

Enabling Multifaceted Innovation

Consumer Products CEOs reaching beyond the familiar





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“Services-related offerings recognize the fact that products are getting increasingly commoditized ...profitability will be under threat if some form of differentiation is not achieved.”

– CP industry respondent, IBM Global CEO Study 2006

Introduction

The consumer product (CP) industry has thrived for over 100 years by introducing innovative, everyday products that provide convenience at a reasonable price. Historically, CP firms targeted the “mass market” with broad marketing and branding strategies and widespread distribution through a convenient, and often deferential, retail channel. For many years, product line extensions, new advertising campaigns and packaging changes were sufficient to sustain acceptable growth.

Today, however, many CP firms operate in slow growth categories and the ability to grow is complicated by many challenges:

- Rapidly changing consumer preferences and the emergence of multiple consumer segments with different tastes, values and shopping patterns
- Intense competition for mind, wallet, stomach and shelf space
- Pressure from investors for both top-line and bottom-line growth
- Demands from powerful retailers for new products, new services and better trade terms, in addition to competition from private labels.

So, how can CP companies find new ways to grow?

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The IBM Global CEO Study 2006 reinforces that innovation is a key requirement for future success. However, many surveyed CP CEOs indicate that their current focus is primarily on *products, services and markets* innovation. We believe this is insufficient to achieve long-term growth objectives. CP companies need a more strategic, multifaceted approach to innovation, one that also addresses the *business model (BM)*, *operations* and the *regulatory* environment. This new approach should consider shoppers, consumers and the increasingly influential role of retailers.

To be successful, senior CP executives must commit their time and energy to strategic innovation. Establishing the climate, management systems and investment priorities to promote and sustain innovative actions will help address the major barriers to innovation – internal culture and people issues. Also, CP companies should be more willing to embrace external collaboration and improve internal coordination to better source new ideas, develop new solutions and manage go-to-market activities. Finally, improving technology and business integration – particularly in the areas of customer and consumer insights, and new product development – can improve both the efficiency and outcome of the innovation process.

Innovation has the potential to improve brand and consumer value, enhance retailer relationships and stimulate growth. What is your innovation strategy? How will your company create innovation that matters?

The Global CEO Study 2006

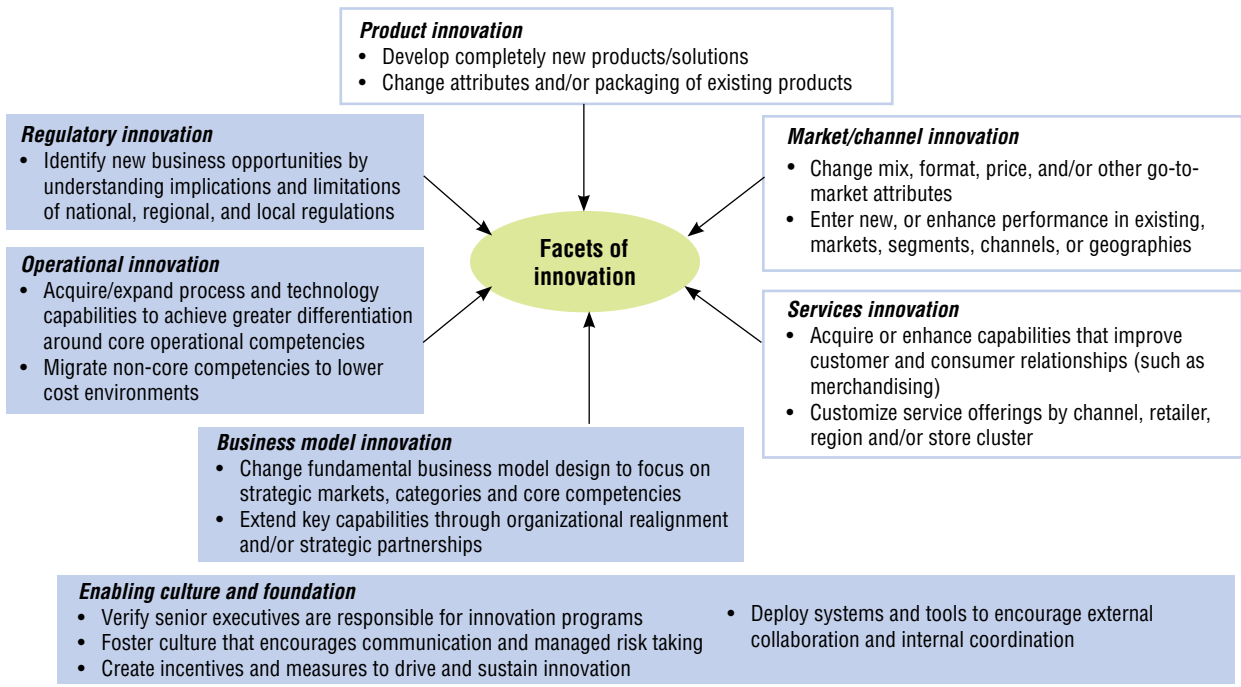
As part of our Global CEO Study, we conducted in-depth, consultative interviews with 765 CEOs, business executives and public sector leaders from around the world.¹ Through these discussions, we explored CEOs' current views on innovation – what was on their innovation agendas, where their innovative energies were focused, and what they were doing to enable innovation. The survey population included leaders of companies both large and small, some public and some privately held. Our sample comprised a broad cross-section of CEOs and public sector leaders, spanning 11 geographic regions and 20 different industries.

