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Finding New Growth in Tough Consumer Markets

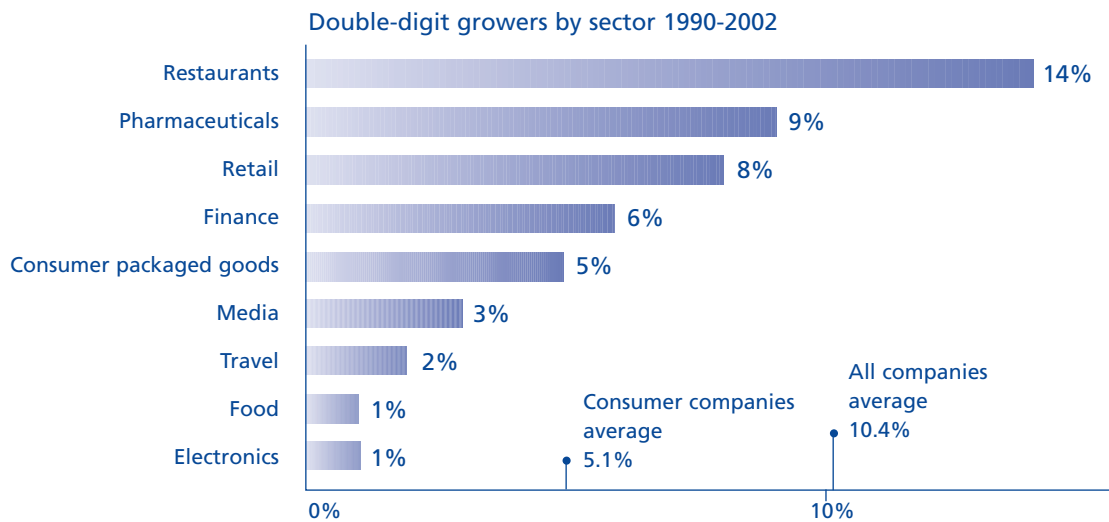
An array of moves address consumers' higher-order needs

By Ana Dutra, James Frary, and Rick Wise

In a world of product and brand proliferation, consumer companies face bleak prospects for sustained revenue growth. But a few firms such as Kraft, Procter & Gamble, and Netflix are creating new growth by using their product position as a starting point from which to create solutions that address the issues and hassles that surround the product.

For most of the past decade, even during the long economic expansion, it has been tough to find growth in consumer markets. With a few exceptions, consumer sectors such as packaged goods, media, travel, food, and electronics had relatively poor revenue growth, producing consistent double-digit growth at just half the rate of U.S. industry overall (Exhibit 1).

Exhibit 1 Tough consumer markets



Note: Of the 3,252 publicly traded companies analyzed, double-digit growers are defined as companies with at least eight years of double-digit sales growth. Source: Compustat data, Mercer analysis

Double-digit growth, the investor's ideal, has become difficult to achieve for several reasons. The proliferation of new brands and products has made operations more complex and expensive. Even a company's own brand and product extensions—think of Diet Cherry Coke or Gillette's Venus razor for women—may lead the company into ever-smaller market niches while cannibalizing core brands, introducing higher distribution costs, and creating additional complexity in terms of consumer choices.

