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General Mills taps into the ingenuity of start-up companies

General Mills made a critical business decision: Rather than compete with innovative food start-ups, the corporate giant is investing in them.

By Kristen Leigh Painter Star Tribune

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One year ago, the leaders at General Mills had a revelation: it couldn't keep up.

Specifically, the Golden Valley-based food giant was struggling to develop new, creative products at the pace of innovation that is required in today's ever-changing food industry.

The company for several years had been trying to come up with high-growth products to capture consumers' shifting, and fragmenting, preferences. But last October, General Mills realized it would never be able to out-innovate the plethora of small food start-ups pervading the national market.

Rather than compete with them, General Mills decided to invest in them. The company changed the marching orders for its in-house innovation division, 301 Inc., from an idea-generator to an idea-backer. 301 Inc. is now the venture capital arm of General Mills and has invested in five smaller outside firms. The group's ultimate goal is to find future acquisition targets from among those it supports.

301 is focused on a different type of innovation than General Mills' primary marketing teams. While the company's various food divisions work to identify trends that it can apply to General Mills' existing products — like making Cheerios gluten-free — 301 is seeking disruptive and niche food brands.

Concepts that have caught 301's attention include Kite Hill, which makes nut-based dairy products; Good Culture, a maker of organic and creamy cottage cheese; Tio Gazpacho, which makes chilled and ready-to-drink bottled soups, and Rhythm Superfoods, a maker of vegetable-based snacks. The company's first investment was in Beyond Meat, a plant-based protein maker.

"What we found, to no one's surprise, is that it is very difficult for larger companies to [create this kind of product]," John Haugen, founder and general manager of 301 Inc. and vice president at General Mills, said. "It is really hard to bottle up and replicate that passion and vision and energy that these early-stage -entrepreneurs have."

The 150-year-old company, like most major food processors, has seen sales level off in legacy brands, which for General Mills includes Betty Crocker, Pillsbury, Progresso and others.

"In prior years, clients came to us when they were seeing slippage in their [market] shares and were looking to innovate on their existing brands," said Shelley Balanko, senior vice president of the Hartman Group, a consumer foods research firm. "But there is a certain point in time when culture takes over and no matter what sort of innovation you do, if the consumers don't value your brand, it doesn't matter."

Some of General Mills' biggest competitors, like Campbell's Soup, Hain Celestial and Kellogg, as well as companies like Coca-Cola and Anheuser-Busch, have created their own versions of 301 Inc.

The approach holds the prospect of saving the big companies money. Most have a track record of buying more established firms for exorbitant sums. General Mills, for instance, spent $820 million to buy Annie's

Homegrown, an organic packaged food maker in 2014. Coca-Cola spent $4.2 billion in 2007 to acquire - vitaminwater.

“The investment community spent years focused on midsize brands that have $100 million in (annual) sales or more, but these became really expensive,” Balanko said. “When you acquire them young, you can get them for a good value.”

Shifting strategies

General Mills first chartered 301, named for the address of the original Pillsbury A Mill in Minneapolis, in 2012.

Executives realized that consumers viewed food differently than in previous eras and this shift would have a fundamental and long-lasting effect on the industry. More specifically, mass marketing was no longer going to work for all consumers. Instead, consumer desires were fragmenting and these various factions would need to be sold on products differently.

So while 301 produced some new ideas for its existing brands in those first three years, it wasn’t going to be enough for real future growth.

But the company also lacked the time for small brands to reach critical mass.

“Most early-stage businesses are going to fail,” Haugen said. “It is difficult to replicate the skill set that those early-stage entrepreneurs have but also the patience and perseverance that they have.”

It will take a smaller brand on average between three and five years to reach $100 million in sales, Balanko said, while a typical consumer-packaged goods brand will hit $100 million in a year. Haugen said large food companies don’t have that kind of time or patience. General Mills and its peers are beholden to shareholders and must prove a product’s value quickly.

For 301, those first few years of entrepreneur experimentation gave the team insight into the challenges of starting a new specialty brand.

“While we really struggled to replicate that muscle, as I spent more times talking to these businesses, I realized there are a number of things that are really challenging to them — efficiency, scaling, new category expansion,” Haugen said. “We are looking to make a difference by providing those capabilities.”

So, beyond investing a few million dollars in each company, 301 is offering these companies General Mills’ expertise in distribution, client relationships and business efficiency.

Shared benefits

The fledgling companies gain the firepower of General Mills, and General Mills is not under pressure to attain immediate national success with the new brand.

General Mills’ long-term goal is to become an indispensable partner to these companies so that if and when the start-up achieves greater traction, General Mills is well positioned to potentially acquire the firm before multiple bids make it too expensive.

Of course, there are many challenges to this approach. There is no guarantee General Mills will acquire one of the companies. These small companies could fail or an outside competitor could bid faster or bigger. Just last week, Tyson Foods gained a position with Beyond Meat, the first small business 301 invested in, when it announced a 5 percent equity stake in the plant-based protein maker. Haugen said the food industry is flooded with start-up companies and it can be challenging to weed through all of their pitches. Innovation within food is happening at a voracious rate, evident in the number of venture capital firms looking to fund the next hot brand, said Dayton Miller of Boulder Food Group, a venture capital firm that invests in food start-ups similar to 301 Inc.

Miller and his partner started their fund in November 2014, and since then, the group has witnessed the launch of about 30 more food and beverage investment firms and has tracked about 650 food and beverage deals in the U.S. during those two years.

Balanko said these companies are supported by the increasingly disparate desires of consumers who have splintering priorities, values and views about food.

“Today’s consumer sees themselves as more and more unique,” said Balanko, whose company tracks these patterns. “We are no longer marketing and innovating toward those mass needs. Instead it is about innovating to several of these unique needs.”

Miller said look back 15 years when there were three or four national iced tea brands. Then compare that to today when there are about 100 kombucha (a specialty beverage) brands across the country. Only two have significant recognition nationwide.

“The future of the food and beverage industry might not see the billion-dollar brands,” Balanko said. “It might come from the aggregate of several multimillion-dollar brands.”

This is a challenge for investors like Boulder Food Group and General Mills, said Miller, because “you may need 10 brands to satisfy the market and that’s less operationally efficient.”

But these smaller niche brands often fetch “premium” prices and a passionate consumer base, Balanko said.

“So, yeah, these younger brands aren’t speaking to the masses, but those who buy it, spend a lot of money,” she said. “The key take-home message is that today’s marketplace requires different strategies. It will be interesting to see which large companies will have the patience and intellectual flexibility to recognize they need a different set of metrics to judge success.”

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