

Chapter | 1

WHY NEW MARKETS MATTER

On April 3, 1973, Martin Cooper turned the heads of even jaded New Yorkers as he strolled the sidewalks while talking into a brick-like device. Cooper, head of Motorola's Communications Systems Division, was placing the world's first call on a cellular phone. In his triumphant moment, he mischievously dialed his archrival at AT&T's Bell Labs. A new market was born.

Cell phones are representative of new markets and their huge potential. Like the steam engine discussed in the Preface, they had been years in gestation. People with money to burn could use primitive car phones with an operator's help in setting up calls. Humphrey Bogart used one playing the mogul Linus Larrabee in the 1954 movie *Sabrina*. But there were many problems that prevented systems from being scaled—for several years, Britain's Prince Philip had the United Kingdom's only mobile phone.¹ Motorola's technology removed these issues. It allowed many people to use a network simultaneously,

traveling between cells, calling through a totally automated process. The dawn of a new era finally seemed at hand.

In a press release issued that historic day, Motorola confidently projected that cell phones would be in public use by 1976.² Yet it took until 1979 for the first commercial cell phone networks to be deployed, in Bahrain and Tokyo, and a U.S. network did not exist until 1983. Motorola's sales of cellular equipment were exceptionally small for over a decade after that first call was made. The first handsets cost \$3,500, weighed 28 ounces,³ and appealed to a sliver of the population. As is frequently the case in a market's early days, the future seemed uncertain.

In 1980, AT&T commissioned a study to project the total number of cell phones in use worldwide by 2000. The study's answer: 900,000. The company decided to sit out as others built the first U.S. cellular networks. The correct number for the year 2000 ended up being 750 million,⁴ and by 2010, worldwide users stood at 4.6 billion.⁵ AT&T was forced to pay \$11.5 billion in 1994 to buy McCaw Cellular, one of the early movers in the industry.⁶ Motorola had been too optimistic, but AT&T had been expensively pessimistic. Both had severely misjudged the market.

Following the pattern of many new markets, the cell phone spawned several other industries. Wireless networks became a business exceeding \$150 billion in the United States alone.⁷ Mobile mapping has taken off so rapidly that Nokia recently spent \$8 billion to acquire a navigation company. The iPhone has created a market for over 400,000 software applications, and that number keeps growing. The cell phone enables mobile marketing campaigns by giant brands such as Coca-Cola and Adidas. People using this small device now transact nearly 5 percent of Zambia's gross domestic product (GDP).⁸

Perhaps the most astonishing thing about these markets is that they were latent for years. The potential for over 400,000 applications of a mobile device existed long before the iPhone came around to unlock

that demand. For millennia, people have wondered about tomorrow's weather, played games, and sent messages to friends. The cell phone allowed that latent demand to be channeled into a commercial transaction.

As often happens, the cellular industry did not so much cannibalize an old one as create an entirely new source of growth. Think about the calls you make today on your cell phone—how many would never have been placed if your only option was a landline handset? Think too about the leaders in the cellular business—giants such as Nokia and Vodafone were not present in traditional telecoms.

Cellular telephony also was typical in other respects. Initial take-up was slow. Expensive and bulky handsets hindered the industry's expansion, yet the tiny market seemed not to warrant big investment to make these devices significantly better. Competition generated awareness but also created problems as companies rolled out conflicting technical standards and offered pricing plans that made it costly for customers of one carrier to interact with subscribers on rival networks. Behavior change at first took root through leveraging existing habits, such as checking the weather, and then rocketed into new directions, such as finding friends' locations. The industry shifted from a handful of vertically integrated players to today's gaggle of competitors. Advances in component technologies, like digital photography, enabled totally new and unexpected uses of the device.

Given the criticality of new markets to business growth, it is essential for companies to pursue these opportunities in an appropriate manner. Unfortunately, when firms assess and enter new markets, they often cross-apply the principles, strategies, and analytical tools used by mature industries. The results can be profoundly misleading. As we shall see throughout this book, there are clear patterns that govern the creation and growth of new markets, and these principles contradict common behavior in established fields.