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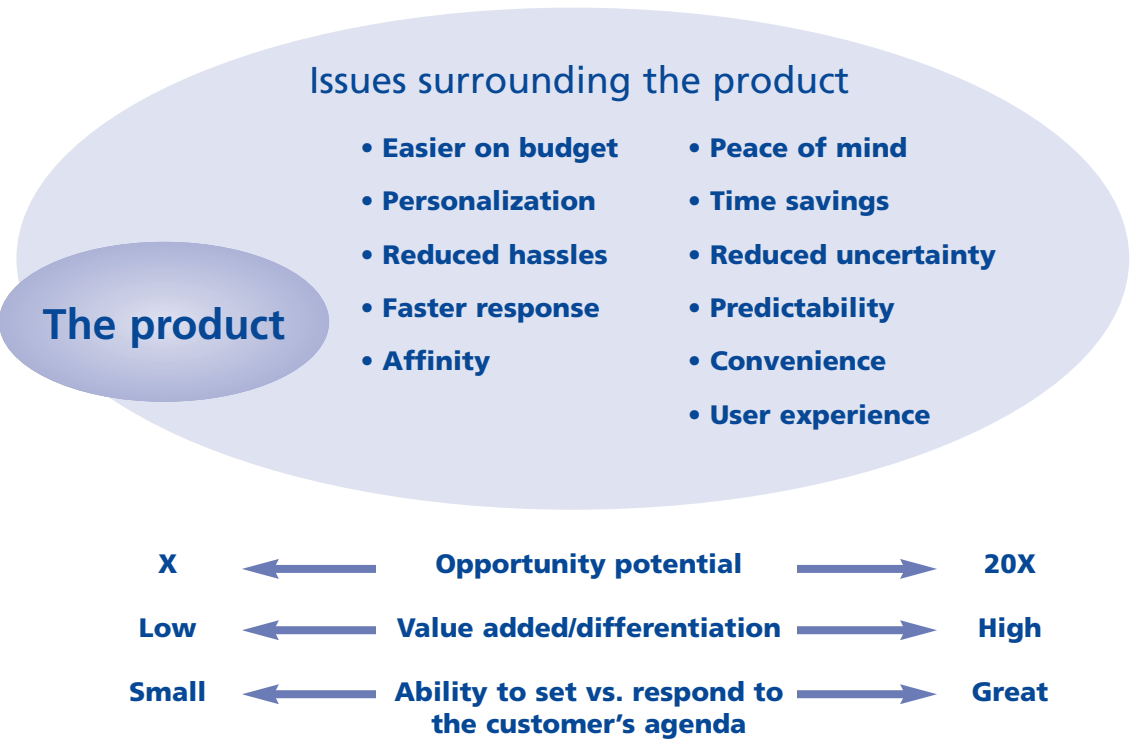
Externally, consolidation among retailers, especially in Europe, and the rise in private-label store brands have shifted pricing power away from suppliers in household and packaged goods.

Yet a few consumer companies are prospering or starting down new avenues to growth. These firms have moved beyond product innovation to emphasize *demand innovation*. Demand innovation entails understanding the higher-order needs of consumers and then creating service and product solutions that directly address those needs.

Consumers are driven by many kinds of ideas and emotions. Most of us yearn for the peace of mind and the feeling of security that a favored brand can give. We enjoy the sense of self-definition that comes from choosing and using products that reflect our personalities, and we crave both a feeling of connection to others and a sense of individual superiority. These and other desires are reflected in the cars we drive, the jeans we wear, and the beers we drink.

But not all of the higher-order needs of consumers are emotional. Consumers also have some of the same sorts of practical higher-order needs as businesses. While individuals don't keep balance sheets and profit and loss statements, they do have budgets, schedules, and the need to juggle both in an increasingly complicated world. So consumers, like businesses, want more efficiency, streamlining, and ease of use in the products and services they buy (Exhibit 2).

Exhibit 2 **The consumer's total economic equation**



Source: Mercer Management Consulting

These are important higher-order needs, and consumers are willing to reward companies that effectively address them. Finding ways to meet such demands can provide consumer companies with an unprecedented opportunity to build loyalty, differentiate their offerings, expand their market opportunities, and create ways to capture value. But few consumer companies have seized this opportunity.

Making the shift to demand innovation is not easy, to be sure. Many suppliers lack direct access to consumers, and alternative channels are littered with failures such as Webvan and Kozmo.com. In addition, the small price tag on many food and household products limits the opportunities to bundle additional services or support. Finally, the sheer size of the core business design at large consumer firms can deter them from trying new business designs.

