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The Role of Unexpected Market Events in Market Creation Strategies

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It all begins with three US sailing enthusiasts, one of whom has bought a pair of foam clogs in Canada, made by a Canadian manufacturer, Finprojects.[1] The clogs are made of a special resin called Croslite which makes the shoe extraordinarily comfortable and odour resistant: perfect for sailing. The three men believe that other sailing lovers may find the clog interesting and decide to build a business around it by distributing Finprojects' product with the brand name Crocs. They set up their base in Florida, to work in the same place where they go sailing. The business starts well, with 1 million US dollars in revenues in 2003. But, completely unexpectedly, Crocs clogs become very popular among doctors, waiters, gardeners, and other people who have jobs that keep them on their feet all day long. Revenues go up at an impressive pace. The new company buys Finprojects and gains full control of the manufacturing process. The product can be slightly changed by adding colour variants and enhancing fashion appeal: that triggers the boom. Crocs spread all over the USA and even become a global phenomenon,

[1] For a detailed description of the Crocs case, see *CNN Business 2.0 Magazine*, 3 November 2006.

with celebrities adopting them too. In 2006, revenues reach 322 million US dollars, with 30% coming from foreign markets. At the 2007 Drapers Footwear Awards, which celebrate the best in footwear retailing, Crocs wins the Footwear Brand of the Year, the only award dedicated to manufacturers.

What is interesting about the Crocs story is that it represents the creation of a new market whose success was far beyond the expectations of the company that launched the product. The product was conceived for a single market segment, but the huge market now is made of completely different segments. And this was completely unexpected. The Crocs case is only one of many other stories where no company - neither the innovator nor its competitors - has the capacity to anticipate the birth and fast development of a new market that proliferates beyond all competitors' expectations.

In this chapter we will focus on the concept of unexpected market events as generators of completely new markets. Our point here is that those market events, which are inexplicable, surprising, even unbelievable when you try to interpret them with the current conventional wisdom of competitors, have an enormous potential to bring completely new markets to life. Unfortunately, most companies do not give such events the necessary attention just because they do not fit with expectations; businesses find it easier to discard them simply as "chance". In the following sections, we first describe how new market creation, innovation, and unexpected market events are connected. To do that, we elaborate on the concept of market structural holes to identify the discrepancies between the evolution of supply and demand where a new market can nest and take life. Then, we provide a taxonomy of unexpected market events that will help us identify the processes that companies can implement to leverage on such events in order to innovate and create new markets. After describing these processes, exploration, and leveraging, we conclude with the organizational characteristics that make it easier for companies to identify and exploit unexpected market events.

Radical innovation, new market creation, and market structural holes

Innovation has two main driving forces: the market, when demand provides ideas for new product design, and technology, when science is transformed into new technical solutions. These two dimensions can be used to classify product innovation, as Chandy and Tellis suggest (1998). A technology involved in creating a new product may be completely different from, or a derivate of, an existing technology. Or, a new product can better fulfil key customer needs in comparison with existing products, that is, it offers improved or completely new benefits.

As suggested by Chandy and Tellis (1998), incremental innovation is such because it provides relatively low incremental benefits due to slight changes in technology. New products that incorporate existing technology are incremental innovations when customers do not perceive them as really new products. When moderate changes in technology have remarkable effects on customer needs (as perceived by customers themselves), innovations are market breakthroughs. Market breakthrough occurs only when customers perceive a high degree of innovativeness owing to some kind of reconfiguration in, say, product positioning, marketing approach, or distribution channels.

On the other hand, a technology breakthrough occurs when new technical solutions are improved but they have little effect on customer need fulfilment. Radical innovation has a significant impact on customers owing to major technological changes. A radical innovation occurs when new products incorporate a substantially new technology to satisfy existing customers and fulfil their needs better than competing products, that is, with a lower price and/or higher performances.

However, if you consider the degree of newness of customer needs that are satisfied by innovations (compared with needs currently satisfied by existing products), you can reconfigure the previous typology into a different one (Figure 9.1), where new market creation occurs when a new product satisfies completely new customer needs, by incorporating either a totally new technology or an existing one (e.g. Zhou, Yim, & Tse, 2005).

What are the conditions for creating a new market? When does this happen? How can a company identify the opportunity for market creation?

Every day, firms deal with the problem of managing existing products. They regularly face the challenge of incremental innovation, but it is not that common for businesses to focus on new market creation. The fact is that market creation is considered a highly unpredictable issue; it is very rare in the life of a company and extremely difficult to manage.

NEWNESS OF TECHNOLOGY	CUSTOMER NEEDS	
	Existing	*New*
Low	Market breakthrough and incremental innovation	New market creation
High	Technological breakthrough and radical innovation	

Figure 9.1 Innovation and new market creation

Theoretical literature on the creation of new markets is quite scarce, and the few studies on the topic attest to the high risk, uncertainty, and unpredictability in new market creation (e.g. Gort & Klepper, 1982). One explanation is that new markets arise because of technological, political, or regulatory changes (Bala & Goyal, 1994), which create opportunities to be seized by either incumbents or new companies.