In this chapter, we will look at

- What defines a new market
- How new markets create big industries
- How new markets build great companies
- Why ignoring new markets is perilous
- How new markets can become a source of corporate renewal
- What trends make new markets particularly critical today

What Is a New Market?

The words *new market* are often used loosely. Google references over 8 million pages with the term. This book does not focus on new technologies catering to existing markets (Blu-Ray replacing DVD), ways to enter an industry by seizing a share of existing customers (Walmart becoming America's leading grocer), or new competitors entering an existing territory (South African winemakers rising to equal France's share of the British wine market). These other topics involve different customer and competitive dynamics than the creation of new markets.

This book's focus is on markets that have not existed previously. It is concerned with tapping latent demand to create new sources of consumption, much as the cell phone did. A new market might cannibalize some of the old, but it also expands overall consumption—cars significantly hurt the makers of buggy whips, but they greatly expanded the use of transportation. If fighting competitors for share is a zero-sum game, new markets are about positive sums that create economic growth.

There are two general ways in which new markets create growth:

- *New customers.* A new market often will lead to people or institutions buying products or services that they had not purchased

before. Sometimes these products may be new-to-the-world, such as Apple's iPad, whereas in other circumstances they might be newly affordable or accessible, like cell phones have become in developing countries.

- *New consumption occasions*, A new market also may result from new consumption occasions. Colgate created a new market with its Wisp toothbrush, an ultraportable single-use brush meant to be used on the go. E*Trade enabled consumers to trade stocks far more frequently than they could with traditional brokers.

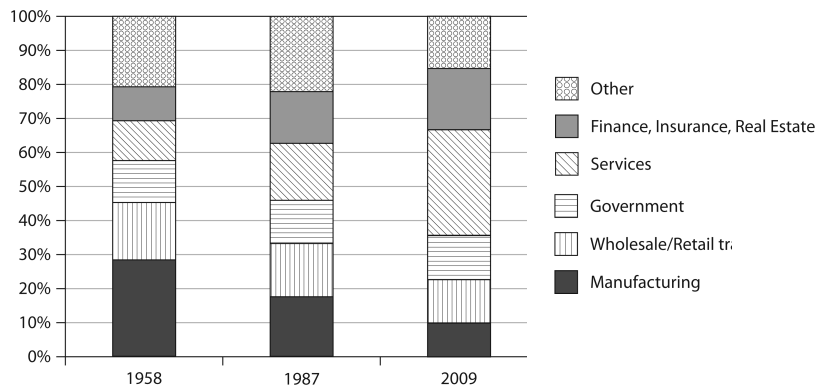
New products, services, or technologies do not necessarily lead to new markets. The key distinction is whether they ultimately lead to new consumption.

As with many definitions, there are gray areas. Wind energy is not a new market for electric utilities because it does not materially change the amount of power that people consume. However, for turbine companies, it is clearly a vast new market. This book does not dwell on exploring fine definitional distinctions. Unless otherwise noted, each example of the 181 used qualifies as a new market under the basic definition given earlier.

New Markets Create Big Industries

Over the past 50 years, the U.S. economy has gone through waves of transformation. An agriculturally oriented nation had already given way to one focused on manufacturing. Services then became predominant. Information and communication became vastly larger components of GDP than before. As Figure 1-1 illustrates, the makeup of the economy and size of key industries have shifted enormously.⁹

Sometimes the rate of change has caught the statisticians off-guard. The Census Bureau has counted nationwide sales of greeting cards since before World War II. However, the biotechnology industry, with

Figure 1-1 Economic transformation over five decades.

annual revenues now exceeding \$60 billion in the United States alone, was not tracked as recently as 1997.¹⁰

Indeed, the most recent Census of the U.S. economy lists myriad industries that scarcely existed 20 years ago—satellite communications, Internet publishing, data hosting services, and more. These new technology-related industries constitute nearly 8 percent of today's economy.¹¹ Moreover, a look within preexisting industries shows the growth that new markets can create. Hotel accommodation was an industry before Rome was a city, but the rapid growth of extended-stay hotel chains over the past 20 years has led to their becoming almost 7 percent of all U.S. hotel rooms.¹² People have cleaned their homes since the dawn of civilization, but innovations such as Procter & Gamble's Mr. Clean Magic Eraser recently have grown this industry in totally new ways.

