HOW TO IDENTIFY DISRUPTIVE NEW BUSINESSES

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ABSTRACT

In almost any industry, the most dramatic stories of growth and success were launched from a platform of disruptive innovation (Christensen et al., 2002). The probability of creating a successful, new growth business is 10 times greater if the innovators pursue a disruptive strategy rather than a sustaining one. Genuinely disruptive innovations are the ones that result in the creation of entirely new markets and business models. Few companies have introduced these innovations. Disruptive innovations appeal to customers who are unattractive to the incumbent companies. According to Christensen (2012) companies that want to create new growth businesses should seek disruptive opportunities because industry leaders will not be motivated to pursue them. The successful disruptive innovators always target customers who welcome simple products and affordable. The disruptive business model strategy needs to be sure that it is unattractive to every powerful incumbent. The purpose of this article is to present the concept of disruption from the perspective of a Social E- Commerce company that is the leader in group buying daily deals in Puerto Rico. In four years, Social Media Group obtained 80% of the market share of the group daily deal companies in the island. It achieved sales of $12.5 million in 2011 and $25 million in 2012. The owners are three brothers of less than 30 years old! The chief of operations is only 26 years old. This is an example of young genius entrepreneurs.

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INTRODUCTION

In almost any industry, the most dramatic stories of growth and success were launched from a platform of disruptive innovation (Christensen *et al.,* 2002). The probability of creating a successful, new growth business is 10 times greater if the innovators pursue a disruptive strategy rather than a sustaining one (Christensen, 1997). Genuinely disruptive innovations are the ones that result in the creation of entirely new markets and business models. Few companies have introduced these innovations. Disruptive innovations appeal to customers who are unattractive to the incumbent companies. According to Christensen (2012) companies that want to create new growth businesses should seek disruptive opportunities because industry leaders will not be motivated to pursue them. The successful disruptive innovators always target customers who welcome simple products and affordable. The disruptive business model strategy needs to be sure that it is unattractive to every powerful incumbent (Dewald and Bowen, 2010).

Social E-commerce is growing at five times the rate of traditional retail channels. New avenues of e-commerce, such as daily deals offered by companies like Groupon and LivingSocial, have boosted the sector's momentum since 2010 (Gridley and Company, 2011, p. 6). The group buying industry has an estimated value of approximately $2.7 billion (Kessler, 2011). This translates into roughly 138% growth in 2011 alone (Kessler, 2011). The rapid growth that both of these companies have experienced in less than five years since their launch dates and the unparalleled pace of adoption and frequency of utilization by consumers, merits an investigation of this emerging business model (Hughes and Beukes, 2012).

The purpose of this article is to present the concept of disruption from the perspective of a Social E-Commerce company that is the leader in group buying daily deals in Puerto Rico. In the last four years, Social Media Group has obtained 80% of the market share of the group daily deal companies in the island. It achieved sales of $12.5 million in 2011 and $31.3 million in 2012. The owners are three brothers of less than 30 years old! The chief of operations is only 26 years old. This is an example of young genius entrepreneurs.

The organization of the article is as follows. The first section describes the relevant literature review of disruptive business models and identifying disruptive new businesses. The next sections are Data and Methodology, Social E-Commerce and Social Media Group. The last section includes concluding comments and recommendations according to Christensen's disruptive theory.

LITERATURE REVIEW

Disruptive Business Model

Disruptive business models introduce threats to existing ways, but also opportunities for new sources of competitive advantage (Markides, 2006). Christensen's landmark disruptive theory explains how fringe ideas come to redefine entire markets, not only explains why new businesses emerge and mature companies fall. It actually helps to predict the future success of new ventures more accurately. Raynor (2011) argues that Disruption theory is the only theory which has been statistically proven to be an effective predictive tool.

Despite the growing shelves of books offering advice on innovation, most managers continue to struggle to create the profitable growth their companies need. What is the reason? The vast majority of management theories base their prescriptions on explanations of the past. When it comes to predicting successful innovation, a willingness to apply the empirical and theoretical rigor of the scientific method to prove what will work in the real world has been notable by its absence (Raynor, 2011).

