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CONSUMER GOODS INNOVATORS INDEX

DECONSTRUCTING INNOVATION

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CONSUMER GOODS INNOVATORS INDEX

The consumer goods industry is in a period of rapid change, and innovation from industry newcomers is meaningfully impacting the market share of formerly entrenched industry incumbents. Indeed, our discussions with business executives indicate that many believe their company's main source of revenue growth will come organically from innovating. But how are newcomers innovating today? Can we deconstruct the different forms of innovation? Furthermore, how should incumbents respond?

To answer these questions, Oliver Wyman considered over 86,000 companies to create the Consumer Goods Innovators Index, which comprises consumer goods companies across five sub-vertical areas: apparel and footwear, beauty, food and beverage, home, and other consumer goods. Our methodology evaluated how long a company has been operating, where they are located, what consumer goods sub-vertical industry they are in, and ultimately, how innovative and how disruptive they have been to incumbents. Using this approach, we arrived at our index of leading consumer goods innovators.

Companies that made our index have typically innovated across multiple dimensions. For example, rather than merely creating a new product, the most innovative companies are also seeking to engage with customers in new ways or introducing novel commercial terms, such as subscriptions, rental models, and sharing. Additionally, companies that bubbled to the top tended to introduce innovation that could (and often has) significantly disrupted or fundamentally altered an industry. Finally, many of these companies have a strong social media presence, an indicator of the level of traction they have achieved in the market.

We invite you to explore the full list of companies in the Consumer Goods Innovators Index on Oliver Wyman's website to find out what lessons you can learn from them and how to potentially respond.

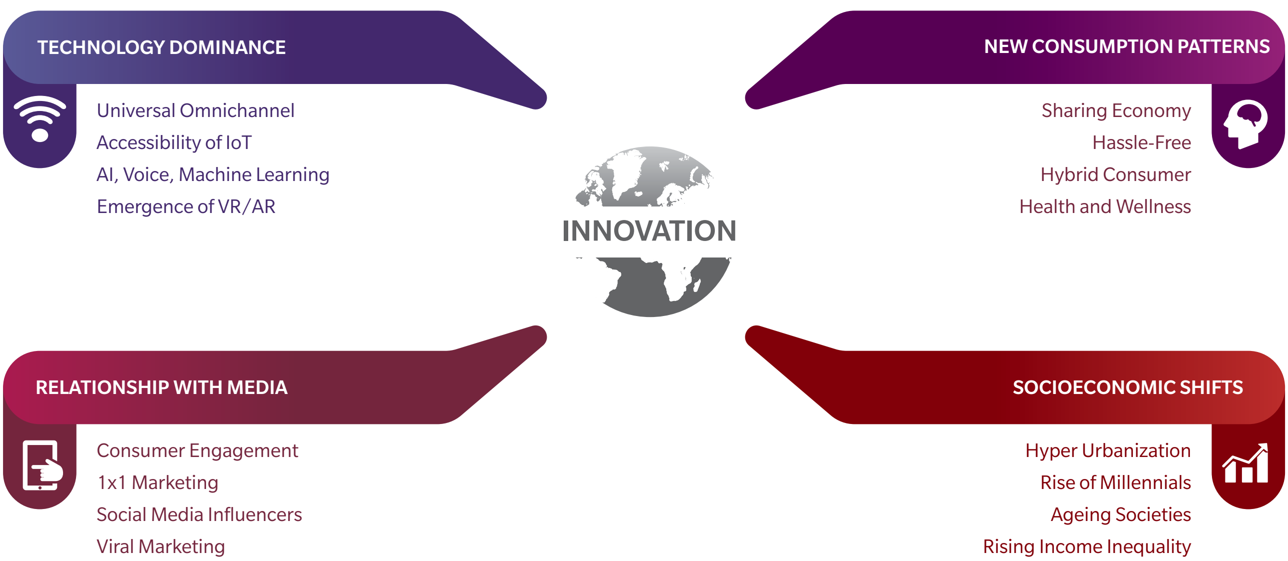
THE CHANGING CONSUMER GOODS LANDSCAPE DRIVING INNOVATION

At the most fundamental level, the way consumers buy goods and services and their perception of what is considered acceptable or valued is very different than only a couple decades ago. From the places where people shop, to how they decide to purchase a product, consumers are changing in a big way.

