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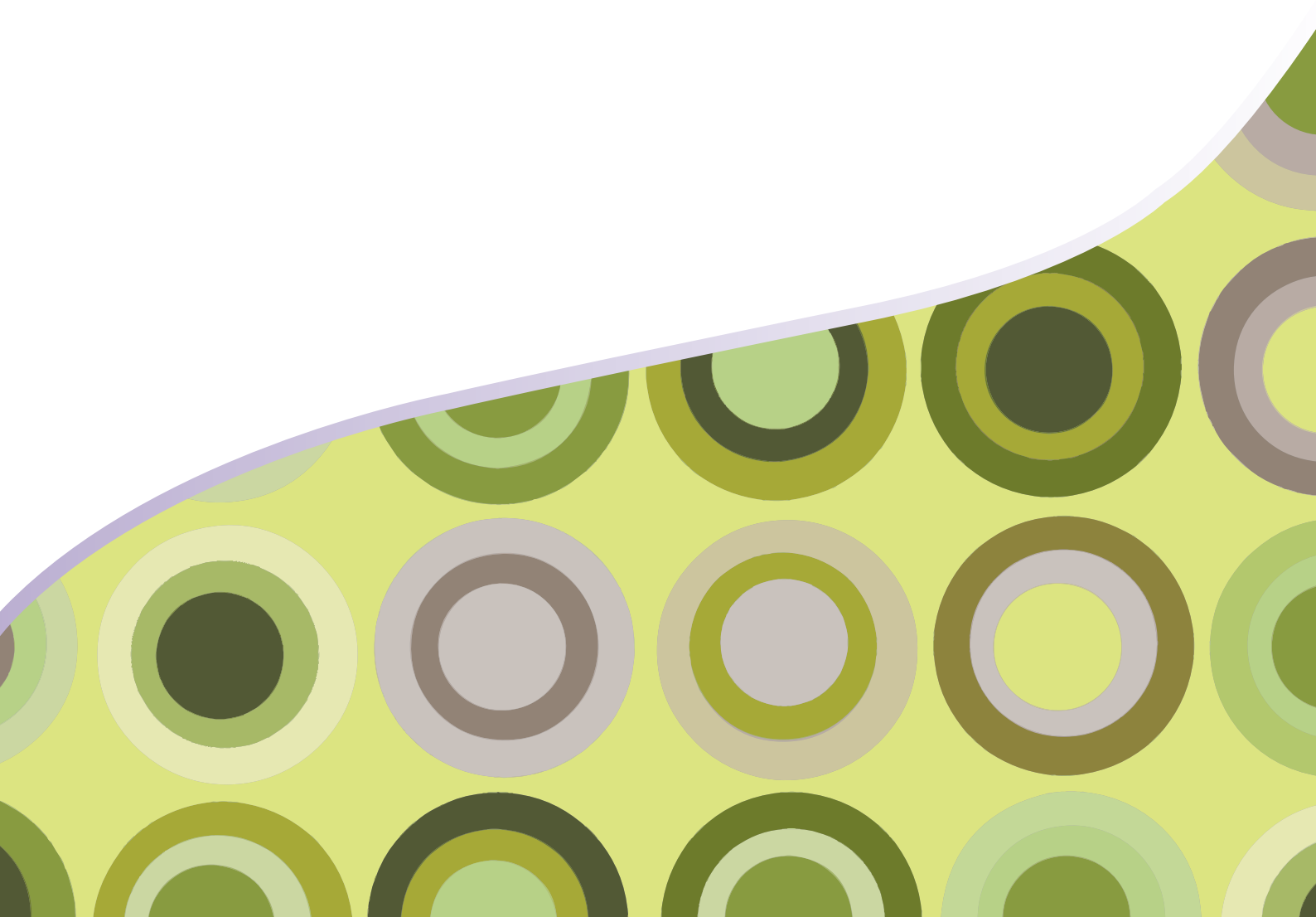
What's New Anyway?

The Importance of Innovation Efficiency



Innovation is the key to more prosperity, more growth and added value. This particularly applies to the branded goods industry in its struggle against private brands. Innovations and their quality protect against copying and determine market entry barriers. Finally, successful innovations provide an opportunity to beat the competition over the long term.