Established companies in industries as diverse as airlines, media and banking are seeing their markets invaded by new and disruptive business models. The success of invaders such as easyJet, Netflix and ING Direct in capturing market share has encouraged established corporations to respond by adopting the new business models alongside their established ones (Markides and Oyon, 2010). According to Markides and Oyon (2010) the markets that get created by new business models are not necessarily more attractive than existing markets. In addition, the new customers who are attracted to the new business models are not the kinds of customers that established corporations should necessarily pursue. For example, Internet brokerage created a huge market in the United States. Even though this market is big and growing, is it a market that all established brokers ought to go after? The answer is most probably not.

According to Markides (2006) researchers examined the theory behind disruptive technological innovation and identified a number of issues that require further and deeper exploration. The business-model innovation is one type of innovation that tends to be disruptive to established competitors. A Business-model innovation is the discovery of a fundamentally different business model in an existing business. Another type of innovation that tends to be disruptive to the established competitors is radical innovation, which creates new-to-the-world products. A radical innovation is disruptive to consumers because it introduces products and value propositions that disturb prevailing consumer habits and behaviors in a major way (Markides and Oyon, 2010). Christensen, Clayton M. (1997), in his original formulation of disruptive theory, focused primarily on technological innovation and explored how new technologies came to surpass seemingly superior technologies in a market.

Raynor (2011) suggests that all disruptive innovations stem from technological or business model advantages that can scale as disruptive businesses and move upmarket in search of more-demanding customers. These advantages are what enable the extendable core. They differentiate disruption from mere price competition.

“A disruptive innovation is an innovation that transforms the complicated, expensive services and products into things that are so simple and affordable that you and I can use them” (Christensen, 2002). According to Christensen, most of the times at the beginning of an industry, the services or the products that are available are so complicated and expensive that the only people who can participate are people with a lot of money (Richardson, 2010). Christensen (2012) explains that a disruptive technology is an innovation that transforms a product that historically was so complicated and expensive that only people with a lot of money and a lot of skill had access to owning and using it, into a product or a service that is so much more simple and affordable that a much larger population of people can now own it and use it.” It’s not a breakthrough. The meaning in Christensen’s work is simplicity and affordability. “A disruptive innovation describes a process by which a product or service initially begins as a simple application and then moves up market, eventually displacing established competitors.” “An innovation that is disruptive allows a whole new group of consumers’ access to a product or service that was originally only accessible to those who could afford it (Christensen, 2002, 2012).

The characteristics of disruptive businesses, at least in their initial stages, can include: lower gross margins, smaller target markets, and simpler products and services that may not appear as attractive as existing solutions when compared against traditional performance metrics. Because companies tend to innovate faster than their customers’ lives change, most organizations eventually end up producing products or services that are too good, too expensive, and too inconvenient for many customers. By only pursuing sustaining innovations that perpetuate what historically helped them succeed, companies unwittingly open the door to disruptive innovations (Christensen, 2002, 2012).

Identifying Disruptive New Businesses

The disruptive theory developed by Christensen (2002) indicates that most managers understand that significant, new, sustainable growth comes from creating new markets and ways of competing. But few of them make such investments in creating new markets because, first of all, when times are good and core businesses are growing robustly, starting new generations of growth ventures seems unnecessary. Secondly, when times are bad and mature businesses are under attack, investments to create new growth businesses can’t send enough profit to the bottom line quickly enough to satisfy investor pressure for a fast turnaround. The second problem is virtually insurmountable, thus, senior managers must rethink their reluctance to start new ventures in good times. After all, business units that are growing robustly today will become mature, and thus vulnerable, in the future. The only way a corporation can maintain its growth is by launching new growth businesses when the core units are strong. Christensen (2002, 2012) research indicates that “if senior managers pursue this path, and if the growth businesses they start or acquire are truly disruptive, companies will find it less difficult and risky than many have supposed to create wave after wave of new growth.”

According to Christensen’s theory, disruptive innovations appeal to customers who are unattractive to the incumbents. Although they typically involve simple adaptations of known technologies, entrants almost always beat incumbents at this game because established companies lack the motivation to win. In the day-to-day internal competition for resources and attention within large companies, projects that target large, obvious markets, invariably get priority over disruptive ones. Although every major attractive market that exists today, was at its inception small and poorly defined, just as the major growth markets of tomorrow are small and poorly defined today.