Despite these challenges, our research has documented at least a dozen patterns of demand innovation in consumer markets (Exhibit 3). The list of patterns is not exhaustive, and some of the growth innovators have combined multiple moves successfully. Some are relatively simple steps to enhance a product or service and thereby steal market share and expand margins. Others allow companies to leverage their assets in more radical ways, opening up entirely new opportunities. Let's look at how three consumer companies have managed to improve the consumer experience and find incremental ways to grow in the process.

Exhibit 3 **Patterns of demand innovation**

Demand innovation move	Description	Example
Integrated solutions	Provide integrated offerings to reduce customers' total systems cost or complexity	<ul style="list-style-type: none"> • Kraft Lunchables made lunch easy for mothers and fun for kids. • Best Buy teams set up home media centers. • BT Home Computing integrated purchase support and installation, in addition to telecom connectivity (e.g., broadband). • Time Warner launched a new voice, broadcast video, and high-speed Internet "triple play" bundle of services.
From product to systems	Create a synergistic system offer of products that are designed to yield more than the sum of the parts	<ul style="list-style-type: none"> • Ensure created complete nutritional systems of meal plans, recipes, nutritional logs, and shopping lists. • Thule built hauling components to attach to a car roof-rack base. • Bose built interoperable audio and video components.
Shift your buyer definition	Use skills, knowledge, or relationships gained in serving consumers to focus on opportunities with other businesses	<ul style="list-style-type: none"> • Fidelity used its experience in consumer mutual funds to serve the greater demands of 401(k) plan administrators. • UPS moved up to supply chain managers, down to retail. • Cisco moved from IT managers to home computer users.
Reengineer the consumer process	Enhance consumer interactions by streamlining transactions and removing related costs and hassles	<ul style="list-style-type: none"> • Netflix took movie rentals online, at a fixed monthly subscription, with personalized recommendations. • Progressive removed administrative hassle and reduced insurance claims processing time. • DeWolfe bundled home purchase with mortgage, insurance, and moving services.

Exhibit continued on next page

From professional to do-it-yourself	From technical/professional service to product which enables easy to administer do-it-yourself	<ul style="list-style-type: none"> • Crest Whitestrips turned an expensive dental procedure into a low-cost, easy-to-administer home solution for teeth whitening. • Intuit TurboTax programmed tax preparation and advice in PC software. • Expedia took travel planning and booking online.
Resegment for new purchase occasions	Resegment customer base according to second-order unmet needs	<ul style="list-style-type: none"> • Home Depot expanded its one-size-fits-all model through targeted offerings for high-end “do-it-for-me” customers, contractors, and urban consumers. • Coca Cola went beyond take-home packs to cold, single-serve beverages for immediate consumption. • Enterprise expanded from vacation rentals to errand and loaner vehicles.
Lifestyle brand extension	Build out scope and range of offering by virtue of a brand’s authority and access to user community	<ul style="list-style-type: none"> • Virgin built a brand based on emotional affinity, enabling it to easily expand into new products and services. • MTV built a hip brand over multiple media channels and entertainment formats. • Harley-Davidson fostered a user community that reinforced sales of core motorcycles and additional products.
Products + supporting or licensed services	Provide or license services that augment/supplement core product	<ul style="list-style-type: none"> • GM’s Onstar expanded beyond navigation to become the leading mobile services company. • Apple iPod/iTunes developed a legitimate service for content that reinforced the core iPod players. • Kodak bought Ofoto to transfer its film-based authority into new digital services and technologies.
Move downstream	Reach consumers more directly by moving into downstream channels	<ul style="list-style-type: none"> • John Deere used its lawn and agriculture authority to move into direct installation and maintenance of landscaping. • Luxottica expanded its retail footprint to push its large stable of eyewear brands. • Boise-Office Max combined to offer multiple channels for office supplies.
Reverse the pyramid	Target low- to middle-market customers with a tailored, yet low-cost, offering	<ul style="list-style-type: none"> • Whirlpool created an economical, yet tailored, washer to meet the needs of underserved, low-income markets. • Dollar Store offered smaller portioned, low-priced goods in inner-city locations. • Haier moved up the value chain to market a stable of brands in China and developed markets.
Support and service the installed base	Use installed hardware for profitable follow-on sales of consumables	<ul style="list-style-type: none"> • GE offered financing, maintenance, and operation of installed engines. • TiVo offered a monthly service contract for directory information. • Swiffer makes its money on disposable mop inserts.
Channel business partner	Build new revenue streams through innovative customer support	<ul style="list-style-type: none"> • Clarke American expanded from check printing to bank support for consumer check ordering and account management. • Cardinal Health built systems and services to solve the headaches of pharmacies.

