

The Innovation Death Spiral

How Companies Get Stuck Throwing Good Money After Bad Ideas—and What that Mistake Is Costing Them

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Far too many companies are now finding themselves trapped in a phenomenon we will refer to as the "innovation death spiral." The spiral begins when a company's new products, developed and launched with high hopes, end up yielding only disappointing results. Nonetheless, once those products are out in the field, they soak up valuable resources, including manufacturing and purchasing capacity, marketing budgets, warehouse space, back office systems and management attention. So the company has fewer resources to invest in other initiatives that may prove more successful, including the bold, truly game-changing innovations that alone can provide sustainable competitive advantage and fuel profitable growth. As a result, the company is constrained to limit its investments to "safer," merely incremental extensions of existing products and services, which again prove disappointing and absorb undue resources, accelerating

the downward spiral. Moreover, once the company is perceived as less than innovative, it suffers both strategically and operationally. For companies caught in this spiral, increasing innovation budgets only make things worse by putting more non-differentiating products out into the market.

Meanwhile, in contrast, companies that take a bolder, more balanced, and more far-sighted approach to innovation are on the opposite trajectory: becoming a high-performing organization. They trace a virtuous cycle in which a balanced portfolio of successful innovations—including incremental, platform, and sometimes breakthrough innovations—reinforces customer loyalty; wins new buyers; grows the market; attracts valuable suppliers, partners, investors, and employees; and generates lots of cash, which the company can then invest in even more

exciting innovation. It is now clear that the gap between these two kinds of companies—the 'innovation challenged' and the 'innovation savvy'—is inexorably widening.

For companies in the first category to break out of the innovation death spiral, it is essential to understand very clearly what is going on, and then to make critical interventions and radical changes in the way the company operates.

Here, we first set the stage by defining the three main kinds of innovation, then lay out the characteristics of the innovation death spiral, how companies get trapped in it, and the approach they need to make to transition to the upward spiral.

Exhibit 1

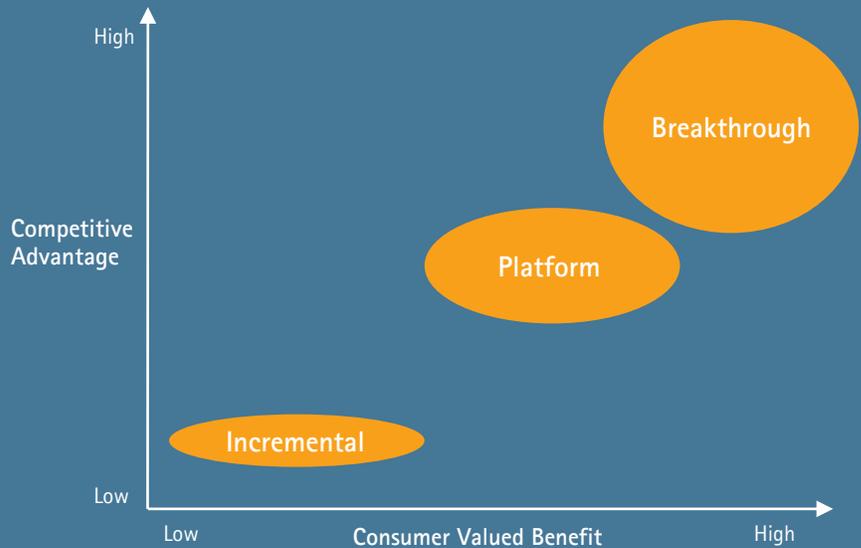
The Three Principal Kinds of Innovation

Accenture distinguishes among three main types of innovation: incremental, platform, and breakthrough (see Figure 1). Innovations in these three categories deliver different benefits in terms of consumer value and competitive advantage. Ideally, companies should maintain balanced portfolios that contain, at a minimum, both incremental and platform innovations. The pursuit of breakthrough innovations requires acquiring or developing breakthrough-specific capabilities and therefore requires a significant strategic decision and commitment.

