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**INNOVATION STRATEGIES IN CENTRAL EUROPE:
A CORPORATE PERSPECTIVE**

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Abstract

This paper seeks to outline the innovations strategies that various corporations have pursued in Central Europe over the last few decades. It will examine from a corporate perspective the scope and definition of innovation, highlighting how this has changed in today's eclectic ever changing environment. Drawing upon cases studies, this paper will highlight best practice in formulating innovation strategies within Central Europe. In conclusion, it will be argued that in spite of living in an environment where the pressure for companies to constantly reinvent some part of themselves is increasing, companies could greatly benefit from taking time to pause and consider how they can capitalise on the key lessons and best practice considerations that have arisen.

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Innovation strategies in central Europe: a corporate perspective

Innovation practices exist today in an environment characterised by increasing speed, an increasing value of intangibles and pervasive connectivity. Whilst there are a plethora of definitions the most apt definition reflecting this new world, stems from that formulated by Cap Gemini's Ernst&Young's Centre for Innovation. Innovation is defined as "the realisation of value from a new solution to a problem, changing the rules of the game." Whilst this definition succinctly defines the innovation agenda – there are two caveats. Firstly, changing the rules of the game differs depending upon the industry in which you operate and secondly, in some companies (for instance Unilever, the multinational consumer goods business), it is about providing a solution to a need rather than to a problem.

However, the message is succinct: there is recognition that in order to survive, businesses can no longer continue to operate under a business as usual operandi. Such complacency is tantamount to the death of their business. As a case in point, within the UK banking industry today no merchant bank has survived – they have either been acquired or merged. A sobering fact. Furthermore, operating in such an environment where things are changing, there is a real advantage to changing the rules: straight line, linear thinking is of the past. We are in the era of disruption technologies with blurred boundaries and one in where most large organisations having embarked on a "destroy you business.com" type of initiative originally pioneered by General Electric initiative have erected their own 'idea factories'. For example, Pitney Bowles, has a think tank in which last year its 600 employees (2% of the group's total) generated 36% of the entire corporation's profits.

Examples of companies who have adopted this non-linear thinking and toppled incumbent giants head on include Dyson and Egg transforming their respective industry's landscape. However, whilst innovation is critical for all businesses it is a matter of gradation and does differ from industry to industry. On one end of the spectrum, it is essential for impulse driven businesses. For example, within fashion retailing companies such as Levis are desperate to innovate at any level – their recent range included a key feature where the zip was now on the other pocket or for Gap who having capitalised on the casual wave in States with khakis are now frantically seeking

for the next innovating idea. For other organisations it is about identifying a need - successful organisations include DoCoMo who tapped into and recognised a latent need for mobile telephones over and above the functionality of connectivity – gaming. Yet for others, in industries such as consumer packaged goods, innovation is synonymous with package or marketing innovation rather than wholesale product change. L’Oreal is an excellent example; the organisation sells the story well but does not really change the product. On the other hand, Procter and Gamble’s Durk Jager’s “bigger innovations” to market faster vision- fundamentally altered the way the organisation did business. The emphasis was on lifestyle related innovation rather than Unilever’s services orientation. His objective was to drive blockbuster innovation based on creating new categories and getting products to market faster. Whether this was successful is debatable but the point is that companies are seeking to innovate because they recognise that it is as one of the key value drivers of their business. Not only does the type of innovation differ by industry but the advent of technology has heralded a different form of innovation. Napster, the company which allowed free internet access to music, offering free MP3 downloads, for example adopted the viral form of innovation, and within 6 months had notched up 5 million users. Netscape, the internet browser company, issued free copies of its Navigator and as a result acquired 40 million customers. Sun and Java are other examples.

Most large organisations recognise that the scope of innovation spans across the value chain and implicitly or explicitly categorise innovation into four major types. The four major areas of innovation span across the organisation’s offering (product/service), process (along the value chain and the speed of roll-out), structural (organisational local versus regional versus central set up), and strategic (the role of innovation within the context of the organisation’s vision). These areas of innovation are superimposed along the product lifecycle curve, spanning from the early idea generation stage through its diffusion and eventual end or eclipse

In today’s era of pervasive connectivity, this matrix framework of innovation has radically changed. Offerings have been translated from their traditional product specific attributes into service/experience based ones. The supply chain has collapsed from a vertical end to end flow into an economic web. Structural innovation no longer focuses on the degree of centralisation but on organisational forms, which facilitate the

connectivity of consumers. Strategically, no longer is innovation the preserve of a ring fenced set of individuals shut in an ivory tower, but is instead defined as a core process, which is embedded into the organisation. All this against an axis where the product life cycle has been drastically shortened with discontinuous shifts made possible by the pervasive technologies present.

