Innovation, Value Discipline and Marketing Of Market Leaders

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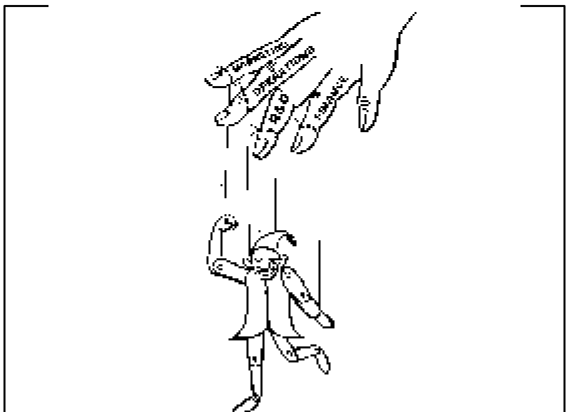
Innovation is a process that endows resources with a new capacity to create wealth. Successful entrepreneurs try to create value and to make a contribution. To quote Peter Drucker "Systematic Innovation therefore consists in the purposeful and organized search for changes, and in the systematic analysis of the opportunities such changes might offer for economic or social innovation."

Innovation is the specific tool for entrepreneurs, the means by which they exploit change as an opportunity for a different business or a different service. Entrepreneurs innovate. Innovation and entrepreneurship go hand in hand. The two are like the Siamese twins. One cannot be separated from the other.

Innovation need not be technical like the invention of steam locomotives or the telegraph or the Wright Brothers' airplane. It can be economic and social. An example of a social innovation would be newspaper or insurance while an illustration of economic invention would be installment buying.

In his book *Innovation and Entrepreneurship*, Peter Drucker argues that social invention has been far more critical than technical invention and corroborates his argument with the example of Japan. The Japanese concentrated their resources on social innovations (like building the institutions) and to imitate, import and adapt technical innovations (successful creative imitation which has been often a very successful entrepreneurial strategy)



How and Where does Innovation Take Place?

The practice of innovation and entrepreneurship involves three important elements. The first element is how and where the entrepreneur searches for innovative opportunities and develops an innovative idea into a viable business or service. The second element is the practice of entrepreneurship itself and focuses on the institution that is the carrier of innovation. The third element is the entrepreneurial strategy which brings innovation successfully to market. The test of an innovation lies ultimately in its success in the market place and not in its novelty.

Systematic innovation, according to Drucker, involves looking at seven sources for opportunities. It is purposeful search and analysis of the innovative opportunities. It is imperative to go out to look, to ask, to listen. The seven sources of opportunities are

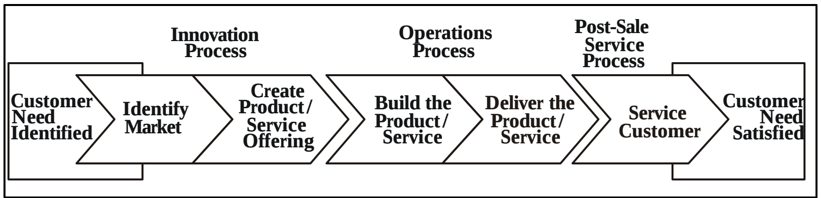
Within the Enterprise or Industry

- **The unexpected**—the unexpected success, the unexpected failure, the unexpected outside event.
- **The incongruity**—between reality as it actually is and reality as it is assumed to be.
- Innovation based on process need.
- Changes in industry structure or market structure outside the enterprise or industry.
- Demographics.
- Changes in perception, mood and meaning
- New Knowledge, both scientific and non-scientific

The lines between the seven sources are blurred and there is considerable overlap between them. From a different perspective, the innovation process is encapsulated in a generic value chain model shown below.

According to Kaplan and Norton, there are three principal business processes in the Generic Value Chain (a) Innovation (b) Operations (c) Post-sale service.

