

## **THE CUSTOMER VALUE INNOVATION IMPERATIVE.**

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To a greater extent companies today are driven by an innovation imperative. It is essential to sustaining competitive advantage and the extent and success of a company's innovation efforts are indicators of its overall performance. As Peter Drucker the revered father of modern management warned, "An established company which, in an age demanding innovation, is not capable of innovation is doomed to decline and extinction"<sup>1</sup>. To put it simply, in today's fiercely competitive environment, most firms have only one choice. "Innovate or die."

Innovation is about finding a new and better way to do things. It is about the exploitation of new ideas that bring about the creation of a new product, process, service, a new business system or a new method of management, that have a significant impact on productivity and growth. As Drucker put it, "Innovation is change that creates a new dimension of performance"<sup>2</sup>. It might involve technological transformation and even management restructuring. It may mean the exploitation of new technology and the deployment of serious creative thinking to provide new value.

Ultimately however, innovation is all about bringing new value to customers.

Competition is a major determinant of innovation. It has never been as intense as it is today in a global marketplace where many businesses face weakening demand, climbing costs, pressure on pricing and numerous other drivers of change. Competition encourages the adoption of innovation, as companies seek to make progress in their competitiveness so as to prosper and grow in the marketplace. Innovation can help a business to stay fresh and perhaps even to reinvent itself if required as conditions in the marketplace change. Innovation fosters economic growth in the global marketplace and kick starts the real possibility of new markets, enabling companies to reach new customers with current products and services and to offer existing customers attractive and sometimes exciting new products and services. This is why innovation is such an important strategic issue today.

Tidd et al (2005)<sup>3</sup> argue that there are four types of innovation; consequently the innovator has four routes to explore when searching for good ideas:

- 1) Product Innovation – new products or improvements on products e.g. the new cardiovascular stent or the updated Apple iPhone, flat screen television and so on.
- 2) Process Innovation – where some part of the process is improved to bring benefit. Good examples include the booking of travel tickets online which has dramatically changed the travel industry; the use of barcodes, scanners and the Internet that allows customers to track parcels in real time as couriers transport them.
- 3) Positioning Innovation – Baileys changed its brand positioning from being a traditional special occasion liqueur to being a mainstream spirit drink with an emphasis on pleasure for all social occasions, bringing lots of younger drinkers to the brand and a dramatic increase in sales volumes.
- 4) Paradigm Innovation – Opportunities for innovation sometimes emerge when we reframe our mental model or the way we look at something. Recent examples of 'paradigm' innovation include the shift to low-cost airlines, the provision of online financial services, and the repositioning of drinks like coffee (Starbucks).

It is not so much the coming up with a new idea that is critical, but it is more about the ability to bring the idea to the market and exploit it successfully. For example Apple, Tandy and Motorola brought the personal digital assistant (PDA) to the market. This was an extremely innovative product but it was not successful when it was first introduced. What happened

was that manufacturers did not choose the right target market to exploit to get the market up and running. Crucially they didn't understand how their target customers were going to get value from the product, so they ended up highlighting and stressing the wrong features of the product. Palm subsequently arrived on the scene and introduced the PalmPilot which was essentially the same product but by carefully investigating how customers would use the product and get best value from it, the company marketed a feature that was highly attractive to customers. The outcome was that it was Palm's version of the PDA that was successful and it eventually sold in millions<sup>4</sup>.

One strategic approach to business growth developed by Kim and Mauborgne (1999), involves a shift away from a focus on existing competition to one of trying to create entirely new markets. Value innovation they argue can be achieved by implementing a focus on innovation and creation of new marketspace<sup>5</sup>. In their work they showed how valuable innovation seldom happens when companies compete on a head-to-head basis in established markets. Industries that have been around for a long time tend to be very competitive and seek to make progress by growing market share at the expense of the competition, which is still the focus of much strategic thought and effort today. This leads to further market segmentation and slicing and dicing of the market and eventual focus of effort, pressure on price with a negative impact on cost and margins. The evidence is that the innovations that were the most successful were those where a company located new demand or a new market space that was not being served and where there was no direct head-on competition.

