Strategy For Startups: The Innovator's Dilemma

Posted Apr 8, 2012 by Uzi Shmilovici (@uzisho)

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Editor's Note: *A guest post by Uzi Shmilovici, CEO and founder of Future Simple, the company behind Base CRM.*

Strategy. Unfortunately, it suffers from a bad reputation among startups. It is associated with consultants who are paid millions of dollars only to come back with a two-by-two matrix of animals. Not that there is anything wrong with it. Some of my best friends are consultants.

However, strategy is crucial for startup success. Startups usually operate in an environment of constrained resources while competing with strong incumbents. Hence, the right strategy can be a matter of life and death. This post is the first in a series of posts that will explore concepts in strategy and how they apply to startups.

The first concept we'll look at is the "Innovator's dilemma", a term coined by Clayton Christensen from the Harvard Business School. The innovator's dilemma discusses a situation in which there are established incumbents in a specific market who are investing in sustainable innovations — these are incremental improvements to an existing product. Usually, they are doing that to support the incremental needs of their customers.

They are then faced with a new entrant to the market that introduces a disruptive innovation. The new entrant attacks only a small part of the incumbents' business, usually the one in which

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are afraid of cannibalizing their main business. As a result, the new entrant is then able to capture a significant market share in that specific segment.

What happens next is funny. After it captures the low end of the market, the entrant moves upstream to the next part of the business. Again, the incumbent is reluctant to compete in that segment which is now its newest least profitable segment. The entrant then captures a significant market share in this second segment.

What happens next is funny. OK, you got the point…

Before we continue, it is important to understand the types of disruptive innovation that exist. There are four: a new product, a new technology to produce a product, a new way to distribute a product and a new way to provide services. The entrant can introduce a disruptive innovation along one or more of these dimensions.

Why would anyone buy books on the internet?

1995. The commercial internet is in its early days. Jeff Bezos decides to start selling books online. At that time, the biggest booksellers in the United States are Barnes and Noble and Borders.

Bezos understands that he can disrupt the book industry by taking advantage of the internet as a new distribution channel. Amazon launches and grows exponentially. It takes B&N two years to open its own website. What took them so long? Well, not too many people buy on the internet and they are far better investing their resources in their major business — the retail stores.

It takes Borders three years to launch their website. At this point, Amazon is far down the road. In 2001, Borders decides let Amazon run their website for them. After all, the internet is just a small percentage of their sales anyway.

On February 16th, 2011 Borders files for bankruptcy.

If you'll look around, you'll find many industries that experienced or are experiencing a similar type of disruption. A small sample from internet startups — Zynga : Gaming Companies, AirBnB : Hotel Chains, Box : Sharepoint.

The Innovator's dilemma and your startup

There's a reason why so many internet startups were able to use the concepts from the innovator's dilemma. The internet provides an amazing platform to build disruptive products, and more importantly, create and leverage new distribution channels.

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1. Understand what is the source of your disruption. Is it a new product or a new way to distribute an existing product? This will help you understand whether you are really disrupting the market or just building an incremental product.
2. Pay attention to opportunities in new distribution channels. Zynga's biggest innovation was taking advantage of Facebook as its distribution channel before the traditional gaming companies could say "Mark Zuckerberg".
3. Start by marketing to the group of customers for which the incumbent in your industry has the lowest margin or the lowest interest to defend. Don't go head to head on their most important customers. They will crush you.
4. Remember these lessons when you are at the top.

Figuring out how to compete in your market will take a lot of time and effort. Remember that these frameworks are just tools to help you think through the problem and will not provide you with a magic answer. You'll have to discover it yourself.

Image credit: isdky — Brian Barnett, Flickr

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Uzi Shmilovici

BIO
Uzi's passionate about building products at the intersection of design, technology, and business. He's obsessed with creating amazing customer experiences, and doesn't believe patience is a virtue. When he can find the time, Uzi likes to write about the future of software, and has written for TechCrunch, GigaOM and ReadWriteWeb.

Full profile for Uzi Shmilovici

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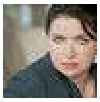
Shawna Rife · Owner/CEO at Can Do Consulting

I can't find the other parts of the series? Can you post links?

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David Ward · Manager at Ryder System, Inc.

Great post Uzi! Great synthesis of a timeless concept!

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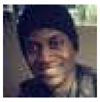
Christian Christian · Brussels, Belgium

This definitely makes Strategy look so sexy. I'm going to buy "Lean Startup" and "Innovator's Dilemma" as my spring break readings...

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Tom Sieger · Sugar Land, Texas

The nibbling away at the periphery is much easier when the innovation whether distribution or product is a B2C innovation because of the sheer number of consumers and relative ease of the stealth assault. When you're dealing with solutions for large enterprises it gets a little more tricky. I'd be curious to see some examples of that. Some will point to salesforce.com but they really competed at the individual buyer level initially before attacking the enterprise market. How would you apply the "Innovator's Dilemma" to data mining, compliance, analytics and other enterprise software that really doesn't have an individual buyer market?

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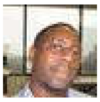
Jaron Hunter · Boca Raton, Florida

flows like poetry!

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Robert W Price

As the author of the Roadmap to Entrepreneurial Success, the Executive Director for the Global Entrepreneurship Institute who has mentored thousands of student-entrepreneurs, I feel qualified to contribute on this discussion. Thank you for taking the time to prepare a detailed article Uzi. It is very helpful. Currently we have some student entrepreneurs who have graduated and recently been accepted into incubators. We tell them: "Building a castle is difficult. Defending and maintaining it is harder still." (Asian proverb) I wanted to share this clip (2:36) from Stanford's excellent STVP program about "Developing and Operating Range." Sometimes tech-entrepreneurs find it challenging to "see the big picture at the 50,000 foot view" and instead will stay focused on the 500 foot view in the heads-down mode building their castle. Thus, they can miss new entrants and fast followers.
http://ecorner.stanford.edu/authorMaterialInfo.html?mid=2899

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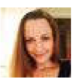
Katharina Kolos · Founder & Creative Mind at Toucan Brands

Love the proverb - describes the situation perfectly!

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Jamie Sutherland · San Francisco, California

It is almost like this is the natural evolution of industry. An incumbent becomes so large and n an existing revenue line(s) that it becomes almost impossible to disrupt

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