FOUR GLOBAL MEGATRENDS ARE DRIVING INNOVATION IN CONSUMER GOODS

We believe the pace of change and innovation in consumer goods is rapidly increasing as a result of four megatrends. (See Exhibit 1.)

Exhibit 1: Drivers of Change in Consumer Goods



TECHNOLOGY DOMINANCE

The rapid advancement of technology facilitates new ways for companies to interact directly with consumers. Companies now seek to offer a universal omnichannel experience by taking every opportunity to interact with, learn about, and serve customers. One study found that 85 percent of online shoppers start a purchase on one device and finish on another, showing the importance for companies to connect with customers across various platforms.[1] Consumer goods companies are also leveraging the Internet of Things (IoT), Voice features, and the emergence of virtual reality (VR) to embed intelligence into retail products and experiences. One noticeable feature of Disney's new retail store design is the installation of giant movie-theater-sized screens that will be used to stream daily parades at its theme parks, as well as allow kids to interact with Disney characters.

NEW CONSUMPTION PATTERNS

Consumers themselves are also changing, from what they buy to how they want to buy it. As an example, the sharing economy is expected to reach $335 billion in 2025, more than a twenty-fold increase compared to 2014.[2] Additionally, today's consumers are also more willing to concurrently shop at both ends of the value spectrum. Take for example the recent entrance of Lidl, a hard discounter, into the US grocery market; in our Oliver Wyman survey, we found that an equal share of households with income above $75,000 and those below $25,000 were excited about shopping at Lidl.[3] These "hybrid consumers" are forcing businesses to develop tailored solutions for different customer needs and purchase occasions, including "premiumizing" high-value spaces and developing low-cost solutions to address the commoditization of mid-range offers.

RELATIONSHIP WITH MEDIA

Innovation is also driven by consumers' evolving relationship with media. Low-cost media options are helping new entrants reach a wide, yet targeted, audience more easily than ever before. Over the years, Michelle Phan gained a cult following for her makeup tutorial videos and today enjoys close to nine million subscribers on YouTube. Along the way, she was able to leverage her followers when she co-founded **Ipsy**, an online beauty subscription service that is included in our Consumer Goods Innovators Index. More and more publishers and media companies are now embracing influencers, seeing them as scaled distribution channels, ripe for monetization.

1 OuterBox "Mobile eCommerce Stats in 2017 and the Future"

2 Oliver Wyman analysis

3 Oliver Wyman Perspective "Lidl's Threat to Incumbent Grocers is Real" 2017

CASE STUDY
ONLINE GROCERY DELIVERY

The confluence of these four drivers is enabling more companies to challenge incumbents. Consider the online grocery-delivery business as an example. Today, approximately 25 percent of American households buy groceries online from a number of successful companies.[4] Contrast this with the story of a company that most US consumers no longer remember: Webvan, one of the greatest dot-com failures in history. Webvan was an online grocery business founded in 1996 and employed 3,500 people at its peak, before declaring bankruptcy in 2001. Webvan's catastrophic plummet highlights how factors across all four megatrends have contributed to the proliferation and success of today's grocery delivery services.

To start, Webvan promised to deliver groceries to customers at the same price as if they were to shop in supermarkets. The company was ultimately unable to fulfill this promise in a profitable way. In contrast, today's customers are willing to pay extra for convenience and a hassle-free experience in the form of delivery charges or subscriptions. Webvan's mass-market approach also contributed to an unsustainable pricing strategy. The company tried to market itself as a high-end option with wide selection but at a value price point. In comparison, today's online grocers are more sophisticated with their customer segmentation and data analytics and are able to engage in hyper-targeted marketing. Finally, Webvan had a singular mindset of rapid geographic expansion. By contrast, several of today's grocery delivery services, such as FreshDirect and AmazonFresh, initially focused solely on densely populated areas before considering other geographies.