Therefore, companies that want to create new growth businesses should seek disruptive opportunities because industry leaders will not be motivated to pursue them. Christensen indicates that this approach applies to venture-backed startups, cash-rich giants and everything in between. According to Christensen’s research, the probability of creating a successful, new growth business is 10 times greater if the innovators pursue a disruptive strategy rather than a sustaining one (Christensen, 1997). Christensen suggests two general strategies for turning ideas into plans for disruptive growth businesses. The first idea requires the creation of a new market that can serve as a base for disruption; the second is based on disruption of the prevailing business model from the low end. The success of each strategy is predicated on the managers' ability to shape ideas that conform to a set of litmus tests. In creating a new market as a base for disruption companies should first search for ways to compete against nonconsumption: people's inability to use available products or services because they are too expensive or too complicated. It's much easier to target potential customers who aren't buying at all than to steal customers from an entrenched competitor. Strategies that disrupt by creating new market applications for entirely new customers should meet the following three litmus tests (Christensen 2002).

Test #1: Does the innovation target customers who in the past haven't been able to "do it themselves" for lack of money or skills? Many of the most successful disruptive growth businesses give people direct access to products or services that had been too expensive or too complex for the mainstream.

Test #2: Is the innovation aimed at customers who will welcome a simple product? If the innovation enables a new population of customers to consume for themselves, it can more easily be shaped to pass the second litmus test: The disruptive product must be technologically straightforward, targeted at customers who will be happy with a simple product. Successful disruptive innovators always target customers who welcome simple products.

Test #3: Will the innovation help customers do more easily and effectively what they are already trying to do? It is important that innovators keep in mind one essential fact: At a fundamental level, the things that people want to accomplish in their lives don't change quickly. According to Christensen, if an idea for a new growth business is predicated on customers wanting to do something that hadn't been a priority in the past, because of this stability, it stands little chance of success.

To succeed in disrupting the business model from the low end, this second strategy must meet two litmus tests. First, it must target the least-demanding tiers of a market in which prevailing products are so good they "over serve" customers. It means that there must be less demanding customers who would happily buy a good-enough product that is cheaper than those currently available. Second, the product must be made and marketed within a disruptive business model. In other words one that enables the entrant to compete profitably while pricing at deep discounts. According to Christensen, managers who shape a strategy to conform to these litmus tests can successfully create a new growth business within an existing market.

Test #1: Are prevailing products more than good enough? If available products aren't yet good enough, a disruptive innovation whose performance is even lower will not gain any traction in the market. Managers who are shaping a disruptive strategy can determine when a product's performance has overshot what customers can use, by examining rigorously market tier by market tier and the extent to which customers are willing to pay premium prices for further improvements in the functionality, reliability or convenience of a product or service. According to Christensen, if companies can sustain price increases in a given tier when they introduce an improvement in one of these areas, customers are not yet over served and that tier cannot be disrupted.

Test #2: Can you create a different business model? If the low end of a market is over served and thus, open to disruption, the second test requires managers to craft a new business model. This new business must be able to earn attractive returns at prices that can steal business at the low end. This disruptive business model consists of a cost structure, operating processes and a distribution system in which profit margins are thinner but net asset turns are higher. Thus, it creates the asymmetric motivation needed for disruptive success.

Therefore, executives who are shaping a low-end disruptive business model strategy need to be sure it is unattractive to every powerful incumbent.

The disruptive strategy needs nourishment to survive in the corporate environment. Its resources, processes and values need to be managed carefully. Managers need to determine which resources, processes and values to leverage to help the new business succeed. The counterintuitive point is that managers whom corporate leaders have learned to trust, because of their success in the mainstream business, probably cannot be counted on to lead a radical new venture. It needs a new team of managers with a disruptive thinking mind.

DATA AND METHODOLOGY

This research is qualitative. The type of study is descriptive. The technique of information gathering used was from interviews of employees and the Chief of operations.

<u>Social e Commerce</u>

Web 2.0 is a phenomenon that has transferred internet and the W.W.W. to a social environment, creating platforms where people can interact and create content online (Hajli, 2013). This advancement has also elevated online communities to a level where new business plans can be developed and implemented (Hajli, 2013). The emergence of Web 2.0 applications transferred human approach to the web and interconnectivity among users (Mueller et al., 2011). This interconnectivity among users created a virtual world which enables people to interact on the internet (Mueller et al., 2011). These social interactions, especially in social networking sites (SNSs), created a new stream in e-commerce. This new stream is social commerce. Social commerce is the use of Web 2.0 and social technologies to support interactions in an online context to support consumers' acquisition of services and products on the internet (Liang and Turban, 2011).

