



Clayton Christensen's Reflections on Disruption

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*The Innovator's Guide to Growth:
Putting Disruptive Innovation to Work*

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FOREWORD

Reflections on Disruption

By Clayton M. Christensen

It has been more than ten years since I first published the findings from my research indicating that the very principles of good management could inhibit companies seeking to master disruptive change successfully. In industry after industry, my research has shown that simple, convenient, affordable innovations can disrupt and overwhelm even seemingly unassailable market leaders.

Over the last decade, my academic research has been augmented with the field work of Innosight, a consulting and executive training company I cofounded in 2000. I and my colleagues at Innosight have worked to help dozens of innovative companies and creative entrepreneurs maximize their ability to create booming growth businesses. Additionally, we have engaged with like-minded academics and practitioners, such as Jeffrey Dyer of the Marriott School of Management at Brigham Young University; Vijay Govindarajan of the Amos Tuck School of Business; former Merck CEO Ray Gilmartin; Richard Foster, whose early work on innovation and seminal findings relating to S-curves and the competitive effects of technological discontinuities greatly influenced my own work; former Arrow Electronics CEO Steve Kaufman; Michael Mauboussin of Legg

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Mason Capital; and Willy Shih, who ran Eastman Kodak's digital operations for several years.¹

I have been grateful for all of Innosight's work over the past several years. I formed Innosight because I recognized a limitation in my own brain. Because the patterns of disruptive innovation are so crystal clear to me, I can underestimate the very real difficulty of actually creating new growth businesses, especially in large corporations. Innosight's ability to make the theories of disruption more tractable has been a great asset for the body of knowledge relating to disruptive innovation. This book, written by three of my colleagues at Innosight and a like-minded executive, aims to make the disruptive theories even more accessible to corporate managers and entrepreneurs.

Before turning the pen over to my colleagues, I wanted to summarize four key paradigms that inhibit the successful creation of new growth businesses and to describe my own thoughts about the key ingredients of transformation.

Flawed Paradigm 1: Always Listen to Your Best Customers

At the core of the research summarized in *The Innovator's Dilemma* is the notion that companies intent on listening to their best customers frequently miss opportunities to create new growth businesses. There is tremendous value in listening to demanding customers. Feedback from demanding customers helps to map out a trajectory that allows companies to continue to charge premium prices, earn attractive margins, and beat market competitors. However, established firms' proclivity for responding to the needs of their best customers makes it difficult to see the future impact of disruptions on their core businesses.²

Companies that focus *only* on their best customers end up producing products and services that are too good for more mainstream customers. This overshooting creates opportunities for disruptors armed with simple, inexpensive business models. Responding to the disruptor in the lower tiers of the market never looks as attractive as serving higher-end customers, so profit-maximizing companies flee upmarket. In industry after industry, this pattern has resulted in market leaders eventually

getting “pinned” to the high end of their industry and missing the growth created by disruption. Furthermore, a singular focus on demanding customers leads companies to miss growth opportunities that originate in the lower rungs of their market or in seemingly fringe markets of “non-consumers.”

Following this flawed paradigm has led to many classic cases of disruptive innovation, such as the disruption of integrated steel mills by steel minimills, the disruption of department store retailers by discount retailers, and the disruption of minicomputer manufacturers by personal computer manufacturers.

Flawed Paradigm 2: Market Segmentation

I have come to the conclusion that most companies segment markets the wrong way, making it hard for them to spot real opportunities for innovation. The concept of jobs to be done, which holds that customers don’t buy products or services, but rather hire them to get jobs done in their lives, provides a superior alternative to traditional segmentation schemes.³

Generally speaking, the way in which a company chooses to define market segments influences which products it develops, drives the features incorporated in those products, and shapes how the company takes them to market.⁴ Segmentation schemes define who is framed as a competitor and how large specific market opportunities are believed to be. Most companies segment along lines defined by the characteristics of their products (category or price) or customers (age, gender, marital status, geographical location, or income level). Some business-to-business companies slice their markets by industry; others do so by size of business. The problem with such segmentation schemes is that they are static. Customers’ buying behaviors change far more often than their demographics, psychographics, or attitudes do. The 18–34 age demographic that is often used in consumer marketing, for example, lasts 17 years. Education level is generally fixed by age 30. An individual’s income might vary more often, but it is generally stable for years. Demographic data cannot explain why a man takes a date to a movie on one night but orders in pizza to watch a DVD from Netflix the next.