According to a different explanation, new market creation can be seen as a social process that involves transforming an environmental opportunity into an innovation and then into a new market operated by a group of interested people. Creating a new market is a highly unpredictable and uncertain process, so people involved are not aware of what information is available, and, of that, what is relevant and worth trying to get (Sarasvathy & Dew, 2005). In this situation, managers and entrepreneurs use a "try and learn" approach. They try to organize some kind of coalition among possible actors (other managers, distributors, venture capitalists, customers) who have a strong enough motivation to work together to choose new possibilities and to bring something new to life. They transform existing solutions and needs into new ones in order to solve the current problems of the actors involved. If this process is successful, it enlarges the initial coalition to include new members, expanding until we have a new market. This usually takes a long time, because the process of creating a social network, which is the basis of the new market, is a time-consuming one.

In order to explain market creation, we consider both these explanations, adding the notion of the *market structural hole.*[2] A market structural hole is a mismatch between the existing offerings and the existing needs of customers (explicitly expressed or latent) in a market.

Every market changes systematically because customer needs, motivations, attitudes, and behaviours are continuously being modified by the thousands of stimuli they receive. Also, competitors regularly change their behaviour, trying to defend themselves from the decisions of their rivals and to outdo them in the struggle for market dominance. Distributors change their approaches as well, taking into account modifications in the supply market and changes in the demand market.

When, for any number of reasons, there is an asynchronous movement in supply and demand, we find a mismatch that can be very large and last for a long time. This mismatch is what we define as a structural hole. The larger and longer-lasting the mismatch, the bigger is the structural hole.

Changes in supply and demand are not synchronized by definition owing to a variety of factors:

- *Different elasticity to modifications in the business environment.* Companies, distributors, and customers have a different capacity to react to environmental modifications because they do not have the same ability to change their decisions and their behaviours. Rigidity can depend on a variety of possible factors, such as scarce cognitive pliability, past investments and exit barriers, path dependency effects, and time and cost of technological improvements. A different readiness to environmental changes brings about a market structural hole.
- *Lack of information about changes made by other actors.* Actors in a market take decisions and behave according to information about market evolution and the moves of other actors. However, when information is lacking, decisions and behaviours are taken on without a thorough representation of the market, and this causes a mismatch between demand and supply, leading to market structural holes.

[2] The concept of structural hole is derived from social network theory and was originally proposed by Burt (1992).

- *Cost of change.* Sometimes companies and customers are aware of the mismatch between them, but they think the cost of reducing the distance is too high when weighed up against the potential advantages. This perception can depend on the actual cost structure (for instance, rigidity associated with the fixed cost structure or with non-recoverable past investments) or an undervaluation of possible benefits associated with the change. Again, the existence of this cost leads to a market structural hole.

Whatever the origin, the existence of a market structural hole indicates that there are unmet customer needs that can be potentially satisfied. Therefore, *market creation consists in filling up market structural holes through innovation, by systematically searching, analysing, and replenishing them.* Referring back to Figure 9.1, new market creation occurs when a company is able to leverage on existing or completely new technology to fill a market structural hole and satisfy customer needs that are not satisfied by existing products.

The problem is: how can you identify structural holes? Our answer is: by identifying unexpected market events.

Unexpected market events, market structural holes, and expectations about the future

Unexpected market events (UMEs) are any events that are not in line with managers' expectations. They are not things that happen suddenly, but events that are different from what was expected. Managers usually judge the likelihood of a given event on the basis of how easily they can imagine it happening. They do so because they anticipate future events according to past experience, sometimes based on simple prejudice. When managers have strong expectations about the future, UMEs are more likely to come up. In fact, expectations of market events have to do with customers' behaviours and competitors' moves. These expectations are based on the experience of past behaviours and moves. When there is a mismatch between demand and supply in the market – a market structural hole, in our terms – past expectations cannot make sense of all the changes, and UMEs emerge. Hence, the stronger the expectations, the higher is the probability that UMEs will occur.

Such strong beliefs about the market often depend on a strong market orientation and linkages with customers that are too tight. A strong market orientation has proved to be a key factor in determining successful market behaviour, through better understanding of customer needs and higher customer satisfaction. Loose linkages with customers may have the negative effect of a poor customer orientation but also have positive effects, particularly on the ability of a company to remain flexible in a dynamic environment, and to grab market opportunities when they come up.

Customer tastes can be quite well defined when companies deal with existing products and markets. However, when customers face radically new products and new markets, their needs become evanescent, vague, and ill defined. This means the new market cannot spring up simply from existing or predicted needs. Mowery and Rosenberg (1979) and Dosi (1997) have made strong arguments against demand–pull theories, which add up to the conclusion that abstract demand has little influence on the creation of new markets (Sarasvathy & Dew, 2005). So some literature seems to suggest that firms should forget their customers if they really want to be radically innovative.