Innovation is a critical internal process. Being effective, efficient and timely in innovation process is, for many companies, even more important



than excellence in the day-to-day operating processes. The relative importance of the innovation cycle over the operating cycle is especially noticeable for companies with long design and development cycles, such as pharmaceuticals, agricultural chemicals, software and high-tech electronics. The innovation process consists of two components. The first component comprises of identifying the market size, customer's preferences and price points for the targeted product or service. These are the sources from outside the enterprise or industry viz Demographics, Changes in perception etc. Information about markets and customers provides the input for the actual product/service design and development processes, the second step in the innovation process. In this context, 3M with a product line totaling more than 50,000 different items serves as an excellent example for technical ingenuity and marketing innovation. 3M is known for innovation, speed and an entrepreneurial culture which enables it to dominate niches. The company remains a model of decentralization and a small government. Researchers spend 15% of their time on any project of their choice. One third of 3M's $16 bn in revenues come from products that did not exist four years ago. Its global revenues constitute more than 50% of its total revenues which today stands at $16 bn.

The operations process represents the short wave of value creation starting with the customer order receipt and ending with the delivery of the product or service to the customer. This process stresses efficient, consistent, and timely delivery of existing products and services to existing customers.

The final stage in the internal value chain is post-sale service which includes warranty and repair activities, treatment of defects and returns, and the processing of payments, such as credit card administration. Companies that sell sophisticated equipment or systems, like General Electric Medical Systems and Otis Elevator know that any downtime on their equipment is extremely expensive and inconvenient to their customers. Both these companies enhance the value of their equipment by offering rapid, reliable service to customers to minimize such disruptions. They even embed electronic technology in their equipment that senses and transmits signals to company service personnel when the equipment shows signs of imminent failure.

Three Prerequisites for Business Success

What does your company do better than anybody else? What unique value do you provide to your customers? How will you increase that value next year? As customers' demands for the highest quality products, best services, and lowest prices increase daily, the rules for market leadership are changing. Once powerful companies that haven't gotten the message are faltering, while others, new and old, are thriving.

What is the discipline needed for a corporation to become and remain the market leader. How do these corporations do it? What are the mechanisms that they put in place to make it happen? What is the science and art of formulating strategy, in choosing their customers, narrowing their focus and dominating their respective target markets.

Michael Hammer and James Champy, in their book *Reengineering the Corporation* published in 1993, launched a business revolution. They advanced a set of ideas as to how companies can redesign the way they do their work. It was about how to run a race. In the book, *Discipline of Market Leaders*, Michel Treacy and Fred Wiersema argue that success is about choosing the race to run.

There are three prerequisites to success. The first is the value proposition, which is the implicit promise a company makes to customers to deliver a particular combination of values—price, quality, performance, selection, convenience and so on. The second concept, the value-driven operating model, is that combination of operating processes, management systems, business structure, and culture that gives a company the capacity to deliver its value proposition. If the value proposition is the end, the value-driven operating model is the means. And the third concept, the value discipline, refers to the desirable ways in which companies can combine operating models and value propositions to be the best in their markets.

Fig 1: Value Leadership and Profit

	Cost	Benefit
Products	**Best Total Cost** Achieve the low cost position on Product and Service support	**Best Product** Build a better Product for which Customers will Pay a premium
Services		**Best Total Solution** Solve the client's Broader problem and Share in the benefit

Fig 2: The Three Value Disciplines			
	Operational Excellence	**Product Leadership**	**Customer Intimacy**
Value Proposition	Best total cost	Best product	Best total solution
Golden Rule	Variety kills Efficiency	Cannibalize your success with breakthroughs	Solve the client's Broader problem
CoreProcesses	End-to-end product delivery Customer service cycle	Invention Commercialization Market exploitation	Client acquisition and development Solution Development
Improvement Levers	Process redesign Continuous improvement	Product technology R&D cycle time	Problem expertise Service customization
Major Improvement Challenges	Shift to new asset base	Jump to new technology	Total change in solution paradigm

How do these three pre-requisites tie up with the concept of core competencies and re-engineering. The philosophy of core competencies and re-engineering a company's business processes is to assure its competitive future. The inadequacy in this thinking lies not with the principles and practices of core competencies and reengineering, which are powerful concepts and tools. The inadequacy lies in the assumption that they are all that an ailing company needs. They are not. Sick or not, if a company is going to achieve and sustain dominance, it must first decide where it will stake its claim in the marketplace and what kind of value it will offer to its customers. Then it can identify core competencies and reengineer the processes that make up the operating model required to get the job done.