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Product and customer characteristics are poor indicators of customer behavior, because from the customer's perspective that is not how markets are structured. Customers' purchasing decisions do not necessarily conform to those of the "average" customer in their demographic; nor do they confine the search for solutions within a product category.

When customers find that they need to get a job done, they "hire" products or services to do it. Companies therefore need to understand the jobs that arise in customers' lives for which their products might be hired. In other words, it is the job, not the customer or the product, that should be the fundamental unit of market segmentation and analysis.

Most of the "home runs" of marketing history were hit by marketers who sensed the fundamental job that customers were trying to get done—and then found a way to help more people get it done more effectively, conveniently, and affordably. The strike-outs of marketing history, in contrast, have generally been the result of developing products with better features and functions than other products in the same category, or of attempting to decipher what the average customer in a demographic wants. Working to understand the job to be done is worth the effort.

Flawed Paradigm 3: Sunk Costs

The third flawed paradigm is the doctrine that fixed or sunk costs should not be considered when evaluating future investments. This doctrine confers an unfair advantage on attacking firms. It shackles incumbent firms that attempt to respond to a disruptive attack.

The basic argument is that managers should compare only the future or marginal cash outlays (either capital or expense) that are required for an innovative investment, subtract those outlays from the marginal cash that will likely flow in, and discount the resulting net flow to the present. Despite the logic that underlies this principle, this approach can make the same investment appear attractive to an attacking company, but unattractive to the incumbent leader being attacked. It exacerbates the innovator's dilemma.

For example, integrated steel mills seeking to respond to disruptive steel minimills had a choice: build competitive minimills or seek to fill

slack capacity in existing plants with cost-competitive products. The choice to maximize marginal profitability always biases a company to focus first on filling idle capacity. True to this reasoning, the integrated steel mills decided against building new plants to lower their long-run average costs. This seemingly sensible decision facilitated minimills' ability to drive disruption.⁵

When a successful attacker is gaining ground, therefore, executives of the companies being attacked need to do their investment analyses in the same way that the attackers do. This is the only way they can see the world as the attackers see it, and the only way they can predict the consequences of not investing to preempt the attackers' growth plans.

Companies seeking to unlock the power of disruptive innovation need to make sure they don't allow this and other flawed paradigms of financial management to lead them in unproductive directions. For example, it is critical to consider alternative scenarios when running net present value analyses and rethink financial incentive schemes that divert resources away from strategically critical investments whose payoff lies beyond short incentive horizons.⁶

Flawed Paradigm 4: Core Competencies

Companies make a raft of decisions based on what they perceive to be their core competencies. More than forty years ago, Theodore Levitt pointed out how a company's misperceptions of its core competency would frequently cause it to miss opportunities for growth.⁷ Forty years later, I note regretfully that companies still make mistakes based on these false perceptions.

These mistakes come in many flavors. Processes that facilitate the successful innovations that make up a firm's core products often constitute disabilities when new architectural innovation is required.⁸ Companies that outsource what seems at this point to be a peripheral value-added activity often find their outsourcing partner building its own opportunities to develop competencies that are required to succeed in the future.⁹ Finally, companies often fail to understand the true competencies of their managers: Experienced managers whose competence we have

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learned to trust in delivering the needed results in our core businesses may not actually be equipped to build new businesses.¹⁰

How to Drive Transformation

A slew of barriers stand in front of the manager seeking to create growth through innovation. Conventional wisdom works in conventional circumstances, but it misleads when circumstances change. This difference tilts the advantage toward the entrant and forces incumbents to work hard to create the organizational space they need to succeed through disruption.