Fundamentally, these shifts have combined to unify innovation with corporate strategy. It is a shift that has taken half a century. Innovation strategies in the 1950s-1960s were driven by intuition which was characterised by a "we" versus a "them" culture – the goal was to employ a creative, talented pool of people who were set up in a creative environment, supply them with funds, and then leave them alone until that "eureka" moment emerged. A shift occurred in the 1970s – 1980s: innovation were driven by projects – and categorised by the crude definition of customer orientation versus supplier orientation; innovation was not only driven by projects but managed as projects, linked to business unit objectives. However, whilst their performance were assessed, no priorities were set. From the 1990s onwards, to the present day, innovation is now driven by strategy. There is a partnership model: where innovation is driven by corporate strategy, underpinned by business unit and corporate priority setting. Furthermore sophisticated portfolio techniques are used to prioritise how the innovation function can be integrated into the business.

This shift in the role of innovation within the corporation provides the context in understanding how and why innovation strategies have been formulated within Central Europe. Central Europe in this paper is defined as Eastern Europe, together with the Baltics. Specifically, these countries are categorised into tier clusters – tier one and tier two. Tier one clusters countries include Hungary, Czech Republic, Poland and Baltics – which total a material market size of approximately 65mn. Tier two include the remaining countries.

Central European strategies have been borne out of the recognition of the importance of being able to manage connectivity at four key levels: connectivity between functions within R&D: (Research, Development, Engineering); connectivity along the entire value chain of one product; connectivity between several products (synergy) and connectivity between internal and external competences/knowledge. Specifically, a fundamental driver

for innovation strategies within Central Europe lies in this recognition that the boundaries of internal and external are now blurred. Thus, from an internal corporate perspective the ambition to be an innovator; pursue an optimum product portfolio; and be operationally effective, with a greater emphasis on business focus, new business and professional development is intertwined with the division's ambitions to shift towards seeking growth and expansion in new markets and products. Essential to this is a consumer centric orientation and an exploration into new channels to market. This underlines the necessity of the corporation's ability to externally scan the environment (akin to the 'Foresight' initiatives that Shell and Unilever have undertaken.). Thus, being able to formulate solutions for individuals, ever getting connected, with an increasing recognition for better health, a greater demand for instant availability, and an acute awareness of the bruising of the planet are characteristics of organisation's consumers which they can no longer afford to ignore. Indeed, they are themes that are pervasive encompassing the Central European consumer.

Within this context, there are three key reasons why companies have sought to innovate in Central Europe. An obvious reason for companies attracted to Central Europe, as outlined above, in an intensely competitive market lies in their insatiable quest for growth: the lure of Central Europe promises the prospect of widening the corporation's geographical footprint into areas which have yet to grow and mature, discounted of course for risk. Tesco the UK retailer is a case in point. The second key motivation, a corollary of the geographical extension, lies in the potential ability to portfolio stretch products into a greater breadth. Finally, the relatively safe haven of Central Europe affords the type of environment where risky products can be tested and so many organisations have used Central Europe as a test bed for new products. Telephone banking is an excellent example.

Precisely how these innovation centres have been organisationally set up has differed depending upon company culture and definition of geography. On a language criteria, some organisations perceive Central Europe as a collection of countries, given the different number of languages within the region. This is in contrast to Latin America, with two major languages, which is perceived as a region. As such, separate management structures are established. To an extent, Nestle is a case in point. However, on the basis of economics, other organisations such as Unilever, have now integrated a cluster of

Central European countries (tier one countries - Poland, Czech Rep, Hungary) into Western Europe. This organisational structure reflects the degree to which innovation is centralised. Whilst some companies have established one trickle down strategy global centre, others have established regional innovation centres. Today, driven by the need for efficiency and to reap economies, businesses that have adopted the local innovation centre model are few and far between. Economics aside, there are of course, other natural limits to the extent that innovation can be devolved particularly for global brands. For example in Unilever, the Lux soap brand has 22 languages on its packaging. To resort to one packaging format, as in a global brand, will necessitate these languages published on its packaging – an obvious operational difficulty.