Incremental Innovation

These are “running to stand still” innovations. Because they do not offer customers superior benefits, they don’t create additional demand for the company’s products. Nonetheless, incremental innovation plays a necessary role in defending the company’s baseline against competition; it can be seen as a form of maintenance, more renovation than innovation. Many consumer goods companies spend over half their innovation budgets on incremental innovations, generally because they lack the ability to systematically scan the market for the most attractive opportunities and develop winning ideas to capitalize on them.

Figure 1. Competitive innovation matrix



Size represents market impact

Platform Innovation

These are “share of market” innovations. By delivering superior customer benefits, they drive some market growth, often in terms of heightened value thanks to premium pricing rather than in terms of expanded volume. But their main function is to grow the innovator’s market share by giving customers a reason to switch from a competitor brand. Companies that create platform innovations must be sure to secure sustainable competitive advantage through brand, technology, customer lock-in, etc. Examples of platform innovations are Vanish and Coke Zero, both of which drove some market growth but primarily increased their innovators’ share of market.

Breakthrough Innovation

These are market-changing innovations. By delivering new benefits to customers, they create a new market that the innovator can dominate for some time. A common misunderstanding is that breakthrough innovations are necessarily large technological inventions. In fact, breakthrough innovations often use existing technology in novel business models. Innovators need to establish firm protection for their large investments in this type of innovation. A successful breakthrough innovation is of course Apple’s iPad. An example of a breakthrough innovation that was not adequately patented is Senseo coffee pads by Sara Lee, where competitors were quickly able to start selling cheaper pods, undercutting Sara Lee’s potential market.



Understanding the Innovation Death Spiral

Innovation is all about allocating scarce resources to projects of which the outcome is uncertain. In deciding which projects to invest in, companies must assess not only actual out-of-pocket costs but opportunity costs.

In our experience, companies tend to be reasonably familiar with the need to address market opportunity costs and technological opportunity costs. But they tend to systematically ignore the strategic, operational, and systemic opportunity costs associated with the innovation spiral, and therefore to overvalue their merely incremental—and apparently safer—innovation development projects. Yet the innovation spiral engenders very real costs that these companies will surely incur by failing to invest in platform and breakthrough innovation.

The innovation spiral consists of two types of negative spirals: strategic and operational. These spirals are interrelated and reinforce each other; companies that are trapped in one are likely to be caught in the other as well. Both are exacerbated by the systemic negative effects of ineffective innovation.

The Strategic Negative Spiral

Unsuccessful innovation not only cuts into profitable growth but also affects market positioning. For instance, companies that have relatively undifferentiated products are forced to play a cost game and are prone to lose market share to private labels, or even have to produce private-label

versions of their products. This results in further reductions in R&D budgets and again less product differentiation. The descent along the spiral begins.

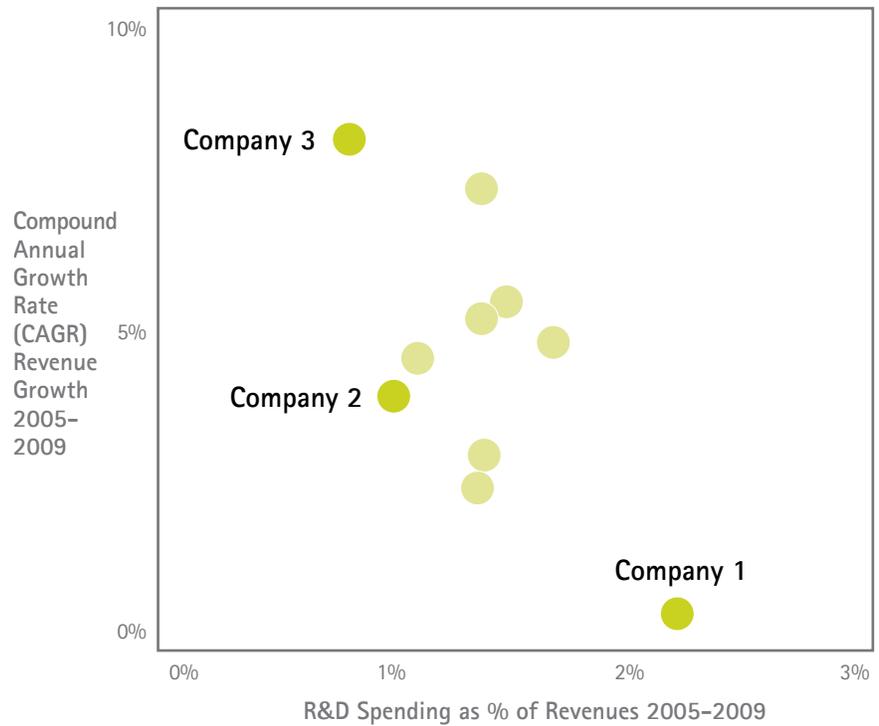
Similarly, less-innovative companies find themselves in a weak position toward potential partners and suppliers. For example, in the automotive industry several years ago, when U.S. automotive manufacturers were in decline, their ability to attract top-notch suppliers and partners was fairly limited. In contrast, Toyota and Honda were able to attract strong partners, which played an important role in helping them build their capabilities—in Toyota's case, to develop hybrid vehicles.

