Technology and Operations Strategy–Part 1: Innovation Strategy
3/30: Business model innovation

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Change position, Change strategy

Prahalad and Hamel (2003) explained that core competencies lead to the development of core products which further can be used to build many products for end users. However, we found that even if the company has a core competence, engaged in the most good things, but also may lead to failure. For example, HP first invented the tablet, but lost to ipad. Sony is the first invented Walkman, but lost to ipod. Why innovators failed, but competitors catch up from behind? The key is not only technological innovation, design innovation, but also the business model to be innovative.

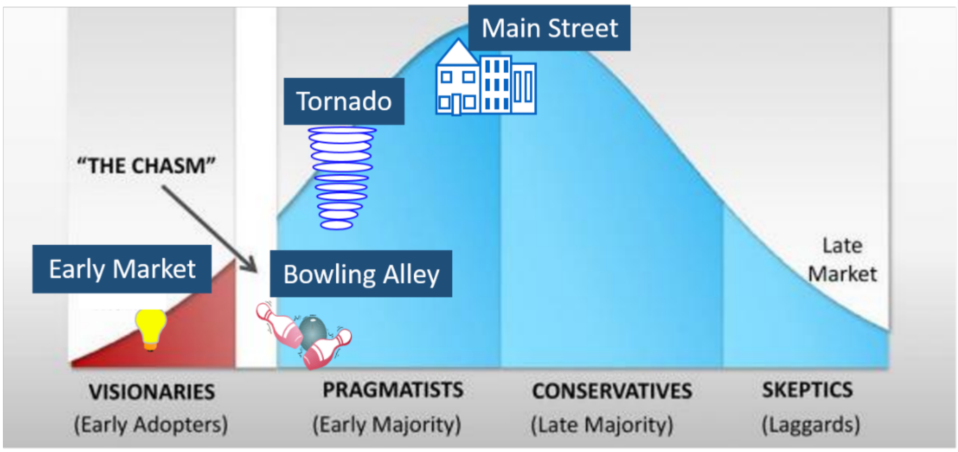
The most important is that the firms must have different business models and strategies in different stages. Everett Rogers(1962) argued 'the technology adoption life cycle' which describes the adoption of a new product or innovation. Geoffrey Moore(1991) proposed amendments to the theory that there is a ' chasm' between the first two adopter groups (innovators/early adopters), and the early majority (see figure 1).

Further, Moore(2000) divides the technology adoption cycle life into four stages, and suggests strategies that are required at different stages. While the firms know the importance of different stages, the problem is how to reinvent the business model. Johnson and Christensen (2008) offered four elements to build a successful business model. In order to explain these theories, the following example is Netflix how to beat the Blockbuster.

1. The Category Maturity Life Cycle of Netflix

While Netflix was founded in 1997, Blockbuster which founded in 1985 dominated the video rental market and had grown to a commanding 40% share of the market, but surprisingly, Blockbuster issued a bankruptcy warning in 2010. What happened in the past ten years? I apply the Moore theory to explain the strategies of Netflix (see figure 1).

Netflix 's Technology Adoption Life Cycle Model



Stage	Early Market	Bowling Alley	Tornado	Main Street
Year	1997	1998	2007	2013
Strategies	• Video-by-mail	• All you can eat • No late fees • Fast, free delivery • Video recommendation engine	• Streaming videos • Video-on-demand • Big data	• Original programs • Bundle deals • TV everywhere

Source: Moore, G. A. (2000). Living on the fault line: Managing for shareholder value in the age of the internet. New York: HarperBusiness.

Figure 1: Netflix's Techology Adoption Life Cycle Model

(1) The strategies in Early Market

Moore(2000) believes that with the 'Discontinuous innovation' to grasp the advantages of first-mover, to find the 'future' market positioning in early market stage. In 1997, Pepsi has a wide range of physical stores, in contrast, Netflix launched the 'Video-by-Mail' service, but consumers don't have the patience to wait so Netflix don't operate well at that time.

Think of it this way: Blockbuster had more than 5,000 video rental stores in U.S, and about ten minutes by car to arrive. Consumers need to pay the freight and wait for several days in Netflix, moreover, Blockbuster had more new films. Faced with these weaknesses, how Netflix apply the strategies to break through the dilemma?