Loose ties with customers can allow companies to avoid the trap of a served market, that is, the influence of existing needs and customers on a company's innovative market behaviour (Hamel & Prahalad, 1994). Some empirical research seems to confirm that a strong market orientation leads to less radical innovation (e.g. Gatignon & Xuereb, 1997). Christensen (1997), in his research on innovation in the rigid disk-drive, copier, tyre, and computer industries, found that too strong a tie with customers had a negative impact on the ability of dominant players to maintain their market position through technological innovations. So having loose ties with customers positively affects the ability to innovate (Danneels, 2003), especially in fast-changing markets, where staying flexible and not too closely linked to existing needs can be a good strategy.

Nevertheless, tight linkages with customers produce quite strong expectations on probable future market trends. For instance, having a deep knowledge about customer needs implies that unshakable convictions about what to expect from the market go around the organization. Therefore, expectations about the market and its possible evolution are usually quite strong.

According to our prior definition of unexpected events, that is, something that is not in line with managers' expectations, such strong anticipation of future market events is the condition in which unexpected events are likely to come to light.

When managers are open minded, when they consider many different outcomes as possible, they may not be surprised when something new happens. But if managers have strong ideas about future market events and something different happens, then they are really amazed. Unexpected market events occur especially when companies have strong market orientation, that is, a tight coupling with their customers.

Consistent with this view, some authors suggest that companies should have a "future-market focus" – that is, they should focus on future customer needs and competitors' moves, instead of and regardless of current ones – because such companies show a terrific ability radically to innovate (Chandly & Tellis, 1998). Firms with a strong orientation towards future markets broaden their horizons and are ready to detect new technologies, new competitors, and new needs (Moorman, 1995). A good example of a company with a future-market focus is Nokia, leader in the cell phone industry. In fact, when Apple announced its intention to launch i-Phone as an evolution of its successful iPod and a potential breakthrough in the telephone market, Nokia immediately began to work on a new product that could outperform the expected features of Apple's new product.

Types of unexpected market event

UMEs emerge when companies face market structural holes with a strong, conventional view of the market. There are three major types of UME: unexpected market re/actions, accidents, and market contradictions.

- *Unexpected market re/actions.* Companies act in a given market according to a view of that market and a planned set of activities. They act expecting a reaction from their customers and competitors. For instance, a company launches a new product after having identified target market segments with certain needs served by specific competitors. This company expects some reactions from both the targeted segments (buying the product, for example) and from identified competitors (launching me-too products). However, what may happen is that customers who were not targeted buy the new product, or competitors from completely different industries, launch products to seize the new market opportunity. These events are totally unexpected for the company, and can open the door to new market creation.

Consider the success of SMS (Short Message Service). This means of sending messages of up to 160 characters to and from GSM mobile handsets has progressively become one of the most popular applications in the communication market, for both business and personal use. The first commercial SMS message was sent in the United Kingdom in 1992. Initial growth was slow, among other things because operators did not set up adequate side services for a product they did not see as having a high market potential. Why would the mass market be interested in a way to send simple, short messages instead of speaking directly? Initially, people used SMS to save time and money. No one believed that the service would be used as a means of sending text messages. Unexpectedly, a lot of customers started using SMS as a new and different way of communication. SMS has become one of the most profitable and growing services for mobile operators and is now one of the largest markets in the TLC industry. The number of SMS users in 2006 reached around 1.36 billion.

Unexpected successes and failures are typical examples of unexpected market reactions. According to Peter Drucker (1986), no other area offers a better opportunity for innovation than unexpected success. It occurs when you project positive results in a product launch, but actual revenues or profits are much higher than planned and even hoped. Sometimes this happens because sales also come from customers who were not in the company's target. Other times products are extremely successful because customers use them for a different application that was not projected by the technical or marketing team. In such cases the unexpected success can be an indicator that a completely new category of needs is being satisfied by the new product. Therefore, a market structural hole has been intercepted and a new market can be created.

Managers hardly understand and recognize an unexpected success as an opportunity for a new market creation because this could be a challenge to their ability to judge and to evaluate their own products and markets. And they quite often prefer to consider a success no more than that, and stop there.

If it is difficult to recognize a success as a source of a big opportunity, it is much harder to evaluate a failure as such. Unexpected failure is quite a common outcome in innovation processes. Most new products fail for technical or marketing reasons, and in many cases such products have to be discontinued; the result is a loss for the company. However, failures are not necessarily bad if they are the take-off point for discovering a new promising market.

When a failure is due to incapacity, ignorance, superficiality, or sluggishness, then it is probably nothing more than a simple mistake; as such there is no opportunity in it, only costs and losses. However, as Drucker (1986) noted, when something is carefully analysed, evaluated, planned, and implemented, the failure is something more. It means that something nobody had understood has happened or is happening: that demand is moving elsewhere, that distribution channels are changing, or that competition is changing in some fundamental way. Understanding what is going on could reveal a very interesting market structural hole.

