

REINVENTING THE MARKETPLACE: Asking the right questions

Introduction: Stuck in a trap

It's always the same during each planning cycle – we look at our established and often crowded marketplaces and think how can we gain – or just hold on to - market share without reducing profitability. This can be a real challenge, especially when all the obvious segments and strategic positions are taken up.

One answer – an issue that I would like to explore in this ebriefing – is to change how we look at our market places. By examining how organizations such as *easyJet*, *Direct Line* and *Amazon* have redefined what many commentators would describe as mature markets, I will propose that there are three key questions that should always be in the mind of the strategist wishing to reinvent her or his marketplace. I will also present a conceptual model for incorporation into your business planning process to help ensure a permanent focus on reinvention.

Learning from others

I would like to start by looking at three well-known organisations that have fundamentally changed the rules of the strategy game in mature marketplaces – marketplaces where established players may have thought that there were no new moves to explore.

Case Study 1 – Direct Line Insurance. Once, the insurance sector was described as the marketplace that never changed. Then in the 1980s – a new entrant – *Direct Line* changed the rules of the game in one simple move. That move was to hedge hop the traditional distributor of insurance products – the insurance intermediary – and provide products directly to the end customer. This now well-known case study is more than just a story of cutting out the middleman, it is an example of examining the value chain in the marketplace and locating *frictional costs*. As I will argue later in this ebriefing, frictional costs should be the first port of call for any manager seeking out opportunities for reinvention. So what exactly are *frictional costs*? Frictional costs have two broad characteristics:

- § Duplication. Examine the activities that are carried on in the value chain at quite a detailed level. You will probably find a number of activities – and associated costs – that are duplicated. In an insurance example, just take the activity of keying in the customer's name and address – how many times is this repeated? This is exactly what Direct Line did – it saw substantial frictional costs in the value chain and created an opportunity.
- § Zero value adding. One exercise that I like to carry out with clients is develop a process map and then, for each activity, identify the activity costs contrasting the cost with the value created. Quite often you will find that the equation just doesn't stack up – many activities are just there because they have been there historically. If the cost doesn't justify the created added value then we're concerned with a potential frictional cost and a source of reinvention.

Frictional costs are still out there to be taken advantage of. Examples of frictional costs in insurance will be found in one of my earlier articles – *Use IT or lose it* - Post Magazine 11 October 2001.

Case Study 2 – Amazon. Amazon.com - the online bookstore - is a story from 1994, the dawn of the ecommerce age – but the early lessons still hold good. It's an example of both finding a new route to the customer through technology and using that route to unlock frictional costs both by doing away with a bricks and mortar distribution strategy and developing a streamlined relationship with suppliers – not physically holding books in stock awaiting customers - but ordering them from suppliers after a customer has placed an order.

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After only four years in operation, Amazon's business model offered attractive benefits when contrasted with the traditional bricks and mortar bookstore:

Measure:	Amazon.com	Traditional Bookstore
Available titles	3,100,000	175,000
Sales per employee	\$375,000	\$100,000
Inventory turnover (annual)	24 X	3 X

Source: Piercy (1999) *Tales From The Marketplace – Stories of revolution, reinvention and renewal*. Oxford: Butterworth Heinemann

The lessons here are two-fold. Look for new routes to the customer and look for frictional costs right across the value chain. Remember that technology can turn traditional capital-intensive distribution routes from once reliable conduits into frictional cost ridden millstones.

Case Study 3 – easyJet. easyJet is more than a case study in cost reduction. It is an example of a new entrant into a mature marketplace with a new vision built from three separate perspectives:

- (a) Customer Segments. What easyJet saw – and other more established players did not – was that there were unserved customer segments that could be reached profitably. In fact Stelios Haji-Ioannou, easyJet's founder, wanted to open up air travel to all making it "as cheap as a pair of jeans" to quote one ad campaign.
- (b) Getting to the customer. Again, following *Direct Line* and *Amazon* it's a case of using technology (in the early days of both *Direct Line* and *easyJet* yes this was the telephone) to carve out a new route to the customer that would leave established competitors with a value chain almost instantaneously burdened down with superfluous costs.
- (c) Frictional costs. Cutting out both duplicated and historic activities where costs outweigh any value added. Breaking the traditional approaches to ticketing and checking in are just two examples.

And of course there are many more examples, but looking at these case studies we can see that there are three key questions that we need to almost permanently hold in our minds when considering the opportunities for marketplace reinvention.