To achieve high growth Kim and Mauborgne (1999), argue that companies need to break free from this "vicious cycle of competitive benchmarking, imitation and pursuit", they call for a change of strategic focus and for companies to pursue "value innovation". With value innovation, it is the buyer and not the competition that is placed at the centre of strategy and the idea is that managers should aim for 'leapfrog' advancements, and not small increases in advantage over the competition.

Interestingly, the authors point to the low-cost business models that provoke such operators to question just about everything in their industry and what its competitors are doing, in search of a leap in value. This immediately brings to mind much of the innovative steps Ryanair have taken e.g. they don't use passenger boarding bridges at airports because it costs too much, slows down the unloading of passengers from aircraft and by using stairs they can get people off quicker from both ends of the plane; they introduced on-line boarding passes; they discourage checked in luggage by levying a charge on each item and other innovations. It is such questioning that immediately clarifies the difference between how an industry competes and what it is that their customers really value and how that can be provided at a low cost.

Over a period of five years Kim and Mauborgne set out to investigate the 'roots' of high growth companies<sup>6</sup>. They studied those with high growth in both revenue and profits and those with less successful performance records, interviewing hundreds of managers, researchers and analysts in 30 companies around the world in approximately 30 industries. What materialised was that the managers of high growth companies, irrespective of their industry, all described what Kim and Mauborgne came to call the "logic of value innovation", whilst the managers of the less successful companies all thought along conventional strategic lines. The two types of logic are outlined in Exhibit 1.

### Exhibit 1: Two Strategic Logics

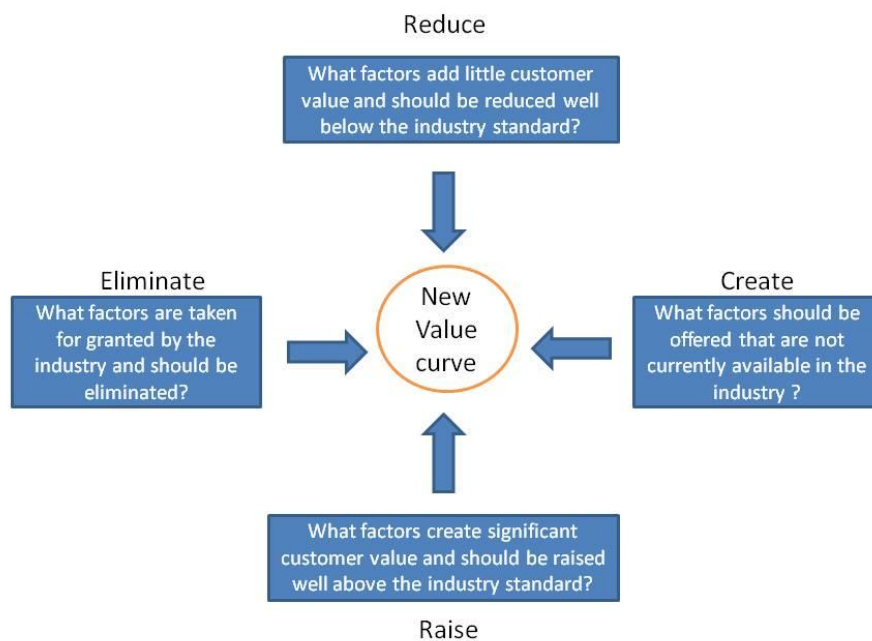
The Five Dimensions of Strategy	Conventional Logic	Value Innovation Logic
<b>Industry assumptions</b>	Industry's conditions are given	Industry's conditions can be shaped
<b>Strategic focus</b>	A company should build competitive advantages. The aim is to beat the competition.	Competition is not the benchmark. A company should pursue a quantum leap in value to dominate the market.
<b>Customers</b>	A company should retain and expand its customer base through further segmentation and customisation. It should focus on the differences that customers value.	A value innovator targets the mass buyers and willingly lets some existing customers go. It focuses on the key commonalities in what customers value.
<b>Assets and capabilities</b>	A company should leverage its existing assets and capabilities.	A company must not be constrained by what it already has. It must ask, what would we do if we were starting anew?
<b>Product &amp; Service Offerings</b>	An industry's traditional boundaries determine the products and services a company offers. The goal is to maximise the value of those offerings.	A value innovator thinks in terms of the total solution customers seek, even if that takes the company beyond its industry's traditional offerings.