(2) The strategies in Bowling Alley

At this stage, Moore (2000) suggested the companies adopt the 'Application innovation' to create a niche market. In 1998, Netflix took four strategies: 'all you can eat' model, no late fees, fast and free delivery, and video recommendation engine with big data and data mining.

Netflix is cheaper, more convenient, and more understanding the consumers' needs. It was conceivable that Blockbuster's expensive late fees and 'pay as you rent' model failed. Netflix mad a market and created a value chain where there were no market and no value chain before, and developed "killer app" to expand niche to niche (Moore,2000).

(3) The strategies in Tornado

As customers increase, companies usually takes the strategy of 'product innovation' , emphasizes the sales and service to develop the market, and focuses on defeating the competitors in the tornado stage (Moore,2000). Netflix launched video on demand service via the Internet called 'Watch Instantly' on December, 2007.

The cheapest plan, only $7.99 per month, customers can see hundreds of thousands of videos. After Netflix launched this service not long, Blockbuster shares fell sharply, and collapsed in 2010 (see figure 2).

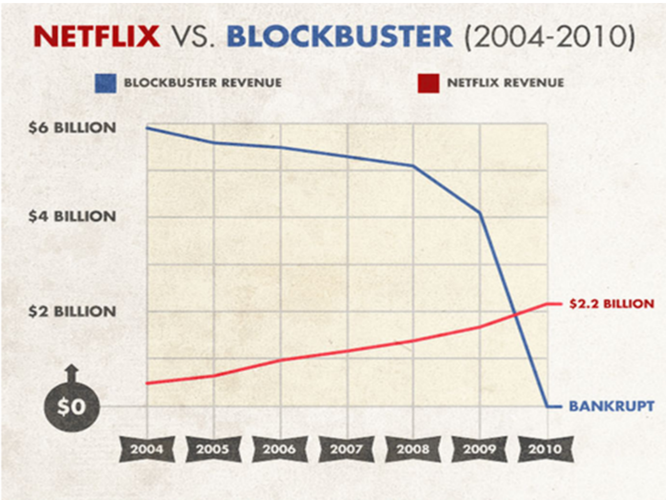


Figure 2: Chart Of The Day: Netflix v. Blockbuster

Source: http://www.outsidethebeltway.com/chart-of-the-day-netflix-v-blockbuster-edition/

(4) The strategies in Main Street

When the market boundaries have been set, the company began through accessories, supplies, customer service, and differentiated products to profit (Moore,2000).

In 2013, Netflix began work on producing its own original content – House of Cards which received four nominations for both the 65th Primetime Emmy Awards and 65th Primetime Creative Arts Emmy Awards. Is different from the traditional model to play a weekly episode, Netflix once provided a quarter of the thirteen sets of content. This is because after the big data analysis, Netflix know the audience's hobby, so get the majority of praise. Not only did the drama earned a huge amount of product placement advertising, but also attracts more people to subscribe to Netflix.

Just as Netflix's Slogan "Watch anywhere. Cancel anytime." , in addition to using PC to see Netflix, Netflix actively cooperate with the hardware manufacturers, so the audience can watch Netflix movies and TV shows online or stream right to the smart TV, game console, PC, Mac, mobile, tablet and more. Netflix CEO Reed Hastings predicted that in the next 10 to 20 years, all of television will be on the Internet.

(5) The Next strategies

The more important contribution to the theory of Moore(2005), is to extend the product life cycle. After entering the main street stage, companies should continue to adopt strategies to extend the profits (See the figure 3).

Netflix is not easy to be imitated, because it constantly update the business model and innovation, I think Netflix is currently in 'growth market ' to 'mature market' which include the 'customer intimacy zone' and 'operational excellence zone'. In these zones, companies need apply process,experiential, line extension, enhancement, marketing, value engineering, integration, and value migration innovation (Moore,2005).

Now, Netflix faces competition from Amazon's and Apple. Netflix plans to launch 30 original programs under way for 2016, and it's not only the series, but also the documentary and stand- up comedy to attract more subscribers. Meanwhile, Netflix focus on expansion in international markets. It is worth looking forward to the future development.

