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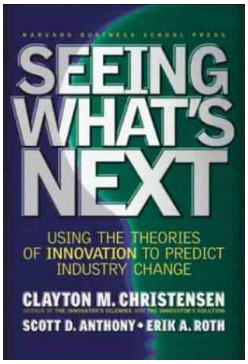

Seeing What's Next

Using the Theories of Innovation to Predict Industry Change

by Clayton M. Christensen, Scott D. Anthony and Erik A. Roth
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312 pages

Focus

- **Leadership & Mgt.**
- Strategy
- Sales & Marketing
- Corporate Finance
- Human Resources
- Technology & Production
- Small Business
- Economics & Politics
- Industries & Regions
- Career Development
- Personal Finance
- Concepts & Trends

Take-Aways

- Theory can be useful if put into practice.
- There are two kinds of innovations: sustaining and disruptive.
- Disruptive innovations initially offer poor performance but ultimately redefine the value proposition for an industry.
- Sustaining innovations support established industries but often reach a point at which they outstrip market needs.
- Companies derive their capabilities from resources, processes and values.
- The resources, processes and values that make companies successful can also incapacitate them in the face of disruptive innovations.
- Consumers do not purchase a product – they purchase a job. Companies should see how customers use products and take the appropriate cues.
- Companies can innovate with better products for high-margin customers, with cheap alternatives for low-end buyers or with offers for current nonconsumers.
- Nonmarket forces, such as government regulations, can make or break innovation.
- The education, airline and health care industries are ripe for disruptive innovation.

Rating (10 is best)

Overall	Applicability	Innovation	Style
7	**7**	**8**	**6**

Relevance

What You Will Learn

In this Abstract, you will learn: 1) How to use theories about sustaining innovations and disruptive innovations to assess the future of innovation in your industry; 2) How disruptive innovations move up the market chain and affect it; 3) What strategic decisions confront innovative industries; and 4) Which markets are ripe for disruption.

Recommendation

Clayton M. Christensen's first book, *The Innovator's Dilemma*, was a work of impressive insight and originality. His second, *The Innovator's Solution*, was somewhat less insightful but added a necessary extension to the first by telling readers how they might begin to extricate themselves from the dilemma of industry disruption caused by an upstart innovation. The current book is a dense, harder to read compilation of the first two books, with added theoretical insights. Christensen and co-authors Scott D. Anthony and Erik A. Roth tell readers how to use theories of innovation to predict change. *getAbstract.com* applauds the effort. Don't miss the helpful appendix that summarizes the previous two books.

Abstract

"*Seeing What's Next* is written for those who watch industries from the outside, and who must make important decisions based on what they see."

A Theoretical Approach

Theory is a statement of why things happen. Business researchers do three things when they develop a theory:

1. They observe what has happened and document it.
2. They categorize observations and draw distinctions between categories.
3. They test the theory by making predictions and noting whether the predicted outcomes happen.

It is important to account for a theory's exceptions and anomalies, but when a solid theory is developed, practitioners can put it to good use.

Disruptive Innovation

There are two kinds of innovations:

"What makes disruption so powerful is that it occurs through a series of incremental decisions, each of which appears completely rational."

- Sustaining innovations – These are improvements to existing products that enhance performance in dimensions traditionally valued by mainstream customers. They make existing products and services better.
- Disruptive innovations – These innovations change the value proposition. Initially, disruptive innovations under-perform mainstream products but offer some advantages of cost and ease of use. They cause fundamental changes in the marketplace.

The customers for sustaining innovations are an industry's mainstream buyers. Typically these customers are not interested in disruptive innovations. This is because, like their established traditional suppliers, they are part of a value network that prizes performance as measured by pre-defined metrics.

"Using theory to predict industry change involves understanding when to reasonably expect innovation to lead to the emergence of new companies or business models that could be harbingers."

"The best way to make accurate sense of the present, and the best way to look into the future, is through the lens of theory."