Financially, companies simply do not generate the growth premiums with incremental innovations that they do with platform or breakthrough innovations. In many industries, it is possible to identify the value premiums that innovative companies earn in their stock prices, relative to companies that are not innovative. The delta between the two is the opportunity cost that the latter are paying.

A recent Accenture analysis of ten large players in the global foods industry over a three-year period—2005 through year-end 2009—provides evidence of the strategic costs of failure to innovate successfully. Notably, the study found that there is little correlation between R&D spending and revenue growth (see figure 2). Although Company 2 and 3 invested the lowest percentage of their revenues in R&D compared to the peer group, they achieved good revenue growth. In contrast, Company 1 spent a relatively large percentage of its revenues on R&D but was unable to convert this into organic revenue growth.

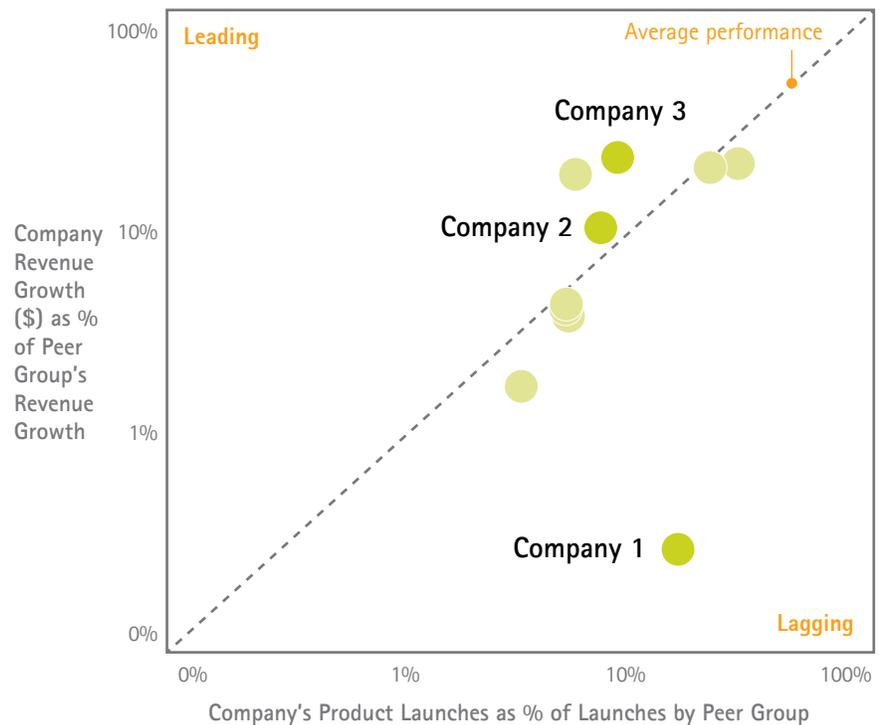
When we plot revenue growth against the number of product launches, it becomes evident that while Company 1 launches more products than Company 2 and 3, these are clearly not contributing to organic revenue growth (see Figure 3). Company 1 launches primarily incremental innovations, whereas Company 2 and 3 launch a balanced portfolio of incremental, platform and breakthrough innovations that are perceived by the market as adding value.

