CHAPTER TWELVE

Creating New Businesses

The most effective way to cope with change is to help create it.
—I. W. Lynett

Only the paranoid survive.
—Andrew Grove, Former CEO, Intel

The unexpected is the best source of inspiration.
—Peter Drucker

Enterprise Rent-A-Car, which passed Hertz in sales during the 1990s, had sales of 10.1 billion dollars in 2008 as compared to Hertz's 6.7 billion and was much more profitable. Enterprise, formed in 1957 in St. Louis, focused on the off-airport market, catering to leisure travelers and (more important) to insurance companies that needed to supply a car to customers whose car was being repaired, a market that Enterprise created and nurtured. With a signature "We'll pick you up" offer, its inexpensive off-airport sites were run by entrepreneur managers motivated in part by a bonus system tied to customer satisfaction. Not until the late 1980s when it was already nipping at the heels of Hertz did Enterprise begin national advertising and get on the radar screen of its competitors, who were all after the prime market of business travelers who wanted a car at the airport.

Cirque du Soleil started in 1984 with a few street performers. A traditional circus with animals, trapeze artists, clowns, three-ring entertainment, and tents was oriented to families with children. Competitors were always tweaking the acts and setting. Cirque du Soleil ("We reinvented the circus") was qualitatively different, appealing to a different customer group—adults and corporate clients, who would pay a significantly higher price. The performers were talented acrobats, the clowns were more sophisticated, and there was a motivating story line somewhat like a theater production. Further, much of the expense was eliminated: There was only one "ring," no animals, no star performers, and no aisle concessions. It was so

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different that it made the traditional circus irrelevant and changed what the customer was buying.

Yamaha revitalized a declining piano market by developing the Disklavier, which functioned and played like other pianos except that it also included an electronic control system, thus creating a modern version of the old player piano. The system allowed a performance to be recorded and stored in memory. It provided a professional piano experience (with an artist who did not charge or get tired) for the home, hotel lobby, restaurant, or wherever entertainment would be welcome.

During the last century, the automobile industry experienced a dozen or more innovations that have created new business arenas—the Model T, the enclosed car, the GM spectrum of cars from Chevrolet to Cadillac, installment buying, the automatic transmission, the original Ford Thunderbird, the VW bug, the inexpensive and reliable Japanese cars of the 1970s, minivans, SUVs, and hybrids. In each case the innovators achieved above-average profits that extended for years. In particular, the Chrysler minivan, introduced in 1983 with first year sales over 200,000, maintained leadership in the category for at least a decade, and was a critical contributor to the very survival of the firm.

THE NEW BUSINESS

It is natural to look for growth by energizing the current business or by leveraging that business into new products or markets using the approaches described in the last two chapters. The organization understands the existing business and probably has programs in place to improve margins, beat competition, enhance the customer experience, upgrade the products, and leverage their considerable assets and competencies.

There is another strategic route, though, that needs to be understood if not employed—to bypass established business arenas with their fixed boundaries and create a new business in which, by definition, there will be no direct competitors, at least initially. That route, as illustrated by Enterprise, Cirque du Soleil, Yamaha, and the major innovations within the automobile industry, involves changing what the customer is buying by creating a new market or submarket. It is usually based on a transformational innovation that changes the market by introducing a qualitatively different business strategy from what came before.

Consider the new industries that have emerged in recent times, such as mutual funds, cell phones, smart phones, servers, coffee house chains, snowboards, video rentals, 24-hour news networks, multiplex theaters, express package delivery, discount retail in various categories, SUVs, low-carb foods, organic foods, and so on. Each of these innovations has supported high returns, sometimes for a lengthy period of time, for its participants. If a firm can develop or participate in such an emerging arena and do it successfully, growth and profits will follow.

Kim and Mauborgne suggest that such new businesses enter "blue oceans," a space that contains all business arenas not in existence, an unknown market space.[1] In contrast, "red oceans" are established markets where boundaries and operating parameters are established and accepted. When competing in a blue ocean, the challenge is to create demand where it did not exist and to make competition irrelevant. In red

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oceans the goal is to beat competition, to improve market share. As the red ocean space gets crowded, overcapacity, commodization, and low margins are often seen.