Source: Mercer Management Consulting

Integrated solutions: Kraft Lunchables

Combining an array of goods and services into a bundle that solves a customer's problem is a proven approach in complex business-to-business settings. Industrial machinery, for example, often comes bundled with financing, parts, maintenance, and support options. These solutions offer large new revenue sources and tend to have higher profit margins.

Integrated solutions can work as well in even the most prosaic consumer markets. Several companies have started to expand their offerings beyond the product itself to incorporate broader solutions that address consumers' higher-order needs. At electronics retailer Best Buy, for instance, one option when buying a home media center with all the attendant components, cables, and connections, is to contract for a Best Buy team to set it up. That saves the consumer time and hassle, while providing Best Buy with higher-margin revenues as well as an opportunity to further enhance its brand equity.

When done well, the integrated solutions move can both reinforce the core product or brand and also earn the permission of consumers to move into adjacent products and services. Integrated solutions can even work in consumer packaged goods, as demonstrated by the experience of Kraft's Lunchables line.

In the late 1980s, Philip Morris was under pressure from investors to realize growth from its many recently acquired food businesses including Oscar Mayer and Kraft Foods. Philip Morris charged these operating units to break down organizational barriers and find ways to use its broad food portfolio to devise innovative offerings. In response, Oscar Mayer accelerated the development of an offering for consumers of their core meat and cheese products, based on research showing that time-pressed working parents found the process of making lunch for themselves and their children to be time consuming, impractical, and often unrewarding. Each item has different expiration dates, requiring multiple visits to the grocery store in a week. Oscar Mayer thought it could address this need with its new Lunchables refrigerated meal kits.

Initially, Lunchables were targeted to adults. After a respectable launch and growth over a couple of years, the product lost momentum. More sophisticated corporate cafeterias and frozen meals heated by office microwaves proved to be tough competition. Insufficient scale led to serious operational challenges, as complex manufacturing lines and significant manual labor were required to assemble each kit.

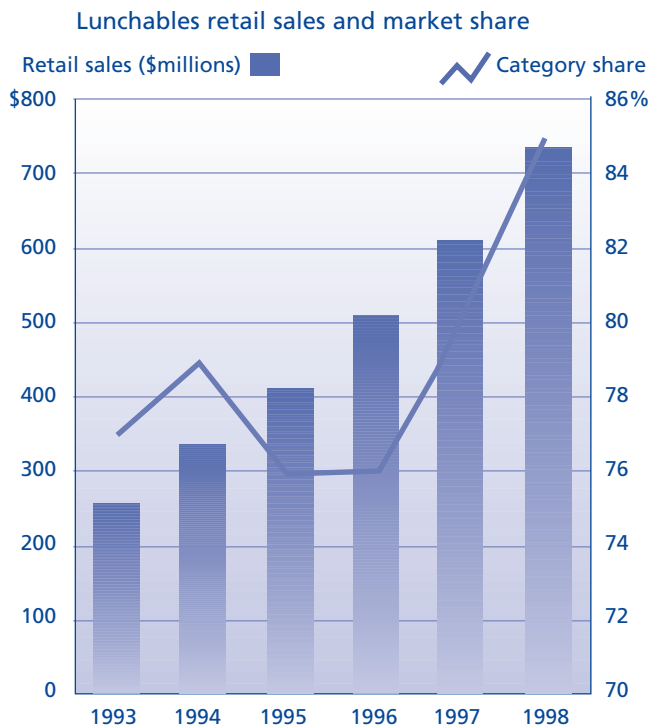
In 1991, the Lunchables team started to sharpen its understanding of customers. Further research found that nearly 40% of Lunchables were consumed by children. Kids loved the convenience and recreational aspect of the tray of snacks. Some status-conscious teenagers found them cool. Kids were also eating Lunchables at occasions other than lunch, such as before sports practice.

