Chapter 4

Brands, Innovation and Growth: The Role of Brands in Innovation and Growth for Consumer Businesses

Tony Clayton
Office for National Statistics, UK

Graham Turner
Strategic Planning Institute, USA

Benchmarking Business Performance

For over 20 years, a programme of business measurement and comparison has been in operation, capturing data on the markets, operations and performance of thousands of businesses, in companies across all sectors of the economy. If invented today, this work would carry a name including the word “benchmarking”. It is called PIMS, which stands for Profit Impact of Market Strategy. Its purpose is to quantify and compare for client companies the key differences between successful and unsuccessful businesses, and to advise them what aspects of “winners’” behaviour and marketing strategy are likely to pay off in the long run.

PIMS was originally born at General Electric (GE). The company developed, by the early 1970s, a consistent framework for measuring and comparing business units and understanding the differences between those which were consistently profitable and growing, and those which were not. In 1973, GE decided to move this framework outside its own markets and involve many other North American companies. PIMS was created as an independent organisation to hold confidential information under secure
conditions from a range of companies, and to develop the measurement and applications approaches for quantitative comparison.

The framework used in PIMS comparisons has evolved and expanded over time, with key components added as new research is completed. Over 200 variables are captured and tracked in constituent parts of PIMS, with the most extensive range of experience still focused in the core areas of competitive position, market attractiveness, cost structure and productivity. The key measures used for comparison are summarised in Table 1.

The early research results from PIMS, based on the original measurement parameters covering competitive position, market attractiveness and productivity, made a significant impact on business planning concepts and practice. Evidence generated on links between non-financial measures

<table>
<thead>
<tr>
<th>Measures of:</th>
<th>Example</th>
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<tbody>
<tr>
<td><strong>Competitive Position</strong></td>
<td>Share of target or “served” market</td>
</tr>
<tr>
<td>• Scale</td>
<td>Relative share = business share/share of top three competitors</td>
</tr>
<tr>
<td>• Relative scale</td>
<td>Weighted preference score versus major competitors</td>
</tr>
<tr>
<td>• Relative quality</td>
<td>Preference score set against relative price positioning</td>
</tr>
<tr>
<td>• Relative value</td>
<td>R&amp;D spend as a percentage of sales</td>
</tr>
<tr>
<td>• Innovation output</td>
<td>Percentage of revenue from products/services under three years old</td>
</tr>
<tr>
<td><strong>Market Attractiveness</strong></td>
<td>Importance of product to buyer budget</td>
</tr>
<tr>
<td>• Customer price sensitivity</td>
<td>Amount negotiated in one contract/transaction</td>
</tr>
<tr>
<td>• Customer buying power</td>
<td>Number of key customers, customer communication cost</td>
</tr>
<tr>
<td>• Seller power</td>
<td>Share of top four sellers into the market</td>
</tr>
<tr>
<td><strong>Productivity</strong></td>
<td>Net assets as a percentage of business value added per annum</td>
</tr>
<tr>
<td>• Investment intensity</td>
<td>Gross fixed assets as a percentage of value added</td>
</tr>
<tr>
<td>• Capital flexibility</td>
<td>Value added per employee</td>
</tr>
<tr>
<td><strong>Human/organisation capital</strong></td>
<td>Measured attitude to problem resolution</td>
</tr>
<tr>
<td>• Culture</td>
<td>Balance of top management time on tasks</td>
</tr>
<tr>
<td><strong>IT capital</strong></td>
<td>Balance between IT spending and strategic goals</td>
</tr>
<tr>
<td>• Strategic fit</td>
<td>Percentage of IT investment in change related projects</td>
</tr>
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and financial results shaped a generation of thinking. The importance of quality, share and customer value for business unit profits, and the damage caused by fixed capital intensity, are covered in a range of PIMS publications (Buzzell and Gale, 1987).

**Benchmarks for Growth**

PIMS’ early focus on the determinants of profit margins or return on assets as performance measures quickly broadened to include the drivers of growth. Benchmarking profit and growth plans became the core of work for contributing companies.