Successful blue-ocean businesses usually are based on significant innovations that create a new business model. The innovation is more often conceptual rather than technological, although a technological advance such as the mini-steel mills can be a driver. It can be based on an innovative idea such as mutual funds, a new product form such as the iPod, a new benefit such as eBay delivers, a new concept such as Southwest Airline's city-to-city no-frills service, or a new channel such as Netflix's use of mail and the Internet to distribute film rentals.

The innovation often involves a qualitative leap in value. Innovations that may be dramatic but do not lead to a value jump are seldom drivers of a new business arena. The value achieved can have a cost component as well as delivering customer benefits. In fact, while in red-ocean strategies there is usually a trade-off between differentiation and cost, in blue-ocean strategy firms such as Enterprise and Cirque du Soleil, it is often possible to achieve both low cost and differentiation.

The concept of "newness" is not black and white (or blue or red). There is a spectrum, from the creation of a new category to something less dramatic. A key indicator is the competitive climate—the length of time in which there is little or no competition, and the ability of competitors to become a factor when they do enter. A business that truly establishes a new category could have no competitors at all, perhaps for a decade or more, as was the case for Enterprise, Cirque du Soleil, and CNN, the first 24/7 news channel. Another indicator is how different the business strategy is from that seen before—the market served, the products or services offered, the value proposition, the assets and competencies employed, the service delivery, and the functional strategies. Many of the businesses discussed in the last chapter represented some degree of newness because some elements of the strategy were new and different, and the subcategories established had reduced or little competition.

In the case of Enterprise and Cirque du Soleil, the business could be described as radically different because it differed on so many dimensions of strategy from what came before and because the competition was subdued. In particular, new assets and competencies had to be developed.

There is evidence suggesting that blue-ocean businesses have attractive financial returns. In a study by Kim and Mauborgne of 150 strategic moves spanning a century, the 14 percent that were categorized as being blue ocean contributed 38 percent of the revenues and 61 percent of the profits of the group.[2]

Studies of the dynamics of companies provide supporting evidence. Of the S&P 500 in 1957, only 74 firms remained in 1997, and these firms performed 20 percent under the S&P average during that period—meaning that the newer firms performed at a higher level.[3] McKinsey has collected a database of over 1,000 firms (all with sales of over 50 percent in one industry) from fifteen industries over forty years. One finding was that new entrants into the database (84 percent of the firms were new entrants at one point) achieved a higher shareholder return than their industry average for the first ten years after entry.[4] That return premium was 13 percent the first year, falling to 3 percent in the fifth year and never rising above that level for the

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second five years. Further, there was an extremely high correlation between industry newness (defined as the number of new firms entering, less the number of firms leaving during a seven-year period) and industry profitability. Thus, since new firms are more likely to bring new business models than existing businesses, the implication is that blue-ocean businesses will earn superior profits.

The fact is that firms with established businesses struggle to grow and thrive no matter how excellent their management is. An analysis of a database of some 1,850 companies in seven countries followed for ten years revealed that only 13 percent of companies were able to achieve modest growth (5.5 percent real growth) and profitability targets (exceeding the cost of capital) over a ten-year period.[5] It a firm has performed well for several years, the chances are high that it will falter soon.

There are several barriers to long-term success in existing product markets. First, competitors respond faster and more vigorously than ever. It is hard to turn a product advantage into a sustainable market position or point of differentiation. Second, incremental innovations are difficult to hide because of the "flat world" phenomenon and information technology. A firm's strategy in established product markets is transparent. Third, the markets are so dynamic that it is easy to get behind and become less relevant. Fourth, overcapacity, which seems to emerge in all established industries as firms make capacity decision based on their growth objectives that collectively are unrealistic, results in price and margin pressures. Thus, despite their risk, new business models in the aggregate offer the best hope for sustainable growth and financial success.

THE INNOVATOR'S ADVANTAGE

A prime reason that new business innovators earn more than the average firm is the innovator's advantage. Innovation can create what is often termed a first-mover advantage based on several factors. First, competitors will often be inhibited from responding in a timely manner. They may believe that the new business will cannibalize their existing business. Thus, competitors to Chrysler held back in responding to the minivan because they wanted to protect their station wagon business. Chrysler was "blessed" with a weak position in station wagons and thus had less to lose. Further, they could be worried about the impact on their brand; Xerox did not want to be associated with the low-end desktop copiers that were being offered by Canon even though Xerox had access to one from its Japanese affiliate Fuji-Xerox. Because of these two concerns, firms are tempted to minimize the long-term impact of the innovation and make themselves believe that it is a passing fad.