While many observers grasp the potential of new technologies to create industries, one of the most stunning facts about new markets is that some of the greatest successes have come from relatively low-tech offerings. General Electric (GE) makes nearly one-third of its \$158 billion in revenue from capital finance, thriving in once-obscure

niches that banks largely overlooked.¹³ Overnight package delivery was feasible long before the creation of Federal Express in 1971, yet the company pioneered a market that today is worth \$74 billion.¹⁴ One wonders about what the next great industries will be that have nothing to do with new technologies.

New Markets Build Great Companies

Table 1-1 shows the top 10 U.S. firms by market capitalization. Eight of these 10 firms have become giants through repeatedly finding and dominating new markets.¹⁵ Several of these companies' stories will be explored in this book. Let us look at two of them now.

Table 1-1 Most Valuable Companies in the United States and a Few of Their New Markets

Company	Example New Market
ExxonMobil	Kerosene, gasoline, components of lithium batteries
Apple	PCs, laser printers, MP3 players, smartphone hardware
Microsoft	PC operating systems, PC application software
Berkshire Hathaway	N/A
Walmart Stores	N/A
Procter & Gamble	Disposable diapers, fabric softener, safety razors
IBM	Mainframe computers, magnetic tape, PCs, information technology services
Johnson & Johnson	Sterile sutures, dental floss, stents, laparoscopic surgery
General Electric	Commercial finance, electric toasters, moldable plastics
Google	Paid searches, smartphone operating system

Google was born in 1998 (its incorporation took place in a garage, one not even belonging to the two founders).¹⁶ In its early days, a venture capitalist considering investment counted 17 other search

engines that seemed just as good.¹⁷ Internet search was growing rapidly, with Yahoo, Netscape, and Excite leading the pack.¹⁸ Yet no one was making much money because these firms had not figured out how to derive significant revenues from the millions of hits they were generating every day. It was late-coming Google that created a new market, as opposed to a new product, through pioneering the now-commonplace practice of paid search—having a company’s laser-targeted ads appear alongside the results provided by the search engine. Paid search opened up new consumption among Internet searchers as well as new advertising spending from businesses that finally could target customers with pinpoint accuracy but without ad production cost. These concepts became an immense business for Google, generating over \$22 billion in revenue during 2009 alone.¹⁹

Google moved on to have higher aims—to organize the world’s information and make it universally accessible and useful.²⁰ This mission led the company to launch services such as Google Reader, which allows users to organize their favorite blog and news feeds into a customized magazine-like experience. The service created many more consumption opportunities for the company’s advertising-powered business model. It produced Google Maps, a compelling way to find local resources that opens up new possibilities in location-based search and advertising.

The company did not stop there. It understood the potential of its dominance on the PC desktop and the threat as well as the opportunity of the cell phone usurping much of the PC’s functions. It invested heavily to launch Android, a rapidly ascendant cell phone operating system that creates countless more consumption opportunities for highly targeted advertising. It has experimented in other markets as well, such as using Internet technologies to radically change the way that television ads are targeted and sold.

While Google is clearly a technology-based company, its ascent has had little to do with any scientific breakthrough. The firm succeeded

by recognizing the new markets that technology can open up rather than from creating breakthrough technologies that subsequently generate markets on their own. In other words, we should not be deterred by Google's ranks of engineers—any company can follow in Google's footsteps.