As we have seen, despite the significant economic progress of Central Europe over the last few decades, the region still today presents attractive potential for organisations driven to expand. Expansion is the underlying motive. How innovation strategies, that is how corporations have innovated in Central Europe fall into one of three categories. They either choose to innovate locally, tailoring their existing products or services to the tastes and needs of the “consumer”, or trickle down technological innovation from mature established advanced markets. Finally, although not mutually exclusive they elect to brand stretch their existing products into a different portfolio offering, perceiving Central Europe as a test bed environment where they can incubate ideas.

1) Innovate local strategy

The “innovate local” strategy recognises disparate differences between Central European and Western European countries – from a language, religious and cultural perspective. It clearly assumes that tastes and needs of the Central European are sufficiently distinct from their Western European counterparts. Furthermore, some organisations perceive that these differences are sufficiently great enough at an individual country level, that their products and services are tailored to meet the specific needs of the consumer.

2) Trickle down strategy

At the other extreme, the transfer/trickle down technology perceives that global brands or services formulated by advanced markets will appeal to the palate of the Central European consumer – in the end, it is countered in a global environment with converging tastes, the Central European will have a desire for those very same needs as their Western

counterparts. As such, the degree of customisation of the company's products to the consumer's palate is minimal. An obvious example is Coke.

This debate is neatly reflected in the polarisation of brand strategies within the packaged consumer goods industry. Whilst Unilever, Procter and Gamble and Colgate have pursued a regional brand strategy, Nestle have sought explicitly a local brand strategy. These strategies are reflected in the organisational structure: Unilever have now integrated tier one Central European countries into their classification of "Europe". Thus, all the business processes including innovation are driven from satisfying the needs of the regional consumer.

As an additional level of complexity, the degree of centralisation does differ by processes. Thus, whilst innovation processes within an organisation may be of a local nature, the finance and administration processes could be organised as a regional central model. Thus, the scope of integrating Central Europe into Western Europe for some countries has extended beyond the front-end consumer innovation process to the administrative/infrastructure enabling processes such as finance. There are numerous example of how in Central Europe whilst organisations have chosen a local innovation strategy instead of a regional one, they have chose to integrate Central Europe into Western Europe for consolidation of back office processes such as procurement and finance and administration.

3) Incubate/use as a test bed

Finally, over the last decade, there has been a proliferation in a third innovation strategy, borne largely out of exploiting the possibilities afforded by the discontinuities that technology has generated. Increasingly, organisations are using Central European countries as a "greenhouse" to incubate new ideas. Central Europe proffers three unique advantages: it is a lower cost environment, with media rates offered at a discount to Western Europe; it is a safer, lower risk climate where a test market failure does not have the potentially disastrous consequences as a failed market test in Western Europe; and finally, it provides access to relatively sophisticated consumers who do not have to "unlearn" habits or are encumbered with prejudices which involve high switching costs. An obvious example is the development of Short Message Servicing telephone banking which was trialled in Czech Republic a year before the service was offered in UK. In the

telecommunications industry, Vodafone has long favoured Central Europe as a manufacturer friendly environment and a significantly cheaper cost of development and integration of finance and communication. Many consumers in Central Europe do not have the entrenched habits associated with landline telephones or the prejudices against mobile telephones. Another example of how Central Europe has been adopted as a test bed for ideas is that of Coke and mobile 'phones. The extent to which the region is used as a test bed lies largely in the ability to trail products which do not require behavioural change but rely on the consumers making informed choices. Shower gels are a case in point – these require a behavioural change.

Companies within Central Europe have applied one of the three innovation strategies in Central Europe described above. Which strategies they have pursued have been largely dependent upon their intent, their culture and their industry. Some have been successful, others have failed. From these wealth of experiences, a tome of war stories and recipes of successes emerge. These in turn, can be distilled into a series of seven leading practices. These are summarised below.

Seven Leading Practices



1. Adopt a portfolio approach



2. Enter by acquisition



3. Market the local brand positively



4. Align technology with product mix



5. Consumer strategy based on choice



6. Ring fenced long term finance strategy



7. Agile organisational structure

1. Adopt a portfolio Approach

Most successful companies have sought to adopt the “portfolio” approach in Central Europe as a means of securing market share. Rather than entering the Central European market with a single product or service, a portfolio of products and services within the category is introduced. The breadth of the portfolio has clear distinct positionings in the low cost, premium and super-premium categories. Thus, for Unilever, in the Czech republic the Lux brand was positioned as a superior premium brand, Dove premium, with a local brand (which Unilever acquired) as the low cost player. The portfolio acts as an effective tactical barrier to entry for potential competitors such as distributor own brands and retailers.