Second, competitors often are simply not able to respond. They may be playing catch-up technologically, especially if the technology is evolving or if patents are involved. Sometimes there might be natural monopolies (an area might be able to support only one muliplex cinema, for example). More common are organizational constraints. Responding to an innovation might require changes in organizational culture, people, and systems, which can be all but impossible. Many retailers attempted to duplicate Nordstrom's customer service but were unsuccessful because, although they could copy what Nordstrom's did, they could not duplicate what Nordstrom's

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was as an organization—its reward system, culture, heritage, in-store organization, and more.

Third, the innovator can create customer loyalty based on the exposure and experience with its product or service. If the concept and experience are satisfactory, there may be no incentive for a customer to risk trying something that is different. The innovator can also earn the valuable "authentic" label. This was a factor facing competitors such as Kirin when they tried to duplicate Asahi Dry Beer's success in Japan. Customer-switching costs, perhaps involving long-term commitments, can create a distinct disadvantage for a follower. Or there could be network externalities. If a large community begins to use a service such as eBay, it may be difficult for a competitor to create a competing community.

To capture a first-mover advantage, it is important to hit the market first and invest to build position. While high initial prices may be an attractive way to capture margin and recover development costs, a low-price strategy may serve to build share and thus increase the barrier to followers. Followers will have the benefit of seeing the innovation, but will often need to be significantly better to have a chance of dislodging the first mover among the user base. So it is helpful to make that user base as large as possible.

It turns out that true market pioneers often do not survive, perhaps because they entered before the technology was in place or because they got blown away by larger competitors.[6] Pioneers such as Dreft in laundry detergent, daguerreotypes in photography, Star in safety razors, and Harvard Graphics in presentation software did not or could not capitalize on their first-mover status. In contrast, Golder and Tellis found that early market leaders, firms that assume market leadership during the early product growth phase, had a minimal failure rate and an average market share almost three times that of market pioneers, and a high rate of continuing market leadership.[7] They noted that successful early market leaders tended to share certain traits:

- ***Envisioning the Mass Market.*** While pioneers such as Ampex in video recorders or Chux in disposable diapers charged high prices, the early market leaders (such as Sony and Matsushita in video recorders or P&G in diapers) priced the product at a mass market level. Timex in watches, Kodak in film, Gillette in safety razors, Ford in automobiles, and L'eggs in women's hosiery all used a vision of a mass market to fuel their success.
- ***Managerial Persistence.*** The technological advances of early market leaders often took years of investment. It took ten years of research for P&G to create the successful Pampers entry and two decades for the Japanese firms to develop the video recorder.
- ***Financial Commitment.***The willingness and ability to invest are nontrivial when the payoff is in the future. For example, when Rheingold Brewery introduced Gablinger's light beer, it had a promising start, but financial downturns in other sectors caused it to withdraw resources from the brand. In contrast, Philip Morris invested substantially in Miller Lite for five years in order to achieve and retain a dominant position.

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- ***Relentless Innovation.*** It is clear that long-term leadership requires continuous innovation. Gillette learned its lesson in the early 1960s when the U.K. firm Wilkinson Sword introduced a stainless steel razor blade that lasted three times longer than Gillette's carbon steel blade. After experiencing a sharp share drop, Gillette returned to its innovative heritage and developed a new series of products, from the Trac II to the Altra, Sensor, Mach 3 and finally to the Fusion.
- ***Asset Leverage.*** Early market leaders often also hold dominant positions in a related category, allowing them to exploit distribution clout and a powerful brand name to achieve shared economies. Diet Pepsi and Coke's Tab, for example, were able to use their distribution power and brand names to take over the diet cola market from the pioneer, Royal Crown Cola.

Being a first mover and owning an emerging market or submarket does more than provide a competitive edge in that market. It also leads to a perception of being innovative. Gaining perceptions of innovativeness is a priority for nearly all businesses because it provides energy and credibility for new products. But few brands break out and reach that goal. In Figure 12.1, examine the top 15 brands on an innovativeness scale according to the 2007 BAV (Brand Asset Valuator from Y&R) database covering over 3,000 brands.[8] Nearly all have created and/or owned a new submarket using transformational innovation.