The story of Jacuzzi is a good example of an initial failure that ended up as a great success. At the beginning of the last century, seven Jacuzzi brothers immigrated to California from Italy. They invented the first enclosed cabin monoplane, an accomplishment that led to the airplane that carried mail for the US Postal Service, and passengers from the San Francisco Bay Area to Yosemite National Park. In 1956, the idea of treating a family member's arthritis symptoms with a hydrotherapy pump came up. The Jacuzzi brothers invented a pump that did not enjoy the hoped-for success, because few arthritis sufferers could afford the expensive bath. A small niche business was developed by providing the J-300, a portable pump, to hospitals and schools. The idea languished until they tried to solve the problem of the high cost of the product, targeting a new market. Roy Jacuzzi, a third-generation family member, sensing the American consumer interest in health, fitness, and leisure activities, marketed the first self-contained, fully integrated whirlpool bath in 1968. While his family members looked on with both surprise and delight, Roy slowly – and nearly single-handedly – created a brand new industry. The Roman whirlpool tub became an icon of free-spirited relaxation in the 1970s. Today, Jacuzzi has become the world's most recognized and largest-selling brand of jetted/whirlpool baths and spas.

- *Accidents.* Accidental market events can be due to a phenomenon called serendipity. According to Wikipedia, serendipity can be defined as "the effect by which one accidentally discovers something fortunate, especially while looking for something else entirely". The word derives from an old Persian tale and was coined by Horace Walpole on 28 January 1754. In a letter he wrote: "I once read a silly fairy tale, called The Three Princes of Serendip: as their highnesses travelled, they were always making discoveries, by accidents and sagacity, of things which they were not in quest of" (Lewis, 1965).

Serendipity is not easy to illustrate, because inventors and managers are reluctant to confess that the merit of their successes is due to an accidental and unexpected discovery. In fact, serendipity is a major component of breakthroughs and scientific discoveries. Aspartame, for example, one of the most popular sugar substitutes, was discovered accidentally.[3] In most food, a sweet taste is frequently associated with calories and carbohydrates, and much effort has long been put into finding alternative solutions. For example, saccharin was discovered in 1879 and used in many different products. In 1965, a researcher at Searle and Co., James Schlatter, was using aspartame in his work on an anti-ulcer drug. Inadvertently, some aspartame spilled on his hand, but he did not wash it off because he knew it was not toxic. Only when he accidentally licked his finger did he discover aspartame's sweet taste. Searle introduced the product into the market in 1983.

Another innovation that is the fruit of serendipity is the Velcro hook and loop fastener.[4] The story begins with George de Mestral, a Swiss engineer, taking a walk through the countryside with his dog one day in 1941. On his return, he noticed that flowers of mountain thistles were tenaciously stuck to his clothes and his dog's fur, and very difficult to detach. He removed them carefully and observed them under a microscope. He discovered that the flowers were covered in hundreds of tiny but strong hooks that allow them to attach themselves to any soft surface. From that day, Velcro – from the French words "velours" (loop) and "crochet" (hook) – became a revolutionary fastening system whose simplicity and strength superseded all previous systems.

One of the innovations reported to be a serendipitous outcome is the discovery of a process that gave life to the inkjet printer at Canon. In 1977, Canon wanted to create a better xerographic technology. Ichiro Endo, one of the company's researchers, accidentally touched the tip of an ink-filled syringe with a hot soldering iron while fabricating a piezoelectric system. The ink inside heated up suddenly, increased in volume, and spurted forth. The squirt of ink changed the course and fortunes of Canon's research and led to the development of a simple inkjet printer that was known as the Bubblejet. Endo became Canon's Director of Product Development.

A more recent example of a successful company created after a serendipitous discovery is Geox, described in Box 9.1.

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[3] Source: Stacey, L. (ed.) (2002) "Aspartame", in *How Products are Made*. Gale Group, Inc., Blachford. [Online]. eNotes.com (2006). Available: <http://www.enotes.com/how-products-encyclopedia/aspartame> [20 November 2007].

[4] For further information, see www.velcro.com.