As part of this worldwide study, we interviewed 49 CP industry CEOs and senior business executives from a diverse mix of operating geographies. Of these 49 CEOs, 74 percent characterize their market as mature, 20 percent as growth and 6 percent as relatively new and emerging.

Considering a multifaceted approach to CP innovation

In the broadest sense, innovation is about “new ideas or current thinking applied in fundamentally different ways, resulting in significant change.” It is applicable across many aspects of business strategy and operations. While *product, market/channel* and *services* innovation will continue as focus areas for CP firms, business model, operational and even regulatory innovation should be considered to drive future performance and success. A supporting culture will be vital to enabling this broader, more strategic innovation agenda (see Figure 1). This, in turn, will require active leadership from senior CP executives.

Figure 1. A multifaceted approach to CP industry innovation, with supportive culture as the foundation.



Source: IBM Global Business Services.

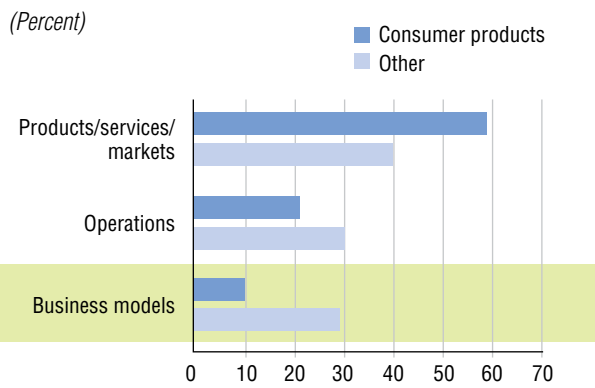
Traditional approaches still dominate

“If we don’t effectively innovate in the area of products and services, the others become irrelevant, they don’t matter.”

– CP industry respondent, IBM Global CEO Study 2006

Compared to their peers in other industries, CP companies have a narrower innovation focus, with emphasis on products, services and markets innovation. The IBM CEO study shows this emphasis may come at the expense of opportunities created via business model (BM), operations and regulatory innovation (see Figure 2). The IBM CEO study included a comparison of the past five years’ financial

Figure 2. Innovation priorities.



