

Stuck on the Past - A Primer on Value Migration & How to Avoid It

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At least since the mid-1960s, conventional wisdom has held that corporate success requires a customer focus. More recently, it's become clear that value migrates from companies that fail to understand the changing patterns of customers' wants, needs, and willingness to pay and migrates toward others that possess superiority in satisfying those changing priorities. A critical challenge most companies face is combating institutional memory, which can impede the latter's ability to recognize and respond to those changing customer priorities.

Like Marcel Proust, whose reverence for the past is legendary, many companies focus too narrowly on their past patterns of success. And, regrettably, these companies ignore changing customer needs and priorities while institutionalizing norms, values, and behaviors that end up dominating the organization's mind-set and culture. Ultimately, they lose sight of their customers—who move from center stage to the periphery—and, even, lose them to competitors who are better able to satisfy the changing patterns of customer needs, wants, and willingness to pay (Slywotzky, 1994, pp. 16-17). Value migration, as this process is called, arises from a company's inability to understand that just as products experience a lifecycle extending from growth to obsolescence so, too, do business designs—i.e., the activities in which businesses engage and the relationships they cultivate in order to deliver utility to customers and earn profits for companies. What happens to a company when its business design reaches economic obsolescence? In brief, customers move, staff moves, and value migrates from these companies and toward others that are better designed to maximize customer utility and company profits (Slywotzky, p. 4).

Antecedents

Though increasingly relevant in today's quick-paced, highly unpredictable business environment, the phenomenon of value migration is hardly new. Indeed, Adrian Slywotzky, the guru of "value migration" has brilliantly fleshed out the economic conditions for, and implications of, value migration and a number of earlier works have made significant contributions to this area. Among the most important of these was Theodore Levitt's ground-breaking, 1960 article, "Marketing Myopia," which challenged then-traditional thinking about the process of organizational obsolescence. In that work and in a 1975 retrospective commentary of the original, Levitt argues that in order to take advantage of growth opportunities and ensure continued growth, organizations must define their industries—i.e., purposes—broadly (Levitt, 1975, p.2). To support his case, Levitt charges that by focusing narrowly on the railroad business instead of more broadly on the transportation business, the railroads hastened their own decline despite an increased demand for passenger and freight transportation. The real stumbling block, he argues, was that the industry was product-oriented when it should have been customer-oriented. This engendered a myopic view of the true nature of their business, leaving the railroads incapable of taking advantage of opportunities for growth (Levitt, 1975, pp. 2-4).

Levitt also takes aim at so-called growth industries, of which he vigorously denies their existence. Marshalling a variety of examples—the above-mentioned railroads, dry cleaners, grocery stores, the U.S. automobile

Stuck on the Past - A Primer on Value Migration & How to Avoid It

Laraine Spector

industry, computers, movie industry, among others--Levitt ominously warns that "industries that assume themselves to be riding some automatic growth escalator invariably descend into stagnation" (Levitt, 1975, p. 4). How can companies ward off decline and extend growth? According to Levitt, by ascertaining their customers' needs and desires and, above all, by focusing their actions on helping customers solve their problems (Levitt, 1983, p. xii). Customers, Levitt contends, buy solutions to problems, they don't buy things. To continue growing, therefore, companies must be "customer-creating," "customer-satisfying organisms;" that is, they must do the things that induce people to do business with them (Levitt, 1975, p. 12).

The Value Migration Perspective

Fast-forward to the mid-1990s where we find many of Levitt's key concepts have been reworked and refined by Slywotzky. Like Levitt, Slywotzky emphasizes the importance of a customer orientation to a company's success. However, Slywotzky's perspective is more technical, more focused on the financial and managerial aspects of economic obsolescence. His concern is with process—the process whereby changing customer needs and priorities influence customers' product/service choices, resulting in the development of potential value for certain businesses from which they buy and, eventually, the reallocation of value to various business designs (Slywotzky, 1994, p. 17). Describing the ongoing impact of changing customer priorities, Slywotzky posits the following scenario:

As customers' priorities change and new designs present customers with new options, they make new choices. They reallocate value. These changing priorities, and the way in which they interact with new competitors' offerings, are what trigger, enable, or facilitate the Value Migration process (Slywotzky, p. 13).