In 1994, the Industry Directorate of the European Union (EU) approached PIMS, on the recommendation of its clients, to advise on the key determinants of business growth. The study they commissioned was designed to test the relative importance of “intangible” business measures, alongside “hard” measures such as costs and productivity. It looked at the role of such business measures — quality, innovation, intellectual property and marketing investment — in driving growth, value added, employment and profits. We chose these indicators because they measure:

(i) The ability to compete for customers preferences.
(ii) The ability to create value and jobs.
(iii) The ability to compete in markets for capital — an essential for growth.

Our findings were no surprise to companies that had worked with PIMS. But they were sufficiently different to be published in the Commission’s Panorama of EU Industry (EU, 1996). The three main findings — all proven from the businesses we observed — were that:

(i) “Intangibles” are not necessarily difficult to measure and they are powerful growth drivers for individual businesses.
(ii) Innovation and intellectual property are the key determinants of growth in competitive markets.
(iii) Quality, innovation and intellectual property are more effective as creators of wealth and jobs than investment in fixed assets.

The 1997 EU “Competitiveness” White Paper accepted this PIMS evidence on the key role of intangibles, including quality, innovation and intellectual property, in driving business and employment growth.
Do Brands Help Growth?

The earlier work outlined above, although highlighting the importance of intellectual property, did not say anything specific about brands. Brands represent an important part of intellectual property for businesses, sometimes more than the technical know-how behind product or service advantage.

The European Brands Association, therefore, commissioned the research described below to examine behaviour and performance in branded consumer markets. The purpose of the study is to test whether the competitive forces that drive individual businesses are the same as those which create consumer value and economic growth, and if brands play a measurable part in turning new product ideas into growth.

Scope of the Study

We look at how branded fast-moving consumer goods (FMCG) businesses grow by:

(i) Winning market share in the battle against competitors for customer preference.

(ii) Creating additional value added — their contribution to growing the economy.

(iii) Achieving return on capital employed (ROCE) above the cost of capital so that they can compete for investment capital — essential for any business wanting to grow.

We also look at job creation, which is closely related to business growth. Evidence comes from over 200 businesses in the PIMS database, mainly in the EU and NAFTA, which are clearly FMCG operations. Each is tracked in detail over a minimum of four years on financial and non-financial measures. Most are branded, but the sample contains some businesses which are “unbranded” or which do not support their brands, and these provide some interesting comparisons. The conclusions we show from this data have been separately tested on both sides of the Atlantic, and over time.
The Role of Brands

The economic case for branding is dynamic. A brand should be a means of communication to facilitate innovation and to help realise benefits from R&D investment. There are at least two ways in which this can happen:

(i) Known brands can help consumers recognise trusted suppliers in changing markets, that is, brands aid the process of consumer choice.
(ii) Brands can help producers gain trust for new approaches to meet consumer needs thus providing access to market for innovation.

If this case is real, we should expect to see the processes of choice work more responsively in branded markets. Branded businesses should be sensitive to “value for money” pressures and are more likely to compete through innovation.

What the Evidence Shows

The data shows that branding in FMCG markets does boost competitive innovation. Branding is associated with more dynamic response by producers to consumer needs and competitive activity. Branded businesses do invest more in innovation, strongly associated with business and employment growth. Successful brands must deliver improving value to consumers through innovation — otherwise, they cease to prosper.

Earlier PIMS work showed that quality, innovation and intellectual property drive business and employment growth in the wider economy. We can now show that the links from investment in innovation, quality and value to business growth are stronger for branded consumer products than for other sectors.

Competitiveness and Growth

We begin with an analysis of the ability of a business to grow “relative market share”, defined as share of the target market divided by the sum of shares of its top three competitors.

In the branded FMCG sector, more than any other, the drivers of business growth are dynamic; to win the competitive battle for market share,
businesses must be able to:

(i) Offer improving quality and increasing value for money to consumers.
(ii) Move faster and more successfully than competitors on innovation.
(iii) Sustain a strong market reputation.

Just “being good” isn’t enough (Fig. 1).

In the charts which follow, we show the impact of value, innovation and reputation on share change versus competitors for branded FMCG businesses. To do so, we must first establish and allow for the starting share position of a business — since for very high share operations, there is nowhere to go but down!

Improving value for money is an important way for high share businesses to limit share loss and for low share businesses to grow (Fig. 2). A business can boost its value position either by improving the relative quality of the offer or by reducing the relative price. When it comes to sustaining growth, “intangible” quality is a more powerful driver than price.