In today's new competitive environment, the choice of a value discipline must be made.

Value Discipline Framework

- The core of any business strategy is the value proposition delivered to the customer. The value proposition describes the unique mix of product, service, price, convenience, reliability, image and relationship that the company offers its customers.
- The value proposition determines the market segments to which the strategy is targeted and how the organization will differentiate itself, in the targeted segments, relative to competition.
- The value propositions (value disciplines) match with three different strategies (operating models)
- The three operating models are (i) operational excellence (ii) Product leadership (iii) Customer Intimacy
- Operationally excellent companies deliver a combination of price, quality and hassle free service that no one else can match. Companies such as PriceCostco, Dell Computers and McDonald's follow this strategy.
- Product leadership companies constantly strive to design, build and create a superior product/service offering. They concentrate on offering customers products or services that expand existing performance parameters. Intel Corporation and Sony Corporation epitomize this operating model.
- Customer intimate companies build relationships with its customers. They know the people they sell to and the products and services needed by these people. Home Depot and Airborne Express execute this operating model.
- The central idea is that by concentrating on one value discipline, you achieve breakthrough-performance in one dimension of value while maintaining threshold levels in the other two value disciplines.

Value Proposition (New Rules of Competition)

Sony and Home Depot are clear leaders in their markets. Sony outperforms its competitors. Its average annual growth over the past five years was 29% compared to 14% for its rivals. Home Depot has averaged 37% annual sales growth over the past five years, almost triple the average for the industry. Return on equity over the same period came to 26%, more than twice the industry average.

By delivering superior value, these companies have changed their customers' expectations. They believe in three important truths that characterize the new world of competition:

- Different customers buy different kinds of value. You cannot hope to be the best in all dimensions, so you choose your customers and narrow your value focus.

Fig 3: Dimensions of Customer Value

Products "What we make	• Price • Reliability & durability	• Unique features • Brand experience
Services" "How we do business"	• Service dependability • Convenience	• Expert advice • Personalized services

- As value standards rise, so do customer expectations; so you can stay ahead only by moving ahead.
- Producing an unmatched level of a particular value requires a superior operating model—a machine—dedicated to just that kind of value.

The figure below shows a simple matrix that shows the dimensions of these values. Price, product quality, product features, service convenience, service reliability, expert advice, and support services can either create or destroy value for the customer. The value added or destroyed depends on how much the value exceeds or falls short of customer expectations.

Some customers, including those of Nike and 3M, view a product's performance or uniqueness as the pivotal component of value. Price plays some role in their decision making because there is a limit to how much they will pay, but product results matter most.

A second group of customers, which includes those of Airborne Express or Nordstorm, most value personalized service and advice. Companies that serve such customers emphasize relationships, develop an intimate knowledge of the customer's needs and make a commitment to providing a total solution.

A third group of customers look largely for the lowest total cost, through some combination of price and dependability. Customers of Hertz #1 Club Gold, Fedex and McDonald's are examples. For them, no-hassle, speedy service is important. Customers of companies like Southwest Airlines, PriceCostco and Arco which put a high premium on price, fall into this group as well.

Value among the customers of these three categories of market leading companies has come to mean three different things: best products, best total solution, best total cost. Market leaders choose to excel in delivering extraordinary levels of one particular value and their customers recognize them for it. This is illustrated in the figure below.

How can a company offer the best value proposition in the market and still make money?

How can a company provide better customer value every year and still make money in the long run? Wouldn't you burn out your employees if you are never satisfied with the level of value you offer. Isn't delivering value to customers in potential conflict with delivering value to shareholders?

It is observed that in all market leading companies like Wal-Mart, Southwest Airlines, Fedex, Airborne and Intel, customer value, shareholder wealth and employee satisfaction move in lockstep. These companies view customer value as the indispensable source of both shareholder value and employee satisfaction. Without customer value, there is no sustainable business.

Value proposition must stress just one particular kind of value that customers want. Leaders will not pursue a diffused business strategy, but must continually focus on running a tight ship where the business practices enhance the one special value that they can provide better than anyone else.

