Creating New Market Space

by W. Chan Kim and Renée Mauborgne

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Creating New Market Space

The Idea in Brief

When the market in which you compete gets overcrowded, innovating is the only way to break free from the pack. But how do you begin? Consider value innovation—a strategic concept Kim and Mauborgne introduced in their 1997 Harvard Business Review article. Value innovators create products or services for which there are no direct competitors—and use those offerings to stake out and dominate new market spaces. They don't possess special vision or prescience; rather, they look across the conventional boundaries of competition for opportunities to provide breakthrough value for customers.

Take Intuit. In 1984, the software company looked beyond its own industry to identify choices available to consumers seeking to manage their personal finances. Buyers’ options? The computer, for which costly, complicated financial management software was available—or the lowly pencil, which didn’t simplify things or save time but was cheap and easy to use. Intuit created a third option: the astoundingly successful Quicken software. With its user-friendly interface, basic functions, and affordable price, Quicken leverages the computer’s advantages (speed and accuracy) and the pencil’s advantages (simplicity of use and affordability).

Operating in markets that initially have no rivals, value innovators enjoy steep growth. Consider Starbucks, which transformed a functional product (coffee) into an emotional one with its chain of “caffeine-induced oases” offering chic gathering places, relaxation, and creative coffee drinks. Starbucks enjoys margins roughly five times the industry average.

The Idea in Practice

To spot additional value innovation opportunities, consider these approaches:

Look across strategic groups. Strategic groups are clusters of companies within an industry that all pursue a similar strategy, such as offering low prices or a glamorous image for consumers. Most companies try to enhance their competitive position within a strategic group. To create a new market space, identify factors that determine buyers’ decisions to trade up or down from one group to another.

Example: Sony created a whole new market: personal portable stereos. Its Walkman combined the virtues of products created by two strategic groups: manufacturers of boom boxes, characterized by great acoustics and “cool” image, and makers of transistor radios, valued for their low prices and convenient size and weight. The Walkman grabbed market share from the two strategic groups, and attracted new groups of customers, such as joggers and commuters.

Look across the chain of buyers. Instead of targeting a single obvious customer group, target other customers involved in the buying decision. Overlooked buyer groups value different features than target customers, suggesting fresh innovation opportunities.

Example: While other on-line financial-information providers served brokerage IT managers, Bloomberg began serving traders and analysts. Bloomberg designed a system to offer these neglected buyers tools for accessing and immediately acting on financial information. The system included keyboards labeled with familiar financial terms, press-of-a-button analytic capability, and dual monitors for multitasking. The system also improved the quality of traders’ personal lives—providing purchasing services that enabled overworked traders to buy flowers, clothing, and jewelry during trading lulls that occurred during the workday.

Look across complementary products and services. Seek untapped value hidden in other industries’ offerings that affect your offering’s value. Define the total solution buyers seek when choosing a product or service—including what they do before, during, and after using your product.

Example: With their blockbuster superstores, Borders Books & Music and Barnes & Noble transformed their product from books to the pleasure of reading. Coffee bars, wide aisles, and comfy armchairs invite people to linger. Book-savvy staff help customers make selections. And late-night closing times provide evenings of quiet reading away from harried home fronts.
A systematic approach to value innovation can help companies break free from the competitive pack.

Creating New Market Space

by W. Chan Kim and Renée Mauborgne

Competing head-to-head can be cutthroat, especially when markets are flat or growing slowly. Managers caught in this kind of competition almost universally say they dislike it and wish they could find a better alternative. They often know instinctively that innovation is the only way they can break free from the pack. But they simply don’t know where to begin. Admonitions to develop more creative strategies or to think outside the box are rarely accompanied by practical advice.

For almost a decade, we have researched companies that have created such fundamentally new and superior value. We have looked for patterns in the way companies create new markets and re-create existing ones, and we have found six basic approaches. All come from looking at familiar data from a new perspective; none requires any special vision or foresight about the future.

Most companies focus on matching and beating their rivals, and as a result their strategies tend to converge along the same basic dimensions of competition. Such companies share an implicit set of beliefs about “how we compete in our industry or in our strategic group.” They share a conventional wisdom about who their customers are and what they value, and about the scope of products and services their industry should be offering. The more that companies share this conventional wisdom about how they compete, the greater the competitive convergence. As rivals try to outdo one another, they end up competing solely on the basis of incremental improvements in cost or quality or both.