Innovation advantage is essential for businesses with high shares to maintain their position. Again, simply maintaining high rates of new product introductions isn’t enough; what matters is increasing success in innovation versus the competition (Fig. 3).

Reputation, or brand image, can give a huge boost to the share prospects of small share businesses (Fig. 4). Reputation is a key enabler for share growth; without it, businesses are less likely to get new products tested in
Brands, Innovation and Growth

Fig. 2. Better value for money helps share retention or growth.

Source: PIMS branded FMCG database.

Fig. 3. Staying ahead on innovation helps drive share gain.

Source: PIMS branded FMCG database.

their markets or quality/value improvements appreciated. At the same time, failure to maintain a strong brand reputation by a market leader can bring rapid erosion of share position. There is little chance of a “quiet life” for high share branded produces — if their competitions innovate or match them on image, they can lose customers quickly.
Starting Relative Market Share

Worse/Same Better

Low High

Annual Change in Relative Market Share (% p.a. over four years)

Relative Image/Reputation

Fig. 4. Superior reputation helps market share.

Source: PIMS branded FMCG database.

For each of these key relationships, we can track the driving forces of growth back to investment in product and process R&D, to advertising and promotion, and to key capabilities in intellectual property, speed to market and service to distribution channels. These linkages are:

(i) R&D and intellectual property investment in consumer businesses boost successful product innovation and, thus, relative quality.
(ii) Process innovation reduces competitive costs and improves value to consumers.
(iii) Innovation, good service to retailers and investment in commercial communication enhance brand image and company reputation.

The entire set of relationships combines to present a dynamic mode of competitive growth more explicit and powerful than in other types of business. It is a model (Fig. 5) which responds rapidly to changes in consumer requirements and gives branded businesses a major incentive to invest in new products to meet them. Each of the relationships in this model can be demonstrated in multi-variate regression and by simple statistical relationships.

Evidence on value added growth shows a very similar set of relationships (Fig. 6). Innovation, the ability to deliver superior quality products and services and to reduce costs are the key drivers of real value added growth at
**Brands, Innovation and Growth**

Fig. 5. From intangible investment to business growth.

*Source: PIMS branded FMCG database.*

**Fig. 6.** From business investment to economic growth.

*Source: PIMS branded FMCG database.*
the business level. Not only do businesses which win on these factors gain a bigger share of their markets, they also make the biggest contribution to the growth of the economy. And, as we shall see later, innovative branded businesses grow employment and, at the same time, achieve the highest level of productivity.

**Brands and Innovation**

Not surprisingly, given this set of relationships, branded businesses undertake more innovation in the consumer products sector than unbranded producers (Fig. 7). They spend more on product and process R&D as a percentage of their sales revenue. New products, defined as the percentage of products with significantly new characteristics introduced in the last three years, also represent a much higher proportion of their sales.

For jobs, after stripping out the impact of market growth (clearly a strong driver of employment creation), innovation matters a great deal. Innovative branded businesses in growing markets are where new jobs are created faster. This is because meeting new consumer needs creates new employment opportunities (Fig. 8). Of course, some of this growth is at the expense of other firms, but the message for European businesses competing in a global context is that successful innovation is the key to growth.

But what about the costs and benefits of innovation to business profits? Evidence shows that strong brands are an essential part of sustainable innovation. Preferred brands help manufacturers to invest in innovation

![Fig. 7. The majority of branded businesses innovate.](source: PIMS branded FMCG database)
Brands, Innovation and Growth

Real Market Growth (% p.a.)

<table>
<thead>
<tr>
<th>Growing</th>
<th>Static or Declining</th>
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<tbody>
<tr>
<td>3.2</td>
<td>-2.8</td>
</tr>
<tr>
<td>7.8</td>
<td>-0.9</td>
</tr>
</tbody>
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Annual Employment* Growth (% p.a. over four years)

New Products % of Sales

Fig. 8. Innovation is linked to new jobs.
Source: PIMS branded FMCG database.