While "Let's innovate" has become Henkel's motto as coined by Ulrich Lehner[1], A.G. Lafley, CEO of Procter & Gamble, proclaims "Connect and develop" as his company's global innovation initiative. Lafley's objective is for at least 50 percent of the innovative ideas to come from outside Procter & Gamble.

Both views share the idea that innovations are not related solely to products, and are driven by a latent sense of dissatisfaction. In other words: They invite you to question what has been achieved, and look for permanent, creative and disruptive renewal.

What drives these initiatives? Naturally, one ambition is to "make customers' lives better and easier". Customers are expected to recognise and appreciate the value added by an innovation, as well as the brand, and consequently be ready to pay an innovation markup – that is, a comparatively higher price. Lafley says: "Our goal at P&G is to delight our consumers at 'two moments of truth': first, when they buy a product, and second, when they use it."[2]

Despite these positions, which ultimately also stem from a dissatisfaction with the achievements, it's clear that improving innovation is an ongoing management task.

After all, the failure rate of new product launches remains high. In Germany, for example, about 70 percent of new products and as many as 90 percent of new brands fail. Annual unprofitable investments in Germany (the largest European market) are estimated at €10 billion. In other cases, new product launches are mainly incremental innovations. According to market research firm GfK, 81 percent of new products have only a low or medium level of innovation. Disruptive innovations, while they exist, are rare.

The challenge is to transform a company into an "innovation machine". This journey should start by objectively assessing the company's own innovation successes. When doing so, the head of one firm's research and development department (R&D) made the following observations about the company's innovation deficiencies:

- A silo-oriented, multi-local capability profile
- An introverted innovation culture
- Prioritisations and innovation output always oriented towards the company's own capacities
- Many bits and pieces, no real focus
- No rules for completing projects
- No processes that clearly govern the efficient collaboration with other service units and external partners
- No transparency of the projects in the different countries
- No tools and service parameters that effectively support the management of the R&D portfolio

The deficiencies listed above can be translated into four task areas of innovation management:

1. Focus and set priorities
2. Call for efficiency and establish it in the organisation
3. Open innovation
4. Ensure market acceptance

Focus and set priorities

One prerequisite is to define the right focus for the innovation value chain – idea generation, evaluation and selection, development and testing, and launch – and secondly to align the innovation value chain in decision routines. Here, the majority of companies employ "stage gate processes", whereby a "gate" has to be passed after each process "stage" (see figure "New product development process").

To get to the next stage, defined and measurable criteria need to be fulfilled. If applied consistently, ideas are dropped and projects stopped and removed from the process when the criteria are not met. Key questions include: Are the solution requirements feasible in terms of technology and unit costs? Can the volume and price targets be realised? Are new market rules likely to be set?

Stopping projects with a limited chance of success is a central task of innovation management. When "killing" projects, the risk inherent in innovation decisions becomes obvious.

1 Henkel Geschäftsbericht, 2006
2 Lafley, A.G.(2008), "The game changer," S.5
3 Acquisa, Heft 09/2007, S. 32-34, mit Verweis auf GfK
4 GfK, "Consumer Scan Innovation Day," May 2006

Investments accrued are depreciated, and time and motivation invested are written off.

In combination with innovation-oriented portfolio management, this allows setting sensible priorities and assigning capacities to projects. Portfolio management aims at leading valuable projects with a balanced risk profile through the innovation value chain. In addition, it helps to conduct the right number of projects based on capacities and strategic targets and influence the course of investments (see figure "Shaping the cash curve of innovation").[5]

Strictly organising and applying the stage gate process is decisive for the development of the value of R&D. Here, the interrelation between investment intensity and innovation cannot always be proved. For example, based on 2007 company annual reports, L'Oréal invests 3.28 percent of its turnover in R&D, while P&G spends 2.73 percent and Henkel 2.68 percent. In absolute amounts, the investments vary substantially : 1.5 million at P&G, 560 million at L'Oréal and 350 million at Henkel.[6]

Studies indicate that an increased R&D budget does not necessarily lead to more innovations.[7] Rather, R&D needs to be drawn out of the innovation silo and the innovation activities must be dovetailed with other processes, as well as marketing, sales, operations and cost management.