Figure 2. R&D spending vs. organic revenue growth (2005 through 2009)



Source: Accenture Innovation Performance Monitor – Foods & Non-Alcoholic Beverages Industry 2010

Figure 3. Organic revenue growth vs. number of product launches (2007 through 2009)



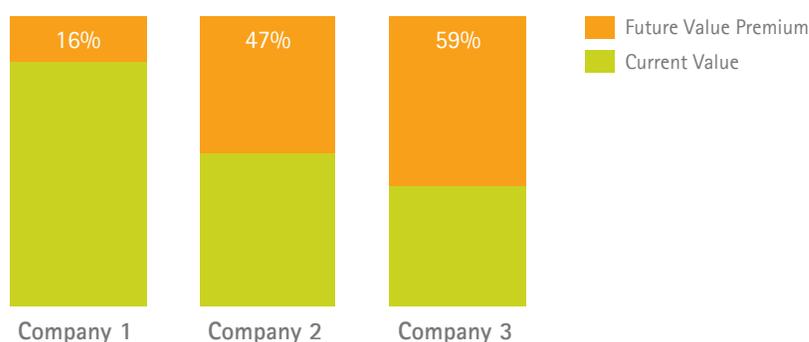
Source: Accenture Innovation Performance Monitor – Foods & Non-Alcoholic Beverages Industry 2010

Successful product innovation can also contribute to future value premiums¹. Performance innovation leads to higher-than-market organic growth that is profitable and capital efficient. Shareholders are willing to pay a premium on the share prices of companies that consistently achieve this kind of growth, because they expect those companies to continue to outperform the market in the future. Our study reveals that Company 2 and 3 earned future value premiums that far outstripped that of Company 1, demonstrating the market's confidence that they will continue to grow their revenues through innovation (see Figure 4).

The Operational Negative Spiral

Once a company has launched a new generation of offerings into the market, those offerings immediately place demands on the company's value chain, from the sourcing team and the operational support groups (e.g., finance and human resources) through manufacturing, sales, distribution, service, and reverse logistics. Whether they turn out to be successful launches or complete failures, new offerings place equal burdens on a company's operational resources. We have seen innumerable companies struggle with the multiple impacts of launching too many offerings, including increased costs, longer-than-projected lead times, and dissatisfied customers. And yet, 44 percent of the respondents to a recent Accenture study reported that their companies gave limited or no consideration to the costs associated with new product introductions or with continuing to produce loss leaders.² The net result is a perpetuation of the spiral, with new offerings grabbing resources and old offerings holding their position in the portfolio.

Figure 4. Future value premiums



Source: Accenture Shareholder Value Analysis 2010

Further amplifying the impact of failed innovation on operations is the inability of many organizations to quickly manage themselves out of failure. Companies invest a great deal in launching new products into the market, but rarely give the same consideration to taking them out of the market. Instead, they allow non-value-generating offerings to persist in consuming valuable resources and organizational attention, while diluting the company's margins and market position. This failure to manage out unsuccessful innovations exacerbates the downward spiral by limiting the amount of capacity the organization has to test and add new innovative offerings, while continuing to maintain a bloated portfolio.

For companies to mitigate the effects of the innovation death spiral and begin to reverse its direction, they need to consider the operational impact of new and innovative offerings on the entire value chain as they are launched. This means assessing both the real cost of their introduction and the quickest and most efficient path for removing them from the market if necessary. Companies also need to have a clear process for actively managing their portfolios of offerings, to make sure they create enough head room to allow for new launches and enough clarity to prevent blind proliferation.