Creating new market space requires a different pattern of strategic thinking. Instead of looking within the accepted boundaries that define how we compete, managers can look systematically across them. By doing so, they can find unoccupied territory that represents a real breakthrough in value. This article will describe how companies can systematically pursue value innovation by looking across the conventionally defined boundaries of competition—across substitute industries, across strategic groups, across buyer groups, across
complementary product and service offerings, across the functional-emotional orientation of an industry, and even across time.

**Looking Across Substitute Industries**

In the broadest sense, a company competes not only with the companies in its own industry but also with companies in those other industries that produce substitute products or services. In making every purchase decision, buyers implicitly weigh substitutes, often unconsciously. Going into town for dinner and a show? At some level, you’ve probably decided whether to drive, take the train, or call a taxi. The thought process is intuitive for individual consumers and industrial buyers alike.

For some reason, however, we often abandon this intuitive thinking when we become sellers. Rarely do sellers think consciously about how their customers make trade-offs across substitute industries. A shift in price, a change in model, even a new ad campaign can elicit a tremendous response from rivals within an industry, but the same actions in a substitute industry usually go unnoticed. Trade journals, trade shows, and consumer rating reports reinforce the vertical walls that stand between one industry and another. Often, however, the space between substitute industries provides opportunities for value innovation.

Consider Home Depot, the company that has revolutionized the do-it-yourself market in North America. In 20 years, Home Depot has become a $24 billion business, creating over 130,000 new jobs in more than 660 stores. By the end of the year 2000, the company expects to have over 1,100 stores in the Americas. Home Depot did not achieve that level of growth simply by taking market share away from other hardware stores; rather, it has created a new market of do-it-yourselfers out of ordinary home owners.

There are many explanations for Home Depot’s success: its warehouse format, its relatively low-cost store locations, its knowledgeable service, its combination of large stores and low prices generating high volumes and economies of scale. But such explanations miss the more fundamental question: Where did Home Depot get its original insight into how to revolutionize and expand its market?

Home Depot looked at the existing industries serving home improvement needs. It saw that people had two choices: they could hire contractors, or they could buy tools and materials from a hardware store and do the work themselves. The key to Home Depot’s original insight was understanding why buyers would choose one substitute over another. (It is essential here to keep the analysis at the industry, and not the company, level.)

Why do people hire a contractor? Surely not because they value having a stranger in their house who will charge them top dollar. Surely not because they enjoy taking time off from work to wait for the contractor to show up. In fact, professional contractors have only one decisive advantage: they have specialized knowledge that the home owner lacks.

So executives at Home Depot have made it their mission to bolster the competence and confidence of customers whose expertise in home repair is limited. They recruit sales assistants with significant trade experience, often former carpenters or painters. These assistants are trained to walk customers through any project—installing kitchen cabinets, for example, or building a deck. In addition, Home Depot sponsors in-store clinics that teach customers such skills as electrical wiring, carpentry, and plumbing.

To understand the rest of the Home Depot formula, now consider the flip side: Why do people choose hardware stores over professional contractors? The most common answer would be to save money. Most people can do without the features that add cost to the typical hardware store. They don’t need the city locations, the neighborly service, or the nice display shelves. So Home Depot has eliminated those costly features, employing a self-service warehouse format that lowers overhead and maintenance costs, generates economies of scale in purchasing, and minimizes stock-outs.

Essentially, Home Depot offers the expertise of professional home contractors at markedly lower prices than hardware stores. By delivering the decisive advantages of both substitute industries—and eliminating or reducing everything else—Home Depot has transformed enormous latent demand for home improvement into real demand.

Intuit, the company that changed the way individuals and small businesses manage their finances, also got its insight into value innovation by thinking about how customers make trade-offs across substitutes. Its Quicken soft-
Creating a New Value Curve

The value curve—a graphic depiction of the way a company or an industry configures its offering to customers—is a powerful tool for creating new market space. It is drawn by plotting the performance of the offering relative to other alternatives along the key success factors that define competition in the industry or category.

To identify those alternatives, Intuit, for example, looked within its own industry—software to manage personal finances—and it also looked across substitute products to understand why customers chose one over the other. The dominant substitute for software was the lowly pencil. The value curves for these two alternatives map out the existing competitive space.

### The Value Curves in Personal Finance

#### Before Quicken

The software offered relatively high levels of speed and accuracy. But customers often chose the pencil because of its advantages in price and ease of use, and most customers never used the software’s optional features, which added cost and complexity to the product.

The key to discovering a new value curve lies in asking four basic questions:

**Reduce**

What factors should be reduced *well below* the industry standard?