Within this portfolio, pricing is critical. Companies competing for detergents, for instance, found that typically, the relationship between the low cost segment and the premium market leader should have a ratio in terms of 1:3. Thus, for Unilever, Dove was priced as being three times more expensive than the low cost alternative. This enabled scale and critical mass to be generated in volume demand for the low cost brands – which at best financially broke even.

2. Entry Strategy

Another distinguishing characteristic of successful companies lies in their entry strategies. There are two key elements – the need to acquire a local brand to gain a foothold into the market and the use of the acquisition to overcome the major entry barriers associated with setting up a Greenfield site in that country. Specifically, these organisations have entered into Central European countries by acquiring a local brand rather than embarking on a greenfield entry strategy with its encumbering regulatory, governmental and cultural barriers associated with doing business in Central Europe. Examples include Proctor & Gamble’s acquisition of the Trix brand. Even more cleverly, some organisations have acquired locally or Unilever’s Czech acquisition of Nela Batola – a dog food brand that was acquired solely for its production facilities (Unilever do not have pet food in its portfolio) and which was subsequently retooled to produce mild baby soap! The prime thrust lies in the commonalities that the acquisition affords

for the business in terms of infrastructure. Thus, in line with the portfolio approach the most successful strategies were those companies who having acquired a local brand, launched premium and super-premium brands.

3. Marketing the local brand.

A clear lesson within the portfolio positioning has been the recognition that the low cost brand benefits should be marketed as a positive. Successful local brands have been associated with advertising which does not patronise the consumer by emphasising the low cost pricing of the brand but instead highlights the heritage of the brand and wit of the consumer in being discerning enough to purchase a good value product.

4. Technology and product mix

Successful organisations have recognised that one size does not fit all and have recognised the importance of successfully aligning the sophistication of their product mixes to the economies of the country. Thus, for example, mass market products in the West need to be aligned to the East, and in some instances redefined as superior products. Occasionally, this results in trickle up technology. That is, with innovation from Central Europe being diffused globally. Unilever for example, capitalised on these differences with Magnum. Within Central and Eastern Europe, the region as an innovation leader customised Magnum to local tastes, introducing fruit strips into the ice-cream. Whilst this was against the corporate centre's wishes it is now available worldwide.

5. Consumer strategy

The degree to which highly innovative products are successful depends fundamentally in the ability to distinguish those products which required consumers to change behaviourally and those brands which relied upon consumers making informed choices. Consider washing habits (soap versus shower gels) or telephony (mobile telephones versus landline 'phones)

6. Financing Strategy

Another distinguishing success factor in organisations lie in those companies who recognise that a presence in Central Europe will not derive quick profits but

instead is likely to yield a return in the long run. Successful companies that ring-fenced the Central European initiative avoided the retailer Carrefour scenario who having underestimated the scale of investment required were forced to prematurely withdraw from Central Europe – allowing its competitors to reap the benefits of its efforts.

7. Organisational structure.

Having a structure that is able to manage and respond fast in a volatile macroeconomic environment (as witnessed for example in the Russian bubble in mid-1990s) was a key leading practice which conferred a distinctive competitive edge. Those organisations that were able to align their innovation structures to the company's and the country's organisation were able to roll out initiatives faster and respond most quickly to a change in the competitive or macroeconomic environment.

Conclusion

Within the context of today's value creation environment, where innovation is recognised as the kernel to the organisation's existence, Central Europe, despite having significantly advanced over the last few decades, continues to be an attractive region. The prospect of not only product and geographical expansion but having an environment where new product/service could be incubated, at literally ones back door, is appealing to businesses keen to maximise shareholder return. This is reflected in the growing number of companies within the region – now populated by a large chunk of the biggest corporations in the world. From their collective experiences to date, one can start to discern a series of best practises. However, in today's era when speed, connectivity and value of intangibles is the new mantra, the pressure is to look out to tomorrow – and not dwell on things past. This brings the risk that companies will fail to capitalise on the lessons learnt – and perhaps with it, the failing of the most important leading practice: to draw breath and consider how they can exploit their experiences to date.