The stock market believes in the potential of Google to create further new markets. Analysts have attributed over 20 percent of the company's value, a sum worth over \$30 billion, to businesses outside paid search.²¹ The analysts are not sure about exactly which new market will be a blockbuster, but Google's portfolio of initiatives is enticing.

As noted in the Preface, Apple also provides a powerful story about the potential of new markets. The company famously helped to create the PC market in 1977 with the Apple II.²² In the 1980s, the company was the first to harness the PC's power for graphics applications. It produced not only the Macintosh in 1984 but also one of the first laser printers in 1985.²³ While the rest of the PC industry raced toward commoditization, Apple cornered a market willing to pay high prices for its compelling offerings.

More recently, the firm has had a string of successes in building new markets. Its iPod was launched three years after Diamond produced the first portable MP3 player,²⁴ yet Apple was able to energize and own that market by offering consumers an ecosystem of device, software, and music that worked brilliantly together. Similarly, the iPhone was a very late entrant into the mobile phone market yet now captures over 30 percent of the profits in the total handset industry.²⁵ It revolutionized how people thought about a mobile device. In 2010, the company launched the iPad, selling nearly \$5 billion in the product's first six months as it created still another new market.

One might think that Apple spends enormous sums on technology to create these magnificent devices. Incredibly, the firm devotes only 3.1 percent of its sales to research and development (R&D),²⁶ considerably under the industry average of 7.1 percent.²⁷ The firm does not rely

on gee-whiz products emanating from years of colossally expensive technology projects. It is the vision of new markets that drives this company's huge success.

New Markets Are Dangerous to Ignore

Some firms choose to stick to their core markets—American Greetings has been a market leader in the greeting card industry for decades, with revenues of about \$1.6 billion in 2009. Unfortunately, those revenues have shrunk since 1990 at an annual rate of 3 percent after inflation. Despite the company rebranding its business as “social expression products,” the stock market seems to find little potential for growth in the company. If Apple's stock traded at American Greetings' earnings multiple, \$140 billion would be knocked from the company's value.

Another outcome of ignoring new markets is illustrated by Blockbuster, the video rental retail chain that once controlled nearly 40 percent of the industry.²⁸ The firm skyrocketed with the spread of VCRs and DVD players. The company seemed unassailable, with over 9,100 stores by 2004.²⁹

Yet, during Blockbuster's best days, the seeds of its demise had already taken root. In 1997, a California film buff named Reed Hastings paid a \$40 late fee when he returned *Apollo 13* to his local video store and had an epiphany. Hastings started a company called Netflix to capture a totally new entertainment market. Rather than compete for spur-of-the-moment rentals to people on their way home from work, Hastings targeted a market that was small because it was poorly served. Netflix renters had to order DVDs in advance over the Internet, receiving them in the mail a couple days later. The benefit was that they could keep them as long as they wanted, paying only a monthly subscription fee and no late charges. This was a terrible proposition for impulsive renters but a great idea for people such as busy parents who had no time to stop at a store and who could never predict which

night their kids would choose for that blissful event—early bedtime. Netflix took off, shipping over 100,000 units a week before it reached its second anniversary of operations.³⁰ The company went public, and the stock soared.

In 2003, a business called Redbox attacked Blockbuster from a different direction. It targeted customers who might be so impulsive that they did not even know they wanted to rent a video. Redbox's business model was influenced by one of its earliest financial backers—the McDonald's restaurant chain.³¹ Placing small, fully automated kiosks in locations such as fast-food restaurants and grocery stores, it offered shoppers a very limited selection of popular videos at the bargain-basement price of \$1 a night. The company quickly succeeded and installed more than 22,000 kiosks across the United States. Like Netflix, it is also growing quickly into the video-on-demand market.³²