ROCE % (four-year average)

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<tr>
<th>Innovation Investment</th>
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<tbody>
<tr>
<td>Preferred Brands</td>
</tr>
<tr>
<td>The Rest</td>
</tr>
<tr>
<td>34</td>
</tr>
<tr>
<td>25</td>
</tr>
<tr>
<td>37</td>
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<td>13</td>
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</table>

Fig. 9. Preferred brands make innovation profitable.
Source: PIMS branded FMCG database.

successfully and profitably; without brand preference, the costs of innovation are substantially higher (Fig. 9). Innovation is, in turn, essential to keep strong brand positions ahead of the competition — without it, they fall behind.
Competition, Innovation and Growth

This research on fast-moving consumer goods is mirrored by work we have done elsewhere on durables markets. This is further evidence that branded consumer businesses have a strong profit incentive to innovate behind good brand positions to keep their offering to consumers fresh and ahead of competition. Competitive forces raise the pressure for innovation and they increase the rewards for “doing it right”. There is a virtuous circle of incentives that should encourage EU branded businesses to compete in global markets through innovation.

If the economic case for branding set out at the start of this chapter is real, we would expect to see branded businesses achieving a significantly better “return” on innovation. If we do the “accounting” in terms of value added, we find that branded FMCG businesses show a strong correlation between R&D and business value added (Fig. 10). Looking at the relationship between R&D spending and value creation per employee, typically an extra Euro of R&D spending in this sector is associated with an extra 2–2.5 Euros in value added. In the rest of the economy, the ratio is typically 1:1.3. This suggests

![Graph showing Value Added/Employee (Euro 1,000 p.a.)](image)

Fig. 10. Brands boost value from R&D.

*Source: PIMS database.*
that branding does increase the effectiveness of businesses in creating value from R&D investment.

These business level incentives help explain the higher innovation in branded markets. And, at the “macro” level, we can also show a strong relationship between innovation and market growth (Fig. 11). It is not possible, from data on individual businesses, to “prove” the direction of the relationship between innovation and market growth. However, it is clear that the markets where our observed businesses have little or no new product revenue are those which do not grow.

Conclusions

PIMS evidence shows that the ability of branded consumer businesses to win the battle for consumer preference is best explained by three interrelated factors:

(i) The ability to improve value to consumers through better products and more competitive price.

(ii) The ability to get new products to market faster and more effectively than competitors.

(iii) A sustained advantage in consumer and trade reputation, without which it is unlikely that value advantage will be seen by consumers or that innovation will reach the market.
We have also examined FMCG producers who focus on unbranded or “unsupported” products. They are much less innovative and invest less effort in key drivers of growth.

The evidence, from real businesses operating in real markets, shows that:

(i) Branding is essential for innovation and growth in consumer markets in competitive economies.
(ii) Successful brands deliver ever improving value to consumers through innovation and quality improvement; if they fail in this, they fail to grow.
(iii) Policies on competition and intellectual property should take as much account of branding in “everyday” products (where the bulk of this evidence comes from) as they do in the more conspicuous “hi-tech” areas of the economy, where much of the debate on intellectual property protection has focused.

Our results show that branding helps producers to innovate and consumers to choose. The economic case for brands stands up; the importance of marketing communication in promoting innovation and growth is proven.

Implications for Policy and for Management

Partly as a result of this study, EU policy-makers have increased efforts to make the single market in commercial communication a reality. European firms suffer the disadvantage in that while they can move products around the single market, the marketing to support them is still seriously limited by national regulations. Restrictions on promotional offers in Italy and bans on advertising toys in Greece are examples.

American companies — in addition to their advantage of a having a single language for their domestic market — suffer fewer restraints on marketing and the use of brands. This helps to explain why US businesses have historically been better able to capitalise on quality advantages in their markets and have been more innovative. It is not always appreciated by policy-markets that the commercial communication costs associated with innovation can be greater than the costs of technical development. Therefore, restraints which push up marketing costs can stifle new product
launches. Europe needs more than a single market in physical products to compete on equal terms in innovation markets.

There are lessons, too, for branded business managers. A brand is not, as some have suggested, a device to “tax” consumers. Successful brands justify themselves through innovation and improving value to consumers. If they fail in this, leaving themselves with nothing to communicate, they die. PIMS evidence shows that branding sharpens the operation of competitive forces. Any brand owner who ignores this does so at his or her own peril.