**Source:** Kim and Mauborgne (1999)

Kim and Mauborgne suggest the following four steps to develop and build value innovation in an organisation, to create a compelling strategy to bring about the promised financial rewards and attain both remarkable value for buyers and low cost for the company.

- 1) Identify and articulate the company's strategic logic.
- 2) Challenge it.
- 3) Think about the industry's assumptions, the company's strategic focus and its approach to customers, assets and capabilities and product and service offerings that are all taken as a given.
- 4) Having reframed the company's strategic logic around value innovation ask the four questions outlined in Exhibit 2 that will translate that thinking into a new value curve.

**Exhibit 2: The Four Actions Framework:** The key to discovering a new value curve lies in asking four basic questions:



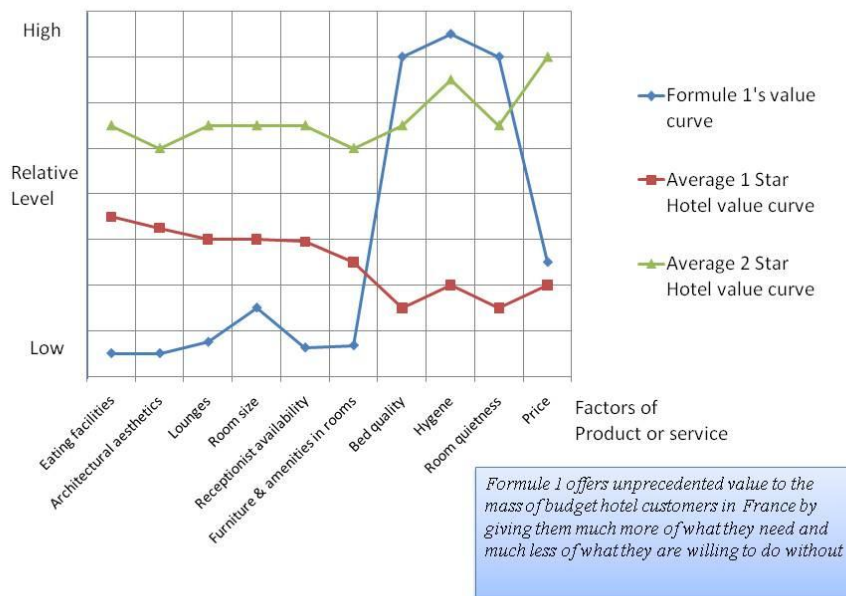
**Source:** Adapted from Kim and Mauborgne (1999)

The concept of the value curve uses “a graphic representation of a company’s relative performance across its industry’s key success factors” (what it takes to be successful in the business). It contrasts products on a range of factors, rating them on a scale from low to high. The combination of these factors defines the product or service. To discover and bring to light potential spaces or gaps in the market, multiple value curves need to be prepared to provide a visual comparison between products, to allow investigation and reflection on the feasibility of the gaps – will customers want this feature, can we afford to offer it? In so doing it may be possible to strengthen the value proposition.