"Good theory provides a robust way to understand important developments, even when data is limited. And theory is even more important when there is an abundance of data. Theory helps to block out the noise and to amplify the signal."

"The theory holds that existing companies have a high probability of beating entrant attackers when the contest is about sustaining innovation. But established companies almost always lose to attackers armed with disruptive innovations."

The customers for disruptive innovations are usually at the low end of the market, or may not yet be in the market at all. It is common for established companies to improve their products to the point that the products offer better performance than the market really needs – and cost more than the market would prefer to pay. Disruptive innovators offer products that are technically basic, but that function well enough to satisfy customers at the low end of the market. They often succeed because those people are tired of paying for more technology than they need. Alternatively, disruptive innovators offer a better-than-nothing proposition to people who are not currently in the market at all.

Although disruptive innovations begin their sales attack at the low end of the market, they quickly move up the market chain. Consider telecommunications, for example. Alexander Graham Bell began with a rudimentary device that allowed people to talk to each other over short distances. Technologically, the first telephone was not an advance over the telegraph. The telegraph, after all, allowed communication over long distances. It is no wonder that Western Union declined to purchase the Bell patents, even for as relatively small a sum as the $100,000 the inventor wanted. But although Bell's phone was not as powerful as a telegraph, it did enable people to talk to their neighbors without having to walk to a telegraph station to have the exchange. It was better than nonconsumption. Moreover, Bell steadily improved the technology and the telephone network, and within a short time, his AT&T eclipsed Western Union as the telecommunications leader.

Resources, Processes and Values

Resources are the assets that a company commands. Processes are its way of working. Values are the criteria it uses to make decisions. Collectively, resources, processes and values determine how a company evaluates and responds to an opportunity. One of the disruptive innovator's most powerful competitive advantages is that it does not make sense for established firms to compete in the market that the disruptive innovator has targeted. Because the disruptive technology is usually less powerful, less sophisticated or less functional than existing technologies, the established firm's customers generally are not interested in it. Moreover, the disruptive technologies usually earn lower profit margins in the marketplace.

So, an established company looking at a disruptive opportunity is looking at something its customers do not want and that is less profitable than its alternative investment opportunities. It is not irrational for established firms to ignore disruptive opportunities. On the contrary – the decision not to compete in disruptive technology is often a sound business decision. It only looks disastrously wrong in retrospect.

What Customers Really Buy

Customers do not really purchase products. They really hire performance – the ability to accomplish jobs. The most successful companies make it possible for customers to accomplish their jobs more economically or conveniently. Market segmentation can be misleading, because market segmentation rarely looks at how customers actually use a product. Companies that segment markets according to demographics or product preferences miss the point. Companies can develop breakthrough innovations if they pay close attention to the jobs people are trying to do and find ways to make it easier, cheaper or less unpleasant to do those jobs.

"One of the most predictable events is that after establishing an initial foothold, new firms experience a strong incentive to improve, acquire more customers and migrate into high-profit tiers of their market."

"Every innovator – from the entrepreneur sketching on a Starbucks napkin to an engineer at a multibillion-dollar company – needs funding."

"Factors such as a market's size and prospects for growth, the general industry attractiveness, the attractiveness of specific business models and the level of competition determine motivation."

"Airplane flight is a modern-day miracle. Every day, tens of thousands of flights move people and goods around the world at speeds unimaginable a century ago."

Three Roads to Innovation

Companies can innovate three ways:

1. Introduce new and improved products for high-margin customers for whom existing products just are not good enough.
2. Introduce cheap alternatives to existing products for customers at the low end of the market who have to pay for more technology than they need.
3. Introduce products that create a new market among nonconsumers who are not in the current market at all.

Nonmarket forces, such as government regulations, can influence or even determine the success of innovations. Questions for companies to ask include:

- What are our customers trying to do?
- Is our current technology too much for the job? Too little? Is there a large group of nonconsumers who might be interested in a new offering?
- Do fringe markets present opportunities for growth?
- What innovations have customers been willing to pay a premium for in the past?