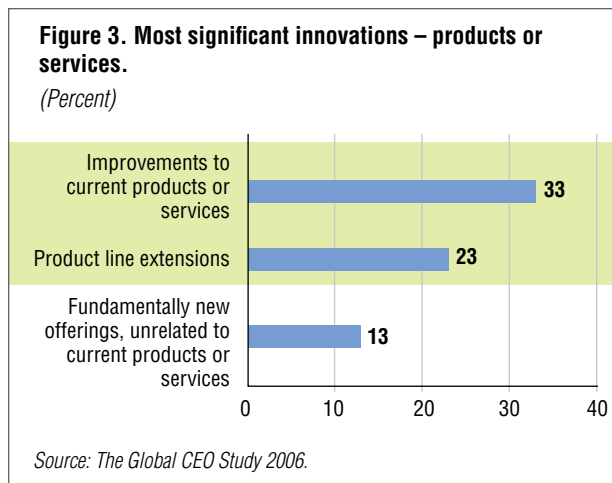
Source: The Global CEO Study 2006.

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performance – the average revenue growth, operating margin growth and historical operating margins of an industry-accepted list of nearest competitors. Companies that have grown their operating margins faster than their competitors were putting twice as much emphasis on business model innovation as those who ranked in the bottom 50 percent on these financial measures.

Product innovation

Developing and bringing new products and solutions to market will remain the lifeblood of a CP company. However, *the majority of time and resources is spent* on developing incremental changes to existing offerings, rather than on delivering the truly innovative products which may encourage consumers to part with their money. CP respondents reported that 56 percent of their efforts entailed improvements to current products and services, such as flavor or packaging changes and line extensions, while only 13 percent were fundamentally new offerings (see Figure 3).



As consumer preferences diverge in both mature and emerging markets CP firms need to balance time spent developing incremental improvements with the risk of neglecting or missing emerging needs.

According to Information Resources, Inc, a record number of new products were introduced in the CP industry in 2005.² Only 10 percent of these new products exceeded US\$20 million in sales and less than 1 percent reached sales of US\$100 million.³ The overwhelming majority of food and non-food products within that top group offered new or unique varieties.⁴ So, while “significantly” new offerings comprised only 13 percent of total new products, these products generated nearly two-thirds of total new product sales. Leading drivers of product innovation were health and wellness (such as reduced calorie and portion control), performance improvements from new technologies and convenience factors.

Markets and channel innovation

Entering growing markets such as China, India, Brazil and Central Europe can provide new revenue and profit opportunities. However, even the most experienced CP firms may need to adapt their strategies, operations and portfolios to meet local market needs and tastes. Kellogg, for example, has recognized that cold cereal and milk are not as popular in China and parts of Asia as they are in the other regions. As a result, the company is reportedly looking into developing more cereal bars and hot cereals which will require more product innovation.⁵

Like other established CP firms, Kellogg has stated that it is looking to buy local firms as a way to participate in regional growth opportunities.⁶ Establishing joint ventures, purchasing local firms and entering into local distribution partnerships are common CP

strategies – all of which may require innovative thinking to create profitable business models in markets with traditionally lower discretionary spending

Channels also provide new innovation and growth opportunities. As the traditional grocery store format continues to lose ground in North America, mass merchant, drug and convenience channels gain more attention. Recognizing this trend, companies like Hershey Foods have applied innovation across their go-to-market programs, reallocating resources and trade dollars to higher margin and new channels, such as home improvement and electronic stores. Nestlé, with its fastest growing business, Nespresso, has created an entirely new channel. The world's top provider of single-serve coffee capsules sells to "club" members via mail and small boutiques, posting a whopping 36 percent sales increase in 2005.⁷

Services innovation

Consumer and retailer related services are increasingly becoming a new source of differentiation and innovation for CP companies.

Consumer-related activities can include targeted promotions, in-store and other related promotional events, and brand and product educational programs. In addition, some brands – like Jenny Craig, purchased in June 2006 by Nestlé – offer not only consumer products, but also services to help promote new, healthier lifestyles.

As retailers grow in size and influence, they increasingly expect CP companies to deliver more customized services to meet their needs. These range from customized product packaging and promotions to floor-ready

pallets, joint inventory management and flexible order cycle times. Retailers are also looking for ways to differentiate their shopping experience from competitors, and a recent IBM survey reveals they are looking to CP suppliers to help with new services in this area.⁸ Top services requested included: *price optimization, improved wholesale pricing agreements, store-level shopper insights and customer-targeted promotions. Merchandising and category management and retailer-specific products and packaging* were also top contenders.