Systemic Negative Impacts

Also contributing to the innovation death spiral are some significant negative impacts on the company as a whole. These include a large human resources cost: the less innovative a company is, the less attractive it is to first-rate employees and innovators. So the company can no longer hire or retain the top-notch people who are excited by innovation and good at it. Moreover, the lackluster performance of the company's new products affects the company's reward structure, increasing the difficulty of attracting great people and thus accelerating the downward spiral.

Perhaps the most profound impact of inadequate innovation is the shift in the company's culture. A company that has made only incremental changes in its products for a number of years will have diluted its development resources, marketing spending, and other operational aspects of the firm so thoroughly that incremental change is the only thing it can do. In effect, such a company will have fallen into the innovation death spiral. This dysfunctional vicious cycle will affect all the company's functions—strategic, financial, operational, and organizational—and will in turn be driven by them, as described above.

When a company finds itself caught in this downward spiral, its only hope is to break out by adopting a fundamental commitment to groundbreaking innovation. The Anglo-Dutch company Unilever provides an excellent example of a company that has done just that.

Exhibit 2

Managing Out of the Death Spiral: the Unilever Example

Over the past five years, Unilever, which produces and sells such established global brands as Lipton, Heartbrand (Magnum), Knorr, Dove, Cif, and Axe, has successfully transformed its business by simplifying its organization and focusing on its core brands and products. This transformation has affected every aspect of Unilever's business, including its R&D organization.

In 2000 Unilever launched its "Path to Growth" program, which was designed to focus on rationalizing its portfolio. However, that program fell short of delivering the required 5-6 percent top-line growth rate. The company was spending a large share of its revenues on R&D and generating an enormous number of product launches. But because its portfolio still contained so many brands, its R&D program focused primarily on incremental innovation and line extensions, and marketing efforts fell short. While there were some successes, overall revenues weren't growing as expected. Increased investments in R&D just generated more and more non-value-adding incremental innovations. Unilever found itself stuck in the negative spiral described in this document, in danger of losing ground in an increasingly competitive industry. In 2004 Unilever had to issue its first profit warning in its 75-year history.

To address this situation, Unilever CEO Patrick Cescau launched the "One Unilever" program to simplify the company's organization, leverage its scale, and deliver growth. This program's objective was to liberate the company for growth by creating a more interconnected and flexible organization—while also achieving cost savings.

As part of the One Unilever program, the separate Foods R&D and HPC (Household & Personal Care) R&D organizations were consolidated into the global One Unilever R&D organization. The company also expanded its R&D activities in Asia to profit from local knowledge and expertise and to ensure the relevancy of its innovations to emerging markets. Importantly, to emphasize the importance of R&D to the company's future, Unilever created the new position of Chief R&D Officer.

The One Unilever program streamlined the company for speed and competitiveness to ready it for the next phase in its transformation: the journey back to growth. Paul Polman, who took over the CEO position in 2008, launched this phase with a relentless focus on demand-led growth in sales and growth of market share, as well as hands-on involvement in the major operating companies. Under his leadership the company has been focusing on fewer, bigger innovation projects, including some long-term, big-win 'Genesis' projects³. Moreover, the company's top 25 innovations will all be launched in all of its 40 largest markets, compared to an average of 3 markets per innovation in the past.

In 2010 Unilever found itself better positioned than ever before: revenues rose 10 percent (see Figure 6) and volume grew faster than it had in 30 years. The company also performed relatively well through the recent economic downturn, despite rising commodities costs and mounting pressure on prices. The number of category innovation projects shrank from more than 5,000 in 2005 to 700 in 2009 while average project size increased by 10⁴, and the first Genesis projects are expected to hit the market in 2011⁵. All this good news is not yet reflected in the Future Value Premium (see Figure 7), as this usually happens only when a company shows strong results over a longer period.

Unilever has recently made an ambitious commitment to growing as a truly sustainable business, as articulated in its Compass Strategy and Sustainable Living Plan. A large portion of the planned growth will come from emerging markets. Unilever has a flying start there, as it has a very strong position and knows how to win in emerging markets, thanks to one of its most successful subsidiaries, Hindustan Unilever, which has successfully tapped into India's emerging middle class for more than a decade. Unilever's learning from that experience has proven a key success factor for growth and will likely be a driver of expansion in emerging markets.

