developing systematic capabilities—is valuable independently, but maximum impact results from combining the tactics. To understand these dynamics at the level of specific offerings and companies, Deloitte mapped a selection of key in-market offerings launched by broad range of leading CP companies against the companies’ internal innovation capabilities. This analysis allowed us to identify four types of companies based on the intersection of strengths and weaknesses in innovation portfolio (measured by the types of innovation used in market-facing offerings) and innovation capabilities (measured by the presence of the key components of a well-designed innovation system).

Of these four types, only one type was able to drive the substantially greater returns and impact from innovation that we describe at the beginning of this piece. These companies (“Systemic Innovators”) displayed generally strong innovation portfolios and strong internal capabilities. They enjoy the benefits of multifaceted innovations and have set up their innovation systems to repeatedly deliver strong innovative offerings; for example, combining new delivery channels like web engagement and door-to-door delivery, through a subscription profit models, allowing these companies to reach consumers in new ways and reap new sources of revenue. The key question for Systemic Innovators is how to maintain this strong performance.
The other types either suffer from having weak innovation portfolios or lack innovation capabilities to systematically drive the right kind of innovation activity throughout their organization or (or, in rare cases, both!). Companies who fall into these categories and are seeking to shift their positioning should consider the actions indicated for their type:

“Lucky Ones”: Build an innovation system: Other companies indicated the presence of strong portfolios but weak internal capabilities. These companies typically face higher burdens to design and launch innovations, whether from having to navigate restrictive pipeline development processes, compete against other initiatives for a fair share of funding, or demonstrate financial value earlier than is realistic for more ambitious offerings. Focusing on building more systematic approaches to innovation can grease the wheels and streamline identification, development, and market execution of innovative ideas.

“Untapped Potential”: Commercialize and get leverage from the innovation system: A significant portion of companies had relatively weaker innovation portfolios but demonstrated evidence of stronger innovation capabilities, indicating that they are positioned for performance but lack methods or motivation to innovate across multiple types. Leveraging existing capabilities to expand beyond narrow product innovation can help these companies more effectively harness and build on what they are already doing well.

“Room for Growth”: Catch up to the market: Certain companies showed evidence of relatively weaker portfolios combined with limited innovation capabilities. These companies may need to play catch-up along two dimensions, with some well-placed bets on additional innovation types as well as investments in building systematic capabilities. Developing new innovations in parallel with an internal innovation competence can sound overwhelming, but can actually be a quite successful tactic: pilot projects create a sense of concreteness, provide necessary momentum, and can be used to test nascent capabilities.

Key Takeaway: Different combinations of innovation capability maturity and portfolios suggest there is not a one-size-fits-all approach to improving CP innovation across companies. Diversity in companies’ specific situations suggests a range of alternate approaches to stronger and more systematic innovation development.

Final Key Takeaway: Innovate beyond product, design for consumer behavior, and develop systemic capabilities to create sustainable breakthrough innovation
End notes

4 Deloitte 2016 CAGNY Roundup Infographic: “The 20 things they did and didn’t talk about at CAGNY,” an analysis of company presentations made at CAGNY.
5 The 2016 Deloitte Consulting CP Innovation Index and Study combines, for the first time ever, three of Doblin’s recognized proprietary innovation frameworks: The Ten Types of Innovation, the Principles of Behavioral Economics and Design, and the 12 Levers for Breakthrough Innovation.
6 Leaders are defined as the top 30% of companies with the highest innovation scores based on findings from Deloitte’s Consumer Product's Innovation Index, 2016; Laggards are the bottom 30%.
7 “EVA spread” is a performance metric related to the concept of Economic Value Added (EVA), a metric developed and trademarked by Stern Value Management (originally Stern Stewart & Co.). EVA is traditionally defined as Net Operating Profit After Taxes (NOPAT) minus Invested Capital times the Weighted Average Cost of Capital (WACC), and as such measures value creation by a company in dollar terms. EVA spread, also known as “economic spread,” is a percentage-based equivalent of this metric defined as Return on Invested Capital (ROIC) minus WACC. We use EVA spread, rather than EVA, to enable meaningful comparisons across companies of differing sizes.
8 2015 American Pantry Study: The call to re-connect with consumers, 2015.