4 Nielsen and FMI "The Digitally Engaged Food Shopper" 2017

SOCIOECONOMIC SHIFTS

As the demographics of society change, so too do the needs and wants of consumers. Continued migration to urban locations has driven demand for novel ways of product delivery and last-mile logistics for the urban customer. Take, for instance, the mattress company **Casper**, whose mattress-in-a-box model led to a strong following among millennials in urban centers and massively disrupted the mattress business. Indeed, much has been said of the millennials, who continue to defy the consumption patterns of previous generations, with a greater focus on transparency and social good in their decision-making process. Yet while 30 percent of retail sales will come from millennials by 2020, one in five people will be over the age of 65 by 2030.[5] Thus, more and more companies are now creating easy-to-use products targeting the elderly, recognizing the spending power of this segment.

INNOVATION IS CRUCIAL TO CONTINUED SUCCESS IN THE CONSUMER GOODS INDUSTRY

In light of these megatrends driving increased pace of disruption in consumer goods, established companies need to develop a more rigorous and effective approach to innovation. To start, customers expect it. In one study, 84 percent of customers said it was important the company they buy from is innovative.[6] Customers want new, exciting products and experiences and increasingly seek personalization, challenging traditional models of mass production and standardized assortments.

Furthermore, incumbents are losing out. Large consumer packaged-food brands have lost market share to smaller upstart brands in 42 of the top 54 most relevant food categories in a five-year span.[7] We believe companies need to critically better understand innovation and its impact on their business in order to determine how to adapt to the changing consumer goods landscape and stay relevant to their customers.

5 Oliver Wyman analysis and CMO "15 Mind-Blowing Stats About Millennials" July 1, 2016

6 Lab42 "Innovation Survey" 2015

7 Jefferies "Food: The Curse of the Large Brand" 2014

DECONSTRUCTING INNOVATION: THE CONSUMER GOODS INNOVATORS INDEX

Innovation is a broad topic covering multiple dimensions. To deconstruct the impact of innovation on your business and evaluate potential ways to get ahead of innovation, we recommend a three-step process, which involves identifying:

- who the innovators are;
- what they are doing;
- how an incumbent might respond.

WHO ARE THE INNOVATORS?

Incumbent players need to identify and be aware of the innovators who are making an impact in their respective industries. Recognizing that disruptors are sprouting up around you is easy, but identifying the companies that are truly changing the business is far more challenging. To tackle this problem, we developed a methodology to measure innovation. By counting the ways companies are innovating and factoring in significance and traction, we can score companies on their overall innovation impact.

We started by considering more than 86,000 companies. (See Exhibit 2.) We then narrowed our consideration set to retail and consumer goods companies in the US and Canada founded within the past 10 years and refined the list based on product categories and funding levels. Finally, we evaluated how innovative each company has been and how disruptive they have been to incumbents to arrive at our index of leading consumer goods innovators.

Exhibit 2: Consumer Goods Innovators Index Selection Process

Started with more than 86,000 companies

Isolated retail and consumer goods companies in US and Canada founded after 2006

Refined the list of companies based on product categories and funding levels >$2MM

Identified leading innovators based on innovation methods, disruptiveness, and social media impact

WHAT ARE THEY DOING?

Countless companies claim to be innovative, but how can you assess which ones are the most disruptive? Using a structured approach to deconstruct the different forms of innovation into an innovation framework, we identified four primary types of innovation consumer goods companies today are pursuing. (See Exhibit 3.)

Interestingly, although disruption is happening across all sectors in consumer goods, we found that the frequency of adopting each innovation technique varies by industry, highlighting the differences in market opportunity across industries.

PRODUCT, PACKAGING, OR DELIVERY MECHANISM

First, many companies are bringing new products to market and offering new ways to deliver items to customers. Companies in the food and beverage and home-goods sectors are more frequently using this type of innovation. In food and beverage, companies such as **Just**, **Beyond Meat**, and **Califia Farms** are embracing the health and wellness movement and innovating with new products that contain healthy, pure, and non-GMO ingredients. Innovation in the home-goods category is driven by companies such as **Ring**, **Sphero**, and **Hatch Baby**, which are creating “smart” products that integrate with the Internet of Things and create more hassle-free experiences for consumers.

