

How Industries Change & Innovation in Services

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Discussion Questions - McGahan

- ◆ According to McGahan, what are the key trajectories for change?
 - ◆ Are there hybrid models of trajectories, i.e., industries that exhibit multiple kinds of change?
- ◆ McGahan suggests that trajectories set boundaries on how firms will generate profits and that companies incur losses because they try to innovate outside of these boundaries. Do you agree?
- ◆ What are steps should be taken in order to identify the trajectory of an industry?
- ◆ The article was written in 2004. Are McGahan's ideas still relevant in 2008? Are they more applicable to physical based industries than digital-based or hybrid physical/digital based industries? Is the speed of innovation and feedback a factor in the transformation of industries?
- ◆ What are the lessons learned from this article ?

Trajectories of Change - 1

- ◆ Two threats of obsolescence
 - ◆ Industry's core activities are threatened when they become less relevant to suppliers and customers because of some new outside alternative
 - ◆ Industry's core assets are threatened when the resources, knowledge and brand capital that have historically made the organization unique fail to generate value as they once did
- ◆ Four trajectories of change
 - ◆ Radical – occurs when an industry's core activities and assets are threatened. Usually occurs after mass intro of new technology. The change usually takes decades to become clear and play out and the end result is a completely reconfigured usually diminished industry. Example is the travel industry.
 - ◆ Intermediating – Occurs when business activities for dealing in both downstream and upstream markets are simultaneously threatened. Core assets not threatened if they are used in new ways. Companies must simultaneously protect their valuable assets while restructuring their key relationships. Applies to industries with physical assets, .e.g, automobile companies. Question: Can this category be applied to the music industry?

Trajectories of Change - 2

- ◆ Four trajectories of change
 - ◆ Creative Change – Occurs when relationships with customers and suppliers are generally stable but assets turn over constantly. Innovation in this trajectory happens in fits and starts. Example is the film industry where large production companies enjoy ongoing relationships with actors and agents that are stable in combination with unstable assets (new films). McGahan claims that there are no new entrants and these companies have retained their strength in the marketplace because of their networks.
 - ◆ Progressive change – Occurs when industry incumbents have incentives to preserve the status quo. Core assets are not threatened so industries here are more stable. The goal is to build resources incrementally. Examples are commercial airline industries.
- ◆ Identifying the trajectory involves four steps:
 - ◆ Define your industry
 - ◆ Define the industry's core assets and activities
 - ◆ Determine whether assets and activities are threatened with obsolescence
 - ◆ Evaluate where the industry is in the cycle

The Porterian view of Industry Change (from Understanding Industry Structure) HBR, 1979 - 1

- ◆ **Porter delineates five forces and states that understanding these forces enables a strategist to size up any industry regardless of whether it is a product, service, emerging or mature, high tech or low tech. Five Forces**
 - 1. Threat of entry – New entrants to an industry bring new capacity and desire to gain market share and the threat of a new entry puts a cap on the profit potential of an industry. Barriers to entry include customer switching costs, network effects, and capital requirements.**
 - 2. Power of suppliers – Suppliers can exert bargaining power by raising prices, shifting costs downstream to industry participants or limiting quality of goods and services they provide. Powerful suppliers can squeeze profitability out of an industry that is unable to pass on cost increases in its own prices. An industry will depend on multiple groups of suppliers.**
 - 3. Power of customers – Customers can drive down prices, demand higher quality or more service and play competitors off against one another.**
 - 4. Threat of substitutes – Substitute, e.g., videoconferencing for travel, can perform the same function as an industry's product by a different means. These substitutes limit industry's profit potential because they place a ceiling on prices that companies can charge.**
 - 5. Rivalry among existing competitors. The degree to which rivalry undermines an industry's profit potential depends on the basis on which companies compete and on the intensity with which they compete.**

The Porterian view of Industry Change (from Understanding Industry Structure) HBR, 1979 - 2

- ◆ Other Porterian notions:
 - ◆ Technology or innovations alone are not themselves enough to make an industry structurally attractive or unattractive. Mundane low tech industries are more profitable than sexy industries such as software and internet technology that attract competitors.
 - ◆ There is an important role for complementary products and services which are used together with products from different industries.
 - ◆ Changes in industry structure which may occur because of technological or customer developments can boost or reduce profitability, raise or lower the threat of new entrants, change the supplier or buyer power, or create new threats in the form of substitutes.
 - ◆ Understanding the five forces is important for developing strategy:
 - ◆ Need to know how to position company
 - ◆ Need to know how to exploit industry change
 - ◆ Need to recognize that a company can shape and improve industry structure
 - ◆ Need to understand global competitors
- ◆ **Question: Are these ideas relevant today in light of speed of digitalization and development of entirely new ways of conducting business which threaten traditional industries?**