Operating Model

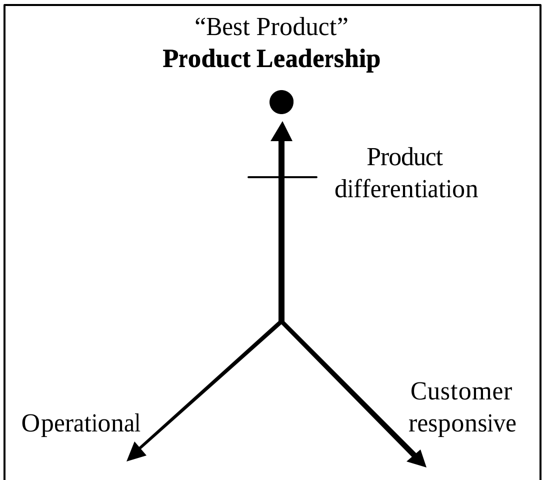
Different value disciplines demand different operating models. The three value disciplines of lowest total cost, best product and best total solution lead to three different operating models for the companies to become market leaders. These three different operating models are operational excellence, product leadership and customer intimacy.

Operating models are made up of operating processes, business structure, management systems and culture, all of which are synchronized to create a superior value. What sets the market leaders apart from the also—ran competitors is the coherence of their operating models. At the heart of the operating processes sits not one but a set of core processes that make or break an organization's ability to create unsurpassed value at a profit.

In the above three value disciplines, what does the value discipline of lowest total cost mean? It can mean lowest price, but not always. What it does mean is that when all the costs to the customer of owning and using the company's product or service are added up—costs such as price, time spent at the checkout counter, the inconvenience of untimely repair—nobody's else deal is likely to be any better.

Companies that excel in the same value discipline have remarkably the same operating model. McDonald and Arco are strikingly similar because both pursue an operating model of operational excellence. Likewise Sony and Johnson & Johnson appear similar in terms of operating processes, systems, structure because both adopt a value discipline of best product which is engineered through an operating model of product leadership.

Within an industry, market leaders pursuing different value disciplines, such as Wal-Mart and Nordstrom, appear different. Homogeneity exists only among leaders in the same value discipline.



Operational Excellence

The early Ford Company was a paragon of operational excellence. The founder's business model was based on a single purpose: Delivering an acceptable product at the lowest possible price. The whole business was built on a single premise of efficient production with a singular focus on achieving efficiency. As the manufacturing costs fell, the Model T car's prices fell from $850 to $290.

Businesses like GE Appliances, Dell Computers, Wal-Mart, Southwest Airlines, McDonald's etc are built around the operating model of operational excellence.

Product Leadership:

Edison epitomized the model of product leadership. His lab at Menlo Park, New Jersey churned out inventions after inventions and converted them into commercial successes. He began by creating an inspiring vision of each new product before development work ever started. He structured his business around talented individuals and was not driven by any procedures. He regularly reorganized and redeployed his team towards the most promising projects. He motivated his team to achieve breakthrough results by setting targets for invention. The result was an amazing 1300 inventions and 1100 patents.

Businesses like Microsoft, Johnson & Johnson, Nabisco, Sony etc are built around the operating model of product leadership. For example, Microsoft introduced Microsoft office, a bundle of software that automatically updates figures in three applications viz Excel spreadsheet, Word word-processing and Power Point presentation packages while working only in one. Johnson & Johnson's endoscopy division has pioneered the less invasive surgical techniques obviating the need for sutures. Nabisco's SnackWell cookies are the best in US. Sony's Walkman is a fine example of a great portable product.

Customer Intimacy

The standard for best total solution was probably set by IBM at the height of its market leadership during the 1970's. Customers never looked to IBM for the hottest product. It was not that IBM did not invest in product innovation, but it knew that product innovation was not the central thing. Best price was not the value proposition either. So if IBM did not mean best price or best technology, then what did it mean? It meant that it was a friend. IBM's people knew the heads of data processing, knew what their problems were, knew how to help them solve those problems and look good to their bosses. IBM assisted them with applications planning and technology architecture. It helped them fight for their budgets. IBM's value proposition was delivering a total solution in a customer-intimate fashion.