Exhibit 3: Innovation Framework

PRODUCT, PACKAGING, OR DELIVERY MECHANISM

- New product offering
- New product packaging or delivery mechanism

COMMERCIAL TERMS

- Subscription service
- Rental service
- Flexible trial/return policy
- Change in price point vs. incumbents

CONSUMER ENGAGEMENT

- Differentiated target customer segment
- New customer experience
- New use of data analytics

OPERATIONAL PROCESSES

- Efficiency gains/ process streamlining
- CSR commitment

COMMERCIAL TERMS

Innovation also comes through new commercial terms. One way new commercial terms arise is through offering products at a differentiated price point, as in the case of **Warby Parker**, which sells glasses at a lower price point compared to its competitors. Other changes in commercial terms include the introduction of flexible trial-and-return policies and subscription and rental services. Popularized initially by **Birchbox**, a number of beauty companies that now include **Ipsy** and **Function of Beauty** are capitalizing on consumers' appetite for novel products through subscription models that deliver new products on a regular basis. New approaches to commercial terms have also been popularized by companies selling razors (**Dollar Shave Club**, **Harry's**) and renting apparel (**Rent the Runway**).

CONSUMER ENGAGEMENT

Companies are also getting smarter about how they engage with consumers. Some are using machine learning to turn customer data into usable analytics to drive incremental sales. This trend is particularly apparent in the apparel and footwear industry. Not only are companies in the apparel space, such as **Trunk Club** and **LE TOTE**, changing the customer experience by allowing more components of the shopping experience to happen from home, but they are also collecting customer information via style quizzes to personalize and curate items they send to drive conversion.

OPERATIONAL PROCESSES

Companies that spike on operational processes are achieving efficiency gains and incorporating corporate social responsibility into their business model. Consider Betabrand as example. Rather than holding inventory and hoping its product sells, **Betabrand** receives customer commitments prior to even prototyping its products. Thus, its operating model ensures that the company is not producing items that will not sell and turns the typical startup working capital challenge on its head.

OUR RECOMMENDATIONS TO INDUSTRY INCUMBENTS

Given all of this information, incumbents must carefully choose a course of action. Consider how Blockbuster failed to recognize the value of the online revolution and passed on the opportunity to buy Netflix for $50 million back in 2000. We all know the fate of Blockbuster, and Netflix is now worth $70 billion.[8]

The ideal approach for most incumbents is to be proactive about innovation and avoid a circumstance where an innovative competitor has disrupted your market position. To do this, start by performing rigorous customer analysis to identify the product, service, or operating model features that really matter to your customers. Through market research and consumer insights, you will be able to better understand what your customers want and the risk new innovators could pose to your business in a particular customer segment or geography. Lunchables is a strong example of an incumbent embracing the power of market research: Oscar Mayer conducted focus groups with parents and recognized a market need for quick school lunches, which turned into a billion dollar business.[9] Today, meal kits like **Blue Apron** and **Habit** are recognizing a similar opportunity to respond to customer needs with easy, prepared, custom meals.

Incumbents can also leverage their suppliers to support their innovation process. As more companies trend towards open innovation, it is key for incumbents to establish collaborative relationships with their suppliers. For example, consider a company like Procter & Gamble, which has placed high value on open innovation through its Connect+Develop program. This led to innovations such as Febreeze or the Swiffer Duster, which are now US household names.

Incumbents must also be prepared to respond quickly to external innovators, who may impact their business. The first step is to closely monitor sales data at the segment level so that any disruption is noticed immediately. Incumbents must remain vigilant and flexible in responding to the innovator. Evaluating your own business and understanding how disruptors in your market are innovating needs to be an active and continuous process to help determine the best path forward.

8 CNN "Netflix is no house of cards: It's now worth $70 billion" May 30, 2017

9 Ad Age "Lunchables Targets Lucrative Teen Market" May 19, 2014

To remain nimble, incumbents can benefit by adopting an agile approach. Many established companies are hierarchical, complex, and steeped in embedded cultures. Agile companies enjoy shorter decision cycles, quicker responses to operational requirements and strategic opportunities, and the use of interdisciplinary teams. Agile organizations are adaptable and resilient, adopting a "fail fast" mindset, and are ready to course correct when things go wrong. Adopting an agile approach increases the ability of an organization to innovate and adapt the business.[10]

When a reactive response to disruption is needed, incumbents have four options from which to choose. (See Exhibit 4.)