Box 9.1 Geox: seek good questions if you look for good answers

In the early 1990s, an Italian wine entrepreneur was in Nevada to present his products at a wine show. At the end of a working day he went for a walk wearing his old sneakers with rubber soles. The hot weather made his feet uncomfortably overheated. To cool them off, he used a knife to make one hole in each sole, and it worked! When he went back to Italy he looked for new shoes with rubber soles that would let his feet breathe, but there were none to be found: the fact was that any hole in the sole would allow water to get into the shoes. Intrigued by this challenging technical problem, he started to work on the idea by looking for technical solutions by scanning specialized technical sources. He discovered that NASA used a special membrane for astronaut spacesuits, with millions of microscopic holes, which permitted body transpiration while being impermeable at the same time. That could be a solution for his problem. He made some sole prototypes with this material - and got a world patent on it - and ended up with a satisfactory product, a good product, he thought, that could be sold to shoemakers both in the casual and in the sport sectors: the breathing shoe. But all the companies he contacted rejected his proposal, as they didn't see any business opportunity in it. In 3 year's time, convinced of the existence of a big market opportunity, the entrepreneur created his own shoe company in 1995 and named it Geox. In 2006, company revenues reached 612 million euros, 50% from 68 foreign markets. Geox is the number-one shoe brand in Italy and the third in the world. It has opened 517 owned shops and sells to 10 000 other shops.

- *Market contradictions.* A market contradiction emerges when two or more market events appear to represent completely inconsistent, paradoxical phenomena. For example, in a market whose customers have a very low income, top-price product sales might reach an all-time record. Or, the technological level of customers in an industry may be very high, but high-tech products sell very few units.

Aristotle's law of contradiction states that "one cannot say of something that it is and that it is not in the same respect and at the same time". This means that what we consider market contradictions are nothing but events we cannot really understand because we use too simple an explanation. When we discover why such events occur, we have probably discovered a market structural hole. An example is the story of Franco Maria Ricci (FMR), an Italian publishing company. In the 1970s and 1980s, book and magazine reading was expected to decline owing to the development of new media and new types of entertainment, like TV, music players, computers, and so on. Many market studies showed that people were less interested in reading than in other pastimes, and there was evidence that consumers were less and less inclined to spend money on magazines and books. Nevertheless, in the same period, a high-quality book publishing company, FMR, enjoyed unexpected success owing to great attention to detail, well-written texts, and cultural and artistic inquisitiveness. It used top-quality paper and printing, perfect graphics, and elegant bindings, as well as texts by famous writers and essayists like Umberto Eco, William Saroyan, Federico Zeri, Octavio Paz, Roy Strong, and Jorge Luis Borges. When everybody expected a decline in turnover for books and magazines and consequently publishers to divest or diversify, why should anyone invest in a publishing company? Nevertheless, this company won success in traditional, high-quality, and expensive books. This was an evident market contradiction. Marilena Ferrari, a sales representative of a publishing company, understood that people wanted to buy high-quality books not to spend time reading but because they wanted something magical, in which beauty, rarity, and exclusivity were the key features: it was a market structural hole. When people buy a volume like an FMR one they are getting an exclusive work of art, and this has nothing to do with reading a book. Ferrari decided to exploit this structural hole, and in 1992 she founded Art'e' ("It's Art"), a company whose business is to promote and sell artwork, fine books, and cultural events. Art'e' started its operations in Italy, and then extended them to Europe; now it is worldwide. The company achieved major success, and, after a sizeable growth in turnover, shares were floated on the stock exchange. In 2003, FMR was acquired, becoming the brand name of the new group.

From UMEs to market creation: exploration and leverage

In order to exploit the potential of UMEs for strategic market creation, a company should implement two processes: stimulate the emersion of UMEs and leverage on them to innovate.

Since UMEs come from market structural holes combined with the existence of strong market conventional wisdom shared among competitors, UME emersion can occur by exploring these holes and by challenging this wisdom. As described above, market structural holes stem from demand and supply evolution that follows different trajectories. So any exploration process of this kind should focus on portions of the market where demand and supply do not match.

Tapping into marginal market segments

Consider [yellow tail] and its huge success in the US wine market.[5] At the beginning of the new century, the US was the third wine market in the world for aggregate consumption, but only the thirty-third for per capita consumption. The market could be considered as split into two main market segments: premium wines and budget wines. Basically, competitors in both segments viewed their customers as informed wine drinkers who considered wine a unique beverage for special occasions. In both segments, strategic efforts of most competitors concentrated on launching more sophisticated wines for the same usage occasions. From the market point of view, the only big difference between the two groups of offerings was price. Given this situation, an Australian company, Casella Wines, focused its attention on the segment of non-wine drinkers, who were 3 times as numerous as wine drinkers. The company came up with the idea that this larger group considered wine as too complex a beverage, and wine appreciation depended on the availability of product knowledge and technical jargon. Thus, Casella Wines decided to launch a new wine brand, [yellow tail], which was targeted at non-wine drinkers as a social, easy drink that every consumer could approach. To build this positioning, Casella Wines eliminated any product feature that could make the product complex: the wine has a soft, fruity taste based on primary flavours that can meet the average consumer's tastes. There is no ageing, no alleged legacy, no technical jargon on the label, which, on the contrary, shows a kangaroo in bright colours, making the bottle very eye-catching and more like other beverage bottles. By August 2003, [yellow tail] was the number-one imported wine in the US, and by 2004 it sold more than 11 million cases. And this result was achieved by broadening the customer base of the whole industry, transforming 6 million non-wine drinkers into actual consumers.