**Eliminate**

What factors should be eliminated that the industry has taken for granted?

**Create**

What factors should be created that the industry has never offered?

**Raise**

What factors should be raised *well beyond* the industry standard?

### Quicken’s Value Curve

Answering the four questions led Intuit to create a new value curve, which combines the low price and ease of use of the pencil with the speed and accuracy of traditional personal-financial software.
ware allows individuals to organize, understand, and manage their personal finances. Every household goes through the monthly drudgery of paying bills. Hence, in principle, personal financial software should be a big and broad market. Yet before Quicken, few people used software to automate this tedious and repetitive task. At the time of Quicken's release in 1984, the 42 existing software packages for personal finance had yet to crack the market.

Why? As Intuit founder Scott Cook recalls, “The greatest competitor we saw was not in the industry. It was the pencil. The pencil is a really tough and resilient substitute. Yet the entire industry had overlooked it.”

Asking why buyers trade across substitutes led Intuit to an important insight: the pencil had two decisive advantages over computerized solutions—amazingly low cost and extreme simplicity of use. At prices of around $300, existing software packages were too expensive. They were also hard to use, presenting intimidating interfaces full of accounting terminology.

Intuit focused on bringing out both the decisive advantages that the computer has over the pencil—speed and accuracy—and the decisive advantages that the pencil has over computers—simplicity of use and low price—and eliminated or reduced everything else. With its user-friendly interface that resembles the familiar checkbook, Quicken is far faster and more accurate than the pencil, yet almost as simple to use. Intuit eliminated the accounting jargon and all the sophisticated features that were part of the industry’s conventional wisdom about “how we compete.” It offered instead only the few basic functions that most customers use. Simplifying the software cut costs. Quicken retailed at about $90, a 70% price drop. Neither the pencil nor other software packages could compete with Quicken’s divergent value curve. Quicken created break-through value and re-created the industry, and has expanded the market some 100-fold. (See the exhibit “Creating a New Value Curve.”)

There is a further lesson to be drawn from the way Intuit thought about and looked across substitutes. In looking for other products or services that could perform the same function as its own, Intuit could have focused on private accounting firms that handle finances for individuals. But when there is more than one substitute, it is smart to explore the ones with the greatest volumes in usage as well as in dollar value. Framed that way, more Americans use pencils than accountants to manage their personal finances.

Many of the well-known success stories of the past decade have followed this path of looking across substitutes to create new markets. Consider Federal Express and United Parcel Service, which deliver mail at close to the speed of the telephone, and Southwest Airlines, which combines the speed of flying with the convenience of frequent departures and the low cost of driving. Note that Southwest Airlines concentrated on driving as the relevant substitute, not other surface transportation such as buses, because only a minority of Americans travels long distances by bus.

**Looking Across Strategic Groups Within Industries**

Just as new market space often can be found by looking across substitute industries, so can it be found by looking across strategic groups. The term refers to a group of companies within an industry that pursue a similar strategy. In most industries, all the fundamental strategic differences among industry players are captured by a small number of strategic groups.

Strategic groups can generally be ranked in a rough hierarchical order built on two dimensions, price and performance. Each jump in price tends to bring a corresponding jump in some dimension of performance. Most companies focus on improving their competitive position within a strategic group. The key to creating new market space across existing strategic groups is to understand what factors determine buyers’ decisions to trade up or down from one group to another.

Consider Polo Ralph Lauren, which created an entirely new and paradoxical market in clothing: high fashion with no fashion. With worldwide retail sales exceeding $5 billion, Ralph Lauren is the first American design house to successfully take its brand worldwide.

At Polo Ralph Lauren’s inception more than 30 years ago, fashion industry experts of almost every stripe criticized the company. Where, they asked, was the fashion? Lacking creativity in design, how could Ralph Lauren charge such high prices? Yet the same people who criticized the company bought its clothes,
as did affluent people everywhere. Lauren's lack of fashion was its greatest strength. Ralph Lauren built on the decisive advantages of the two strategic groups that dominated the high-end clothing market—designer haute couture and the higher-volume, classical lines of Burberry's, Brooks Brothers, Aquascutum, and the like.

What makes people trade either up or down between haute couture and the classic lines? Most customers don't trade up to haute couture to get frivolous fashions that are rapidly outdated. Nor do they enjoy paying ridiculous prices that can reach $500 for a T-shirt. They buy haute couture for the emotional value of wearing an exclusive designer's name, a name that says, “I am different; I appreciate the finer things in life.” They also value the wonderfully luxurious feel of the materials and the fine craftsmanship of the garments.