1.Bluetooth	6. DreamWorks	11. Disney
2. Pixar	7. TiVo	12. Google
3. iPod	8i. iMac	13. Swifter
4. Imax	9. Discovery Channel	14. Wikipedia
5. Microsoft	10. Blackberry	15. Dyson

Figure 12.1 Perceived Innovativeness—2007

MANAGING CATEGORY PERCEPTIONS

When a new product category or subcategory such as iPods, smart phones, Pringles, or hybrid cars emerges, the innovators need to be aware that their challenge is not only to create an offering and a brand, but also to manage the perception of the new category or subcategory. A new business will change what people are buying. Instead of buying a car, some customers will be looking for a hybrid. As new entrants come in, there will be different types of hybrids. So Toyota, the early hybrid leader, has an opportunity to manage the perceptions of the category while simultaneously linking itself to the category as the leading brand, one with authenticity and ability to deliver. For a business innovator, the focus is no longer just on what brand to buy

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PETER DRUCKER'S DO'S AND DON'TS OF INNOVATION[9]

Do:

- Analyze the opportunities
- Go out and look, ask, and listen
- Keep it simple, keep it focused
- Start small—try to do one specific thing
- Aim at market leadership

Don't:

- Try to be clever
- Diversify, splinter, or do too many things at once
- Try to innovate for the future

(the preference question), but rather what product category or subcategory to buy (the relevance question).

In managing perceptions of a category, there are some guidelines. First, there may be a need to focus on attributes and functional benefits at the outset to make sure that the category and its value proposition are communicated. The emotional and self-expressive benefits can have secondary status at the outset. Second, labels such as minivan, camcorder, SUV, etc., help unless the first-mover brand such as TiVo or Xerox becomes the de facto subcategory label. Incidentally, these guidelines apply whenever the category is new to the market, even if it is established elsewhere. For example, many categories of products (such as vans) are new to China long after they have been established in the Western world.

CREATING NEW BUSINESS ARENAS

The first step to the creation of a new business arena is to get ideas on the table and refine the best ones to obtain potential business concepts. Good ideas are more likely to happen if they are valued by the organization and if there is a process to stimulate them. GE has set a goal that each business should generate technology breakthrough ideas, concepts that could lead to a $50 million to $100 million idea in the foreseeable future. As a result, time and resources are given to idea generation.

In the last chapter, the starting point was the assets and competencies of the firm and how they could be leveraged. Here, the starting point is the customer in relation to offerings. In what way are the offerings disappointing? What are the unmet needs? What activities are the existing product or service a part of, and what are the goals?

New business ideas can come from anywhere. However, the history of blue-ocean ventures contains patterns and can suggest possibilities. Among them are technological innovation, going from components to systems, unmet needs, niche submarkets, customer trends, and creating a dramatically lower price point.

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Technological Innovation

A new technology—such as disposable razors, notebook computers, a new fabric, or hybrid cars—can drive the perception of a submarket. By creating a subcategory of dry beer, Asahi Super Dry Beer made Kirin, the leading lager beer brand, irrelevant for a significant and growing segment in Japan. A minor player with less than 10 percent of the market in 1986, Asahi grew to gain market share leadership in the late 1990s, in large part by taking share from Kirin. Kirin finally mounted a comeback by introducing Kirin Ichiban, a different beer formulation, and taking leadership of the low-malt subcategory, *happoshu,* a beer brewed with ingredients that warranted a sharply lower tax, and another no-malt beer with an even lower tax, termed the third beer. Amazingly, considering an average of three new product introductions per month and the marketing dollars spent in the Japanese beer market each year for thirty years, three of the four changes in marketing share momentum were due to these innovations: dry beer, Kirin Ichiban, and low malt beer. The fourth change was due to Asahi's repositioning of the dry beer subcategory. The market share dynamic was explained entirely by the emergence or evolution of subcategories.

Technological innovation can take many forms. Packaging innovation led to Yoplait's Go-Gurt, the yogurt in a tube that kids slurp up, which created a new business with a different target market, value proposition, and competitors than conventional yogurt makers. Software innovation created eBay's online auction category where a host of imitators had difficulty matching both the operational performance and the critical mass of users established by eBay.

From Components to Systems

A classic way to change the market is to move from components to systems. The idea is to look at the system in which the product or service is embedded, to expand perceptions horizontally. Siebel, for example, changed what people bought by creating customer relationship management (CRM). CRM combined a host of software programs (such as call center management, loyalty programs, direct mail, customer acquisition, customer service, sales force automation, and much more) into a single umbrella package. It no longer was enough to provide the best direct mail program, because firms were now buying something much broader and were simply not interested in stand-alone programs that would require idiosyncratic training and would not be linked to other complementary programs.

