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# Disruptive Growth for Established Companies: Going on the Offensive

## Perspective by Waterstone Management Group

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Growth is critical for every company. And market disruption offers the most powerful form of growth possible. Companies that disrupt the status quo can gain outsized rewards through meteoric growth. And, in technology sectors, disruption is occurring constantly. Facebook, Uber, and Airbnb are just a few of the well-known tech companies that achieved huge value for their shareholders by successfully driving disruption.

But what about established players… can they successfully drive disruption? A successful disruptive growth play requires the intersection of a market opportunity with assets and other capabilities that match that opportunity. Established companies often have better capabilities than start-ups to leverage—customer base, financial health, and operating economies of scale to name a few. However, successfully identifying and executing a disruptive strategy is challenging for incumbents. It requires moving aggressively from a defensive posture to an offensive mindset, shifting the necessary level of resources to focus on the new opportunity, and, as necessary, disrupting its own business and operating models. The established companies that successfully design and execute a disruptive strategy will greatly increase their revenue and shareholder value growth.

## Disruptions Are Not Just for Start-Ups

There is no shortage of tech start-ups attempting to shake up various markets. Over the last decade, venture-backed companies have transformed industries such as networking appliances, taxi services, and security software. These successes and dozens more have fostered a point of view that disruptions are the exclusive realm of start-ups. While there is a certain popularity to this perspective, a number of large players have also made successful moves to disrupt:

amazon

Amazon found success in moving beyond its core retail business into on-demand IT infrastructure. Leveraging its highly scalable infrastructure and data centers built to support its fast growth online retailing, it began offering public cloud services in 2006. Amazon Web Services was a key enabler to the growth in cloud, the disruption of software markets, and the reallocation of IT spend. As of Q2 2016, AWS is a $9B revenue business and growing at +60% per year[1].

FUJIFILM

Fujifilm used existing intellectual property to successfully break into a vastly different market. In its pursuit of better performing photo film, its labs had built a library of 200,000 chemical compounds and 4,000 antioxidant samples. In the face of the collapsing film market in the early 2000s, it launched a line of high-end skincare products, which built on its deep expertise around preventing degradation of film (which they claim is not dissimilar to human skin) through exposure and aging. Fujifilm's goal is to increase skincare and supplement sales to ¥100B (~$960M) a year by 2018[2], representing approximately 5% of total revenue[3].

[1] AMZN 10K 2016 Q1
[2] Fiona Wilson, "Renewal Process," *Monocle*, February 2013, https://monocle.com/magazine/issues/60/renewal-process/
[3] CapitalIQ

Established companies do, however, face several challenges that start-ups don't:

- The need for management to balance focus on both current revenue drivers and the disruptive growth opportunity; this is particularly acute when the disruption will cannibalize the core business
- Fear of losing customers due to the reallocation of product and messaging investment away from core products
- Operations and culture that inhibit step-function innovations by focusing on delivering near-term effectiveness and efficiency

While these challenges are significant, they are not insurmountable. Executive teams need to ensure the right directives, operating model, messaging, and incentives are in-place to foster disruptive innovation.

## Identify Assets that Can Be Leveraged to Attack New Markets

A successful disruptive growth play requires the intersection of a market opportunity with assets and other capabilities that match that opportunity. Both the Amazon Web Services and Fujifilm's Astalift examples illustrate companies building on investments in existing assets and entering a new market with a new business model paradigm. To identify potential disruptive growth strategies, executives should begin by conducting a critical assessment of their company's assets and capabilities. Examples of what may be unearthed in the process include:

- Proprietary technology that is leverageable into new markets
- Low cost structure through exceptional economies of scale and efficient management processes/systems
- Deep subject matter expertise or privileged access to information
- A broad and deep base of customer relationships
- Unique access to critical suppliers

Could these assets be valuable in another market? Think beyond immediate customer and product adjacencies to markets that will leverage the expertise or resources that exist within the company. These could be areas to invest in to disrupt an existing market.

## Target Markets that Are Ripe for Disruption

Identifying a market opportunity that intersects with unique, leverageable assets is a critical step in developing a successful disruptive growth strategy. In evaluating disruption opportunities, executives should prioritize markets that may be particularly vulnerable. In Waterstone's experience working across the gamut of tech sectors, we see recurring indicators of a market ripe for disruption (red flags for incumbents, green lights for disruptors). Following are examples of such key indicators:

 