Many CP leaders are responding by transforming their account teams from product-oriented sales teams to cross-functional, business advisors who provide a variety of retailer-specific services aimed at growing the business together. One successful example is the E.J. Gallo account team working with Food Lion. The two companies reviewed store level point-of-sale data to understand local shopper preferences and used this information to improve category planning and product assortment mix. The result was category sales growth of over 14 percent in targeted North Carolina markets, benefiting both companies.⁹

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Turning to other valuable facets of innovation

Business model

Across industries, business model innovation is becoming increasingly important. CP leaders are applying BM innovation primarily in two areas:

- *Go-to-market approach* – Developing or enhancing strategies, products and services for targeted categories, channels and geographies
- *Structure of the organization and the CP value chain* – Aiming for the dual goals of enabling growth and reducing costs.

Go-to-market priorities are changing as many CP firms adjust their strategy of managing hundreds of brands in dozens of categories. Rather than trying to cover numerous aisles in a store, many CP companies are narrowing their focus to selected growth segments and category-leading or “billion dollar brands.” By acquiring and developing products in promising growth categories and geographies, as well as shedding underperforming brands, CP companies gain relevance and increase leverage with retailers.¹⁰ In this way, CP companies such as Colgate, Procter & Gamble, Unilever, Campbell's and others are reshaping their portfolios.

Similarly, companies like PepsiCo have selectively diversified their business models. With its 2001 acquisition of Quaker Foods and an increased emphasis on snack foods and non-carbonated beverages, PepsiCo has generated strong growth and shareholder returns. PepsiCo continues to extend this strategy of concentrating its business model on new sources of customer demand. It recently formed a strategic alliance with Ocean Spray to develop and distribute non-carbonated beverages that have a healthier profile than traditional soft drinks.

Restructuring of organizations and the CP value chain is also evident through new types of partnering, in areas such as research and development (R&D), and distribution, as well the outsourcing of non-core processes.

One innovative R&D example is the joint venture between food company Nestlé and L'Oréal, the cosmetics, and health and beauty products provider. Their innéov joint venture is aimed at exploring cosmetic nutritional supplements. One can only imagine the potential market for chocolate that is also good for the complexion! Similarly, General Mills, a food company, created a joint venture with DuPont, an industrial chemicals provider, to develop and market soy milk products to target a growing consumer trend. These and other strategic partnerships are aimed at developing new categories and markets.

On the distribution side, companies like Danone and Starbucks have established multiple distribution partnerships to expand the availability of their water and coffee products into grocery and convenience channels.

CP companies may need to evolve their business models as customers, channels and consumers change. Amazon.com recently announced its launch of an online grocery store, with a heavy line-up of natural and organic products. This could be a major opportunity for CP companies to develop and introduce products, offers and information services to match the buying habits of Amazon shoppers and increase their share of the shoppers' wallets. It will also allow them to gain direct feedback from shoppers – a capability for which Amazon is famous – and use the feedback for further innovation in this and other channels.

As discussed below, CP companies are also redefining their business models by adopting new operating strategies.

Operational

Many CP companies are increasingly transforming their operating models. The intent is to prioritize investments in market-differentiating capabilities, such as customer and channel management, marketing and supply chain. Other non-differentiating back-office operations are increasingly becoming candidates for outsourcing to lower cost providers.

Procter & Gamble, Colgate, Unilever, Kraft, Diageo, Coty and others have announced outsourcing partnerships in the last few years. These relationships span a variety of functions, including HR administration, IT services, finance and accounting, and indirect procurement. In addition, third-party manufacturing has also gained momentum with many CP firms. As we said at the outset, the current approach to innovation, which relies largely on incremental product improvements, is no longer sufficient. Instead, CP companies will have to concentrate on a few capabilities that can truly differentiate them in the marketplace.

Regulatory

Growing concerns about the impacts of consumer products on society, individual health and the environment are driving fundamental regulatory changes. CP companies increasingly face a dizzying array of national, regional and local regulations that govern the ingredients, formulations, packaging, pricing and even promotions they can use.