KLM Cargo's offering was providing space on its airplanes, a commodity that was becoming a low-margin business.[10] After studying the total system needs for customers who were shipping perishables, KLM determined that significant value could be added by providing not just cargo space but a transportation solution that would include end-to-end responsibility for the product. These customers, importers and retailers, were experiencing spoilage, and it was never clear who in the logistics chain was responsible. Under its Fresh Partners initiative, KLM provided an unbroken "cool chain" from the producer to the point of delivery, with three levels of service—fresh regular, fresh cool, and fresh supercool (where products are guaranteed to have a specific temperature from truck to warehouse to plane

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to warehouse to truck to the retailer). Firms importing orchids from Thailand and salmon from Norway were among those using the service. This initiative allowed KLM to move from a commodity business to one that could capture attractive margins based on the value delivered to customers.

Unmet Needs

Unmet needs provide insight that when translated into products or services will be highly likely to be relevant to the customer and can lead to new business. When Saturn and Lexus, for example, changed the way customers interacted with car dealers, they were addressing a significant unmet need. The result made some other brands less relevant for an important segment. Betty Crocker's Hamburger Helper addressed the need to have a shelf-stable meal preparation tool.

Cemex, a concrete company, realized that its customers had a lot of money riding on predictable delivery because concrete is highly perishable.[11] As a result, Cemex created capabilities of using digital systems that allowed drivers to adjust in real time to traffic patterns and changing customer timetables. It can now deliver product within minutes and process change orders on the fly. It addressed an unmet need, and the totally new business model that resulted has led to Cemex going from a regional player to the third largest concrete company in the world, serving thirty countries.

Customers are not always a good source for some kinds of unmet needs, especially those involving emotional and self-expressive benefits, and so insight from creative and knowledgeable people might be required. The attractiveness of an SUV, for example, did not really result from its functional benefits. Further, customers have a difficult time getting around the boundaries of the current offering and may not have been much help in going from a horse to a car to an airplane. So in analyzing the customer, it is important for the analysis to have both breadth and depth, and that is where ethnographic research excels.

Ethnographic (or anthropological) research, introduced in Chapter 2, is a good way to uncover and analyze unmet needs. Simply observing customers in their "native habitat" can provide a fresh and insightful look at the problems customers are facing.

Niche Markets

The market can be broken into niches with each niche having its own dominant brand. The energy bar market created by PowerBar ultimately fragmented into a variety of submarkets, including bars designed for women (Luna), high protein (Balance), low calories (Pria), and candy bar taste (Balance Gold).

A niche can be defined by an application. Bayer helped define a new subcategory—taking baby aspirin regularly to ward off heart attacks—with its Bayer 81 mg. It attempted to further define the subcategory by introducing Enteric Safety Coating to reassure those who might be concerned about the effects of regular aspirin use on the stomach.

A niche can be also defined by a unique position that appeals to a distinct submarket. In the United Kingdom, the Ford Galaxy minivan was positioned away from

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the functional soccer moms or family outing slot. It was instead introduced as being roomy and comfortable, like first-class air travel, and therefore suitable for busy executives. Starbucks similarly created a different retail coffee experience that made other competitors irrelevant.

Customer Trends

A customer trend can be a driver of a submarket. The expression "Find a parade and get in front of it" has some applicability. That was part of the strategy of Whole Foods with organic foods and Apple's iPod with music sharing.

It is even better if multiple trends can be accessed because the competitors will be more diffuse. The dual trends toward wellness and the use of herbs and natural supplements have supported a new category, healthy refreshment beverages (HRBs). This arena now contains a host of subcategories, such as enhanced teas, fruit drinks, soy-based drinks, and waters. The pioneer and submarket leader is SoBe, which started in 1996 (with SoBe Black Tea 3G, containing ginseng, ginkgo, and guarana) and now has an extensive line of teas, juices, and energy drinks. The large beverage companies ignored this trend for too long and have been playing a frustrating and expensive game of catch-up. Annie Chun developed a line of packaged Asian food that capitalized on a host of trends including the rise of Asian foods, healthy eating, convenience, and quality meals.