For much of this time, Blockbuster did . . . nothing. It enjoyed its highly profitable business and ignored these seemingly insignificant markets. Only in 2004 did the company launch a subscription-based service of its own, with the option of either in-store or mail pickup and delivery. Giving consumers the choice of store or mail theoretically was a superior offering to Netflix, but the service had hidden late charges that created outrage sufficient to prompt lawsuits by the attorneys general of several U.S. states.³³

In 2009, Blockbuster Express was launched as a response to Redbox. Its kiosks rent DVDs at \$1 a night, just like its competitor. There are a few extra bells and whistles, such as the ability to reserve a DVD online, but these features may be irrelevant to the target market for the machines. Redbox has already established itself in many of the best locations, and it may be a tough firm for Blockbuster to beat.³⁴

While Blockbuster pondered how to fight for these new markets, its core business declined. The target customers the company had addressed found that Netflix and Redbox were more convenient and often better value. Blockbuster was stuck with a high-cost business

model due to its retail outlets and so had trouble cutting prices. It became harder and harder for the company to support big stores in prime locations as the number of renters declined. Without big, convenient selection, still more renters defected. The firm entered a downward spiral and ultimately filed for bankruptcy.

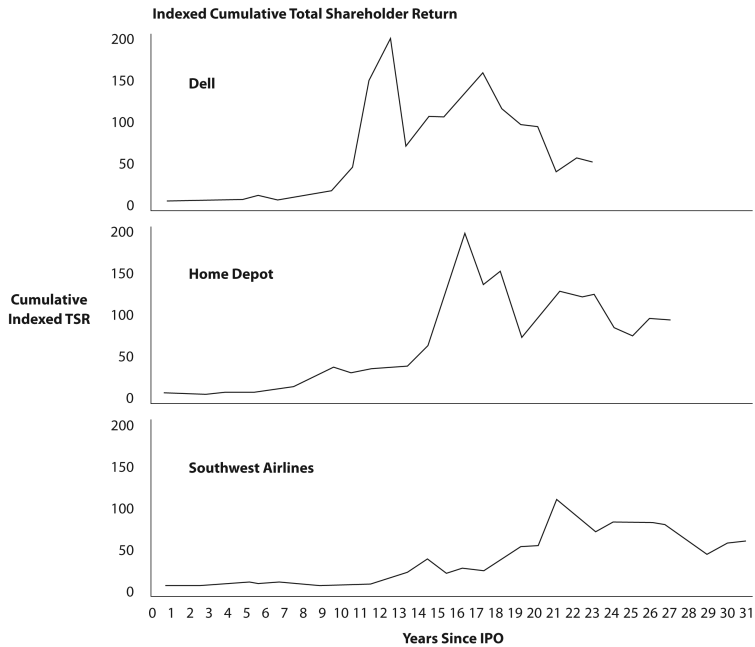
Many firms endure a cycle similar to Blockbuster. Dell grew from a dorm room startup in 1984 to a giant \$107 billion market capitalization 15 years later through its innovative build-to-order business model.³⁵ Dell's approach enabled it to have lower costs than competitors selling through retail channels. Yet the company now seems like a one-trick pony, and its stock trades at less than 40 percent of its value in 2005. Hewlett-Packard, Acer, and other firms emulated Dell's model while being faster to partner with cheaper suppliers. Dell continued to focus on desktop PCs while the market moved to laptops and eventually to inexpensive netbooks. Competitors also upped their game in customer service even as Dell was said to neglect this function because of its cost. In short, competitors copied Dell where they had to, beat it on providing overall value, and embraced new markets that drove industry growth. Dell is still a winner in Intel-based desktop PCs but missed what matters. The industry has moved on.

Some industries seem to have few prospects for such spectacular growth, but often this perspective stems from defining a market in traditional ways.³⁶ Even firms in seemingly static sectors can miss out on major sources of growth by ignoring new markets. Coca-Cola, for example, holds a 42 percent share of the U.S. carbonated soft-drink industry³⁷ but got started late in the nearly \$5 billion market for energy drinks,³⁸ where the best it has been able to muster is a 10 percent share.³⁹ Hertz dominates the airport rental car industry yet largely missed out on the business model embraced by Enterprise Rent-A-Car, which targeted the distinct market of neighborhood-based rentals. Enterprise now holds a 53 percent share of the overall U.S. rental car market, whereas Hertz has only 23 percent.⁴⁰ As this book will

make clear, business history is packed with examples of new markets arising alongside seemingly staid ones.