5 J.P. Andrews, Harold L. Sirkin, Payback: Reaping the Rewards of Innovation
6 Annual Reports 2007
7 Smart Spenders: The global Innovation 1000, strategy + business, 2006

Fig. 1: New product development process

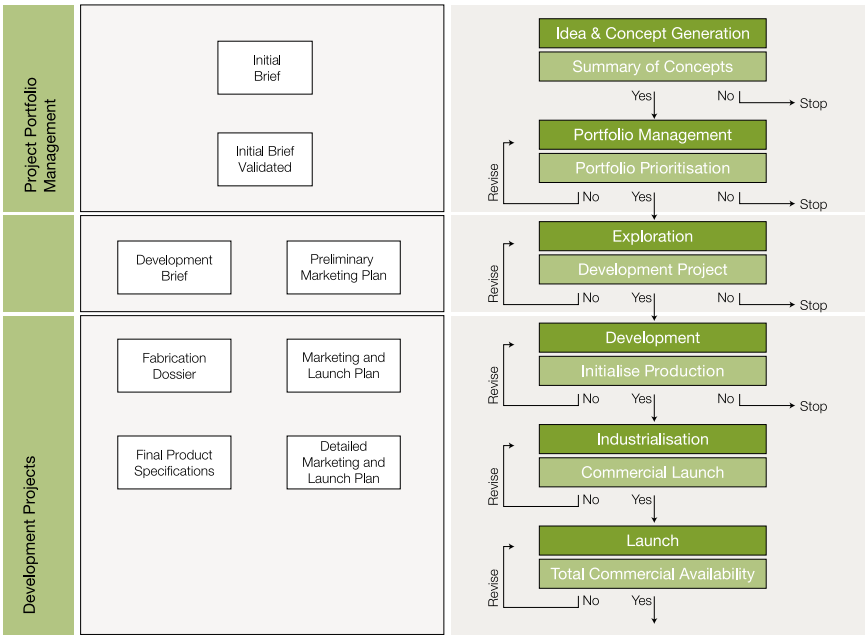


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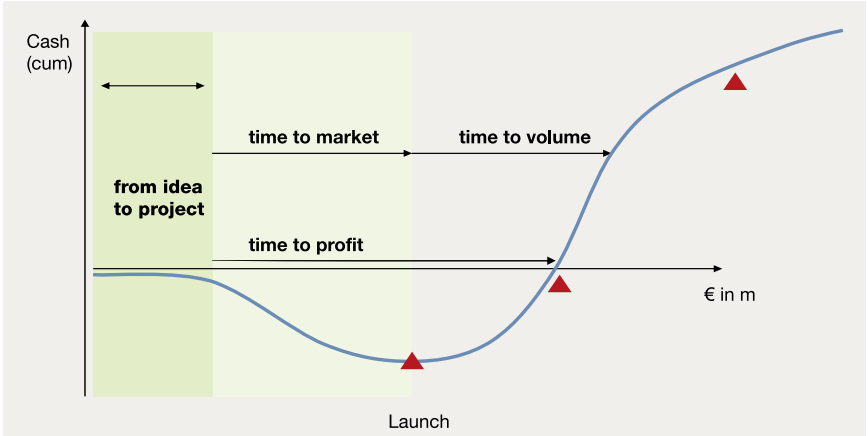
Fig. 2: Shaping the cash curve of innovation



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In this context, H.-J. Bullinger says, "Innovation is not a simple and linear sequence from the invention to the finished product, but a complex interplay between scientific, technical, economic, and social powers".[8]

Call for efficiency and establish it in the organisation

Research and development should not be isolated from the day-to-day business. The question of whether a local or a central organisation principle is the right one is less important than aligning R&D with the requirements of the relevant businesses or markets.

Henkel points out that the close technical co-operation with customers is a key success factor in the innovation management of the industrial business. However, in the consumer goods business it is crucial to know the needs of consumers and translate them into products.

From an organisational perspective, the aim then is to closely dovetail R&D with the market units – in this case, separate R&D for the consumer goods business and the industrial business. The potential disadvantage of staying on the beaten track must be addressed. For example, based on the complexity of the businesses and the respective significance of research and development, satellite organisations can be a sensible organisational principle. Each satellite can correspond to a competence platform.