Creating a Dramatically Lower Price Point

Many blue-ocean businesses occur when an offering appears that is simpler and cheaper than that of established firms. Clayton Christensen, a noted Harvard strategy researcher, has studied a wide variety of industries with a series of colleagues and developed two theories about disruptive innovations. His research is reported in three books: *The Innovator's Dilemma*, *The Innovator's Solution* (with Michael Raynor), and *Seeing What's Next* (with Scott Anthony and Erik Roth).[12]

The first theory is termed *low-end disruptive innovation*, where industries are altered by emerging products whose price appears dramatically low. In these industries, established firms target the best customers and attempt to sell them better products for more money. More features, services, and reliability are all aimed at capturing a higher level of loyalty and margin. The firms that are successful develop structures, staffs, incentives, and skills designed to generate and implement a continuous flow of "sustaining innovations" to improve the offering. They invest in building deeper relationships with their best customers, wealthy clients in the case of financial institutions. Packaged goods firms offer line extensions to provide variety and interest to loyal customers. Retailers and others invest in loyalty programs.

This drive to service the most profitable customers provides an opening in the form of the low-end customer. These customers, often ignored or considered a nuisance by the established firms, are typically "overserved" and would be happy with a simpler, cheaper product that delivered satisfactory performance. Capitalizing on this opportunity, firms (often new to the industry) engage in "low-end disruptive innovation." They introduce an entry that is easier to use and much less expensive. Typically,

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the entrant's product is so inferior that its appeal is to a limited number of applications and customers, which incumbent firms consider marginal anyway. But often these firms then improve their offering over time and become competitors in a broad section of the market. A study of stall points, where steady sales growth abruptly changes to prolonged decline, of some 500 firms over 50 years showed that the leading cause, occurring in 23 percent of the cases, was low-end disruption innovation.[13]

The steel minimills in the 1960s initially made low-quality steel, serving a market for rebar (reinforcing concrete) that did not require high quality and was a low-margin, unattractive business. Over the decades they improved their technology and products, however, and began to challenge the incumbents on a broad front. There are many similar examples. The Japanese car companies entered the market in the late 1960s and provided an option for buyers who did not need the features and self-expressive benefits of the large American firms. The copier market in the 1970s was changed by Canon's low-end disruptive innovation strategy, which met the needs of small businesses that did not need the power of Xerox products.

The Christensen team also advance a second theory, that of *new-market disruptive innovations* aimed at noncustomers. In many markets, large groups of noncustomers either do not buy because the products or services are considered too expensive or complex, or buy much less than they would like because the process is inconvenient. A more accessible offering that is priced right can open up the market. Apple's Macintosh attracted new users into the computer market, and online retail stockbrokers enabled day traders to thrive. The single-use camera provided a new market just as the Kodak Brownie did a century earlier. Vanguard's low-cost index funds attracted new buyers into the industry. The noncustomers have typically been ignored by the established firms who, again, tend to focus their efforts on the current "heavy users," the most profitable customers.

An attractively priced option can appeal to both the low-end and noncustomer segments simultaneously. Southwest Airlines targeted not only customers looking for a value airline but also people who could be lured from their automobiles, a segment that was ignored by the established airlines of the day. Dell Computer also succeeded both serving the low end and attracting new users.

Evaluation—Real, Win, Worth It

The evaluation of a major or transformational innovation is difficult because it will stray from the comfort zone and knowledge base of a business. A structured, disciplined evaluation approach is helpful not only to provide a termination decision but also to identify the roadblocks to success so that they can be addressed. The "real, win, worth it" structure suggested by Wharton's George Day involves the following sets of questions:[14]

- Is the market real? Is there a need or desire for the product? Can and will the customer buy it? Is the market size adequate? Segway's personal transporter was an ingenious technical innovation but did not solve transportation problems for any target market.

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- Is the product real? Is there a clear concept that will satisfy the market? Can the product be made? Putting nuclear energy plants in the ocean presented construction barriers.
- Can the product be competitive? Does it have a competitive advantage, one that is sustainable? If a competitor can copy or neutralize the new product, it may have only a short window to establish a loyal customer base.
- Can our company be competitive? Do we have superior assets and competencies? Appropriate management? The success of the digital animation company Pixar depended on a unique blend of culture and people; it would not have worked in most film organizations.
- Will the product be profitable at an acceptable risk? Is the forecast ROI acceptable? Overoptimistic sales forecasts and unrealistic pricing expectations need to be considered.
- Does launching the product make strategy sense? Does it fit our overall strategy? Will top management support it? 3M launched a privacy computer screen that opened up markets for anti-glare filters.