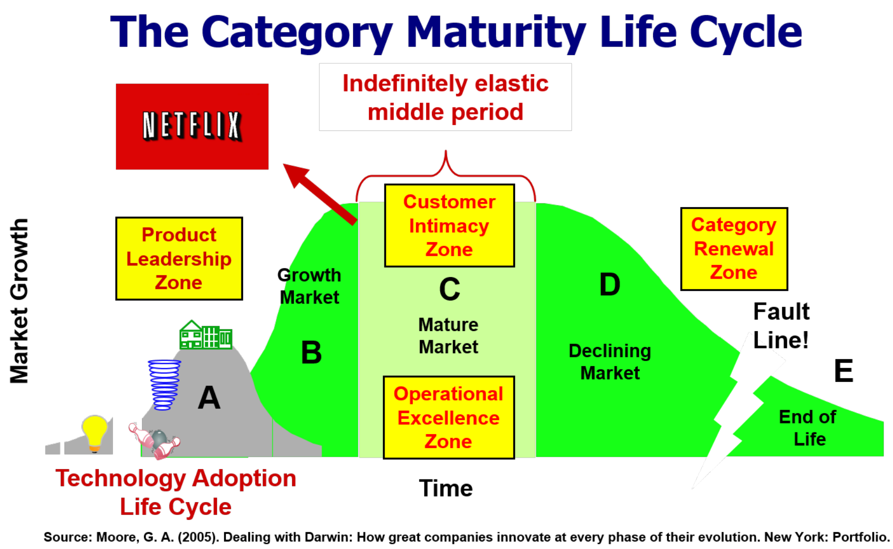


Figure3: The Category Maturity Life Cycle

2. How Netflix cross the chasem?

Through the above analysis, we can find two key why Netflix crossing the chasm, from visionaries to pragmatists:

(1) **D-day strategy:** Moore(1991) argued that companies must focus on resource development niche market. Netflix early on the development of different target markets with Blockbuster. Blockbuster's customers are mostly want to pass the time and watch the new films, but the choice of Netflix as the first niche market for movie lovers.

Therefore, Netflix established a complete database of movies and lunched 'all you can eat' service, so that customers can make an appointment to see all the films at a cheaper price through internet, but also to solve the problem of Netflix inventory.

(2) **Whole Product:** Moore(1991) suggested companies should creat whole prodects by thinking through the customer's problems and solutions in their entirety. This includes the core product including additional software, hardware, systems integration, installation and debugging, training and support, standards and procedures, etc. Moore talks about Theodore Levitt's model(1983) including the generic, expected, augmented and potential products.

Blockbuster only have generic products (rich video database) and the expected product (a number of rental stores), but less augmented and potential products, in contrast, Netflix has a better whole product (see figure 4), and that is why Netflixt is successful.