Facing such regulatory challenges and their associated costs, many CP companies reflexively aim to achieve minimal compliance at the lowest possible cost. In some cases, though, a different perspective can reveal unique growth opportunities. By understanding the trends and motivations behind certain regulations – for instance, the obesity concerns of consumers in much of the developed world – and proactively addressing them, CP companies can turn regulatory challenges into sources of revenue.

For example, Kraft successfully developed a niche segment with 100-calorie, portion controlled snack packs. By repackaging existing products into new sizes, Kraft addressed parental concerns for portion control at the same time it blunted the impact of any potential legislation around this issue. Other manufacturers have quickly followed with their own single-size portions. Unilever's efforts to reformulate its Surf Excel Quick Wash detergent products are an example of environmentally-conscious, regulatory-driven innovation. In response to sharp restrictions on water usage in some Indian states, where the hand washing of laundry is prevalent, Unilever reengineered its products to require much less water during rinsing. Since its relaunch, sales of Surf Excel in those states increased by over 50 percent.

Regulation can also drive the need to change operations. For example, legislation in Europe, the U.S. and Canada increasingly requires detailed food traceability information, including lists of ingredients and their sources on the package. Sensing the opportunity this legislation creates, some CP companies have delivered much greater levels of information than required. Environmentally-conscious companies such as Seventh Generation and Tom's of Maine have built their businesses and intensified customer loyalty by providing highly detailed information about their product ingredients, including their impact and their sources.

Of course, regulation as an innovation driver can be a double-edged sword. In 2006, a drive to offer healthier foods to students in U.S. schools led to a combination of government bans on the sale of soft drinks and snacks, and voluntary agreements with several major CP companies restricting sales of these same items. This raises the question, had CP companies been more proactive in creating innovative, healthier alternatives, could this important channel for young consumers have been preserved?

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Primary innovation barriers: Culture and people

“The issue is employee mindset – most employees see innovation as the responsibility of the R&D head or the marketing manager. The challenge is to drive a culture that encourages innovation at all levels, in all functions and in all activities.”

– Global CEO Study Participant, 2006

An enabling culture is critical for innovation as it fosters internal coordination, external collaboration and prudent risk-taking. However, the top two barriers to innovation most frequently cited by CEOs were an *unsupportive culture and climate* and *internal workforce issues* (see Figure 4).

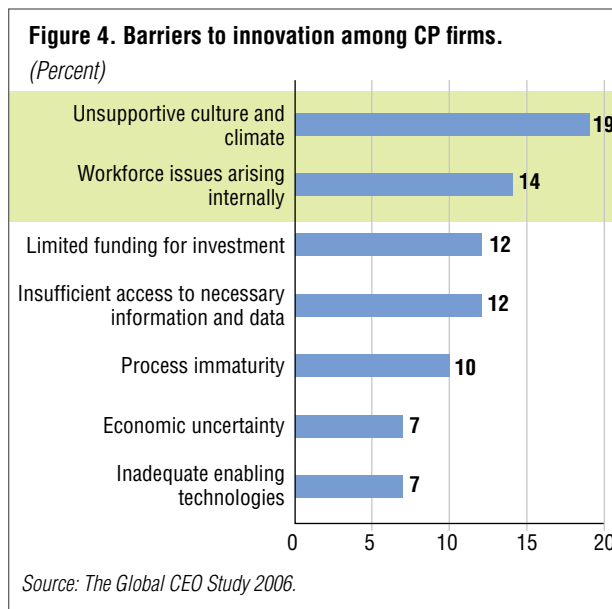
The need for executive leadership is further highlighted by the relatively poor self-assessment given by CP CEOs regarding their innovation enabling capabilities. Just over half of CP respondents assessed

themselves as having *limited to moderate idea generation* and *climate for creativity capabilities*. *Incubation and funding structures*, and *metrics and incentives* were also rated *limited to moderate* by 73 percent of CP respondents.