Keeping the Edge

The goal is to maintain dominance in the new submarket and the returns that go along with dominance. Not so easy when success breeds competitors. Those that have kept dominance have one or more characteristics. Some, like Apple, keep innovating so that they are a moving target. Others, like Snuggles and Asahi Dry, are the "authentic" choice. Still others like Cirque du Soleil have created significant entry barriers in terms of competencies and scale. And there are those like Southwest Airlines that surround their innovation with a personality. The list goes on but there needs to be an edge to avoid a transformational innovation becoming only a short-term win.

FROM IDEAS TO MARKET

The payoff for creating a successful new business is huge. Historically, most financially successful firms are based on the creation of a new business. Yet few firms can have a history of creating multiple new businesses. It turns out that it is not easy for an organization to be successful with an established business and still provide an environment that will foster new business ideas and allow them to flourish. That is exactly what is required, though, when markets get dynamic. The challenge is to create an organization that can excel in existing businesses and still allow a new business, especially a transformational business, to survive if not thrive. In the terms of Chapter 8, strategic adaptability needs to play a more prominent role, either in addition to or perhaps in place of strategic commitment or strategic opportunism.

Most organizations lack a healthy mix of transformational and incremental innovation. One study concluded that the percentage of major innovation in development portfolios dropped from 20.2 to 11.5 from 1990 to 2004.[15] And from the mid-1990s to 2004 the percent of total sales due to major innovations fell from 32.6 percent to 28 percent.

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Why should there be such a bias toward incremental "little i" innovations? To answer that question, we turn to a discussion of the several reasons why organizations fail to support transformational innovations at an optimal level.

Fatal Biases Inhibiting New Business Creation

Understanding the several biases that inhibit firms from innovating new business areas is a first step to dealing with them. These biases can be expressed in terms of six related "curses"—short-term pressures, silo, success, incumbency, commitment, and size.

The short-term financial pressure curse. When the organization is doing well, there is pressure to create short-term growth and margins, in part driven by the desire for stock return and in part driven by managers with short job tenures. Short-term results can best be obtained by diverting R&D funds to sustaining innovation and focusing effort on improving the business model, enhancing the value proposition, and improving efficiency and productivity. Creating a new business platform is risky and expensive and likely to result in short-term financial pain. A new firm, perhaps funded by venture capitalists, will have a time horizon to start making profits.

The silo curse. The power of product silos within organizations often leads to a delegation of innovation and development from the corporation to the silo unit in part to gain accountability and funding ability. Silos by their nature have limited resources and are focused on a particular product line with its associated customer base, operations, assets, and competencies. The natural goal is to respond to opportunities to improve the offering or to leverage the existing business. A transformational innovation will require more resources, will often need to operate between existing silos, and can be a threat to the existing profit stream.

The curse of success. When times are good and the business is doing well, resources should be available to take risks and create new business areas. Curiously, however, complacency usually wins the day. Why change if the current business is generating growth and profits? Why not instead invest in a sure thing, to make the costs even lower and the profits even higher? It is much easier to change when there is a crisis than when things are going well, although in a crisis both resources and time may be in short supply.

The incumbent curse. When a transformational innovation is aimed at the marginal customer or the noncustomer, there is a tendency to ignore the threat to the basic business. The natural strategy is to focus on the good, high-margin customers. If the new concepts steal marginal customers, so what? Those customers were more of a nuisance anyway. Further, it does not seem wise to invest in an offering that will kill the golden goose. Why invest in an offering that may cannibalize your business?

The commitment curse. Successful incumbent firms often have a tunnel focus on their strategic vision. In the terms of Chapter 7, they engage in strategic commitment. They invest vigorously in incremental innovation to reduce costs, improve the offering, and satisfy their loyal customers. The people hired, the culture created, the

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systems developed, and the organizational structure employed all are tailored to the task of making the existing business better. In that context, it is difficult for any new business concepts to get resources or serious traction within the firm.