The key questions are:

1. *Are there frictional costs that we can excise from the value chain?* One of the first steps for the strategist is to understand *intimately* where costs and value are generated in the value chain. Look for duplication and activities that are traditionally thought of as "essential". Remember, particularly from the *Amazon* example, that macro level industry level forces can almost overnight turn a once reliable conduit to the customer into a competitive millstone.
2. *Can we find new routes to the customer?* In particular can we find ways of bringing the product to the customer as opposed to the customer going to the product? How can we provide value for the customer more quickly?
3. *Are there customer segments that are under-valued?* Look carefully for customer segments that are either ignored or alternatively under-served. A good start is to look at established pricing formulae. You will probably find that there are commonly accepted views of what constitutes an unprofitable customer. But following the *easyJet* example, how could we make these segments profitable? Another good example of taking a new broad look at the potential market is eBay, the online auction site. Only 10 years ago the majority of the population would never have dreamt of selling at auction. Now many individuals have an eBay account as a profitable part-time business. I like to call this "market unlocking"

Building a Schematic

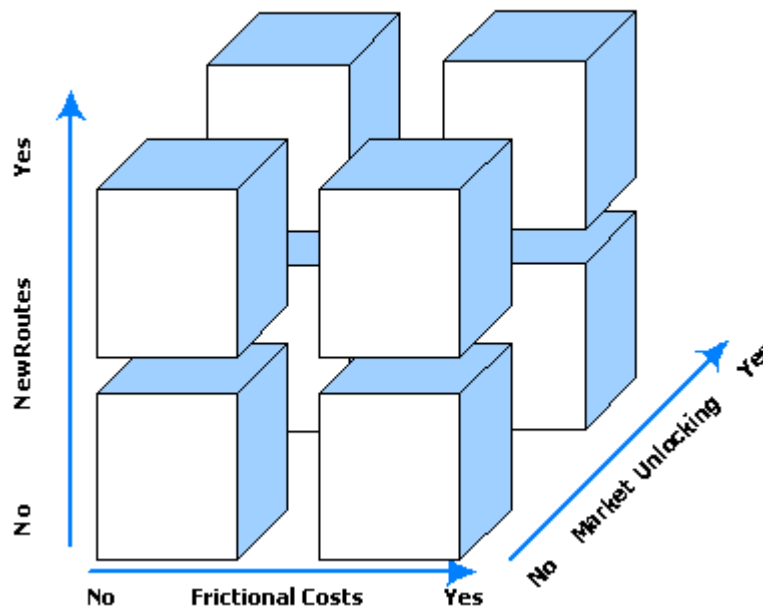
I would like to conclude by presenting a schematic that you might find helpful to include within your business planning process.

In this ebriefing I have proposed that there are three routes that singularly or in combination could lead you to a path to reinvention. The three potential routes to be explored are:

- § Discovering and excising frictional costs. This is always the first area to examine. Make a point, as I have said before, of understanding frictional costs *better* than your competitors.
- § Identifying new routes to the customer. In particular, look for ways to bring the product to the customer as opposed to the customer coming to the product. Provide immediate satisfaction rather than letting your customers wait.
- § Unlock under served or ignored customer segments. Take a look at the entire marketplace and try to find ways around traditional formulaic views of who is a profitable customer.

These three potential reinvention routes are shown in Illustration 1 below:

Illustration 1: The Reinvention Dimensions



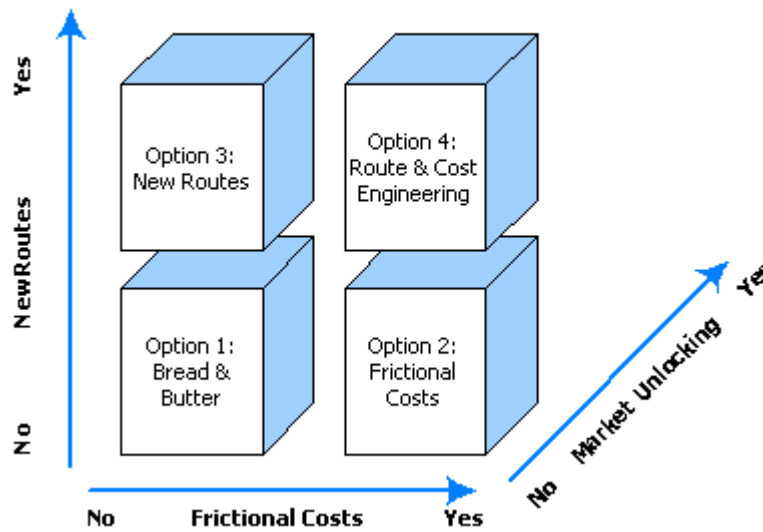
Each of the three routes or dimensions has two positions – “YES” – yes there are opportunities or “NO” – where you are sure that opportunities don’t exist. As shown in Illustration 1, there are therefore 8 options that are split out into “front row” and “back row” options shown in Illustrations 2 and 3 overleaf. I will now take a closer look at each option.