Consider the case of Formule 1 (Exhibit 3), the French chain of budget hotels, introduced to the market by Accor<sup>7</sup>. The management team at Accor carried out an appraisal of what each of the competing budget hotels in France had to offer customers, asking the four specific questions outlined in Exhibit 2. Their judgement of the situation concluded that what budget customers really valued was bed quality, hygiene, and quietness and didn’t really find other factors such as eating facilities and architectural aesthetics of particular value.

The decision arrived at by the Accor team was to eliminate a range of features they felt were of lesser value to customers e.g. restaurants, lounges and receptionists except for peak check-in and check-out times. They now use automated tellers instead of receptionists. They did this despite the fact that both the one-star and two-star hotels offered these features and to offer much better quality than even their two-star competition in the areas they concluded were of most compelling value to customers (bed quality, hygiene, and quietness) at an approachable price similar to that of a one-star hotel. Their rooms are small, include the bare necessities and designed for ease of cleaning. They are constructed from modular blocks that are economical to build and provide good sound insulation. The strategy was a success, and Accor’s market share in France is now larger than its five largest competitors combined.

### Exhibit 3: Budget Hotel's Value Curve



**Source:** Adapted from Kim & Mouborgne (1999)

For almost ten years Kim and Mauborgne researched companies that were successful in creating fundamentally new and superior value. From this they developed a systematic approach to finding new value curves that enable managers to find unoccupied territory that represents a real breakthrough in value by looking across the following six conventionally defined boundaries of competition<sup>8</sup>.

#### 1. Look across substitute industries:

Companies compete not only with their direct competitors but also with substitute products. The space in between provides opportunities for value innovation. For example, Home Depot revolutionised the do-it-yourself market in the US by creating a new market for DIY in the space between hiring contractors to do a job and buying the tools and materials from a hardware store and doing the job yourself. Home Depot made it their mission to boost and strengthen the competence and confidence of customers with limited knowledge and experience of home repair. To enable this, in essence Home Depot answered the four basic questions outlined in Exhibit 2.

Intuit, the personal finance software company identified that the simple pencil had two decisive advantages over computerised solutions – a really low cost and simplicity of use. Existing software packages at the time were too expensive, difficult to use and complicated. Answering the four questions Intuit focused on building on the decisive advantage the computer had over the pencil- speed and accuracy and minimising the decisive advantage the pencil had over computers – simplicity of use and low price – while eliminating or reducing everything else.

#### 2. Look across strategic groups: This term refers to a group of companies within an industry that pursue a similar strategy. In practice most companies try to improve their position within their strategic group. However, what is important to creating new market space across the strategic groups in an industry is to understand the factors that bring about

buyers' decisions to trade up or down from one group to another. For example, the Toyota Lexus opened up a new space by offering the consumer the quality of a top-end Mercedes or BMW at a price closer to the lower end of the market.

Polo Ralph Lauren built on the decisive advantage of the two strategic groups that dominated the top-end clothing market – designer haute couture and the higher volume but lower priced classical line brands that ordinary people wear. By adopting the most attractive factors of both groups and eliminating or reducing the rest, Ralph Lauren took share from both groups and at the same time drew lots of new customers into the market.