With a renewed focus on the meal for kids, the Lunchables team examined other ways to satisfy kids and make Lunchables more fun. The simple meat, cheese, and cracker boxes were soon joined by taco, bagel, and pizza kits with Capri Sun drinks or squeezable yogurts. Promotional campaigns using cartoon characters reinforced kids' enthusiasm for the product.

Kraft realized there were broader opportunities to address the unmet needs of children, who influenced the purchase of food and many household products. Accordingly, Kraft launched a companywide Kid's Task Force in 1994, cutting across all the global giant's business units and

charged with finding ways to leverage their multiple brands to address children’s priorities. One outcome was that the five highest-spending brands took the lead in planning a major advertising event that other Kraft properties could buy into. The first to debut, in 1996, was “Nick in the Afternoon,” through the Nickelodeon television channel. In 1997, Nickelodeon altered a number of its programs to incorporate three-dimensional viewing technology, called Nogglevision, while Kraft included “Noggle Goggles” in Kids Brand packages on grocery shelves.

Exhibit 4 Eating their lunch



Source: CSFB June 7, 1999

Redefining consumer segments was an important step to open up new growth. From 1993 to 1998, Lunchables sales grew at an annual rate of 23% (Exhibit 4) and their market share of the lunch combinations category grew to 85%, impressive for an \$800 million business. Retailers were buoyed by the ability to boost razor-thin margins in the food aisles. Furthermore, Lunchables became the platform for a stream of new products, which benefited from the positive brand association and low-cost trial mechanism.

Kraft continues to evolve the original concept, as growth has slowed in recent years. The company has begun responding to parents’ concerns about nutritional content with the low-fat Pasta Anytime lunch kit and Jell-O Smoothie Snacks.

Innovations such as Make Your Own Magic kits continue to make the product relevant for kids. The challenge for Kraft is to remain connected with consumers in a way that uses the menu of products at its disposal and its expertise at coordinating cross-category efforts.

From professional to consumer do-it-yourself: Crest Whitestrips

The penchant to do it yourself has swept through a variety of consumer sectors. Internet- and software-based technologies make it relatively easy to turn complex procedures and knowledge into easily used tools; hence the success of TurboTax by Intuit and Photoshop by Adobe, which have provided tremendous value for consumers and built trust for subsequent moves. In the world of physical products, Procter & Gamble (P&G) has mastered the professional to consumer do-it-yourself pattern with its Crest Whitestrips.

Demand for teeth whitening has been building for more than a decade, as people who wanted a movie star smile began asking their dentists for peroxide treatments. Teeth whitening was the fastest growing dental procedure during the 1990s and now represents the most common elective procedure, with a cost ranging from \$200 to \$1,000 for the total treatment. More than 1 million Americans whiten their teeth annually, driving nearly \$600 million in revenues for dental offices.

However, dentists' procedures are expensive and require either a two-week peroxide gel treatment or a faster laser process. Given the cost, time, and aversion to dental procedures, whitening by the dentist appealed to a small share of consumers. In the mid 1990s, a few oral care brands introduced home whitening treatments, but they never caught on. Some failed to produce noticeable results because they didn't use bleaching agents that penetrate the surface enamel. Other kits did contain peroxide but used inconvenient, messy melt-and-mold trays.

P&G decided demand was strong enough to warrant developing a product that combined the bleaching agents used by dentists with an application simple enough for consumers to use easily. The big idea was to commercialize a drapeable strip-like material that could adhere to teeth, and put a proven bleaching agent like peroxide directly in contact with teeth—essentially bringing home for consumers what was previously available only through the dentist. P&G borrowed technology for the strip from another business unit that happened to be working on plastic wrap, and this significantly accelerated timing and performance of the product.