Whether the outcome of ignoring new markets is stagnation or decline, the moral is straightforward—firms ignore new markets at their peril. Figure 1-2 shows the total shareholder return (stock price change plus dividends) since initial public offering (IPO) of three hugely successful firms: Dell, Home Depot, and Southwest Airlines.⁴¹ After a period of rapid growth as they tackled a new market, these companies stalled. Like Dell, many firms have only one trick up their sleeve; they are great at doing what they do, even when that thing becomes less and less relevant to where growth in the market is continuing to occur.

Figure 1-2 One-trick ponies?



Note: TSR = (closing price + dividends) opening price; prices are adjusted for stock splits and special events
 Source: Yahoo Finance

The Potential for Corporate Renewal in New Markets

On the other side of the coin, some companies have mastered the art of repeatedly identifying and conquering new markets. Netherlands-based Royal Philips Electronics is one such firm. Founded in 1891 as a producer of light bulbs, the company quickly succeeded and by 1910 was the country's largest employer. Philips continues to be a global leader in the lighting business today, selling \$8.3 billion annually. Yet the firm quickly sought to leverage its electronics expertise into new markets. It produced its first medical x-ray tube in 1918. The company targeted certain sectors very aggressively; for example, it entered the nascent radio industry in 1927 and became the world's largest radio manufacturer within five years. It also created new technologies to transform industries, introducing the compact audio cassette in 1963, the compact disc in 1983, and the DVD in 1997.⁴² Lighting now constitutes only 28 percent of company sales, whereas health-care electronics—an industry that did not exist when the company was founded—contributes 34 percent of revenues.

Philips believes in targeting applications, not industries, which creates a dynamic view about what business the company is in. By evolving to meet customers' shifting needs, the firm keeps pioneering new markets. For example, the company has gone beyond offering home health-care devices—where it is a market leader—to providing health-related services for consumers and their employers. Its new DirectLife business provides a mobile monitor to track physical activity, a Web site personalized with data from the monitor, online coaching, and employer-based motivational programs to improve workforce fitness and health.⁴³

Philips is far from unique. Many firms have established a capability to repeatedly create new markets:

- Fidelity Investments pioneered the concept of mutual funds back in 1930. It also created the first discount brokerage in 1978.⁴⁴ The company's innovations enabled consumers to do new things with their money, even if it sometimes meant paying Fidelity higher fees than for a traditional bank savings account. Along the way, Fidelity became one of the world's biggest money managers, responsible for \$1.5 trillion.⁴⁵
- After Medtronic invented the portable pacemaker, it also pioneered the implantable cardiac defibrillator and many other devices to extend and improve the lives of people suffering from heart disease.⁴⁶ Its cardiac rhythm business unit now generates \$4.9 billion in annual sales.
- Johnson & Johnson has brought us the Band-Aid, disposable contact lens, modern hip replacements, and dozens of other market-creating innovations.⁴⁷

The ability to create new markets has led to the sustainable success of these enterprises. Even as established markets slowly declined, new markets have helped to fuel the overall growth of the businesses. These market-creating firms are not one-hit wonders but rather giants that repeatedly throw competitors off balance by redefining their industries.

Why New Markets Matter Now

New markets are particularly relevant in today's economy. As firms emerge from the "great recession," they are seeking new ways to grow. The downturn has left little appetite to take on the high costs of competing head-on against entrenched competitors, and so it is compelling to pioneer businesses with low costs of entry but high potential rewards.