The trendy designs the fashion houses work so hard to create are, ironically, the major drawback of haute couture for most high-end customers, few of whom have the sophistication or the bodies to wear such original clothing. Conversely, customers who trade down for classic lines over haute couture want to buy garments of lasting quality that justifies high prices.

Ralph Lauren has built its brand in the space between these two strategic groups, but it didn't do so by taking the average of the groups’ differences. Instead, Lauren captured the advantages of trading both up and down. Its designer name, the elegance of its stores, and the luxury of its materials capture what most customers value in haute couture; its updated classical look and price capture the best of the classical lines. By combining the most attractive factors of both groups, and eliminating or reducing everything else, Polo Ralph Lauren not only captured share from both segments but also drew many new customers into the market.

Looking Across the Chain of Buyers
In most industries, competitors converge around a common definition of who the target customer is when in reality there is a chain of “customers” who are directly or indirectly involved in the buying decision. The purchasers who pay for the product or service may differ from the actual users, and in some cases there are important influencers, as well. While these three groups may overlap, they often differ.

When they do, they frequently hold different definitions of value. A corporate purchasing agent, for example, may be more concerned with costs than the corporate user, who is likely to be far more concerned with ease of use. Likewise, a retailer may value a manufacturer’s just-in-time stock-replenishment and innovative financing. But consumer purchasers, although strongly influenced by the channel, do not value these things.

Individual companies in an industry often target different customer segments—large versus small customers, for example. But an indus-
try typically converges on a single buyer group. The pharmaceutical industry, for example, focuses overwhelmingly on influencers—the doctors. The office equipment industry focuses heavily on purchasers—corporate purchasing departments. And the clothing industry sells predominantly to users. Sometimes there is a strong economic rationale for this focus. But often it is the result of industry practices that have never been questioned.

Challenging an industry’s conventional wisdom about which buyer group to target can lead to the discovery of new market space. By looking across buyer groups, companies can gain new insights into how to redesign their value curves to focus on a previously overlooked set of customers.

Consider Bloomberg. In little over a decade, Bloomberg has become one of the largest and most profitable business-information providers in the world. Until Bloomberg’s debut in the early 1980s, Reuters and Telerate dominated the on-line financial-information industry, providing news and prices in real time to the brokerage and investment community. The industry focused on purchasers—the IT managers—who valued standardized systems, which made their lives easier.

This made no sense to Bloomberg. Traders and analysts, not IT managers, make or lose millions of dollars for their employers each day. Profit opportunities come from disparities in information. When markets are active, traders and analysts must make rapid decisions. Every second counts.

So Bloomberg designed a system specifically to offer traders better value, one with easy-to-use terminals and keyboards labeled with familiar financial terms. The systems also have two flat-panel monitors, so traders can see all the information they need at once without having to open and close numerous windows. Since traders have to analyze information before they act, Bloomberg added a built-in analytic capability that works with the press of a button. Before, traders and analysts had to download data and use a pencil and calculator to perform important financial calculations. Now users can quickly run “what if” scenarios to compute returns on alternative investments, and they can perform longitudinal analyses of historical data.

By focusing on users, Bloomberg was also able to see the paradox of traders’ and analysts’ personal lives. They have tremendous income but work such long hours that they have little time to spend it. Realizing that markets have slow times during the day when little trading takes place, Bloomberg decided to add information and purchasing services aimed at enhancing traders’ personal lives. Traders can buy items like flowers, clothing, and jewelry; make travel arrangements; get information about wines; or search through real estate listings.

By shifting its focus upstream from purchasers to users, Bloomberg created a value curve that was radically different from anything the industry had ever seen. The traders and analysts wielded their power within their firms to force IT managers to purchase Bloomberg terminals. Bloomberg did not simply win customers away from competitors—it grew the market. “We are in a business that need not be

Bloomberg’s Value Curve at Its Debut

To establish its value curve, Bloomberg looked across the chain of buyers from the IT managers that had traditionally purchased financial information systems to the traders who used them. Its value innovation stemmed from a combination of creating new features—such as on-line analytic capabilities—that traders rather than IT managers value and raising ease of use by an order of magnitude.
either-or," explains founder Mike Bloomberg. "Our customers can afford to have two products. Many of them take other financial news services and us because we offer uncommon value." (See the graph “Bloomberg’s Value Curve at Its Debut.”)