The [yellow tail] case is very informative in showing that, when a market moves towards the maturity stage, customer preferences and competitor actions tend to

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[5] For a detailed description of this case, see Kim and Mauborgne (2005).

become more stable. On the supply side, competitors tend to pay a lot of attention to each others' moves, and to converge towards similar offerings; by so doing, they also converge towards a shared conventional wisdom about the market. This usually brings about two different market configurations: a concentration of offerings on the largest and most profitable market segments (the so-called "mainstream customers") or market fragmentation, that is, smaller segments each served by more specialized suppliers (the US wine market case). In both circumstances there is a portion of customer preferences that do not match with supplier offerings. In the first case, non-mainstream market segments are forced to adapt their preference curve to that of mainstream customers; in the second case, customers whose preferences are not so well articulated are forced to choose among specialized offerings. Of course, in both cases, customers can decide not to buy products currently available on the market. (Again, this was the case of non-wine drinkers in the US beverage market.) So in both cases there is a mismatch, which gives life to a market structural hole, and a company that focuses its attention on those segments can make a UME emerge. The extraordinary success of Ryanair in the airline industry (see Box 9.2) can give us another important example of market creation following the exploration of new market segments.

Box 9.2 Ryanair: every mainstream market is a niche at the beginning

The growth of the number of Ryanair passengers is astonishing: from 7.2 million in 2000 up to 42.5 million in 2006 (source: www.ryanair.com). How is that possible, especially after 9/11, which proved to be a serious threat to the whole airline industry?

The history of Ryanair began in 1985 when the company was set up by the Ryan family and launched its first route with daily flights from Waterford in the south-east of Ireland to London Gatwick. In 1986, Ryanair obtained permission from the regulatory authorities to operate a Dublin–London route, challenging the British Airways and Aer Lingus high-fare duopoly. The launch fare of 99 return was less than half the price of the BA/Aer Lingus lowest return fare of 209. This strategic price choice would characterize the whole history of the company. Today, Ryanair operates flights all over Europe, and, with a fleet of more than 100 aircraft, it has become the world's largest international airline. However, the peculiar price strategy cannot explain the huge success of the company, which basically created a completely new market in Europe. From the 1970s up to the 1990s in the international airline industry, competitors focused their strategic efforts on the most profitable market segment (at that time): business-class passengers. This strategy was pursued by offering a broad array of on- and off-board services, improving the comfort of the trip, investing in massive loyalty programmes, and developing new international routes to central, attractive locations. A very large part of the potential market was actually kept away from airline services by excessively high fares and, above all, by not having specific reasons to travel. Moreover, small airports are scattered all across Europe, located in cities that are off the main air traffic routes, mostly in economically underdeveloped areas. With its low-fare strategy – combined with intense communication campaigns – Ryanair transformed millions of potential customers into actual customers by giving them a reason to travel. By so doing, the airline has been able to create a connection between a potential demand and a potential supply of tourist attractions. In fact, low fares (that sometimes become no fares at all) make travelling so cheap that many people may find moving around Europe for a few days more convenient than travelling within their own country. This mass of people is also a resource for the underdeveloped areas where small airports are located, which offer Ryanair extremely attractive conditions to fly there. Hence, Ryanair created a completely new business model in the airline industry and a completely new market.

Injecting creativity in gathering and interpreting market information

When most companies share similar conventional wisdom about the market, information regarding market segments and customer preferences and behaviours is usually collected and interpreted in a very similar way. When an undifferentiated view of the market is shared, competitors tend to adopt analogous segmentation strategies and adapt their offerings to the way they represent market segments. Again, a consequence of this behaviour is that offerings tend to be slightly differentiated over time. So a company that uses information in a creative way, and combines data about customers in an unorthodox manner, can build a different view of the market and make underserved segments emerge. The assumption behind this exploration strategy is that every customer can belong to many different segments of preference according to the various segmentation criteria companies use to interpret their markets. By changing interpretation criteria, a company can achieve a completely different view of the market and interpret customer preferences in a novel way. Let's take Linea D'Ombra, the most successful art exhibition organizer in the Italian market.[6] Owing to its immense artistic and cultural heritage, Italy has a long tradition in the organization of art exhibitions. For a long time, large-scale art exhibitions were organized by publically owned museums and institutions that designed temporary shows leveraging on their rich collections. A large number of privately owned organizers operated in the country, but they mostly focused on small-scale exhibitions targeted at local or regional audiences. Based on the conventional wisdom that the main audience of art exhibitions is made up of art-literate citizens - a very small fraction of the population, identified by a high-level education - organizers habitually concentrated their efforts on the quality of the works displayed. What is more, the shared belief was that only large arts cities and historically relevant sites could attract large audiences. Blockbuster exhibitions that were typical of other countries were snobbishly labelled as "pure quality marketing initiatives" for customers with poor cultural capital in search of a way to pass their leisure time. Linea D'Ombra was a small exhibition organizer operating in the north-east of Italy. The experience gained in its small market suggested that the conventional wisdom shared by large-scale organizers could no longer hold true. The belief about large-scale exhibitions corresponded to a shared view of the market that considered only art literates as potential targets for art exhibitions. However, the arts were more and more in the media agenda, and people with a rich cultural background who were not specialized in the arts (a rapidly increasing portion of the Italian population) could also be attracted by arts events. Those people were interested not only in the quality of single artworks but also in a theme that could be represented through the exhibition. Further, visitors were increasingly interested in the full experience of the visit, beyond the exhibition in itself. Thus, the company used this unorthodox view of the market to design an exhibition plan to be deployed in 3–5 years time, by gathering artworks often never displayed before in Italy, courtesy of individual collectors, and aggregating them around easy-to-grasp themes. Leveraging on the sponsorship of a local bank, they launched a