For the more long-term research, competence platforms may then be organised as research systems. The question of the location only comes to the fore when HR costs are to be considered in addition to the capabilities. For example, India has established itself as a prime location for IT development. Henkel is focusing on China, in particular Shanghai, as the research centre for many of its business units. [9]

Although there are no panaceas, it is recommended that a company link short-term development as closely as possible with the operational business units. Based on the "lead market principle", this may in some cases be a large or fast-growing business region. Furthermore, the question of focus is of central importance. Management has to decide whether to base the organisational orientation on existing brands or technologies, or on categories.

In addition, the potential cross-fertilisation of the categories – the white space – must be considered in the organisational alignment. Lafley commented on Procter & Gamble's expensive acquisition of Gillette, amounting to $57.7 billion, saying, "…this deal will accelerate the growth and development of our company by a decade or two. … They're mechanical engineers, we're chemical engineers. I'm very hopeful that this combination will open new business to us. If you put mechanical and chemical engineers together, they're going to see things that we don't see today, because our view of the world is bounded." Ultimately, the combination of ideas or knowledge is a major driver of innovation.

Because results from innovation processes mainly depend on creative ideas, these ideas or projects should run through a defined process. During this process, methods should be applied that enable the innovation teams to consciously take risks. In this context, it is crucial not to compromise the flexibility and speed (time to market/profit) by applying excessively rigid, industrialised and standardised processes.

One possibility to achieve this is to align the rules of the innovation process with different risk classes. For example, projects with high risks should follow a differentiated stage gate process with seven steps, whereas projects with minor risks would only have to run through three stages. The process can also be accelerated by allowing the innovation team itself to release the stages after documenting the gate criteria.

Even changing the structure of the innovation funnel can have a substantial impact on the efficiency of the innovation management. This is illustrated by the figure below ("Designing the innovation funnel"). In this example, one aim is to capture more ideas in the front end of the funnel. In addition, the right ideas should be translated into projects and marketed faster and in a more focused way.

To measure the innovation success over time, success criteria for innovation as a "production process" must be defined and tracked. The following indicators might be used for the innovation result: number of newly launched products, success rate, return on innovation investment, share of growth to be attributed to

8 FTD 7.12.2006 "Innovation & Wachstum"
9 Henkel annual report 2006

the new product, or even the turnover cannibalisation. In addition, indicators relating to the process and input may serve as efficiency indicators: planned vs. actual time, compliance with defined milestones, stop rate per stage, number of ideas or capital invested.

Open innovation

In this context, opening up refers to a broad innovation approach. Not only customers and suppliers should be involved in innovation processes, but also partners. These partners bring their own ideas or make their contribution at defined points in the product development process.

For example, the employees of a company's own R&D department should tap into external idea potential. This can take place in a structured fashion, by shortening the R&D value chain, or with a large-scale suggestion scheme or idea contest.

Here, outsourcing and insourcing go hand in hand. The ability to co-ordinate partners and ideas and use the appropriate technologies thus becomes a key competence in the company's innovation management. Digitalisation, the Internet and the convergence of technologies (PC, Internet, phone and TV) will be the key enablers.

The Internet offers the possibility to work on open innovations. Examples include the operating system LINUX, some of the Google applications, Apple and Wikipedia. As part of the "Summer of Code" initiative, Google invites students to an open source competition. This contest is designed to motivate students to contribute program codes for open source projects. The targeted takeover of smaller companies with talented founder members is another strategy Google uses to increase the speed of innovation. Often, the purpose behind such acquisitions is to capture knowledge and talents.

Besides these well-known examples, open innovation is mainly about changing the innovation culture. This culture is expected to overcome limits in the company's own thinking and shortages in its own capacity by tapping into distributed knowledge and innovation centres that are not part of the company. In this context, it is less important whether 50 percent or 30 percent of the ideas stem from outside the company. Rather, the focus should be on the innovation source most effectively contributing to achieving the target, after taking into account innovation time, cost and quality.

Ensure market acceptance

Ensuring market acceptance implies dealing with opportunities and risks, while also addressing customer needs – strictly speaking, a matter of course. However, it should be noted that the views and assessments by developers and consumers may vary significantly. This is aggravated by the challenge that consumers have in articulating their needs related to actual innovations. In other words, they often don't know what they want or need until they see it.