2011 is an important year for Unilever as it may confirm that Unilever has succeeded in turning around and is moving onto the upward spiral of successful innovation.

Figure 6. Unilever revenues and revenue growth



Source: Unilever annual reports

Figure 7. Unilever future value premium and current value



Source: Accenture Shareholder Value Analysis



The Path Out of the Innovation Spiral into Successful Innovation

As the Unilever example illustrates, strong leadership is essential in creating and driving a successful innovation program. Once the company's leaders have communicated the overall strategy and the role of innovation within that strategy, they need to ensure that the organization focuses on Doing the Right Things and Doing Things Right, and they also need to continuously monitor performance.

Essentially, the process consists of six steps:

1. Define top-level ownership of innovation and clear accountabilities
2. Create an innovation strategy aligned with corporate strategy
3. Identify white spaces and must-win battles (Doing the Right Things)
4. Reduce time to market (Doing Things Right)
5. Increase innovation efficiency (Doing Things Right)
6. Continuously measure and improve innovation performance

Doing the Right Things

We are certainly not advocating that companies jettison all incremental change. Nor do we suggest that any company should focus its entire innovation portfolio on a handful of high-risk, high-gain, "big bet" projects. Companies should strive for a portfolio that is balanced not only in terms of risk and reward, but also in terms of incremental and platform innovations, together with breakthrough innovations as desired. Toward that end, they need to develop the capabilities to identify the white spaces they should play in—those market areas in which they expect growth and in which they want to compete and can win. They also need the capabilities to identify winning propositions in those areas. And they need the vision to use innovation effectively as a driver of top-line growth.

Doing Things Right

Companies need to create an institutionalized innovation capability that is fast, disciplined, and reliable. The challenge for companies that are in the innovation death spiral, and those that are approaching it, is to move from a position of constrained resources, in which they must attempt to mitigate the inherent uncertainties of innovation by doing as little of it as possible, to a position of bold, foresighted commitment to effective innovation. Only by mobilizing all their resources through an effective innovation engine can they embrace those uncertainties, manage them, and turn them to their advantage.



Toward that end, strong, focused leadership is absolutely critical. Specifically, the role of the CEO with respect to innovation is ever more important and needs to evolve from communicating vision and setting direction to enabling and driving execution.

But the CEO cannot do that alone. For innovation to become part of the organizational fabric, it must be managed with as much discipline as every other aspect of the business. A survey conducted by the Economist Intelligence Unit on behalf of Accenture revealed that organizations that have established a single point of accountability for innovation reported innovation performance and capabilities that are twice as high as those of their peers.⁶