[6] For a detailed description of the evolution of Linea D'Ombra's competitive strategies, see Calcagno, Faccipieri, and Rocco (2005).

programme of temporary exhibitions on the Impressionists in Treviso (a small town in the north-east) in a building that had no historical interest at all. The first four exhibitions (over a 4 year time span) were attended by 600 000 people on average, gaining one of the top spots in the world art exhibition attendance rankings. Now, Linea D'Ombra is considered one of the best art exhibition organizers in Europe.

Setting up market experimentations

Experimenting in a market consists in testing the reactions of customers (and competitors) to an innovative offering that is not developed to its ultimate configuration but is still open to further developments (e.g. Hamel & Prahalad, 1991). The main difference between market experimentation and the traditional innovation process lies in the belief that the innovative offering launched into the market is not the conclusion of the innovation process but the beginning, and that is where UMEs emerge. In fact, the final outcome is the result of many interactions between the actions of the company, the customers, and the competitors which will give the offering its final configuration. Basically, market experimentation is a process of co-creation of the offering with the – often unaware – fundamental contribution of customers and competitors. Consider Italian firm Pastificio Rana, the 200 million euro fresh pasta maker.[7] The company became market leader in Italy, France, Spain, and other smaller European countries by paying extraordinary attention to product quality and the construction of a brand personality based on genuine, traditional values. In 2000, a diversification process was started. The market insight was that an increasing number of people were used to having lunch away from home, and a significant percentage complained about the quality of the food, quite different from what they would eat at home. Since Rana had the product many people consumed at home, managers thought it could be a good opportunity to let customers find the same pasta away from home as well. The company built a partnership with an Italian grocery retailer to open a corner in two of their stores, with the brand "La Trattoria di Giovanni Rana". Basically it was an Italian fast food place that served the company's products. Since this new business required completely new competences for the company, the two corners were used as experiments to learn about the acceptability of the product and the consistency with the company competences. The

[7] For a detailed description of the diversification strategy, see the interview with Giovanni Rana, founder and president of the company, in *Micro and Macro Marketing*, December 2005.

experiments were successful, but Rana learned that the investment would have exceeded its possibilities. Rana needed a partner, and it came from France. Casino, the French retailing company, found the idea very attractive, also owing to the large awareness of the Giovanni Rana brand in the country. A partnership was built, and "La Trattoria Giovanni Rana" restaurants were opened in 100 Casino stores, combining the retailing competences of the French partner and the product competences of the Italian partner.

Fostering serendipity

The story of 3M Post-Its is one of the most renowned in the history of consumer product innovation.[8] The formula for the sticky back was developed in 1968 – many years before its actual launch – by a 3M scientist, but it was put aside because its technical performance was poor: the sticking capacity of the product lasted for a short time, and was not very strong. Another scientist of the company loved to sing, and he did it regularly in a church choir of the city. He had to deal with a disappointing problem. To find out quickly the songs he had to sing, he used to put bookmarks in the hymnal. Unfortunately, those bookmarks regularly kept falling out, causing him to lose his place. Finding a way to solve the problem, the researcher stepped into the old formula and took it back to improve it and solve his personal problem. This was made possible by the 3M "bootlegging" policy, that is, technical staff members are encouraged to spend up to 15% of their working time on projects they choose. Post-It was market tested starting from 1977, and launched in the whole US market in 1980.

When companies have a consolidated view of the market, they tend to focus only on the part of the market that they can interpret and make sense of from that perspective. This view becomes a sort of a constraint to the import of completely new signals within the organizational knowledge repository, and, in some respects, it raises massive barriers to novelty. For example, for the market segments 3M was serving in the late 1960s, the Post-It formula was uninteresting. The focus on the benefits sought by actual customers narrowed 3M's field of vision, limiting the company's possibility to imagine other applications of the formula. And only a staff member's attempt to find the answer to a personal problem gave life to an unexpected solution. To explore UMEs, a company may encourage its members to seek out completely new information by accessing

[8] For a detailed description of the Post-It case, see www.3m.com.

far-from-the-norm environments: different industries, different market segments, geographical markets far afield, and non-business events and situations. The new information collected will offer an enriched view of the actual market or provide the chance to build completely new market opportunities.

