

## On Disruption

# Signs that point to danger

**Michael Urlocker**  
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*Trotsky's warning -- "You may not be interested in war, but war is interested in you" -- applies well to businesses facing the threat of disruption. Management consultant Michael Urlocker shows how to identify the early signs of disruption that could disturb a peaceful business.*

Hollywood studios churned out a half-dozen potential blockbuster movies in recent years, including episodes of Harry Potter, Shrek and Pirates of the Caribbean. Yet U.S. movie attendance has been in an accelerating decline since 2002 and fell 8.7% last year.

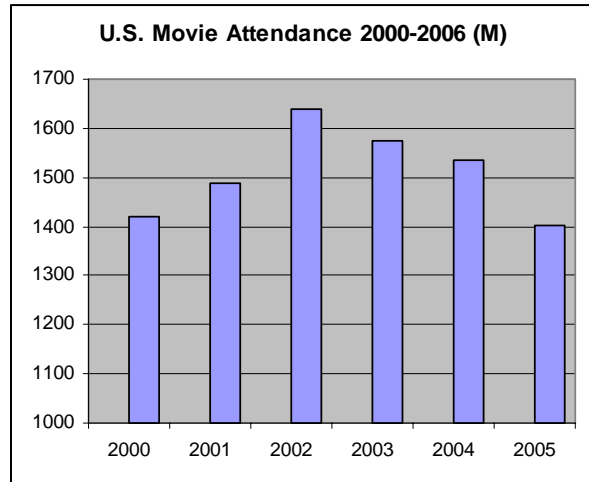
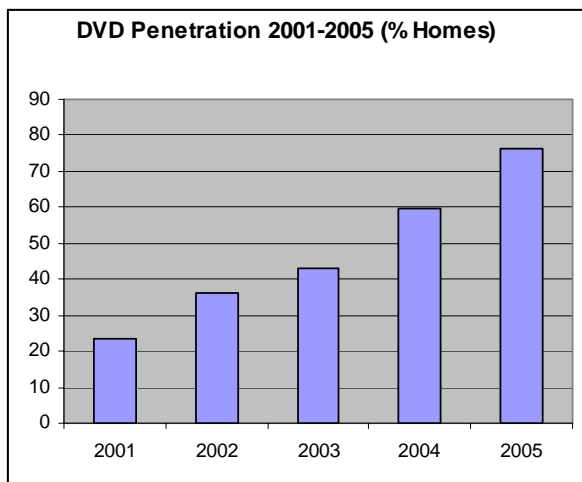
Studio bosses might characterize the trend as a short-term slump, soon to be reversed by the right mix of stars and publicity. With the average movie budget at \$96-million, up 75% since 2000, throwing more money at the problem has long been part of the Hollywood modus operandi.

Yet strange things are afoot:

- The largest studios, including Fox, Disney and Warner Brothers, are making more money in this shrinking market as they squeeze out smaller players.
- Documentary films like Fahrenheit 9/11 and March of the Penguins have become modest hits with more than \$100-million in box office receipts, despite low budgets and absence of stars;
- And YouTube, a bizarre Web site where consumers post their home-made videos, is attracting 100 million downloads daily.

It would seem that the movie industry is being disrupted -- that is, consumers are finding more convenient, alternative ways of being entertained, the most visible of which is watching DVDs at home.

### DVD ubiquity keeps people at home



Source: Motion Picture Association

Edward Jay Epstein, Slate's Hollywood Economist, refers to this as the 55-year "slump" in movie attendance, driven by TV. But with the rise of DVDs, home-theatre systems and high-speed Internet, the decline of the movie is accelerating.

Looking at other industries such as telecommunications, computers and newspaper publishing, disruption seems to play itself out according to the same script. Executives and managers who recognize this pattern can better defend their companies against disruption.

So here are five warning signs of pending disruption that executives can watch for:

- **Rising profit margins:** Sales might flatten or decline but rising margins can lull a company into believing all is well. The reason: disruptive competitors often gain a toehold at the low-end of the market, serving marginal customers, the way VoIP companies like Skype targeted students. Down the road as the disruptive innovation improves, the loyalty of high-end customers vanishes. That's what happened to minicomputer maker Digital Equipment Corp. in the 1980s when the once-lowly PC was able to satisfy mainstream corporate needs.
- **Strange new entrants win:** In the newspaper business, it is an axiom that you need strong local reporters and columnists to differentiate the product for readers and advertisers. Yet Metro International, a global publisher of free tabloid papers in 21 countries, relies heavily on wire copy, a generic news-hole filler. The basis of competition for commuting newspaper readers shifted some time in the past 20 years: Readers care more about convenience than they do about familiar columnists and writers.
- **Experts no longer required:** Disruptors may have products or services that open up markets by eliminating the need for expertise. For example, software from Blogger or TypePad lets consumers create and launch their own Web sites in about 15 minutes. No expert HTML programmers or network engineers needed. The trend of simplified products is especially cruel to companies with an engineering culture because it carries the painful lesson that technically superior products do not always win. Do-it-yourself trends have taken hold of other expert-dominated sectors such as the investment business and even dental care, with home-whitening products.
- **Price becomes the dominant factor:** When customers gripe about price, they are signalling that they are more than satisfied with the current product. The only way out of commoditization is to create not a better commodity, or a lower price, but a product or service that changes the game, often by offering customization or convenience rather than lower price. Starbucks (customized lattes) and Research In Motion (convenience of e-mail anywhere) earn superior profits in otherwise commoditized markets because they avoided the me-too trap by creating something different.
- **The trusted approach fails:** If what always worked in the past starts to fail, it may be a stark warning that customers are now valuing different attributes. Intel and Microsoft had a great gig running for 20 years: A seemingly perpetual upgrade cycle because new, more powerful PCs were needed to run more powerful software. But some time around 2001, that approach started to fail because PCs became good enough for most users. Likewise, cable-TV and telephone companies have been locked in a battle to provide faster Internet service for the past eight years. The speed war hasn't failed yet, but it might soon.

### Signs Your Business Faces Disruption

Sign	Example
Rising margins	Minicomputer industry
Strange new entrants	Free commuter newspapers
Experts no longer needed	Online trading and Internet research
Commoditized pricing	Telephone service Bigger budget movies draw smaller audiences
Tried & true methods fail	

Source: Northern Technology & Telecom Research Inc.

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