| Disruption Indicator | How to Disrupt | Example |
|---|---|---|
| **Markets with Abnormally High Margins**<br><br>*Industries where profit margins are significantly greater than parallel industries* | • An innovative business model (enabled by a pricing or technology innovation) that can be sustainable at significantly lower margins<br>• More than likely, some customers will be susceptible to a new offering at a lower price point | Charles Schwab disrupted traditional brokerages by offering low-priced brokerage to a new class of investors, accelerating the move of investment from Wall Street to Main Street. |
| **Stale Technologies in a New Technology World**<br><br>*Markets where there is a proprietary technology (ideally one without adequate recent investment) that hampers customers' choices* | • Capitalize on parallels from how new technologies are reshaping similar industries<br>• E.g., proprietary hardware giving way to software on commodity hardware, open technology movements, etc. | In the mid-1990s, the market for proprietary servers (with an average sale price of $80,000) rapidly collapsed with the introduction of commodity x86-based industry standard servers priced 85% lower. Within a few years, the average sale price for proprietary servers had been cut in half while the volume of industry standard servers grew by 10x. |
| **Unserved Low-end or Niche Market Segment**<br><br>*Sets of current/potential customers with a lower-level of needs (and potentially lesser profit opportunity) than the market is serving* | • Introduce a selectively stripped-down, lower-cost offering to serve the needs of a niche segment<br>• Incumbents will have a difficult time reacting since they will have to stay focused on their higher-margin customers | Progressive Insurance experienced significant share growth in the auto insurance market by targeting a commonly avoided niche: high-risk drivers. They further disrupted the traditional agent-based insurance selling model with a sophisticated online platform. |
| **Privileged Access to Supply or Customers**<br><br>*Industries where a select few companies control the supply of goods sold or act as gatekeepers to customers and enjoy favorable pricing terms* | • Look for ways to upend the paradigm, either by breaking down the barriers to entry or expanding the supply in previously unthought-of ways<br>• These barriers could also be overcome by regulatory changes, to which incumbents have difficulty reacting | Airbnb and Uber leveraged technology and peer-to-peer sharing to increase the supply of rooms and rides, respectively. |
| **High Level of Coordination Required Between Stakeholders**<br><br>*Industries that rely on complex interactions between different parties or a high degree of coordination within customers' organizations* | • Leverage a new technology to introduce a new paradigm, which either:<br>– Automates the coordination, or,<br>– Addresses the segments that do not require coordination to the extent existing solutions provide | Credit card payments, which have long required a complex set of processes, have been challenged by simpler peer-to-peer transfers enabled by PayPal and Square, among others. |
| **Extremely Fragmented Industry**<br><br>*Some industries have a diverse set of niche players, which operate without the scale and efficiency found in other markets—possibly evolving from historical geographical constraints or traditions of serving small sets of customers* | • If your company has significant scale with access to potential customers or with a key enabling technology, consider a volume play with mass-appeal products and/or pricing to disrupt much smaller scale competitors<br>• The increase of connectivity and rise in platform technology leaves these incumbents particularly vulnerable | Smaller niche retailers were disrupted by big box stores, which were, in turn, disrupted by national/global e-retailers. |

The key to finding a viable disruption opportunity is to look for intersections between vulnerable markets and assets that will enable the disruptor to offer a compelling value proposition with a clear competitive advantage to specific segments of customers.

## Design the New Paradigm

At the heart of every major disruption is a new business model, and the disruptor must define and communicate this, just as early SaaS companies defined OpEx subscription pricing over CapEx-intensive software license and maintenance pricing.

The market's economics will change, and incumbents will have a difficult time reacting due to the nature of their current business and capabilities. There may also be an understanding gap: Existing players are accustomed to the current paradigm and may not immediately understand or acknowledge the benefits of the disruptive offering.

The ecosystem may change as well. New players and partnerships may be required, and the nature of the interactions will evolve. Profit pools and strategic control points may shift, and incumbents may respond competitively to fight or embrace the disruption.

Not only does the impetus to define the disruption, design the ecosystem, and communicate the paradigm fall to the disruptor, but the disruptor must also evolve its capabilities and operating model to successfully attack the market and scale. For example, new sales strategies and resources may be required, development teams may need enhancement, and new expertise may be needed throughout the organization.

Consider the complexities Apple had to overcome when launching the iPod and the iTunes online store. The real value that customers were buying was an easier and cheaper way to listen to the music they wanted, but Apple's play was not providing the content. Instead, it organized an ecosystem of content providers who were completely unaccustomed to delivering music online, while Apple focused on developing hardware and software and building the enabling infrastructure and economic mechanisms.

There are several key steps disruptors should take to find sustainable, profitable growth within an emerging market:

| Disruption Step | Considerations |
|---|---|
| **Articulate the Disruption's Value Proposition** | • Clearly communicate how the disruptive offering is different than customers' current options: What is different? What is better? What is at parity? What is worse?<br>• Define which customer segments stand to benefit the most, and identify which customers are likely to be the first adopters |
| **Analyze and Design the Ecosystem** | • Map the new ecosystems of players, interactions, and economics<br>• Identify shifts in profit pools and strategic control points<br>• Analyze how existing competitors are likely to react |
| **Design the Offering and Ecosystem Play** | • Considering profit pools and strategic control points, develop product/service offering and partnership strategy for target and beachfront segments<br>• Identify how to influence ecosystem |
| **Develop Technology and Enhance Business Model** | • Design operating model and infuse incremental organization with subject matter experts<br>• Identify and address capability and resource gaps to gain a foothold in disrupted market and scale towards profitability; needs may be different than current capabilities and what the old paradigm required:<br>– Sales model<br>– Marketing and customer acquisition<br>– Product development<br>– Services delivery<br>– Governance, etc.<br>• Make build vs. buy decisions where required |

## Complex Disruptions Start with Simple Steps

A successful disruption takes significant resources in planning and execution, and it will not happen without intentional coordination. While the task of disrupting a market that your company does not compete in currently may seem daunting at first, there are several steps to begin the process:

- Assign resources to review assets and capabilities, and identify potential disruptive plays
- Explicitly incorporate the evaluation of disruptive strategies as a part of overall strategic planning
- Consider seeking external perspectives by hiring specialists and subject matter experts to understand new markets and operational implications

## Conclusion

Although challenging, successfully creating a market disruption presents a tremendous growth opportunity for many established companies. Especially in technology segments, markets are continuously being created and disrupted, and established companies must think about expansion beyond their core markets to be successful in the long run. Forward-looking executives continuously seek ways to leverage existing assets and resources to attack new markets in ways that start-ups simply can't, and they approach disruption in a methodical, targeted way.

**Waterstone Management Group helps technology companies and investors create measurable value by identifying and capitalizing on disruptive growth opportunities and driving excellence in Services, Cloud, and Customer Success performance. To learn more about disruptive growth and explore the potential for your company to be a disruptor, please contact:**

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