Evaluating the Competition

Companies seeking growth through innovation should size up their competition, looking at each competitor's strengths, weaknesses and capabilities. The best growth opportunities are those that competitors will not contest. Disruptive innovators often succeed precisely because it does not make sense for established firms to fight over what is, to them, a low-margin, undesirable opportunity. Ask the following questions:

- What business models are our current competitors using?
- Does the innovation fit naturally into our target market?
- Is an important competitor signaling that it intends to abandon the low end and move up market? If so, can it?
- Does the situation favor an attacker or an established firm? In cases of sustaining innovation, the established firm has an advantage. In cases of disruptive innovation, the attacker has an advantage.

Choosing the Strategy

It is easy to make the wrong strategic choices, to focus on the wrong customers or to develop business models or capabilities that overlap with those of an incumbent. In this case, the incumbent has an advantage. Executives who are deciding upon a strategic direction should ask a few important questions, including:

- Is the company giving enough leeway to managers to allow them to discover the right strategy by trial and error, or is it attempting to impose a strategy from above?
- Do investor expectations match the needs and the reality of the company?
- Is it advisable to spin out a disruptive unit to free it from the constraints of the corporation's value network? IBM took this approach with the personal computer, Hewlett-Packard with the ink-jet printer and Intel with its Celeron chip.

Nonmarket forces can have a major impact on innovation. Government regulation or policy can push an industry toward or away from innovation. The 1996 Telecommunications Reform Act in the United States was intended to encourage competition through deregulation. But regulators don't always get what they want, or in the form they want

it. Market uncertainties, technical challenges and the popping of the technology bubble led to chaos in the telecommunications market and left policy makers perplexed and frustrated. Making innovation legal does not make it happen.

Industries Ripe for Disruption: Education, Airlines, Healthcare

"The growth markets of the future will not be in today's monolithic one-size-fits-all product categories."

The education industry may be ripe for disruption. Distance learning institutions such as the University of Phoenix have harnessed technology and reached out to underserved customers with simple, inexpensive, convenient educational products. They will continue to improve their offerings. Community colleges are active at the low end of the market, providing good-enough courses to students for whom other alternatives are inconvenient or too expensive. They are also improving their educational offerings.

The airline industry also faces serious disruption. While Boeing and Airbus fight for the market's high end, manufacturers of smaller jets that fly regional routes are doing well. Meanwhile, established commercial airlines continue to feel competitive pressure as discount airlines move up the market from their foothold at the bottom. Although disruption is occurring industry-wide, it is unlikely to reshape the industry fundamentally. Look for incumbents to create spinouts, and for discounters and independents to attempt to create new value networks.

The health care industry is a classic disruptive opportunity. Patients have to pay for more technology than they actually need. In some circumstances, those who are ill certainly do need the best experts, high tech tests and specialists – but not in all cases. Today's system offers patients one-size-fits-all health care. Disruptive innovations would allow low-cost, low-margin and less technically sophisticated care to be provided at the low end of the market, or to be offered to current nonconsumers of health care. Successful disruptors will push health care from treatment to prevention.

Back to the Theoretical Base

"Theory always advises betting on disruption because growth takes advantage of asymmetric motivation, giving the attackers time to develop unique skills."

Good management theory is grounded in real circumstances and explains why things happen. The theory of disruptive innovation explains that companies fail because they do the right things – things that are correct in the context of their value networks. A company whose capabilities equip it perfectly for one value network may be utterly incapable of operating in another value network. Therefore, a company's resources, processes and values are sources of both potential strengths and potential handicaps.

Established incumbents – those that do a better job of serving the existing needs of mainstream customers – usually have an advantage with sustaining innovations. Disruptive innovators have an advantage in areas of the market that the incumbents often prefer to ignore – the low-end business and the nonconsumers who are not presently in the market at all. Distinguishing between sustaining innovations and disruptive innovations can be difficult, but doing so is essential for strategic success. Note also that nonmarket factors, such as government regulation, can have an important (though not always decisive) influence on the direction an innovation takes within a market.

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