Philips Lighting Company, the North American division of the Dutch company Philips Electronics, re-created its industrial lighting business by shifting downstream from purchasers to influencers. Traditionally, the industry focused on corporate purchasing managers who bought on the basis of how much the lightbulbs cost and how long they lasted. Everyone in the industry competed head-to-head along those two dimensions.

By focusing on influencers, including CFOs and public relations people, Philips came to understand that the price and life of bulbs did not account for the full cost of lighting. Because lamps contained environmentally toxic mercury, companies faced high disposal costs at the end of a lamp’s life. The purchasing department never saw those costs, but CFOs did. So in 1995, Philips introduced the Alto, an environmentally friendly bulb that it promotes to CFOs and to public relations people, using those influencers to drive sales. The Alto reduced customers’ overall costs and garnered companies positive press for promoting environmental concerns. The new market Alto created has superior margins and is growing rapidly; the product has already replaced more than 25% of traditional T-12 fluorescent lamps used in stores, schools, and office buildings in the United States.

Many industries afford similar opportunities to create new market space. By questioning conventional definitions of who can and should be the target customer, companies can often see fundamentally new ways to create value.

Looking Across Complementary Product and Service Offerings
Few products and services are used in a vacuum; in most cases, other products and services affect their value. But in most industries, rivals converge within the bounds of their industry’s product and service offerings. Take movie theaters as an example. The ease and cost of getting a babysitter and parking the car affect the perceived value of going to the movies, although these complementary services are beyond the bounds of the movie theater industry as it has been traditionally defined. Few cinema operators worry about how hard or costly it is for people to get babysitters. But they should, because it affects demand for their business.

Untapped value is often hidden in complementary products and services. The key is to define the total solution buyers seek when they choose a product or service. A simple way to do so is to think about what happens before, during, and after your product is used. Babysitting and parking the car are needed before going to the movies. Operating and application software are used along with computer hardware. In the airline industry, ground transportation is used after the flight but is clearly part of what the customer needs to travel from one place to another.

Companies can create new market space by zeroing in on the complements that detract from the value of their own product or service. Look at Borders Books & Music and Barnes & Noble in the United States. By the late 1980s, the U.S. retail-book industry appeared to be in decline. Americans were reading less and less. The large chains of mall bookstores were engaged in intense competition, and the small, independent bookstore appeared to be an endangered species.

Against this backdrop, Borders and B&N created a new format—book superstores—and woke up an entire industry. When either company enters a market, the overall consumption of books often increases by more than 50%.

The traditional business of a bookstore had been narrowly defined as selling books. People came, they bought, they left. Borders and B&N, however, thought more broadly about the total experience people seek when they buy books—and what they focused on was the joy of lifelong learning and discovery. Yes, that involves the physical purchase of books. But it also includes related activities: searching and hunting, evaluating potential purchases, and actually sampling books.

Traditional retail-book chains imposed tremendous inefficiencies and inconveniences on consumers. Their staffs were generally trained as cashiers and stock clerks; few could help customers find the right book. In small stores, selection was limited, frustrating the search for an exciting title. People who hadn't read a good book review recently or picked up a rec-
ommendation from a friend would be unlikely to patronize these bookstores. As a rule, the stores discouraged browsing, forcing customers to assume a large part of the risk in buying a book, since people would not know until after they bought it whether they would like it. As for consumption, that activity was supposed to occur at home. But as people's lives have become increasingly harried, home has become less likely to be a peaceful oasis where a person can enjoy a wonderful book.

Borders and B&N saw value trapped in these complementary activities. They hired staff with extensive knowledge of books to help customers make selections. Many staff members have college or even advanced degrees, and all are passionate book lovers. Furthermore, they're given a monthly book allowance, and they're actually encouraged to read whenever business is slow.

The superstores stock more than 150,000 titles, whereas the average bookstore contains around 20,000. The superstores are furnished with armchairs, reading tables, and sofas to encourage people not just to dip into a book or two but to read them through. Their coffee bars, classical music, and wide aisles invite people to linger comfortably. They stay open until 11 at night, offering a relaxing destination for an evening of quiet reading, not a quick shopping stop. (See the graph “Value Innovation in Book Retailing.”)

Book superstores redefined the scope of the service they offer. They transformed the product from the book itself into the pleasure of reading and intellectual exploration. In less than six years, Borders and B&N have emerged as the two largest bookstore chains in the United States, with a total of more than 650 superstores between them.