WAIT AND SEE

If the disruptors in your industry are not meaningfully changing the way consumers engage with or buy a certain product or service, or are only targeting a small addressable market, you might determine that the best course of action for now is to monitor the situation and conserve resources. Still, if you choose this approach, you should remain open to changing your response. Consider **Ollie**, a subscription service that sells human-grade pet food prepared and portioned according to each dog's weight, breed, age, and activity level. Although Petco and PetSmart, the two largest pet supply stores, are undoubtedly aware of Ollie given its traction and buzz, the incumbents have not yet announced any intention of selling customized pet foods. Perhaps they have concluded that such a product does not cater to their core demographic. In our view, a "wait and see" approach may be perfectly sensible if the approach is agreed upon through analysis and rigor, rather than inertia.

Exhibit 4: Reactive Responses to Disruptors

10 Oliver Wyman Perspective "Scaled Agility" 2017

BUY HAPPINESS

Another option is to make acquisitions to diversify and expand your innovation capabilities. Acquisitions tend to be the most expensive but quickest path to growth. This approach requires upfront capital and possibly a longer-term integration effort or a more complicated management structure. Nevertheless, this approach has delivered impressive results for some companies. Consider **Dollar Shave Club**, a subscription service that delivers razors and personal grooming products. The company built a powerful brand and amassed more than three million members before Unilever acquired it in 2016 for $1 billion. Unilever's leadership recognized that Dollar Shave Club had become a category leader in the direct-to-consumer space. The acquisition was thus a bid to allow Unilever to immediately compete with its rival Procter & Gamble, which owns Gillette, an entrenched razor brand.

ANYTHING YOU CAN DO, I CAN DO BETTER

Another corporate development option is to copy the innovator and build internally. Sometimes the easiest response is to copy the competitor's offering, opening the opportunity to improve on the innovation. The first step here is to assess whether your company possesses the internal capabilities to develop the innovation yourself. Although it took several years, Sephora finally responded to **Birchbox** by launching its own subscription service – Sephora Play – at the same price point as Birchbox, and the market took notice. And the seven percent dip in Birchbox subscribers over the past 12 months can be attributed to the introduction of Sephora Play, along with **Ipsy**.

IF YOU CAN'T BEAT 'EM...

A final option is to partner with the disruptor in a mutually beneficial manner. This is a lower-risk option, as you can explore an idea without investing significant capital. If the partnership works well, you can always revisit the options of acquisition or building internally to make a larger commitment. Consider the partnership that **Rent the Runway** announced with Neiman Marcus in 2016, which resulted in Rent the Runway opening a store-within-a-store at Neiman Marcus' San Francisco location, with additional store-within-a-store announcements planned. For Neiman Marcus, the partnership is a move to attract millennials and shoppers who may have never entered one of their stores before. Meanwhile, the deal provides Rent the Runway with an increasing brick-and-mortar presence and access to an older, wealthy customer base.

WHAT DOES IT ALL MEAN, AND WHAT SHOULD YOU DO ABOUT IT?

"We didn't do anything wrong, but somehow, we lost."

Stephen Elop, former Nokia CEO (following Microsoft acquisition)

The pace of change and innovation in the consumer goods sector is rapidly increasing, driven by technological advances, new consumption patterns, a changing relationship with media, and socioeconomic shifts. Companies that do not keep up with the evolving environment are already losing and will continue to lose market share to new disruptors capitalizing on these trends.

In our discussions with industry incumbents, executives frequently acknowledge the degree to which innovation is impacting their respective industry and competitive positioning. However, it is important to take a step back to analyze the range of innovations happening in their industry and to find a fact-based path forward. Our experience suggests that a deep and structured review of the innovation happening all around you can help inform the optimal course for your organization.

After identifying the specific disruptors and deconstructing the type of innovation that is helping them be successful, you must carefully choose how to respond. Your decision will depend on several factors, including the industry that you are in, your product categories, and your financial resources. But regardless, the first step should be a careful assessment of the innovators in your ecosystem, their current and potential impact on your business, and a thoughtful evaluation of what strategy you might elect to pursue in the face of this disruption.

ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation.

In the Retail & Consumer Goods Practice, we draw on unrivalled customer and strategic insight and state-of-the-art analytical techniques to deliver better results for our clients. We understand what it takes to win in retail: an obsession with serving the customer, constant dedication to better execution, and a relentless drive to improve capabilities. We believe our hands-on approach to making change happen is truly unique – and over the last 20 years, we've built our business by helping retailers build theirs.

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