Marsden (2011) refers to social commerce as "a subset of electronic commerce that involves using social media to assist in online buying and selling of products and services." Social e-shopping refers to merging shopping and social networking activities through online social media as an application of Web 2.0 in e-commerce (Kang and Johnson, 2013). It is typified as providing online spaces in which consumers collaborate, post product recommendations and reviews, post photos of themselves wearing products, acquire advice from reliable people, seek the right products, make purchases, and form social shopping communities (Kang and Johnson, 2013). Social e-shopping and social commerce are forms of internet-based social media that enable consumers to actively participate in the marketing and selling of products and services in online communities and marketplaces (Stephen and Toubia, 2010).

The convergence of traditional and electronic business models, as well as traditional and new business practices, are changing the face of global business as we know it today. The group buying/local daily deals e-commerce platform represents the collective bargaining power that individuals can leverage to obtain daily deals on local products, services and "experiences" (Hughes and Beukes, 2012). These local discounted deals are distributed via e-mail and the websites of companies like Groupon and LivingSocial that have established themselves as the sector leaders. In Puerto Rico, the leader in this sector is Gustazos, a subsidiary of Social Media Group.

Social E commerce "is a 'disruptive' innovation that is radically changing the traditional way of doing business" (Lee, 2001, p. 349). It has changed the nature of the value propositions that companies now offer to their customers. The convergence of content sites and social networks has resulted in emerging social e-commerce business models (Hughes and Beukes, 2012). Social E-commerce is growing at five times the rate of traditional retail channels. New avenues of e-commerce, such as daily deals offered by companies like Groupon and LivingSocial, have boosted the sector's momentum since 2010 (Gridley and Company, 2011, p. 6). The group buying industry has an estimated value of approximately $2.7 billion (Kessler, 2011). This translates into roughly 138% growth in 2011 alone (Kessler, 2011).

Groupon has taken the established and unquestioned marketing tactic of utilizing discount coupons and brought it swiftly into the 21st century (Hughes and Beukes, 2012). LivingSocial has brought social interaction and life experiences online. In addition, these new technology platforms provide local businesses with access to their closest customers. Customers become co-creators of value. The emergence of daily deal social group buying sites challenges our traditional understanding of what it takes to build a business that is profitable. It is interesting from both a strategy perspective, as well as a development and growth perspective (Hughes and Beukes, 2012).

According to Hughes and Beukes (2012) the term social e-commerce was coined in 2008 when companies, like Facebook, started to receive massive capital injections. Soon, other companies start to emerge when they realized the massive potential buying power of online social groups, thus they focused on capitalizing on this phenomenon. LivingSocial was one of the first companies of this nature to arise. LivingSocial (originally known as Hungry Machine; trading as Living Social since 2009) was launched in 2007 as a group buying social commerce site (CrunchBase, 2011). It offers customers “handpicked experiences that can be shared with friends” (LivingSocial.com, 2011).

In December 2010, LivingSocial secured $175 million investment from Amazon and an additional $8 million investment from Lightspeed Venture Partners (LivingSocial.com, 2012). More than 60 million users and their acquaintances can save as much as 90 percent per day on everything from restaurant meals to hotels and sporting events (CrunchBase, 2011; LivingSocial, 2012; Gridley and Company, 2011).

Groupon, the fastest growing and biggest daily deal social group buying site and LivingSocial’s biggest competitor, was launched in November 2008. It features a daily deal on “the best stuff to do, see and buy in more than 500 markets and 44 countries” (Groupon, 2011). Within a year, Groupon had one million adherents and today it has 143 million subscribers around the world (Anonymous, 2011). In the first 18 months it went from zero to $500 million in sales.

Social Media Group

Social Media Group (SMG) is a social media company established in 2009 by the Villares brothers in Puerto Rico. SMG is the parent company of Gustazos, the group daily deals leading company in the island with 80% of the market share in that category and 738,401 Facebook Fans (as of October, 2013). Gustazos, as a group daily deals company sells any kind of discount coupons, from hotels to Spas, restaurants, adventure tours, etc. The company has 80 employees in Puerto Rico. The organizational environment of Gustazos is open, relaxed and young. The age of its employees fluctuates between 25 and 35 years old. In addition, Gustazos has offices in Jamaica, Tenerife (Canary Islands), Dominican Republic and Canada.