We could cite many other examples of companies that have followed this path to creating new market space. Virgin Entertainment's stores combine CDs, videos, computer games, and stereo and audio equipment to satisfy buyers' complete entertainment needs. Dyson designs its vacuum cleaners to obliterate the costly and annoying activities of buying and changing vacuum cleaner bags. Zeneca’s Salick cancer centers combine all the cancer treatments their patients might need under one roof so they don’t have to go from one specialized center to another, making separate appointments for each service they require.

Looking Across Functional or Emotional Appeal to Buyers

Competition in an industry tends to converge not only around an accepted notion of the scope of its products and services but also around one of two possible bases of appeal. Some industries compete principally on price and function based largely on calculations of utility; their appeal is rational. Other industries compete largely on feelings; their appeal is emotional.

Yet the appeal of most products or services is rarely intrinsically one or the other. The phenomenon is a result of the way companies have competed in the past, which has unconsciously educated consumers on what to expect. Companies’ behavior affects customers’ expectations in a reinforcing cycle. Over time, functionally oriented industries become more

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Value Innovation in Book Retailing

Borders and Barnes & Noble looked across complementary products and services to establish a new value curve in book retailing. Their book superstores raised the selection of books, the level of staff knowledge, and the range of store hours well above the industry standards while lowering price and creating a wholly new reading environment.

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Borders and Barnes & Noble

independent bookstores

mall bookstores

relative level
Creating New Market Space

functionally oriented; emotionally oriented industries become more emotionally oriented. No wonder market research rarely reveals new insights into what customers really want. Industries have trained customers in what to expect. When surveyed, they echo back: more of the same for less.

Companies often find new market space when they are willing to challenge the functional-emotional orientation of their industry. We have observed two common patterns. Emotionally oriented industries offer many extras that add price without enhancing functionality. Stripping those extras away may create a fundamentally simpler, lower-priced, lower-cost business model that customers would welcome. Conversely, functionally oriented industries can often infuse commodity products with new life by adding a dose of emotion—and in so doing, can stimulate new demand.

Look at how Starbucks transformed a functional product into an emotional one. In the late 1980s, General Foods, Nestlé, and Procter & Gamble dominated the U.S. coffee market. Consumers drank coffee as part of a daily routine. Coffee was considered a commodity industry, marked by heavy price-cutting and an ongoing battle for market share. The industry had taught customers to shop based on price, discount coupons, and brand names that are expensive for companies to build. The result was paper-thin profit margins and low growth.

Instead of viewing coffee as a functional product, Starbucks set out to make coffee an emotional experience, what customers often refer to as a “caffeine-induced oasis.” The big three sold a commodity—coffee by the can; Starbucks sold a retailing concept—the coffee bar. The coffee bars offered a chic gathering place, status, relaxation, conversation, and creative coffee drinks. Starbucks turned coffee into an emotional experience and ordinary people into coffee connoisseurs for whom the steep $3-per-cup price seemed reasonable. With almost no advertising, Starbucks became a national brand with margins roughly five times the industry average.

What Starbucks did for coffee, Swatch did for budget watches. Long considered a functional item, budget watches were bought merely to keep track of time. Citizen and Seiko, the leaders in the industry, competed through advances in functionality by using quartz technology to improve accuracy, for example, or by making digital displays that were easier to read. Swatch turned budget watches into fashion accessories.

SMH, the Swiss parent company, created a design lab in Italy to turn its watches into a fashion statement, combining powerful technology with fantasy. “You wear a watch on your wrist, right against your skin,” explains chairman Nicholas Hayek. “It can be an important part of your image. I believed that if we could add genuine emotion to the product and a strong message, we could succeed in dominating the industry and creating a powerful market.” Before Swatch, people usually purchased only one watch. Swatch made repeat purchases the standard. In Italy, the average person owns six Swatches to fit their different needs.

Is the Body Shop a Cosmetics Company?

By reconsidering the traditional basis of appeal of its industry, the Body Shop created a value curve so divergent that it hardly looks like a cosmetics company at all. In appealing to function rather than emotion, the Body Shop reduced price, glamour, and packaging costs while creating a new emphasis on natural ingredients and healthy living.

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**Key elements of product, service, and delivery**

- **cosmetics industry**
- **The Body Shop**
- **price**
- **packaging and advertising**
- **high-tech cosmetics**
- **science**
- **glamorous image**
- **natural ingredients**
- **representation of healthy living**

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Creating New Market Space

The Body Shop created new market space by shifting in the opposite direction, from an emotional appeal to a functional one. Few industries are more emotionally oriented than cosmetics. The industry sells glamour and beauty, hopes and dreams as much as it sells products. On average, packaging and advertising constitute 85% of cosmetics companies’ costs.