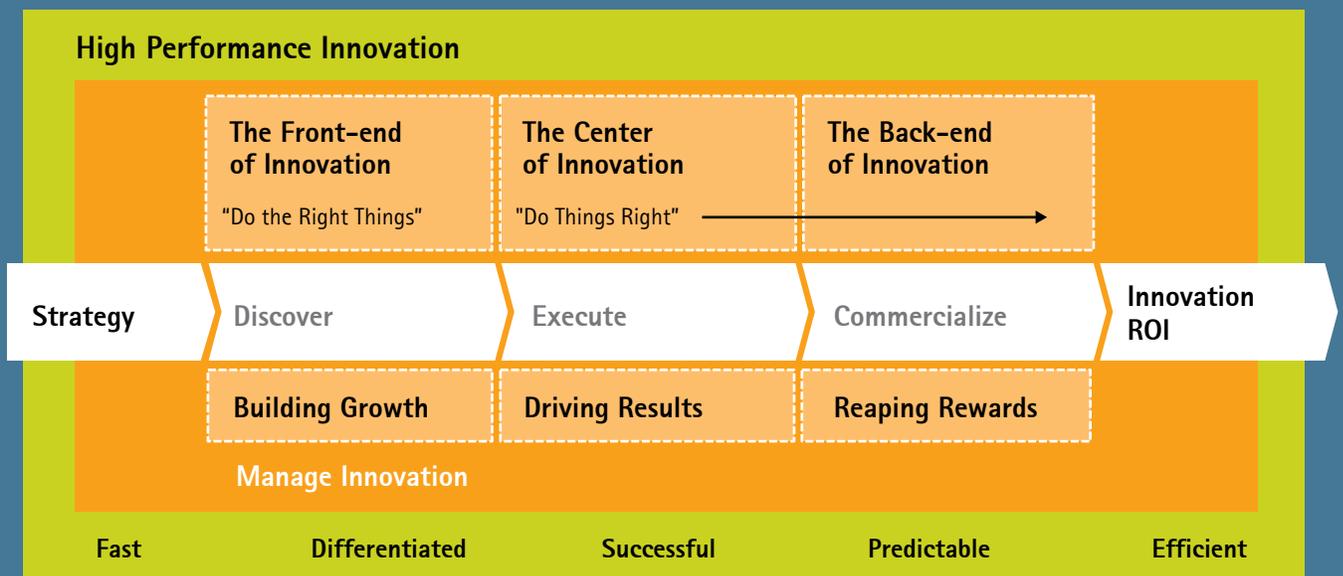
Exhibit 3

The Accenture Innovation Process

Accenture developed the Performance Innovation Engine, which is unique to the extent that it covers the end-to-end innovation chain and addresses frequency, speed, and consistency of innovation results. Figure 8 shows Accenture's Innovation Engine, with the three main phases Discover, Execute and Commercialize. Discover

helps a company invest in the most promising mix of projects. Execute helps to drive an idea or briefing to market launch at speed, with efficiency and meeting the requirements of the briefing. Commercialize maximizes the market coverage of the innovation post launch, and aims to drive up margin and generate new innovation to sustain the competitive advantage over time.

Figure 8. Accenture's Performance Innovation Engine



Conclusion

Many companies are skewing their innovation portfolios toward the low risk, merely incremental end of the scale with their existing mature market spaces, rather than aiming for truly transformational, game-changing innovation in their growth spaces. As a result, they incur strategic, operational, and systemic impacts that they may not be aware of until they have entered the innovation death spiral.

Companies can emerge from that spiral only by radically transforming their organization. We have seen that Unilever is currently experiencing this transformation, and we are eager to see what impact this will have on its competitive position in 2011 and beyond. The path out of the negative spiral is one where leadership drives innovation by setting a clear direction, where "white spaces" and "must win" battles are defined, and where innovation is institutionalized as a fast, disciplined and reliable capability. Such a transformation program will not come easy, and requires significant effort, investment and a change in mindset throughout the entire organization. However it is the only way a company can get back on track to sustainable value-creation and profitable growth through innovation.



About the authors

Wouter Koetzier is the global lead for Innovation in Accenture Process and Innovation Performance.

wouter.koetzier@accenture.com

Soren Kristensen is the managing director for Innovation in North America for Accenture Process and Innovation Performance.

soren.kristensen@accenture.com

Adi Alon is a senior executive in Accenture Process and Innovation Performance.

adi.alon@accenture.com

End notes

1 A future value premium is defined as the value the market believes a company will generate from its investments in its future. It is calculated by deducting the present value of current operations (NOPLAT divided by WACC) from the total enterprise value (market capitalization plus net debt).

2 "Managing the Challenge of Product Proliferation," The Economist Intelligence Unit (2007). Managing the challenge of product proliferation is a survey and executive summary created by The Economist Intelligence Unit and sponsored by the George Group, now part of Accenture.

3 "Unilever R&D Chief Seeks a Swiffer Repeat for Polman," Bloomberg (November 16th, 2009).

4 "Q2 and First Half 2009 Results Roadshow," Unilever (2009).

5 "Unilever May Post Fastest Annual Sales Growth of Polman's Reign," Bloomberg Businessweek (February 1st, 2011).