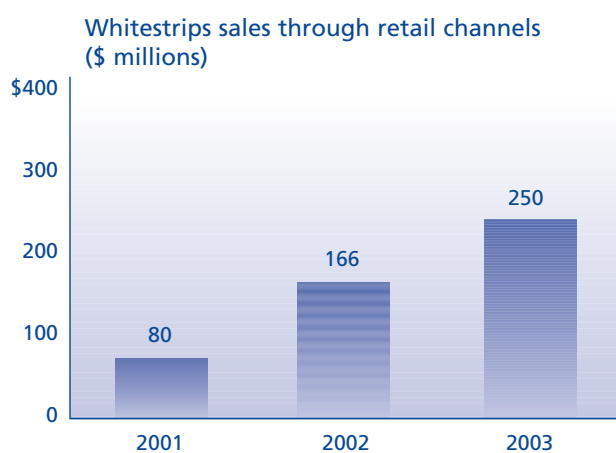
Whitestrips was launched in mid-2001, priced at \$44 for a two-week kit. It generated \$166 million in retail sales in 2002, quickly gained 75% of the home teeth whitening market, and has maintained a healthy growth rate (Exhibit 5). P&G credits Whitestrips for helping Crest to replace Colgate as the leading Oral Care brand in North America.

By transforming a professional procedure to a truly easy and effective home kit, P&G eliminated the hassle, cost, and fears associated with the dentist's office and previous products. Whitestrips could be applied in the car, on the phone, and in the shower. At a relatively low price point, people were willing to try it, and when it produced noticeable results, they kept buying it.

P&G's success with Whitestrips lies not just in an excellent product, but also in how the company identified and deployed various intangible assets. First of all, the trust and equity that the Crest brand had accrued over many years gave P&G the permission among consumers to test a new dental product. P&G also found superior film and bonding technology hidden within another part of the organization.

Less obviously, P&G tapped its existing network of 45,000 dentists. In order not to alienate them, P&G sold Whitestrips through the dental offices before the nationwide launch. This solidified the Whitestrips name as a safe and trusted product. At the same time, instead of cannibalizing the professional procedure, dentists found that selling Whitestrips actually augmented their practice by raising demand for other cosmetic treatments such as veneers, bonding, and straightening. The subsequent release of Whitestrips Professional, sold only through dental offices, allowed dentists to continue reaching out to consumers. Many dentists and pharmacists now recommend Whitestrips as the home whitening product of choice.

Exhibit 5 **Smile**



Source: IRI

P&G's retailer customers such as Wal-Mart have benefited as well. By the time Whitestrips was released through retailers, the product had gained so much buzz through dental office and initial Internet seeding that it was an immediate hit. P&G was able to leverage what it learned from its interactive Web campaign and refine the Whitestrips message for the retail launch. In addition, trial users turned out at retail locations in droves for repeat purchases, creating buzz early on.

Of course, Whitestrips' success attracted competition. Colgate released Simply White in August 2002 priced at \$15, compared to Whitestrips at \$44. Simply White, a liquid peroxide formula that's painted onto teeth, outsold Whitestrips in the final four months of 2002 and gained 30% of market share. P&G then released Crest Night Effects, a similar brush-on product worn overnight and priced to match Simply White. However, Whitestrips remains easier and more effective, and even with a drop in price to \$25, Whitestrips posted four times the sales of both Simply White and Crest Night Effect in 2003. The effectiveness of the product itself, combined with Whitestrips' business design, continues to win over consumers and to create new growth for P&G.

Reengineering the consumer process: Netflix

Reengineering has become a standard approach to fixing inefficient business processes. But sometimes reengineering can be harnessed in the service of demand innovation to create tremendous value. Consumers are willing to reward companies that save them time and reduce frustration or offer personalized choice in previously standardized offerings. Thus, the Internet has allowed upstarts such as Ebay and Amazon to reengineer traditional processes and create distinctive new offerings for consumers. These innovators by necessity develop a deep understanding of consumer needs, knowledge that helps them to innovate further.