Fending Off Value Migration

Despite its apparent simplicity, the value migration process is complex and avoiding or, even, reversing it requires that companies act purposefully to implement more effective business designs. To meet the challenges of value migration, management must understand both the direction and velocity of change in their industry. It must determine which business design elements will be most important in the future and which competitors will present the greatest threats (Slywotzky, p. 19). More importantly, it must recognize that the key to value migration is the customer, who drives the entire process. For that reason, it is critical that companies understand the customer's decision-making system and his/her resulting priorities. Knowledge of the latter will determine the business design that maximizes utility for customers and profit for the provider" (Slywotzky, p.15).

Not surprisingly, value migration has its winners as well as its losers. The losers—i.e., those from whom value shifts as customers' priorities change—become economically vulnerable as value moves toward new business designs whose superiority in satisfying customer priorities makes profit realizable. The winners--new

Stuck on the Past - A Primer on Value Migration & How to Avoid It

Laraine Spector

companies and newly-created competitors that satisfy a specific customer priority better than incumbents or that are more effective at reaching customers segments underserved by existing business designs —benefit and flourish from the newly-created opportunities. However, value migration can be controlled if management can distinguish its basic patterns, identify threats to the current business designs, and initiate actions that enable it to benefit from the next cycle of value growth and to create the next viable business design (Slywotzky, 12-19).

Companies Contending With Value Migration: Some Examples

Hardly an industry or a company hasn't experienced value migration to some degree. Although some companies have warded it off by transitioning to a more effective business design, more haven't and most have lost the value they've created. One of the most obvious examples is offered by the transportation industry. In the 1920s, Ford Motor Company experienced a value outflow from its vertically-integrated, single-car-oriented business design [that is, the black model T] as value shifted toward GM, whose price-laddered, multi-optioned business design proved superior in meeting customers' needs and priorities (Slywotzky, p. 7). An equally compelling example is the railroad industry in the late 19th and early 20th centuries, whose major shortcoming was its failure to understand that its business design possessed only limited value creation potential and that its ability to meet changing customer priorities—for speed, time and location flexibility, and pricing—would be seriously challenged. And it wasn't intra-industry competition from more competitive incumbents that doomed it but, rather, competition from new entrants and non-traditional competitors—automobiles, trucks, and airplanes—who showed greater sensitivity to emerging customer priorities and greater ability to craft business designs to satisfy them (Slywotzky, pp. 220-222). Where will the next threat to the industry come from? To which competitors will value migrate?

In retailing, the winners and losers have been particularly conspicuous. Perhaps no company benefited more from value migration than Wal-Mart, the world's largest and most profitable retail company (Yoffee and St. George, p. 1). With net revenues of over \$200 billion in 2004, it's hard to believe the retail giant was only founded in 1962—and in that most unlikely of retail centers, Bentonville, Arkansas—or that its origins were extremely humble and nontraditional (Bradley, Ghemawat, and Foley, pp. 173-189). Competing in the burgeoning discount retail segment, Wal-Mart profited from the shortcomings of the more traditional retailers dominating the retail scene in the 1950s and 1960s as well as those of emergent discounters.

No doubt, the failure of those traditional retailers—that is, the Macy's, Marshall Field's, and May's at the high end and the Sears, Montgomery Wards, and JC Penney at the middle and lower ends—to perceive or act upon evolving consumer demands or emergent demographic patterns enabled new competitors, including Wal-Mart, to offer business designs that exploited hitherto unmet needs of a number of unserved market segments. In particular, Wal-Mart's strategy was to locate its stores in areas ignored by everyone else

Stuck on the Past - A Primer on Value Migration & How to Avoid It

A JOURNAL OF STRATEGY & BUSINESS TRANSFORMATION

Laraine Spector

(Bradley, Ghemawat, and Foley, pp. 174-175). As such, it triggered a value-migration shift by capitalizing on meeting the priorities of this segment—especially, for greater selection and lower prices for branded staples—that incumbents had neglected or failed to provide. Moreover, its innovative customer-selection strategy combined with an aggressive expansion plan fueled Wal-Mart’s continued, long-term growth (Slywotzky, p. 66).

Other retailers also benefited from the value outflow from more traditional competitors. These included specialty stores, ‘category killers,’ and superstores that responded to changing consumer demands by innovating on such things as depth or breadth of their offerings. Thus, stores like Best Buy, Home Depot, and Toys ‘R Us offered “time-pressed consumers better prices, greater service expertise, and a virtual guarantee they would leave the store with a product they wanted” (Slywotzky, p. 66). Sadly, incumbents’ failure to respond to customers’ changing needs more effectively combined with their inability to detect and block the new entrants or, preferably, to lay claim to the new value space for themselves shifted value from their outmoded business designs toward others that were better designed to maximize customer utility.

