What Is an Innovative Strategy?

To understand innovation, it is first important to understand the difference between an invention and innovation. Invention describes the creation of a unique or novel concept, method, or process that is often turned into a tangible outcome—such as new product. An innovation is the conversion of a novel concept (an invention) into a product, process, or business model that generates revenues and profits.[11] Innovation differs from invention in that innovation refers to the use of a novel idea or method, whereas invention refers more directly to the creation of the idea or method itself.[12]

For example, the scientists at Xerox PARC (Palo Alto Research Center) invented the computer mouse as a new way to navigate a computer. This invention would allow users to select from images and menus on a computer monitor through a Graphical User Interface (GUI). But it was Steve Jobs and Apple computer who launched the Macintosh computer—the first commercialized microcomputer that came with a mouse and graphical user interface. Apple's Macintosh turned Xerox's invention into an innovation that could generate revenues and profits. In similar fashion, the Wright brothers invented the airplane at Kitty Hawk, but Boeing and others commercialized the idea by designing and building commercial aircraft that could be sold as products. As shown in Figure 10.1, an innovation needs to be (1) novel, (2) useful, and (3) successfully implemented, in order to help companies succeed in the marketplace.

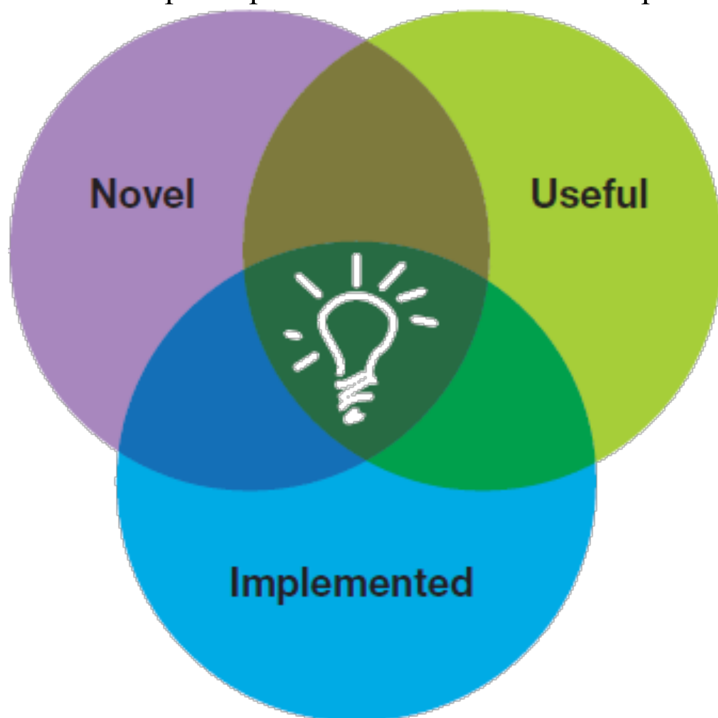

Figure 10.1Definition of Innovation

Incremental Versus Radical Innovation

Innovation enables firms to deliver value in new ways. Innovations fall into two general categories: incremental innovations and radical innovations. An incremental innovation builds on a firm's established knowledge base and steadily improves the product or service it offers.

For example, when Gillette offers a razor with five blades instead of four, or when Samsung offers a TV with an LED screen instead of a plasma screen, those are incremental innovations. In similar fashion, when any company makes incremental improvements to their operations to accomplish a task faster, better, or with fewer resources, these are also incremental innovations. Incremental innovations are also sometimes called "sustaining" innovations because they sustain a company's current product offering and revenues.

In contrast, a radical innovation draws on a different knowledge base, technologies, or methods to deliver value in a truly unique way. Examples of products based on radical innovations include the computer (versus the typewriter), CT scanner (versus the X-ray), cell phone (versus the landline phone), and MP3 player (versus the CD player).

Processes can also be based on more radical innovations. For example, Toyota engineer Taiichi Ohno developed a set of flexible production techniques, often referred to as *lean manufacturing*, that minimizes inventories and waste despite being designed for rapid product changeovers.[13] This system of production was significantly different from the mass production system developed by Henry Ford that was based on standardization, significant automation, and few product changeovers. Toyota's deployment of its "flexible" or "lean" production system has helped it produce high-quality cars at low cost and propelled it to worldwide leadership in the automobile industry.

Strategies that draw on more radical innovations often use new technologies or employ a fundamentally different business model than rivals, meaning they create, deliver, and capture value through very different resources and capabilities. As illustrated in the opening case, Netflix used the Internet, software, and warehouses to deliver video rentals in a radically different way than Blockbuster. Redbox uses vending machines to rent videos, which requires different technologies—and a very different distribution system—than those used by either Blockbuster or Netflix. This chapter focuses on *innovative strategies* that are based on more radical innovations.