By stripping away the emotional appeal, the Body Shop realized tremendous cost savings. Since customers get no practical value from the money the industry spends on packaging, the Body Shop uses simple refillable plastic bottles. The Body Shop spends little on advertising, again because its customers get no functional value from it. In short, the Body Shop hardly looks like a cosmetics company at all. The company’s approach—and its emphasis on natural ingredients and healthy living—was so refreshingly simple that it won consumers over through common sense and created new market space in an industry accustomed to competing on a tried-and-true formula. (See the graph “Is the Body Shop a Cosmetics Company?”)

A burst of new market creation is under way in a number of service industries that are following this pattern. Relationship businesses like insurance, banking, and investing have relied heavily on the emotional bond between broker and client. They are ripe for change. Direct Line Insurance in Britain, for example, has done away with traditional brokers. It reasoned that customers would not need the hand-holding and emotional comfort that brokers traditionally provide if the company did a better job of, for example, paying claims rapidly and eliminating compli-

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### Shifting the Focus of Strategy

**From Head-to-Head Competition to Creating New Market Space**

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icated paperwork. So instead of using brokers and regional branch offices, Direct Line substitutes information technology to improve claims handling, and it passes on some of the cost savings to customers in the form of lower insurance premiums. In the United States, Vanguard Group in index funds and Charles Schwab in brokerage services are doing the same in the investment industry, creating new market space by transforming emotionally oriented businesses based on personal relationships into high-performance, low-cost functional businesses.

**Looking Across Time**

All industries are subject to external trends that affect their businesses over time. Think of the rapid rise of the Internet or the global movement toward protecting the environment. Looking at these trends with the right perspective can unlock innovation that creates new market space.

Most companies adapt incrementally and somewhat passively as events unfold. Whether it’s the emergence of new technologies or major regulatory changes, managers tend to focus on projecting the trend itself. That is, they ask in which direction a technology will evolve, how it will be adopted, whether it will become scalable. They pace their own actions to keep up with the development of the trends they’re tracking.

But key insights into new market spaces rarely come from projecting the trend itself. Instead they arise from business insights into how the trend will change value to customers. By looking across time—from the value a market delivers today to the value it might deliver tomorrow—managers can actively shape their future and lay claim to new market space. Looking across time is perhaps more difficult than the previous approaches we’ve discussed, but it can be made subject to the same disciplined approach. We’re not talking about predicting the future, which is inherently impossible. We’re talking about finding insight in trends that are observable today. (See the diagram “Shifting the Focus of Strategy.”)

Three principles are critical to assessing trends across time. To form the basis of a new value curve, these trends must be decisive to your business, they must be irreversible, and they must have a clear trajectory. Many trends can be observed at any one time—a discontinuity in technology, the rise of a new lifestyle, or a change in regulatory or social environments, for example. But usually only one or two will have a decisive impact on any particular business. And it may be possible to see a trend or major event without being able to predict its direction. In 1998, for example, the mounting Asian crisis was an important trend certain to have a big impact on financial services. But the direction that trend would take was impossible to predict—and therefore envisioning a new value curve that might result from it would have been a risky enterprise. In contrast, the euro is evolving along a constant trajectory as it replaces Europe’s multiple currencies. This is a decisive, irreversible, and clearly developing trend upon which new market space might be created in financial services.

Having identified a trend of this nature, managers can then look across time and ask themselves what the market would look like if the trend were taken to its logical conclusion. Working back from that vision of a new value curve, they can then identify what must be changed today to unlock superior value for buyers.

Consider Enron, an energy company based in Houston, Texas. In the 1980s, Enron’s business centered on gas pipelines. Deregulation of the gas industry was on the horizon. Such an event would certainly be decisive for Enron. The U.S. government had just deregulated the telecom and transportation industries, so a reversal in its intent to deregulate the gas industry was highly unlikely. Not only was the trend irreversible, its logical conclusion was also predictable—the end of price controls and the breakup of local gas monopolies. By assessing the gap between the market as it stood and the market as it was to be, Enron gained insight into how to create new market space.