The size curse. A new business by definition will start small. If a firm has been successful and grown to a meaningful size, it will look to business concepts that can make a difference to shareholders. McDonald's, for example, is inhibited from trying new restaurant concepts because even a successful concept aggressively expanded will have no impact on its financials; the core business is simply too huge. As a result, it became stuck in a model that was not supported by customer trends. Coke resisted marketing waters and other beverages in part because it was so unlikely for such business ventures to materially affect its shareholder value. A related problem is that a huge business like McDonald's or GE has built assets, processes, and organizations that are not adapted to run smaller businesses. One snack company once proclaimed that it was not capable of handling a business that was under $250 million. That inhibited it from participating in potential growth areas.

Making New Business Viable in Established Organizations

The basic problem is that a new business, particularly a transformational one, will require an organization that is very different from that of the core business. It will require people, systems, a culture, and a structure that must adapt quickly to an emerging market area, one that is almost by definition going to be very different from the core business.

One approach is to create a separate organization, either by acquiring the industry innovator and retaining its autonomy or by creating a stand-alone entity within the corporate framework. In either case, the separate organization will be free—indeed, encouraged—to create its own people, systems, culture, and structure. Of course, it can borrow elements of the core business, such as its accounting systems or perhaps marketing skills, but it needs to be committed to the strategic vision of the new organization while still being entrepreneurial and flexible. As the business matures, the link with the core business can become greater.

The other approach is to create a dual organization within the same firm. People who excel at "start-up" adaptability and change, as well as those who have proven to be good at incremental innovation, will need to be developed side by side. A more diverse set of people will likely be the result. Entrepreneurial cultural values will need to be tolerated within the organization. Experimentation and trial and error will need to be accepted if not encouraged. Different cost control systems and performance metrics will be needed. The new ventures will probably require a flatter organization.

Developing a dual organization is difficult and requires active management. However, it is possible and can result in providing new ventures with access to significant assets and competencies while also breathing energy into the core businesses.

In any case, an innovative new business cannot be starved for resources. The reason that most new businesses succeed as start-ups is because they have access to money from the stock market and from venture capitalists. Internally funded ventures

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are often at a disadvantage in obtaining needed resources. Too often, executives in large firms are said to have deep pockets but short arms.

To overcome resource shortfalls, top management has to make a commitment to grow through internal innovation and allocate resources toward that goal. Then a new venture will be able to compete for these resources with other new ventures and not from the existing business units. GE, with its program of encouraging and supporting breakthrough initiatives, does just that. Another key to resource availability is the disciplined process to disinvest in businesses that are not going to be the future of the firm, so that they do not exert their priority over future resources. Chapter 14 discusses the disinvestment decision process.

KEY LEARNINGS

- Over time, businesses that are new and different enough to have reduced or no competition will earn much more than average profits.
- The innovator has the potential to create a marketing position because competitors are reluctant to damage their own businesses, cannot match the technology, or believe it too costly to compete against a firm with an established customer base. Often it is not the innovator but the early market leader that captures these advantages.
- In creating a new business, managing the perceptions of the category is important.
- A new business can be based on technological innovation, moving from components to systems, by satisfying unmet needs, by creating niche marketing, by responding to customer trends, or by having a dramatically lower price point.
- There are organizational biases that inhibit the development of a new business. These can be described as the short-term financial pressure curse, the silo curse, the curse of success, the incumbent curse, the commitment curse, and the size curse.

FOR DISCUSSION

1. Why didn't Hertz or Avis start an off-airport business directed at insurance companies and vacationers? What advantages would they have had over Enterprise? Why didn't Steinway come up with the electronic organ? Why didn't Barnum and Bailey create the Cirque du Soleil?
2. In order to revitalize the Reebok brand with women, the company that rode the aerobics craze two decades ago introduced Jukari Fit to Fly, an exercise program designed with Cirque du Soleil. A piece of equipment, the Fly Set, allows a person to fly through the air hanging

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on to a low trapeze. The goal is to invent a new fitness fad in exercise establishments with a program that is supported by a line of Reebok clothing.

a. Is this a transformational new business?

b. Evaluate its pros and cons for Reebok.

3. Think of some transformational new businesses such as Starbucks, TiVo, or Amazon.

a. How was each different from what came before? What was similar? Scale them in terms of "newness" from truly transformational to substantial (some elements common to what came before, but enough new to create a new subcategory).

b. Was there an innovator advantage? How long did it last and why?

c. Did the business originate from an established business? If not, why not?

d. Where did the idea for the business come from? If you don't know, try to speculate.

4. Consider some new businesses that have managed category perceptions well. Consider others that have not.

5. What firms have changed from components to offering systems? Have they obtained an innovator's advantage?

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