We define an innovative strategy as a strategy that introduces a fundamentally different business model than rivals. The term business model refers to the rationale of how an organization delivers and captures value. More specifically, business models typically differ on one of three dimensions:

- 1.The choice of customer segments to serve and the unique value (value proposition) offered by the company
- 2.The choice of activities the company performs and the resources used to deliver value to customers
- 3.The way a company generates revenue streams to get paid for the value it delivers. The term revenue model is sometimes used to refer to the approach, or pricing strategy, a company uses to get paid for the value it delivers through its business model (see Strategy in Practice: Understanding Business Models)

Strategy in Practice Understanding Business Models

Over the past few years, the term *business model* has often been used to describe a company's strategy. Perhaps the most comprehensive approach to defining a company's business model has been developed by Alex Osterwalder and Yves Pigneur in their tool, the Business Model Canvas.[14] They argue that there are nine components to a business model and firms can innovate by changing one or more of those components as they

seek to deliver and capture value. The nine components are:

- 1.Value propositions. A firm seeks to solve customer problems and satisfy needs with a particular unique value or value proposition.
- 2.Customer segments. The value propositions are designed to meet the needs of one or several customer segments.
- 3.Channels. Value propositions are delivered to customer segments through communication, distribution, or sales channels.
- 4.Customer relationships. Customer relationships are established and maintained with each customer segment.
- 5.Revenue streams. Revenue streams result from value propositions that are successfully offered to customers through pricing strategies.
- 6.Key resources. Key resources are the assets required to offer and deliver the company's value proposition.
- 7.Key activities/capabilities. Value propositions are developed and delivered through key activities or capabilities.
- 8.Key partnerships. Some resources and activities that are critical to delivering the value proposition are outsourced to partners outside the company.
- 9.Cost structure. The business model elements above result in the cost structure for delivering the value proposition to the customer. These costs must be covered by the revenue streams in order for a firm to be profitable.

To illustrate, Amazon has a different business model than Barnes & Noble (B&N), with the most obvious difference being *channels*—Amazon sells books over the Internet rather than through bookstores. But this means that Amazon's *value proposition* is different, as are its primary *customer segments*. Amazon's primary customer segment prefers the lower prices that Amazon offers but it also likes the convenience of shopping from their computers or cell phones. In contrast, B&N's customers like the ability to get their books immediately and may enjoy the shopping experience at a B&N store. To deliver their value propositions through the distribution channels they've chosen, each firm must be good at different *activities* and have different *resources*. For example, Amazon needs to be good at writing software and fulfilling orders from warehouses, whereas Barnes & Noble has to be good at finding the best locations for its stores, designing stores to create a great shopping experience, and efficiently operating each store. Amazon and Barnes & Noble are described as having different business models because they differ on most, if not all, of the nine components of the business model canvas.

In some cases, firms deliver similar value to similar customer segments—and might even use similar resources and capabilities to deliver value—but they may differ in their pricing strategy or their approach to generating revenues streams and capturing value. For example, Apple, Spotify, and Pandora use different revenue models or pricing strategies to generate revenue streams. Apple makes money by selling songs and albums over the Internet for a specific price. In contrast, Spotify provides consumers with unlimited access to all songs in its library for a monthly subscription fee. Pandora uses a “free” revenue model like a radio station, and provides songs via the Internet that are tailored to a listener's preferences. Pandora makes money by selling advertising.

Companies sometimes attempt to change their business model in response to competition. For example, Barnes & Noble added the online book retailing business model to its bricks-and-mortar bookstore business model in response to Amazon's entry into book retailing.[15] In similar fashion, Apple launched iTunes Radio in 2013 to directly compete with Pandora.[16] In this way, it has imitated Pandora's business model including the revenue model for capturing value. In most cases, the company that is first to launch a business model has a first-mover advantage because it becomes known as the pioneer. In order to successfully compete with pioneers, second movers must offer unique value relative to the first mover—for example, lower prices, more features, or greater convenience—to lure customers in their direction.

Innovative strategies based on radical innovations are sometimes referred to as disruptive innovation because companies in the same industry find the innovation so disruptive that they can no longer do business as usual. For example, when Netflix introduced an innovative way for customers to access home entertainment, it “disrupted” Blockbuster's strategy and Blockbuster could no longer succeed by doing business as usual. Blockbuster had to make a drastic change or it would go out of business. Innovative strategies are disruptive when they offer value that is attractive to incumbent's customers, and are delivered through a business model that is difficult for incumbents to imitate. Not surprisingly, new entrants with innovative strategies want to disrupt established companies and offer value in a way that is difficult to imitate. We now turn to discussing different types or categories of innovative strategies that have been successfully deployed by various companies.

Concept Check 10.1

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RESET ASSESSMENT Question 1 of 4 NEXT

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