Aside from the short-term economic climate, several long-term trends are also converging to force new markets onto companies' strategic agendas:

- *Globalization.* For many firms, emerging markets are new territory. With 80 percent of the world's population and 40 percent of the global economy, emerging markets account for just 12 percent of sales for the Standard & Poor's (S&P) 500.⁴⁸ While companies may understand at a gut level that they need to play in these settings, they often lack a road map for upending their long-standing business models to attack these new markets. Worse, they fear that enterprises that triumph in this setting may leap into developed markets and threaten incumbents on their home turf. If firms do not play offense in emerging markets now, they soon may be playing defense against globalization's winners.
- *Information.* Thanks to innovations such as the Internet, e-mail, social networks, and cheap telecommunications, information flows far more rapidly today than ever before. The easy availability of information enables markets to form quickly. Niche communities can discover highly relevant new offerings, share experiences, and give confidence to later adopters about the value of these solutions. Yet information also can lead to transparency of competitors' pricing, easy comparison shopping, and commoditization. Industries can rise and decline fast. In this situation, it is imperative to discover new markets that will generate future growth.
- *Virtual sales channels.* As well as enhancing information flows, the Internet has created virtual channels that link pioneers with target customers, bypassing the middlemen who often neglect new markets because of their focus on short-term sales quotas.

Through Google's paid-search advertising, LinkedIn's microtargeting of demographics, and blogs that generate attention virally, the companies creating new markets now can reach nontraditional sets of customers in hyperfocused ways. Moreover, they can communicate their message directly without reliance on channels that can have their own agendas.

- *Open platforms.* Many new markets build on innovations that originally had an entirely different purpose. Global Positioning System (GPS) technology underlies industries such as car navigation devices, vehicle tracking, and location-based advertising. The technology was originated to aid in targeting submarine-launched ballistic missiles.⁴⁹ GPS is an example of an open platform—a technology that is freely available for others to build on. The steam engine, integrated circuit, Internet, radio, and electric grid are other examples. Open platforms can trigger innovation in completely unexpected directions, and the constant acceleration of technical progress generates these platforms at a growing rate.
- *Discontinuities.* Traditional tools for marketing and strategy are predicated on continuous trends from the past to the future. Businesspeople can extrapolate market growth rates, project competitors' shares, estimate profits, and more confidently plan long-term investments. All this information is comforting. Unfortunately, as AT&T discovered in its projection of a global market in 2000 of 900,000 cell phones, these approaches can be profoundly wrong when an industry is experiencing rapid change. Discontinuities seem to be occurring at an ever-faster pace. Competitors from emerging markets, new technologies disrupting traditional industries, concerns about environmental sustainability, dramatic improvements in life expectancy, new communications tools,

and a host of other factors are moving the economy in radically new directions. While change can shut down growth prospects for some firms, such as Blockbuster, it can open up potential for others willing to embrace new markets, such as Netflix.



The economic history of the twentieth century frequently was the story of new markets.⁵⁰ Industry after industry arose to expand consumption, from household cleaning products to information technology services. If this was the case over the past century, what will happen in this one? The trends that made new markets a powerful engine of growth are even stronger today. Businesses that seize the opportunity of new markets may grow enormously. They also can stay vibrant as the economy changes around them.

Summary

- New markets tap latent sources of demand to create new consumption. They arise from creating either new customers or new opportunities for consumption by existing customers.
- New markets are a critical source of both economic and company growth. They have created huge new industries, such as cellular communications, and big firms.
- Even companies in seemingly stable industries jeopardize their future by ignoring new markets. Markets that can seem uninteresting, irrelevant, or invisible can quickly power the success of emerging rivals.

- Some firms, such as Philips, Fidelity Investments, Medtronic, and Johnson & Johnson, have shown that repeated discovery of new markets can power sustained corporate success over decades or longer.
- Several current trends make new markets particularly important today. These include globalization, the free flow of information, the rise of virtual channels, the fast introduction of new open platforms, and economic discontinuities.