According to the Royal Academy of the Spanish Language Dictionary, “Gustazo” means great pleasure that someone gives himself doing something unusual, or even harmful, thus satisfying an aspiration, his own pride, or a desire for revenge. The basic idea behind Gustazos business is nothing new. The consumers sign up to receive offers from local firms by e-mail each day. The offers range from restaurant meals to dancing lessons, at discounts of up to 90%. What makes Gustazos really stand out, however, are its margins. Gustazos typically charges businesses half of the discounted price of a voucher. This goes a long way towards explaining why the start-up was able to raise $6 million in 2010, $12.5 million in 2011, and $25 million in 2012.

In the group daily deals sector competition is fierce. Almost anyone can set up a daily-deals site. There are hundreds of clones in the United States of America alone, most specializing in certain product categories.

To help overwhelmed consumers, there is even a service, The Dealmap, which lists all the daily deals available in a city. Big online firms have begun to enter the fray. In December, 2010, Amazon invested $175 million in LivingSocial, the market's number two, which is said to be in talks to raise a further $500 million. In addition, Facebook, the world's biggest social network, will soon start testing local discounts (Anonymous, 2011).

Gustazos target market is high-end businesses, five star hotels, restaurants, spas, etc. In order to improve its efficiency in the hotel services, Gustazos decided to create Guestserve. This is an independent division that manages everything regarding hotel reservations and payments, once the members buy a hotel coupon. In addition, Gustazos has SI3D, Search in 3D, a digital engineering division in charge of design. A new division still in development is 360 hang out. This new division records live concerts with special cameras, getting a 360 view of the place. This is going to be a smartphone application.

Another microbusiness division is called Merodea.me. This division is dedicated to sell fashion design clothing and accessories from designers of Puerto Rico at great discounts. It works by invitation. Members need to register and get invited to be members, and then they are allowed to buy. JoinaJoin is a vacation rental microbusiness division. Anybody that has a vacation property that wants to rent for short time periods use JoinaJoin services. Hidden and secret places are spotted in JoinaJoin.

All of these divisions even though they work independently, use Gustazos resources and membership. In exchange they share profits with Gustazos according to their contracts. In addition, they take advantage of the dynamic organizational culture of this company. The most valuable asset is the people that work in there. They have passion for what they are doing; all are young and have a sense of responsibility and commitment in their jobs. The company is the leader in this market because the owners know the idiosyncrasy of the Puerto Rican culture. Gustazos is disrupting the market with new ideas. All employees are welcome to bring wildest ideas to break the paradigms of social businesses.

Gustazos' mission statement is "Help and encourage people to experience the best life has to offer. "Gustazos offers to its business clients, "an efficient and cost effective way of obtaining what you've always wanted from publicity: new clients!" (This is the slogan written in their web page). The competitors of Gustazos in Puerto Rico are: Oferta del Día (from El Nuevo Día newspaper), Pero Qué Descuentos, Groupon, Cuponeando, Yupiti, Kiero Kiero, Shop PR and GrooPanda. All these competitors are fighting the 20% market share left by Gustazos.

CONCLUDING COMMENTS

The purpose of this article is to present the concept of disruption from the perspective of Social Media Group and its subsidiary Gustazos. This is a qualitative research case study. The information gathered was from interviews of employees and Gustazos' Chief of Operations. Gustazos has disrupted the market of the group buying daily deals in Puerto Rico. It is a sound example of a disrupted business model.

Gustazos is a social commerce company that is the leader in group buying daily deals in Puerto Rico. Its strategies of disrupting the market with new divisions, new technology and developing new markets, have made them the leader in group daily deals in Puerto Rico, capturing 80% of the market in only 4 years. Gustazos created a new market and broke the paradigm of group buying daily deals. Christensen (1997) pointed out that the new markets created by the invading disruptive business model are different from the established market. In the disruptive business theory the most important rule is to adopt a strategy that breaks the rules of the game in that market. This generalization has been supported by many high-profile examples, including Canon's success in entering the copier market, IKEA's entry in the furniture retail business, Southwest's entry in the airline market and Enterprise's entry in the car rental market (Markides and Oyon, 2010).