6 For a more complete discussion of the role of the Chief Innovation Officer, see Accenture's report: *Overcoming Barriers to Innovation: Emerging Role of the Chief Innovation Executive*.

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About Accenture

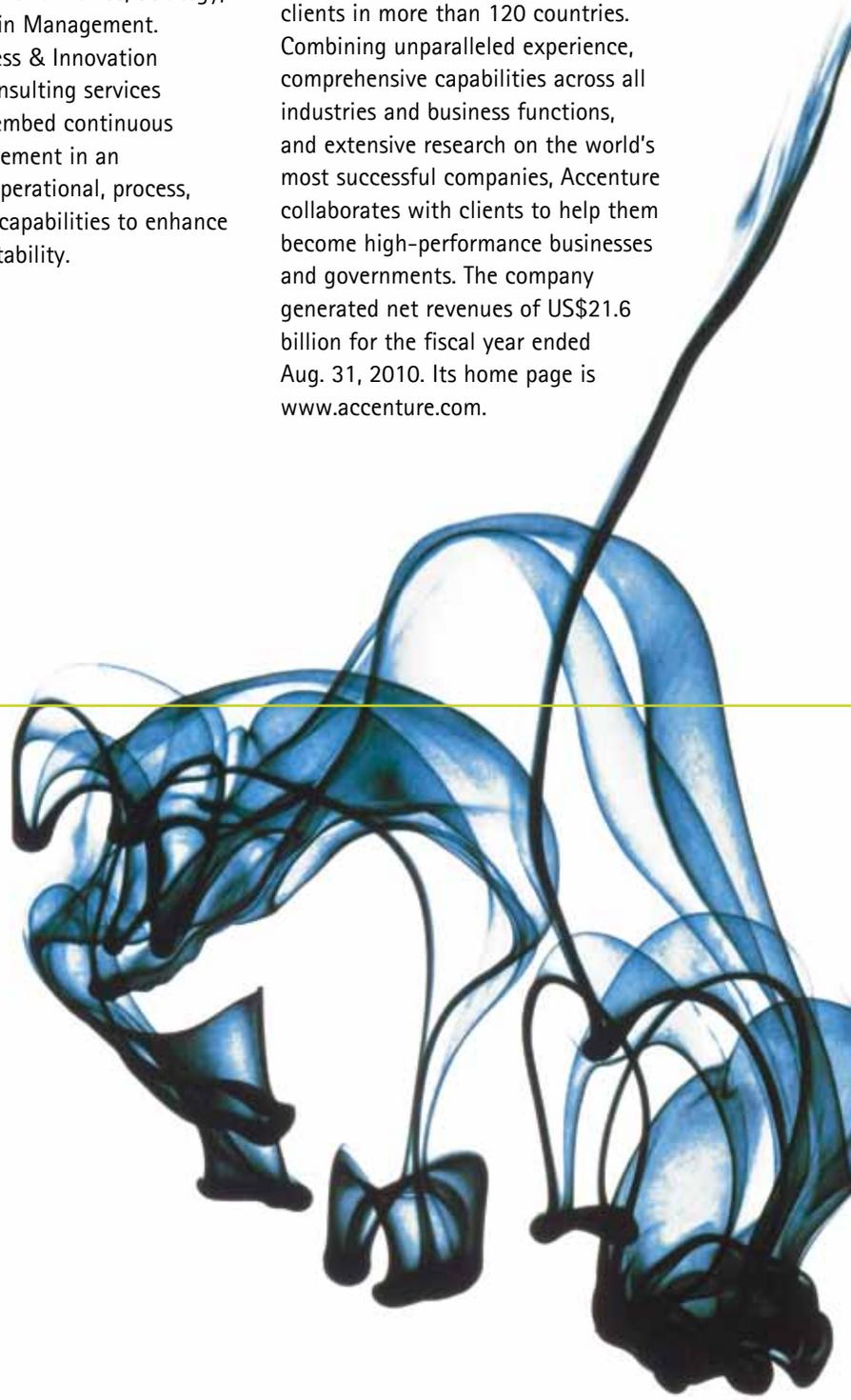
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