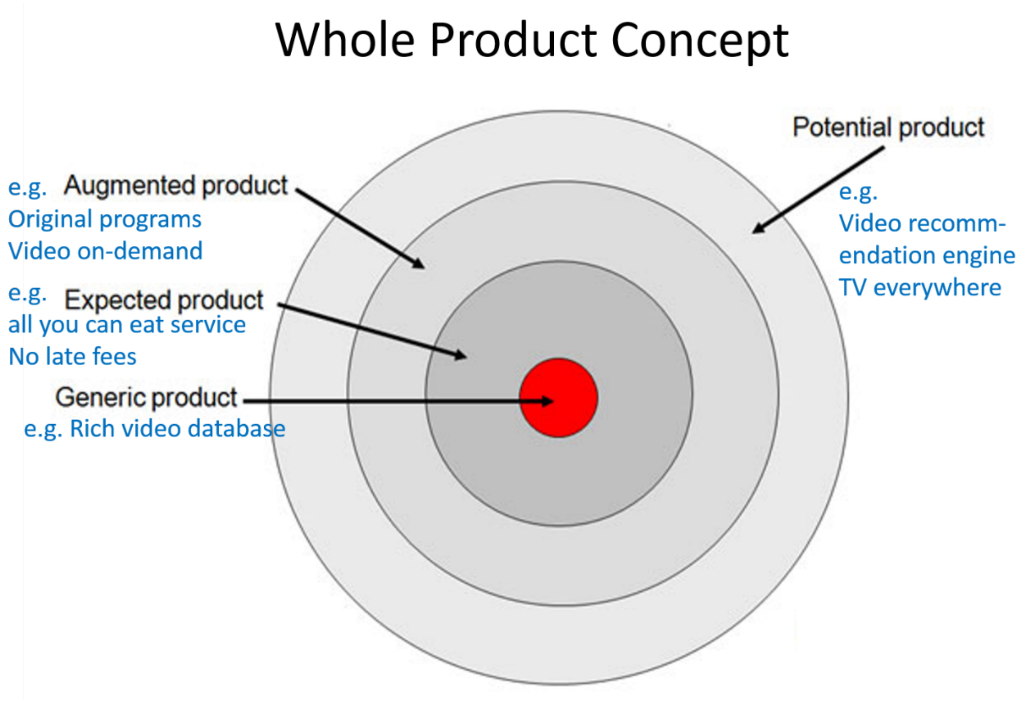


Figure 4 : Netflix's Whole Product Concept

3. The Business Model of Blockbuster and Netflix

Many people believe that Netflix's success was the internet application, but I think the key is not technology, but Netflix has completely different strategies and value network with Blockbuster.

The following is an analysis(see figuree 5) of the differences between these two business models by Johnson and Christensen's theory (2008):

(1) **Customer value proposition:** The target customers of Blockbuster were mostly impulse consumers, eargering to see the latest movie in the fastest time. Netfliex’s customer is more rational.

(2) **Profit formula:** The rental fees and late fees were the main profit source of Blockbuster. The profit of Netflix is most from monthly fee and the increase of new users will not increase the cost. But Blockbuster need to increase the cost(people,equipment,etc) to expand the stores.

(3) **Key resources:** Blockbuster expanded a large number of chain stores to increase the convenience of customers and to achieve market size effect. The founder of Netflix is an engineer, so they focus on the technology to develop the video recommendation engine and streaming videos with big data and data mining to grasp customer needs.

(4) **Key processes: I**n 2006, Blockbuster had more than 5,000 stores and was less than 10 minute of drive from a blockbuster store. The strategy of intensive stores was to increase the customers’ convenience, but also increase the operating costs. On the contrary, Netflix offered an online videos rental service with no physical store location, and change the cost of physical stores to invest in network technology.

Figure 5: The Business Model of Blockbuster and Netflix

	Blockbuster	Netflix
Customer value proposition	Customers can quickly rent videos.	Customers can rent videos at a low price.
Profit formula	Pay as you rent with late fees service, and physical store costs higher	All you can eat model with no late fees, and low overhead to accommodate lower margins, high throughput
Key resources	A large number of chain stores to increase the convenience of	Video recommendation engine and streaming videos with big data and

	customers and to achieve market size effect.	data mining to grasp customer needs.
Key processed	The strategy of intensive stores was to increase the customers' convenience, but also increase the operating costs.	Offered an online videos rental service with no physical store location.

4. After crossing the chasem

Moore (2000) defined 'the fault line' as a dangerous, unstable seam in the economy where the Internet and other powerful innovations meet and create market-shattering tremors. The first step is to understand the customer value proposition (Christensen,2008), in other words, it is to ask the right questions and to solve the problem, and apart from doing the right thing to do, but also to do the right thing. Just as Facebook founder and CEO Mark Zuckerberg mentioned that entrepreneurs should think of solving problems instead of founding a startup.

In addition to the Moore (2000) mentioned in different stages with different strategies to extend the product life cycle, in my view, there is a very important trick , is to increase the switching costs. Because humans are creatures of habit and routine, and maybe that is why the early majority and the late majority making up about 68% of the population (Rogers,1962).

Blockbuster had lower switching costs, and even more, customers dislike the late fees. Netflix which kept customers wanting to enjoy their service has higher switching costs, and as a consequence, the competitors are not easy to exceed Netflix. As the key to success of apple is not just technology, but the whole platform system, increasing the switching costs. Crossing the chasm is very difficult, but after the chasm, companies have more things to do, though no one can control it, we must learn how to deal with it.

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