Businesses like Home Depot, Nordstrom, Cable & Wireless, Cott Corporation, Baxter International etc are built around the operating model of Customer intimacy. For instance, Home Depot and Nordstrom continually surprise customers with knowledgable, caring and unhurried salesmen who give wise advice about their products and applications, whether it's replacing a broken light switch or assembling a wardrobe. Similarly, Cable & Wireless, The Great Britain based telecommunications company, offers its clients customized network and service features that could not be obtained from MCI or British Telecom. So also Toronto-based Cott Corporation which makes private label soft drinks provides total solution to its customers in terms of marketing, package design, promotion and product formulation. Finally, Baxter International's hospital supply unit continues to take over the job of managing supplies for its customers.

Why Choose a Value Discipline

Choosing a value discipline is a critical event because it commits a company to a single path to achieve greatness. It also purposely destines the company to choose a secondary role in the other two disciplines. That's because each discipline requires a company to emphasize different processes, to create different business structures, and to gear management systems differently. The central idea is that by concentrating on one value discipline, you achieve breakthrough performance in one dimension of value while maintaining threshold levels in the other two value disciplines. The claim is that successful companies excel at one of these three dimensions of value while maintaining threshold standards on the other two. For instance, Home Depot differentiates itself through superior knowledge and helpfulness of its sales staff, a customer intimacy strategy. The company must still have excellent product selection, high quality inventory management, and reasonable prices, but these are not the primary reasons for its targeted customers to shop there.

In his book, *Good to Great* and the *Built to Last*, Jim Collins mentions that one of the major findings is that Good to Great companies carefully focus on what not to do and what to stop doing than on what to do to become great. It is this same discipline required in choosing the value discipline and therefore the corresponding underlying operating model built around core processes, structure, systems, information technology and culture to deliver a superior value to the targeted customer. It is about getting disciplined people who engage in disciplined thoughts and who then take disciplined action. It is about making choices and sticking to them.

Marketing Opportunities

Choosing a value discipline is about choosing the market and customer segments the business firm intends to serve, identifying the critical internal business processes, structure, systems that the firm must excel at to deliver the value propositions to customers in the targeted market segments.

The first step in choosing a value discipline is to choose the markets and the customer segments the entrepreneur intends to serve. Philip Kotler in his book on Marketing defines a marketing opportunity as an area of buyer need and interest in which there is a high probability that a company can perform profitably by satisfying that need. A marketing opportunity exists when an entrepreneur identifies a group of sufficient size whose needs are not being met. Ray Kroc's genius in creating McDonald's was in identifying that a gap existed in the market for fast food service, low cost and a consistent taste. No one addressed that market need before McDonald came.

There are three main sources for innovative marketing opportunity.

- Supplying something in short supply.
- Supplying an existing product or service in a new or superior way.
- Supplying a new product or service.

When something is in short supply and the buyers are queuing up to buy it, a marketing opportunity exists. This requires the least amount of marketing talent. An example would be McDonald's, Nike and other retailers quickly moving into Russia to remove the shortages.

Southwest Airlines stands as an interesting example of providing an existing airline service in a superior way. It was able to fill the market gap in terms of low cost with no frills. The airline service does not offer food and reserved seats. Even at the low cost, the airline does not compromise on comfort and reliability.

Supplying a new product or service is the credo that market-driving companies adopt. Such companies create new markets or refine segments or change the rules of the game. For instance, Sony innovated Walkman, Betamax or Video-Cameras. The customers did not propose it. Sony did not serve markets but created the market. Similarly, Dupont came out with breakthrough products like Nylon, cellophane, Teflon and others redefining the customer's expectations.

In a robust strategy, a company has strong points of differentiation with its own unique set of marketing qualities and activities

Innovation and Marketing

What constitutes a winning marketing innovation strategy? Clearly there is no one marketing road to riches. Porter argues that a company is not doing enough when it does most things a little better than the competitors. A company does not have a robust strategy if it performs the same activities as its competitors but being a little better. It is simply operationally more effective. Operational excellence might help the company win the battle in the short run but soon the competitors will catch up. In a robust strategy, a company has strong points of differentiation with its own unique set of marketing qualities and activities.