Lessons Learned

- ◆ Industries continually undergo significant changes and evolve.
- ◆ Companies must constantly adapt to the changes in the business environment. Some may choose to be in sync with the leaders in the industry and some may try to be disruptive innovators and 'break the mold'.
- ◆ Because of digital-based innovations and hybrid digital/physical/wireless innovations, e.g, the Web, new technological devices etc., speed and customer feedback become important factors in how an industry evolves and who takes the leadership.
- ◆ While McGahan and Porter provide well defined trajectories or forces for change, a better framework of thinking might be either hybrids of these constructs or to recognize that it is increasingly harder to define what an industry does, e.g., the radical changes in the telecomm industry, and therefore, that most industries evolve in a more fluid networked environment which is constantly being redefined by its players and by various nodes on the network.

Innovation in a Services Economy

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Key Questions

- ◆ How often does a business model have to change to still be relevant and effective?
- ◆ How are managers coping with an increasingly chaotic business environment? Is this reminiscent of the frenzy during the dotcom boom?
- ◆ According to Geoffrey Colvin (Fortune mag), what is the key issue for managers in this new chaotic business environment?
- ◆ How is innovation in services different from innovation in traditional high tech sectors?
- ◆ According to BW, innovation in services is rare. Do you agree?
- ◆ According to Lyons et al, what are the salient characteristics of innovation in a services organization?
 - ◆ Can such characteristics be applied to all service based industries? s

Managing through Chaos (from Fortune)

- ◆ Today's company is a maelstrom of changing markets, technologies, customers, and products
- ◆ Coping strategies for this chaotic environment include:
 - ◆ Freeing companies from physical assets makes companies more vulnerable but also more flexible
 - ◆ Radically restructuring a company, e.g., Semco where there are no job titles, a few execs trade the CEO role every six months, and workers set their own hours
 - ◆ Letting things happen in the margins outside the core business
 - ◆ Encouraging people to be risk takers and innovators
- ◆ Biggest problem is getting people to behave differently in a group setting: All change creates winners and losers and people resist change.
- ◆ Another problem is leading change and 'abandoning yesterday'
- ◆ Companies will have shorter lives as will industries – the Hollywood model of people coming together for a short period of time and then disbanding (a great group)

Innovation in Services – A New Way of Thinking - I

- ◆ Competing on service innovation requires more intensive set of organizational practices than competing on physical product innovation or traditional engineering based innovation
 - ◆ In Investment banking, innovation tends to be more fluid and evolutionary rather than radical. More incremental and accumulation of small advances
- ◆ Need for fostering service innovation culture which is a consistent, and comprehensive presentation of values and norms that promote fresh thinking and swift execution
- ◆ Innovation in services differs from product innovation
 - ◆ It is not radical, disruptive or game changing
 - ◆ R&D, IP issues, and patents have little to do with services innovation in the traditional sense
- ◆ Four distinct enablers
 - ◆ Client demand for services that span boundaries
 - ◆ Broad and deep client relationships
 - ◆ Tight integration between design and execution
 - ◆ A vision of innovation that is articulated from the top, i.e., support for a culture of innovation

Innovation in Services – A New Way of Thinking – II

- ◆ Emphasis needs to be put on a culture of innovation which permeates the entire organization – this is key to success for services based firms
- ◆ Distinctions between services innovation and manufacturing innovation
 - ◆ Innovation in services distributed throughout the organization rather than an emphasis on individual success and freedom
 - ◆ Innovation in services is continuous rather than done in stages. It is more fluid in nature where design and delivery are linked together
 - ◆ Innovation in services is relevant to hiring and promotion practices
 - ◆ Innovation in services is enabled by leadership where leaders are responsible for managing the seeming contradiction between a strong culture and innovation
 - ◆ Innovation in services balances risks and rewards. Important to create environment where there are rewards for innovative behavior and creativity
 - ◆ Leading through innovation means enabling people to create and deliver small incremental innovations every day.