Other key CEO study findings underscore the need for internal improvements to support innovation:

- Only 49 percent have challenged leaders to develop the positive and creative culture that promotes smart risk taking
- Only 27 percent rated their ability to measure creative outcomes and reward talent as *significant* or *strong*
- Only 19 percent had established a formal process to manage all facets of innovation.

While historically led by the Marketing function, leading CP firms are increasingly turning to senior executives to provide innovation leadership. Chief Innovation Officers and Chief Growth Officers have become more prevalent in the industry and some have been tasked with leading innovation efforts. Ultimately, we believe the CEO must establish the climate for innovation.



Still not enough collaboration

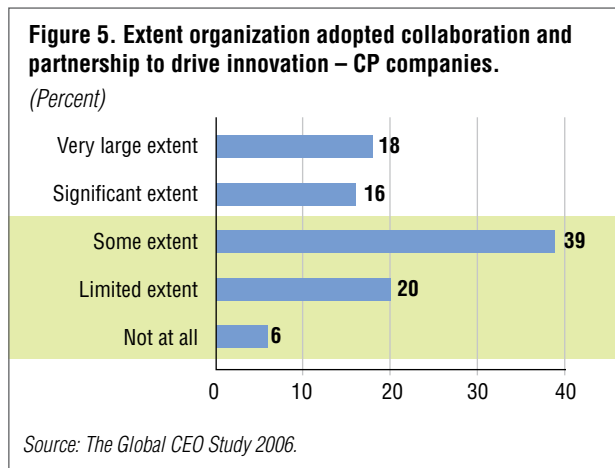
“We need third parties to help benchmark and act as sparring partners. This also helps our staff to broaden their view.”

– CP industry respondent, IBM Global CEO Study 2006

External collaboration

Historically, innovation was considered so important it had to be kept inside the business. In a complete turnaround, today it is seen as so important that it has to involve outside experts to make sure the best ideas and insights are brought into the company. Still, although *the top three sources of ideas among CP firms are external* – business partners, customers and consultants – nearly 60 percent of CP respondents reported that they ultimately *executed on those ideas that were internally generated*.

It's a good sign that CP companies are increasingly looking "outside"; however, many are not yet embracing external partnerships and collaboration for idea generation, co-development and design assistance. Sixty-five percent of respondents described their level of external collaboration as ranging from *to some extent* to *not at all* (see Figure 5).



Reaching beyond company boundaries – Procter & Gamble

Procter & Gamble (P&G) is among the CP companies looking outside of its internal research and development group to capture new ideas and develop new products, anticipating that half of its new products in the next five years will come from outside sources.¹¹

Through its Connect and Develop program, P&G has adopted many "open innovation" principles by leveraging a broad network of scientists, design firms, trade partners and ventures for new product concepts. They have also established innovation "champions" within their market development organizations to identify and explore local market ideas. As of March 2006, more than 35 percent of new products had at least partly originated outside P&G, up from about 15 percent in 2000.¹²

Internal coordination

Coordinating new solution launches should arguably be a core competency for any CP company – not unlike the pharmaceutical industry. However, many CP companies suffer from long product development cycle times, indecisiveness over whether to "cut" initiatives and a lack of effective launch coordination across internal functions. Of the CP companies surveyed, 63 percent cited *improving the new product development process* as the number one action they will take to innovate in the products and services area.

Our experience indicates the companies that are successful in this area demonstrate the following characteristics:

- Senior leaders take an active role in the decision making and portfolio management process
- Product development processes are executed in a parallel or concurrent fashion, as opposed to a traditional serial process
- Measures are highly visible and used to track performance and progress (such as *percent of sales from products introduced in the last three years* and *product development cycle time*).

Technology can help make the process more efficient. For example, the spirits company Diageo adopted new workflow and collaboration tools to better integrate internal resources with external packaging and design partners. These tools, along with cataloging and standardizing product specifications, enabled all parties to work concurrently with access to accurate information. In addition, after new executive leadership streamlined decision making and coordination, Diageo reduced its new product introduction cycle from over 20 months to just 4 months. This improvement enabled Diageo to capture early market share and revenue leadership in the emerging ready-to-drink category.