This battle is currently being fought by Netflix and Blockbuster in the home movie rental marketplace, providing a window onto the pattern of reengineering a consumer process.

Reed Hastings tells a story about his inspiration five years ago to start Netflix, currently the most popular online DVD rental service. He rented *Apollo 13* at Blockbuster, forgot to return the movie, and had to pay a \$40 late fee. In fact, roughly 18% of Blockbuster's current revenues come from late fees. Hastings also felt frustrated that newly released movies he wanted to watch were often sold out. He figured there must be a better way to rent movies. At the time, Blockbuster had more than 70% of the home video rental market, pay-per-view was lagging investors' expectations, and video-on-demand was expected to surge.

Netflix has not yet captured much market share from Blockbuster. But the firm has created a more flexible, interactive, subscription-based process for renting movies and other videos. Customers pay \$22 each month and can rent an unlimited amount of DVDs, keeping up to three titles at any time. Netflix sends a DVD via the mail and the customer returns the DVD in the same prepaid envelope. Upon receiving a returned DVD, Netflix sends out the next title in the customer's online queue. (Netflix made an early choice not to rent VHS tapes, which are more expensive to ship and produce.) With more than 18,000 titles in stock, no lines, and no late fees, Netflix provides relief from the traditional hassles of the video store.

Netflix also reengineered the process in a way that provides more targeted marketing while improving the economics of the business. Movie studios spend the lion's share of their marketing budget on mainstream titles, hoping for a blockbuster. Likewise, the average video

store generates 80% of profits from only 200 titles. Offbeat or niche titles get neglected, which means that consumers with many varied tastes generally end up watching the same set of mainstream movies. Netflix's proprietary recommendation software, CineMatch, asks users to rate movies they've rented and then recommends similar titles, regardless of their popularity at the box office. Roughly 70% of movies rented through Netflix have been recommended by CineMatch. This decreases Netflix's revenue payout to studios, which is much larger for box office hits, and helps build stronger, personalized relationships with customers.

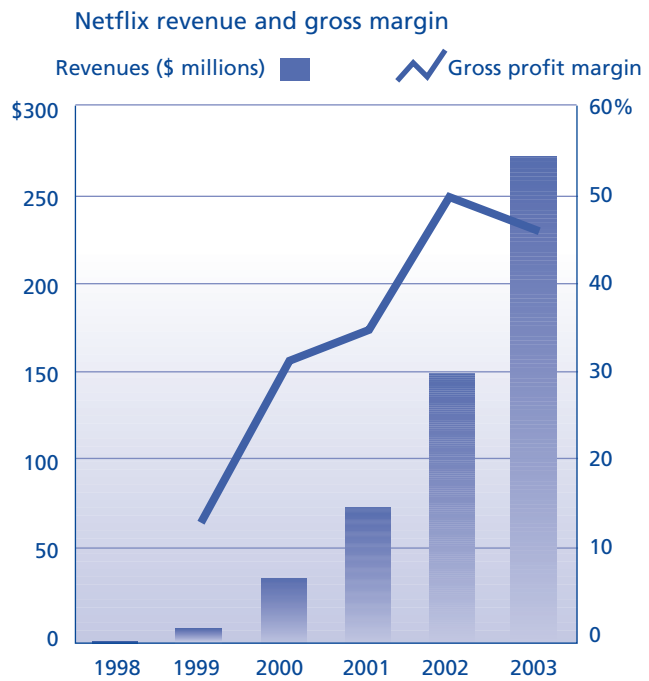
Annual revenues since Netflix's launch in 1998 have grown steadily to nearly \$300 million, with similarly impressive gains in gross margin (Exhibit 6). Netflix's \$82 million public stock offering in 2002 allowed it to open 10 additional distribution centers to speed up delivery—now a one-day delivery for roughly 80% of subscribers. In 2003, Netflix gained 70% more new subscribers than in 2002, ending the year with a subscriber base of 1.5 million. While the company currently has just 4% of the \$8 billion U.S. home movie rental market, market share and revenue growth are rising with the new initiatives and improvements Netflix has made.