3. Look across the chain of buyers: Most industries focus on a common description of who the target customer is, when in reality there is a chain of customers which include purchasers, users and influencers, each of whom may have an involvement in the purchasing decision and may have different perceptions of what value means. Typically an industry fixates on a single group – the pharmaceutical industry for example focus on influencers i.e. doctors; the office equipment business focus on purchasers i.e. corporate purchasing department; and the beer industry focuses on users. However, challenging conventional wisdom can lead to the discovery of new market space. For example Bloomberg transformed the business of information in the trading room by selling to the traders directly rather than to the IT director. Scrutiny of buyer groups can provide new insights into how to redesign value curves that will address the needs of a previously overlooked set of customers.
4. Look across complementary offerings: The key thing here is to realise that other products and services can affect your value offering. It is important to determine the total solution buyers seek when they purchase a product or service. One easy way to do this is to think about what happens before, during, and after the product is used. For example, focusing on lifelong learning and discovery, Barnes and Noble and Borders Books and Music created book superstores where their total offering included the pleasure of reading and intellectual exploration, as well as the book itself. The superstores offer a large selection of books from which to choose, along with knowledgeable staff, armchairs and reading tables, sofa's and coffee bars and classical music to enhance the buying experience of the buyer.
5. Look across functional or emotional appeal: New value curves can be found often times by adding emotional appeal to a product that is usually sold on a basis of functionality and price. For example Starbucks set out to transform coffee, a functional product into an emotional experience. Whilst the main competition sold coffee as a commodity – by the can, Starbucks sold the concept of the coffee bar that offered the consumer a chic gathering place, status, relaxation, conversation, and creative coffee drinks and turned ordinary people into coffee aficionados, where selection shows discernment, all at a premium price.
6. Look across time – trends: Looking at the drivers of change in the broad environment with the right perspective has the potential to unlock innovation that can create new market space. There are three critical principles to assessing trends over time. To form the basis of a new value curve, the trends must be decisive to the business, they must be irreversible, and they must have a clear trajectory. For example Cisco Systems created new market space against such an environmental background – the growing demand for high speed data interchange. Cisco's routers, switches and other network devices were designed to create breakthrough value for customers offering fast data exchange. Their insight is a much about value innovation as it is about technology.

#### Exhibit 4: Shifting the Focus of Strategy

From head-to-head competition to Creating New Market Space

The Conventional boundaries of competition	HEAD-TO-HEAD COMPETITION	➡	CREATING NEW MARKET SPACE
Industry	Focuses on rivals within its industry	➡	Looks across substitute industries
Strategic group	Focuses on competitive position within strategic group	➡	Looks across strategic groups within its industry
Buyer group	Focuses on better serving the buyer group	➡	Redefines the buyer group of the industry
Scope of product and service offerings	Focuses on maximising the value of the product and service offerings within the bounds of its industry	➡	Looks across to complementary product and service offerings that go beyond the bounds of its industry
Functional - emotional orientation of an industry	Focuses on improving price-performance in line with the functional-emotional orientation of its industry	➡	Rethinks the functional-emotional orientation of its industry
Time	Focuses on adapting to external trends as they occur	➡	Participates in shaping external trends over time

**Source:** Adapted from Kim & Mouborgne (1999)

Kim & Mouborgne use the metaphor of two types of oceans (Red Ocean and Blue Ocean)<sup>9</sup> as analogous to competing within the confines of an existing industry or trying to steal customers from rivals versus developing uncontested market space that makes the competition irrelevant and summarised in Exhibit 5.

#### Exhibit 5: Red Ocean versus Blue Ocean Strategy

Red Ocean Strategy	Blue Ocean Strategy
Competing in the existing market space	Create uncontested market space
Beat the competition	Make the competition irrelevant
Exploit existing demand	Create and capture new demand
Make the value/cost trade-off	Break the value/cost trade-off
Align the whole system of the company's activities with its strategic choice of differentiation or low cost.	Align the whole system of a company's activities in pursuit of differentiation and low cost

**Source:** Adapted from Kim & Mouborgne (2004)

Market creation is a central strategic challenge in organisations today and value innovation is central to creating new market space and value curves. If in the business planning process an organisation identifies a differential between what it would like its future revenues to be and what it is predicted to be if the status quo is maintained, filling this planning gap is

only sustainable by creating and recreating new space, new markets and new value, especially in an overcrowded and demand starved economy.

## References

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<sup>5</sup> Kim, W C. Mauborgne, R. Creating New Market Space: A systematic approach to value innovation can help companies break free from the competitive pack. Harvard Business Review, Jan/Feb 1999.

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<sup>8</sup> Kim, W C. Mauborgne, R. Creating New Market Space: A systematic approach to value innovation can help companies break free from the competitive pack. Harvard Business Review, Jan/Feb 1999.

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