Gustazos success in entering the new market is because it developed a different business model that makes it simple and affordable the products and services that they are offering. Established companies that succeed in entering the new markets do so by developing radically different business models, different from the one that the disrupters are using and different from the one it employs in its established market. They follow the same logic that disrupters used to attack them. The disrupters companies succeeded in attacking the main market because they used a disruptive business model. If the established corporations want to have the same success, they also need to utilize a disruptive business model to enter the market that the disruptive business model has created. In a sense, they need to "disrupt the disrupter," as Nintendo did in response to Sony and Microsoft in the video games console market. Instead of targeting teenagers and young men as Sony and Microsoft did, Nintendo developed the Wii specifically to target families. Instead of emphasizing functionality, speed and superior graphics (as the PlayStation and Xbox did), the Wii stressed ease of use and simplicity.

The limitations of the study are lack of literature on this topic and lack of knowledge regarding other companies with a disruptive business model. There are very few studies of disruptive businesses. In addition, companies are reluctant to give information about their strategies and organizational environment due to competition “copycats.” This was the case of Gustazos. Further research could answer questions such as what is the impact of disruptive business models on solving social problems. How many cases like Social Media Group exist in Puerto Rico? What can we learn from them?

RECOMMENDATIONS ACCORDING TO CHRISTENSEN’S DISRUPTIVE THEORY

In an increasingly volatile world it is imperative to develop a disruption of your own before it's too late to reap the rewards of participation in new, high-growth markets--as Procter & Gamble did with Swiffer, Dow Corning with Xiameter, and Apple with the iPod, iTunes, the iPad, and (most spectacularly) the iPhone (Wessel and Christensen, 2012).

Companies need to create different processes for evaluating and shaping disruptive ideas (Christensen, 2002). The process starts with training. In most companies, the sales, marketing and engineering employees have the great ideas. Employees at all levels should be trained in the language of sustaining and disruptive innovation and understand the litmus tests so that they know what kinds of ideas they should channel into sustaining processes and what kinds they should direct into disruptive channels.

Capturing ideas for new growth businesses from people in direct contact with markets and technologies is far more productive than relying on analyst-laden business-development departments. Front-line employees are also well positioned to scout for small acquisitions with disruptive potential. Christensen recommends, if the price is reasonable, it is often better to acquire a company whose strategy passes the litmus tests than to start from scratch internally. Creating processes for shaping disruptive business plans ideas with disruptive potential need a destination. Therefore, senior management should create a team at the corporate level that is responsible for collecting disruptive-innovation ideas and molding them into propositions that fit the litmus tests. The members of this team have to understand the litmus tests at a deep level and use them repeatedly. Such experience will help the team develop a collective intuition about how to shape disruptive business plans (Christensen, 2002).

The process for selecting managers needs to employ very different criteria from those used to promote managers within established businesses. The team should coach each new venture’s management on techniques like discovery-driven planning that can speed the emergence of a winning strategy (Christensen, 2002). This team must also be the visible and vocal advocate of new growth businesses. (In Gustazos’ case management is seriously committed to this principle). Christensen recommends that twice a year or so, team members should hold refresher training sessions with sales, marketing and engineering personnel in each operating unit, in order to provide updates on how previous ideas had been shaped into plans for high-potential growth businesses, and to describe why other ideas could not pass the litmus tests.

Processes are defined only when a group of people does something over and over again. These processes for creating disruptive growth businesses need to be honed in a dedicated group. Christensen proposes that starting successful growth businesses isn't as random and failure-fraught as it has appeared. It is complicated, to be sure, but it only appears random, because managers haven't understood the factors that lead to success or cause failure. Spending too much on the wrong strategy in an attempt to get big fast; putting people with inappropriate experience in charge; violating the litmus tests; and launching growth initiatives in an ad hoc manner when it is already too late; are reasons for failure that can be managed and avoided. The executives who understand the potential pitfalls and work to make the creation of disruptive new businesses a corporate process, an organizational capability that is constantly practiced, can start laying the groundwork for a company future blessed by continuous healthy growth (Christensen, 1997, 2002, 2012).

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