Building demand consists of getting customers, keeping customers and growing customers. Nine different ways emerge to build demand. They are the nine cells in the Products-Markets matrix on the three dimensions of existing, modified and new categories of markets and products. The nine ways are (1) market penetration, (2) product modification, (3) new product development, (4) geographical expansion, (5) modified products to new geographical markets, (6) new products for new geographic markets, (7) selling existing products to new customers, (8) selling modified products to new customers and (9) selling new products to new customers (diversification).

To the nine ways of building demand, two new innovative ways surface, which are not so apparent from the above nine-cell matrix. They are (1) innovative delivery systems and (2) invading new market spaces.

Innovating new delivery systems: Dell Computer developed a robust strategy by choosing to sell computers over the phone instead of retailers. Dell saw that there were enough buyers who would have the confidence to buy over the phone if backed by a money back guarantee. Recently Dell Computers took another innovative distribution step by selling computers over the Internet.

IKEA created a new way to make and sell furniture that stood in stark contrast to typical furniture retailers. In a Swedish market where lower income households and particularly young singles and married, often buy their furniture on credit and have a hard time paying their bills, Ingvar Kamprad the founder of IKEA figured out a way to produce good quality furniture at a substantially lower cost and price. His cost-reducing strategy consisted of ordering large volumes of furniture in knockdown conditions and adopting a mechanism of self-service by the customers in terms of self-delivery and self-assembly of the furniture. All this permitted IKEA to cut its competitors by 20% and still make a profit.

But don't imitators come along and copy. Ikea and Southwest Airlines have learned that it is one thing to copy some aspects of a new strategy, but quite another for an imitator to copy all aspects of the strategic architecture. The great strategies consist of a unique set of reinforcing activities that defy imitation.

Invading New Market Spaces

The other robust strategy for growth is that of invading new market spaces. For instance, the shoe company Nike started out designing high-performance shoes for serious athletes. Later it hired famous athletes who touted Nike shoes. Subsequently it added sports clothing to its line. Its latest move is to produce Nike events such as soccer matches and golf tournaments.

Honda's core product is engines and has distinctive core competencies in making engines. Then it enters different industries requiring engines and makes the end products. In addition to cars, it makes motorcycles, lawn-movers, marine engines, snow blowers and snowmobiles.

Similarly, Disney started out as an animated cartoon film producer. Then it moved into licensing the characters for merchandised goods, entered the broadcasting industry and built theme parks. More recently, the company is developing vacation and resort property.

Towards a Newer Marketing Paradigm

The old marketing is giving way to newer marketing. In the old marketing, the following paradigm existed.

- Equating marketing with selling.
- Emphasizing customer acquisition rather than customer care.
- Focusing on transaction rather than relationship.
- Selling the product rather than trying to understand and meet the customer's real needs.

In the newer marketing, newer ways of thinking are emerging. Newer ways of innovating are emerging. Companies are finding ways to deliver superior value to their customers. They are improving their customer knowledge, customer connection technologies and understanding of customer economics. They are inviting customers to co-design their products. They are ready to make flexible market offerings. They are utilizing more targeted media. They are utilizing more technologies such as internet, video-conferencing, sales automation software. Companies are reachable 24 hours a day. Companies see their distribution channels as partners. To reiterate, companies are developing value propositions that deliver superior value to their customers. The premium will go to those Marketing visionary companies that innovate new ways to create, communicate and deliver value to their target markets. The message is that no company or business unit can succeed by trying to be all things to all people. It must instead find the unique value that it alone can deliver to a chosen market.

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Reference # 10-02-12-01

Biz Speak

Management by objective works - if you know the objectives. Ninety percent of the time you don't.

People who don't take risks generally make about two big mistakes a year. People who do take risks generally make about two big mistakes a year.

The great mystery isn't that people do things badly, but that they occasionally do a few things well. The only thing that is universal is incompetence. Strength is always specific! Nobody ever commented, for example, that the great violinist Jascha Heifetz probably couldn't play the trumpet very well.

Plans are only good intentions unless they immediately degenerate into hard work.

— Peter F Drucker