When local gas monopolies were broken up, gas could be purchased from anywhere in the nation. At the time, the cost of gas varied dramatically from region to region. Gas was much more expensive, for example, in New York and Chicago than it was in Oregon and Idaho. Enron saw that deregulation would make possible a national market in which gas could be bought where it was cheap and sold where it was expensive. By examining how the gas market could operate with deregulation, Enron saw a way to unlock tremendous trapped value on a national scale.
Accordingly, Enron worked with government agencies to push for deregulation. It purchased regional gas-pipeline companies across the nation, tied them together, and created a national market for gas. That allowed Enron to buy the lowest cost gas from numerous sources across North America and to operate with the best spreads in the industry. Enron became the largest transporter of natural gas in North America, and its customers benefited from more reliable delivery and a drop in costs of as much as 40%.

Cisco Systems created a new market space in a similar way. It started with a decisive and irreversible trend that had a clear trajectory: the growing demand for high-speed data exchange. Cisco looked at the world as it was—and that world was hampered by slow data rates and incompatible computer networks. Demand was exploding as, among other factors, the number of Internet users doubled roughly every 100 days. So Cisco could clearly see that the problem would inevitably worsen. Cisco’s routers, switches, and other networking devices were designed to create breakthrough value for customers, offering fast data exchanges in a seamless networking environment. Thus Cisco’s insight is as much about value innovation as it is about technology. Today more than 80% of all traffic on the Internet flows through Cisco’s products, and its margins in this new market space are in the 60% range.

**Regenerating Large Companies**

Creating new market space is critical not just for start-ups but also for the prosperity and survival of even the world’s largest companies. Take Toyota as an example. Within three years of its launch in 1989, the Lexus accounted for nearly one-third of Toyota’s operating profit while representing only 2% of its unit volume. Moreover, the Lexus boosted Toyota’s brand image across its entire range of cars. Or think of Sony. The greatest contribution to Sony’s profitable growth and its reputation in the last 20 years was the Walkman. Since its introduction in 1979, the Walkman has dominated the personal portable-stereo market, generating a huge positive spillover effect on Sony’s other lines of business throughout the world.

Likewise, think of SMH. Its collection of watch companies ranges from Blancpain, whose watches retail for over $200,000, to Omega, the watch of astronauts, to midrange classics like Hamilton and Tissot to the sporty, chic watches of Longines and Rado. Yet it was the creation of the Swatch and the market of fun, fashionable watches that revitalized the entire Swiss watch industry and made SMH the darling of investors and customers the world over.

It is no wonder that corporate leaders throughout the world see market creation as a central strategic challenge to their organizations in the upcoming decade. They understand that in an overcrowded and demand-starved economy, profitable growth is not sustainable without creating, and re-creating, markets. That is what allows small companies to become big and what allows big companies to regenerate themselves.
Creating New Market Space

Further Reading

**ARTICLES**

**The Discipline of Innovation**
by Peter F. Drucker
*Harvard Business Review*
May–June 2000
Product no. 3480

Drucker describes additional techniques for systematically spotting opportunities to create new markets. The most successful innovators, he writes, look for innovation opportunities in areas such as: 1) **Unexpected occurrences**, including failures. The Edsel’s failure, for example, led Ford to realize that the auto market was now segmented by lifestyle, not income group. Its response? The legendary Mustang. 2) **Demographic changes**. The confluence of a baby bust and education explosion prompted the Japanese to anticipate a shortage of blue-collar manufacturing workers—and address the shortage by pulling ahead in robotics. 3) **Changes in attitudes**. Americans’ increasing obsession with preventing disease and staying fit—despite overall improvements in their health—has inspired observant innovators to launch health magazines, introduce health foods, and offer exercise classes.

The keys to successful innovation? The ability to look, ask, and listen—then analyze what an innovation must do to satisfy a particular customer need.

**Knowing a Winning Business Idea When You See One**
by W. Chan Kim and Renée A. Mauborgne
*Harvard Business Review*
September–October 2000
Product no. R00510

You’ve looked across strategic groups, buyer groups, and other competitive boundaries for opportunities to create new markets. How then do you discern which ideas have the most commercial potential? The process is fraught with uncertainty—and even the most admired companies have stumbled. In this article, Kim and Mauborgne introduce three tools for stripping away some of that uncertainty: 1) **The buyer utility map**. This tool indicates how likely it is that customers will be attracted to a new business idea. 2) **The price corridor of the mass**. With this tool, you identify what price will attract the greatest number of customers. 3) **The business model guide**. This tool offers a framework for figuring out whether and how your company can profitably deliver the new idea at the targeted price.

But applying these tools isn’t the end of the story. Many innovations have to overcome adoption hurdles—strong resistance from stakeholders inside and outside the company. The authors discuss how you can head off negative reactions from these players.

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