Consumers' responses are the most telling sign that Netflix is meeting their needs for convenience, flexibility, variety in selection, and personalization. Over 30% of new subscribers in the past two years signed up because of word of mouth. Of new customers who sign up for the free trial month, only 5% reject the service, and that percentage has been decreasing each quarter.

Blockbuster, for its part, has not been standing still. With its dominant presence and strong position with movie studios, the firm has considerable assets with which to improve the Netflix business model. Blockbuster initially tested the DVD Freedom Pass: For \$30 each month, consumers can rent an unlimited number of DVDs each month from stores and hold up to three at a time, with no late charges. The service appeals to people for whom video rentals are an impulse purchase. Blockbuster recently announced the launch of the Freedom Pass online, where subscribers have access to rentals both online as well as in stores.

Along with dozens of small pure-play Internet DVD rental services, major retailers such as Columbia House and Wal-Mart have come out with similar offerings, but nothing better. The surge of new players reflects how well the Netflix business design addresses higher-order needs of consumers in entertainment, covering every aspect from selection to payment. Where consumers are frustrated and traditional business designs have grown stale, there are ample opportunities to reengineer the process with an eye toward growth.

Exhibit 6 **Movies by mail**



Source: Capital IQ

Questions for managers

- What does the broader ownership or consumption process surrounding your product or service look like?
- Where are there points of hassle or anxiety for the consumer that you might help address?
- Could your brand resonate more deeply with consumers on an emotional level?
- Could the brand serve as an affinity hub through which consumers can fulfill their need for belonging? If so, how can you evolve your brand in this direction?
- Are there creative new ways to reach out and interact with your customers more intimately and cost-effectively than in the past?
- Are there elements on the periphery of your core market—untapped customer sets or sales channels, for instance—that might represent fruitful opportunities for growth through serving next-generation needs?

Changing the mindset

Learning to mobilize your tangible and intangible assets and capabilities to serve consumers' higher-order needs is not easy. But managers must learn to master the discipline of demand innovation if they hope to generate large-scale, long-term growth. The experiences of Kraft, Procter & Gamble, and Netflix, among others, show that doing so can be extremely rewarding.

So what stands in the way? Most established businesses will face significant organizational barriers to making this shift. When the core business is large and stable, even companies that understand their consumers' needs are prone to rejecting ventures that require the development of new business designs. They're concerned about distracting the company from its core business, and they're uncomfortable with embarking on a totally new business design to support the growth initiative.

Managers may also be reluctant to lose focus on their core brands, particularly for opportunities they view as small. This issue is especially acute in large corporations that focus more on volume and revenues than on profitability and new demand generation. They end up creating space for upstarts such as Netflix and Starbucks.

New-growth ideas might be impeded by the organization's structure itself. Often, the best opportunities require cross-business unit coordination that can be difficult to maintain with traditional structures and incentives. Had Kraft not created a Kid's Task Force that cut across the business units, Lunchables may not have become a success. Companies that allow product categories or geographies to operate in isolation will find it difficult to muster support from multiple businesses for a joint or comprehensive offering.

Finally, financial and operational hurdles tend to be much higher for demand innovation initiatives than for the existing business. It is easier to deploy millions of dollars to build a new plant in China (if that is in the company's comfort zone) than to launch a promising business that requires new capabilities. And if the business is launched, it's often staffed with second-tier talent and starved for resources.

The first step to success with new demand-generation moves lies with the individual executive, who must acknowledge the limits of traditional product-centric growth, rethink the nature of customer demand, and then creatively identify and manage previously underutilized assets in order to profitably satisfy customers' needs. This shift in mind-set at the individual or the organizational level won't happen overnight. But companies that make the shift will be well positioned to create meaningful new value for customers and double-digit revenue and earnings growth for investors. ❖