The Front Row:

Option 1: Bread and Butter. This is the “no change” option. It will probably represent where you are at the moment. And it is where you earn your profits now. Whilst it is very exciting to go off and explore new options remember not to forget where the current profits come from!

Option 2: Frictional Costs. This should be the first area for exploration. Understanding frictional costs is a mandatory exercise – the aim is to be better at understanding current and future frictional costs than your competitors. Quite frequently, frictional costs will lead to more than cost reduction initiatives - they will spark ideas for new delivery routes and “market unlocking”.

Illustration 2: The Front Row



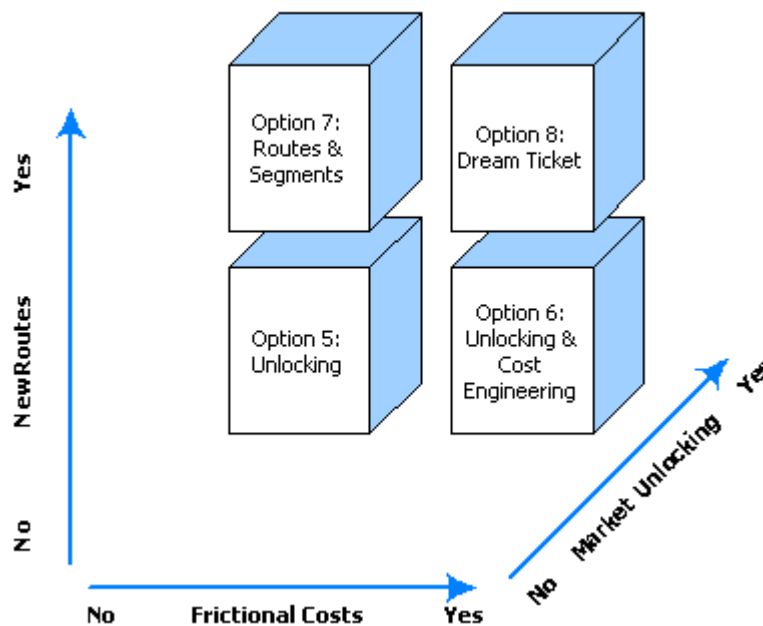
Option 3: New Routes. Consider two questions when thinking about getting to the customer in new ways. Can we take the product to the customer rather the customer coming to us? Can we provide customer satisfaction more quickly?

Option 4: Route and Cost Engineering. A combination of options 2 and 3. The position originally occupied by *Direct Line* and *Amazon*.

The Back Row:

Option 5: Unlocking. Pure market segment unlocking. Discovering segments that have either been entirely overlooked or, more likely, have historically been regarded as too expensive to serve profitability. But how can you change the market profit equation?

Illustration 3: The Back Row



Option 6: Unlocking and Cost Engineering. Our second combination. Unlocking profitability by excising traditional frictional costs.

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Option 7: Routes and Segments. Finding new routes to ignored segments.

Option 8: Dream Ticket. This is a powerful combination of releasing frictional costs, discovering new routes to the customer and opening up overlooked customer segments. A powerful position – examples would include *easyJet* and *eBay*.

Including this schematic and the underlying questions into your business planning process will help to ensure that reinvention stays on the strategic agenda.

Finally

I hope that you have enjoyed this Critical Update.

You can find more on the website or e-mail me using the link below. I enjoy personally helping businesses - some of the work I undertake includes:

- § Market research to identify the product performance and service needs of B2B customers
- § Facilitating board level strategic reviews, with a particular emphasis upon the definition of tomorrow's competitive environment
- § Design and implementation of Balanced Scorecard performance measurement systems
- § Research to help identify what potential capital providers will look for in your business plan
- § Training: Strategic Thinking, Performance Measurement and Strategic Change Workshops.
- § Product portfolio assessment. Helping the business to define the optimal product portfolio – balancing future competitive conditions with the probability of achieving future planned performance
- § Communication programmes
- § Organisational audits – assessing the innovative capability of your organisation

Best regards,

Robert Davies