For the computer industry, the story is much the same. Giants such as IBM and DEC lost over \$50 billion in market value from 1984-1994 while newcomers Microsoft, Intel, EDS, and Novell gained over \$80 billion, thus resulting in a rapid and dramatic reallocation of value in the industry (Slywotzky, p. 3). In effect, IBM and DEC experienced value outflow as customers’ preferences reallocated value toward business designs associated with things that matter to customers—for example, elements of computing functionality such as high-speed processor chips, multi-functional communications, and systems integration—and away from those associated with outmoded business designs—i.e., based on proprietary software and minicomputers (Slywotzky, p. 13). IBM’s response was to change the way it did business—i.e., its business design. Among others things, it purchased Lotus and Lotus notes, refocused from a hardware orientation to one centering on software, personal computing, and consulting. What IBM changed was not simply its technology, but how it organized itself, how it configured its resources, how it fashioned its approach to the customer, and how it evaluated and conceptualized the competitive environment (Slywotzky, pp. 13-215).

A final example is drawn from the telecommunications industry. No industry better exemplifies Levitt’s “growth industry” concept than telecommunications. And, clearly, the industry’s titan was Lucent Technologies. Unfortunately, reflecting the industry’s unexpected and unparalleled collapse in 2002, Lucent’s revenues decreased 72 percent from their peak of \$30.6 billion in 1999 to \$8.5 billion in 2003. Its business, once a cornerstone of the American industrial landscape, has declined as customers shift to new value paradigms—i.e., from Lucent’s large switching-station technology to pizza-box sized routers offered by competitors such as Cisco as well as other new entrants that have introduced innovative and next-generation technologies (Belson, 2004, p.1).

Stuck on the Past - A Primer on Value Migration & How to Avoid It

A JOURNAL OF STRATEGY & BUSINESS TRANSFORMATION

Laraine Spector

Indeed, over the past five years, Lucent's competitive environment has changed dramatically: for decades, phone calls, data, and video traveled over wire lines, and Lucent made the switches and other equipment that sent those signals around the world. However, the new Internet-based technology and other innovations allow all content to travel over unified digital networks. This shift demands new hardware as well as new approaches to the way data is dispersed, organized, and stored--something Lucent's rivals understand very well. The latter--Cisco and Nortel Networks, among others--have the upper hand in this new world. To survive, Lucent has had to form partnerships with its competitors. It has also made a substantial effort to develop next generation high-speed data services for networks--something that has paid off. Indeed, in March 2004, Verizon Wireless awarded Lucent a \$525 million contract to develop the carrier's third generation, or 3G, mobile network. Though pulled back from the brink, Lucent is still struggling for survival and hoping demand for the technology it is developing grows faster than the decline in its traditional businesses (Belson, 2004, p.2).

And, finally...

Value migration is initiated when a critical mass of customers make choices based on their priorities, creating value and opportunities for the businesses from which they buy and shifting value from those whose business designs are outmoded and thus deemed to offer lower utility. The process, which can affect an entire industry, a company, or only specific divisions of a company, is inevitable as companies' business designs go through cycles that culminate in economic obsolescence. However, it is controllable if companies maintain a customer focus and pay careful attention to the trajectory of changing customer priorities and their impact on the viability of their business designs. Recognizing that customers drive the process and that the competitive field must be envisioned broadly enough to uncover and respond to threats from all competitors--traditional and non-traditional, incumbents as well as new entrants--is critical to a company's survival. This stance should enable a company to structure a defensive response but, more importantly, an offensive with the potential to create major value-growth opportunities. Ultimately, every company should have its eyes focused on creating the next viable business design. Figure 1 summarizes the keys to mastering value migration.

Figure 1 How to Master Value Migration

- Recognize that business designs go through cycles from growth through decline
- Understand that customers drive Value Migration--know their needs and priorities
- Broaden your company's competitive field of vision to include direct as well as indirect competitors o Identify competing business designs, assessing their customer appeal and profit potential
- Know the conditions that create opportunities for new, innovative entrants
- Scan the marketplace to identify all companies positioned to act on changing customer priorities
- Always keep focused on the next viable business design-- don't get stuck on the past!

Stuck on the Past - A Primer on Value Migration & How to Avoid It

A JOURNAL OF STRATEGY & BUSINESS TRANSFORMATION

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