Seeking and reconciling market contradictions

As seen above, a market contradiction is hardly an objective characteristic of the market, but it usually depends on the inability of the knowledge structures of current competitors to explain why such contradicting events occur. Reconciling market contradiction basically means building a superordinate cognitive representation of the market that can make those events compatible. It implies the move from an "or ... or" view of the market to an "and ... and" one, where apparently contradictory events can be tied into a common explanation. To do that, a company should recognize that every representation of the market is based on strong assumptions about customer and competitor attitudes and behaviours. Those assumptions are cognitive simplifications of actors that depend on current limitations of technology, products, customer competences, and more. Building a superordinate cognitive representation implies imagining how market reality could be different if such conditions changed. And so, basically, reconciling market contradictions consists in working out how to remove the constraints that give life to these contradictions.

The huge success of Unilever's brand "Quattro salti in padella" is a perfect example of how to reconcile market contradictions.[9] In the mid-1990s, the Italian frozen food market showed a clear market contradiction. On the one hand, consumer life styles were evolving: the number of women working outside the home had increased dramatically; less time was devoted to cooking; the average cooking competences of young consumers was on the decline; natural, genuine, tasty food was in high demand. The frozen food market was born in the 1970s precisely to serve those life styles, but after 20 years the penetration of frozen food in Italian families was very limited and the size of the market at the time was dropping at a steady pace (from more than 6 000 tons in 1990 to some 5 000 tons in 1995). There was a clear contradiction. However, this contradiction originated in

[9] For a detailed description of the development of "Quattro salti in padella", see the interview by Antonella Di Donato, Marketing and Business Director of Unilever's frozen food division, in *Micro and Macro Marketing*, April 2007.

the knowledge shared among competitors regarding the benefits sought by frozen food buyers: time-saving in food preparation and long-term conservation. Thus, most products in the market were precooked pasta dishes and vegetables, the quality of which was very different from home-cooked food. Unilever managers viewed the market differently, by thinking about how to provide customers with a time-saving product that consumers could perceive as being at the same quality level as home-made food. The idea came up to develop traditional Italian dishes, with ingredients that respected the original recipe; customers would prepare this food not just by warming it up in the microwave but by giving it a final touch as well. The quality of the product is ensured because every phase of the production process is carried out internally. The brand name clearly expresses the benefits of the product: in Italian "saltare in padella" is the final activity a cook does to give the perfect taste to a dish, and "quattro salti" is a way of expressing dynamism and movement (like in a disco). "Quattro salti in padella" was launched in 1996 and since then has given a boost to the whole frozen food market: from about 5 000 tons in 1995 to 30 000 in 2006. Its market share today is 60%, with 92% brand awareness.

Conclusion: organizational characteristics supporting exploration and leveraging

Exploring and leveraging on UMEs are highly risky processes. They challenge conventional beliefs, consolidated practices, and efficiently managed activities. This prevents many companies from pursuing an effective exploitation of UMEs and constrains them into the reassuring borders of traditional innovation processes. A company that wants to exploit a UME to foster strategic market creation should be aware of the cognitive, temporal, and financial burden this implies both at an individual and an organizational level.

That is the reason why effective processes of exploration and leverage on UMEs require specific organizational characteristics, in terms of culture, climate, and systems. A *culture* that tends towards conformity hinders the acceptance of the unexpected (cf. Atuahene-Gima, Slater, & Olson, 2005). The ability to build on UMEs depends on the sense of security that organizational members have; they know they are acting in a protected environment where the search for novelty, experimentation, and serendipity are considered fundamental to foster innovation. A culture that is tolerant of errors promotes the willingness to take risks and deal with consequent uncertainty (Smith, Collins, & Clark, 2005).

Beyond organizational culture, openness to the unexpected is favoured by an organizational *climate* that stimulates cooperation and hence interaction. In this regard, an essential element is trust, among members of the organization and in critical actors external to it. In a climate that favours cooperation, employees are more motivated to embark on new paths where the unexpected, and its resulting uncertainty, would find fertile ground. In such a climate, interaction between members of the organization, and between these people and external actors, is based on respect and the conviction that the contribution of the others is indispensable.

Among organizational *systems*, the marketing information system plays a key role in identifying UMEs and amplifying their potential within the company (Vicari & Troilo, 1998; Nonaka, Reinmoeller, & Senoo, 2000). This system must be designed to guarantee that built-in sensors can pick up signals from different parts of the market and various environments. Moreover, this system must be able to disseminate data to all actors who can contribute to challenging traditional views of the market, and must also allow market views to be retained. Only by retaining those views can the company formalize the system of expectations which is then used to compare UMEs and make sense of them.

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