The plethora of barriers supports one of the fundamental recommendations presented in *The Innovator's Dilemma*: incumbent companies hoping to launch disruptive innovations should give disruptive ventures substantial autonomy.¹¹ Placing a disruptive project squarely in the middle of the core operations can consign it to failure.

Successfully creating a *capability* around disruptive innovation, however, requires more. I believe that companies seeking to unlock the transformational power of disruption need a common language, a process that treats different types of innovation projects differently, and demonstration projects that show the value of different approaches.

Common Language

One of the best-known stories in the disruption literature—how in the 1990s Intel recognized and responded to the threats emerging at the low end of its microprocessor business—had a huge common-language component. In the late 1990s, I went out to Intel about twenty times, educating about one hundred managers at a time on the principles and language of disruptive innovation. Some time after going through the sessions, Intel launched what is now known as the Celeron processor, a stripped-down, low-cost chip to compete in the least-demanding tiers in its industry. The Celeron processor slowed the advances of disruptive attackers such as Advanced Micro Devices (AMD) and Cyrix, and became a substantial business for Intel.

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Education played a critical role in helping Intel formulate and execute the Celeron strategy. After the Celeron had successfully entered the market, Andy Grove, then Intel's CEO, told me, "You know, the disruptive model didn't give us any answers to any of the problems, but it gave us a common language and a common way to frame the problem so that we could reach consensus around counterintuitive courses of action."

But Grove stepped out of day-to-day activities in Intel in the mid-2000s, and many of the senior managers with whom I interacted left in the coming years. As the senior leaders I had educated left Intel, the company's ability to continually create disruptive change atrophied. The language system had not penetrated deeply enough in the organization. Companies that truly want to create a long-term capability for disruptive change need to invest in building the common language that can drive longer-term success.

I have been very heartened that some companies have chosen to develop corporate training programs to embed the key tenets of disruptive innovation within the very fabric of the organization.

A Different Process

The resource allocation process is at the root of the innovator's dilemma. Without active management, this implicit, often invisible process will direct money and human resources toward efforts that bolster a company's current business. The process will deflect money and human resources away from the disruptive innovations that power future growth.

Companies have to wrest hold of the resource allocation process, making sure that dollars and bodies flow toward disruptive innovation. Additionally, they need to make sure that they treat different types of innovation opportunities differently. Although managers routinely approach different kinds of problems differently, in my experience companies lump together elements related to growth and manage them by a single set of metrics. This doesn't make much sense. An incremental improvement in an existing market cannot just be measured, monitored, and managed as if it were a bold new strategy in an emerging market. Pursuing fundamentally different opportunities the same way guarantees that one of the opportunities will be suboptimized.

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Generally speaking, new-growth approaches need to go through a more iterative development process, where the focus is on identifying and addressing the key assumptions and risks. The appropriate metrics that guide a new-growth idea should not be measures such as net present value or return on investment, which provide insights into the performance of the core business; rather, companies need to use qualitative measures that relate to success in the target market.

Demonstration Projects

Despite the significant academic research and evidence from the field supporting the power of disruptive innovation, many of the principles required to manage disruptive innovation successfully may still appear counterintuitive at best, and threatening at worst, to managers in established companies. Having a number of demonstration projects can show skeptics the power of following a different approach. Some of the companies detailed in this book that have done the best job of succeeding with disruption have started with one or a handful of clear success stories before seeking to expand their efforts.

I believe you will find that *The Innovator's Guide to Growth* contains a wealth of practical methods to build a common language, follow different processes, and create successful demonstration projects. One of the things I have enjoyed most of all from my own journey over the past decade is learning from like-minded innovators. Please tell me and my colleagues what you learn so that we can strengthen our collective understanding of how to unleash the power of disruptive innovation.