An “integration gap”: Realizing the importance of integration, versus reaping the benefits

“If we had 10 percent more budget, we would... focus on innovation... spend more on IT R&D... get more engaged around analytics to better enable the business in that area”

– IBM/GMA 2006 IT Study respondent¹³

A recent IBM/GMA survey found that, while CP companies state that growth is their main priority and that technology is a key enabler and asset, only 10 percent of technology investments are allocated to revenue growth initiatives.¹⁴ In addition, 74 percent of CP CEOs indicated that business and technology integration is important to innovation, but only 41 percent acknowledge integrating the two to a significant extent.¹⁵

Technology can support many areas of an innovation program, including idea generation, internal and external collaboration, and launch management. It can also help address one of the top barriers to innovation as reported by CP CEOs, *insights and related data analytics*. (see Figure 4).

Other recent CP industry findings further emphasize the need for better integration of business and technology:

- CP companies view account-specific consumer insight development, and consumer data management and analytics as two of the top five capabilities required to improve revenue growth and profitability¹⁶
- Today, the typical CP company spends 80 percent of its time on data collection and management instead of developing and leveraging insights¹⁷
- On average, CP companies spend less than 0.6 percent of revenues on consumer and shopper insight development.¹⁸

Technology-enabled capabilities such as capturing, analyzing and leveraging consumer, customer and shopper-related data have become high priorities for many CP leaders. Data-driven market insights can be used to refine marketing and promotion campaigns, improve product assortment planning and enable new pricing strategies, in addition to helping uncover broader market and consumer trends. In addition, as retailers strive to differentiate their own shopping experience, CP companies that understand shopper preferences by retailer and store cluster will be in a better position to influence store-level marketing, product placement and promotional programs.

Conclusion: Deploying new approaches

Innovation should be a key component of a CP company’s growth strategy. However, CP companies need to move beyond familiar territory and act more strategically. Four key recommendations can help CP companies evaluate their current capabilities and prioritize next steps.

1. Design a broader innovation agenda that considers opportunities beyond the current product and service orientation.

Innovation should not be reserved for just products and services. CP companies need a more strategic, multifaceted approach to innovation, one that addresses the *business model (BM)*, *operations* and the *regulatory environment*

- What is your innovation strategy?
- Does it consider business model, operations and regulatory areas?
- How are you communicating and enacting your strategy enterprisewide?

2. Build a culture and management systems to encourage and sustain innovation. Commit the time and energy of senior leaders to establish the climate, management systems, incentives and investment priorities to promote and sustain innovative actions.

- Who is leading your innovation agenda?
- What is your plan to establish or enhance the management systems, metrics and incentives to promote and sustain an innovative culture?

3. Be more willing to collaborate externally, and make internal coordination more effective, to source new ideas and improve go-to-market opportunities. Establish new intra- and inter-company processes to harness ideas from new sources and equip people with tools to integrate and execute more effectively. Define an approach to investigate and build external partnership opportunities – from idea generation to solution design and prototyping to distribution relationships.

- Are you leveraging input from consumers, retail customers and external parties?
- How sophisticated are your pipeline management processes and tools?
- How are you coordinating internal processes and teams to effectively launch and manage new solution introductions?

4. Improve analytical capabilities and technology integration to gain useful consumer and customer insights. Through better analytical capabilities and tools, CP companies can use customer, consumer and shopper insights to drive marketing, promotion, pricing, customer and supply chain programs.

- How are you capturing and leveraging market and customer insights?
- How are you using this knowledge to improve your go-to-market processes to improve service to consumers and retailers?

What worked in the past is no longer enough to sustain growth. Ultimately, we believe CP companies need to adopt a multifaceted approach to innovation to succeed in the global marketplace.

Further information

To find out more about this study or to speak with the Consumer Products Leader from your region, please send an e-mail to GlobalCEOStudy@us.ibm.com.

To register to receive a copy of the complete IBM Global CEO Study 2006, please visit:

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Related publications

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