However, the more accurately the target group and needs are identified, the higher the success that can be expected. Actively supporting consumers in the various consumption situations becomes the main generator of ideas. For testing, the prototype is of key importance. Consumers and trade partners must be "heard". The consumer can evaluate and provide a response to the

Fig. 3: Designing the innovation funnel

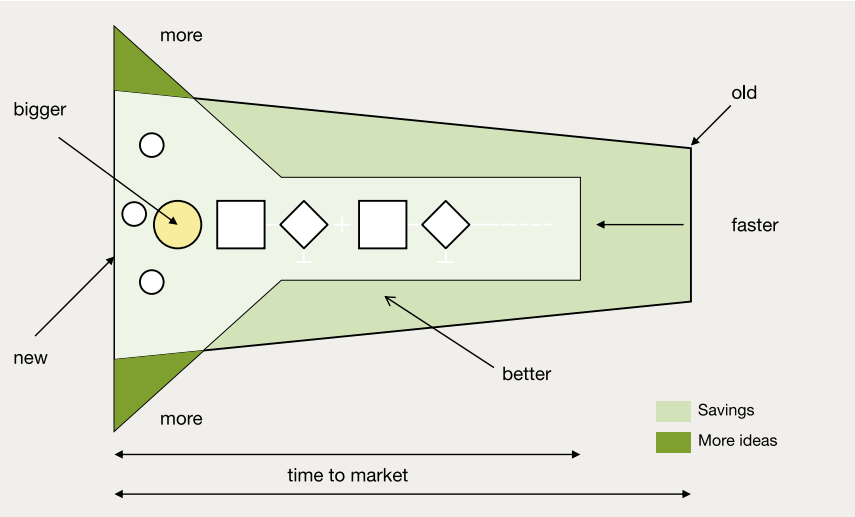

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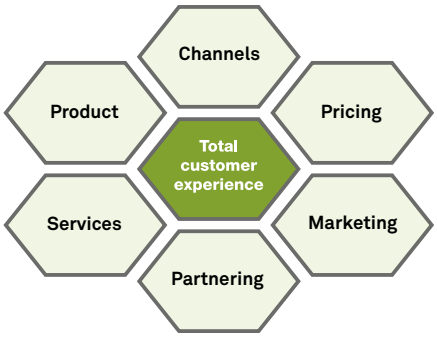
Fig. 4: Total customer experience



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prototype, especially for real innovations where no information on consumer behaviour is available yet.

Besides the prototype, the test market is crucial, as the new product or concept has to take hold at the point of sale. The concept, the "reason why", packaging, customer approach and price point are among the design parameters of the innovation process that ultimately shape the consumer experience.

The first attempt will rarely be the "big hit". Rather, the concept needs to be improved iteratively. In such experimenting or "hothousing" environments, the incremental adjustments can be particularly important for the success of a concept.

Consumers can be even more involved by directly co-designing their products. This does not necessarily include the module-oriented assembly of predefined components (e.g., Dell and Apple), but rather a common value creation. This kind of partnership changes or modifies the industrial business model of mass production and assemble-to-order. Examples include Adidas, where together with a design coach, customers develop a sports shoe that meets their usage and physical needs, or fitness companies that offer an individually developed nutrition and sports plan and nutrition offerings for an overweight person. In these examples, which admittedly do not contradict the existing industry model, several providers then focus on individual customer needs. The front end of the development is thus placed at the interface with the consumers. With their personal circumstances and consumption experience, consumers become the think tank.

Conclusion

To enhance innovation, the ability to partner is critical. Processes, incentive systems, pricing and information architectures need to be adjusted to an open innovation culture. This culture of openness also needs to be established at management level. This includes defining innovation as a strategic priority.

Those involved in innovation need to be treated with patience and tolerance. They should be enabled to take risks. Complying with the rules in the stage gate process provides a structured support for this enablement. Along the lines of U. Lehner, you could add, "Let us take risks and invent the future".

About the author

Dr. Harald Münzberg is responsible for the Consumer Goods Industry and Retail Sector Consulting at Capgemini Germany. His work areas include company transformations, growth, marketing and sales strategies, and complexity reduction programmes, taking into account the productivity-increasing effects of information technology.

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