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# Value Innovation: The Strategic Logic of High Growth

by W. Chan Kim and Renée Mauborgne



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*What separates high-growth companies from the pack is the way managers make sense of how they do business.*

# Value Innovation: The Strategic Logic of High Growth

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After a decade of downsizing and increasingly intense competition, profitable growth is a tremendous challenge many companies face. Why do some companies achieve sustained high growth in both revenues and profits? In a five-year study of high-growth companies and their less successful competitors, we found that the answer lies in the way each group approached strategy. The difference in approach was not a matter of managers choosing one analytical tool or planning model over another. The difference was in the companies' fundamental, implicit assumptions about strategy. The less successful companies took a conventional approach: their strategic thinking was dominated by the idea of staying ahead of the competition. In stark contrast, the high-growth companies paid little attention to matching or beating their rivals. Instead, they sought to make their competitors irrelevant through a strategic logic we call *value innovation*.

Consider Bert Claeys, a Belgian company that operates movie theaters. From the 1960s to the 1980s, the movie theater industry in Belgium was declining steadily. With the spread of videocassette recorders and satellite and cable television, the average Belgian's moviegoing dropped from eight to two times per year. By the 1980s, many cinema operators (COs) were forced to shut down.

The COs that remained found themselves competing head-to-head for a shrinking market. All

took similar actions. They turned cinemas into multiplexes with as many as ten screens, broadened their film offerings to attract all customer segments, expanded their food and drink services, and increased showing times.

Those attempts to leverage existing assets became irrelevant in 1988, when Bert Claeys created Kinopolis. Neither an ordinary cinema nor a multiplex, Kinopolis is the world's first megaplex, with 25 screens and 7,600 seats. By offering moviegoers a radically superior experience, Kinopolis won 50% of the market in Brussels in its first year and expanded the market by about 40%. Today many Belgians refer not to a night at the movies but to an evening at Kinopolis.

Consider the differences between Kinopolis and other Belgian movie theaters. The typical Belgian multiplex has small viewing rooms that often have no more than 100 seats, screens that measure 7 meters by 5 meters, and 35-millimeter projection equipment. Viewing rooms at Kinopolis have up to 700 seats, and there is so much legroom that viewers do not have to move when someone passes by.

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## Researching the Roots of High Growth

Over the last five years, we studied more than 30 companies around the world in approximately 30 industries. We looked at companies with high growth in both revenues and profits and companies with less successful performance records. In an effort to explain the difference in performance between the two groups of companies, we interviewed hundreds of managers, analysts, and researchers. We built strategic, organizational, and performance profiles. We looked for industry or organizational patterns. And we compared the two groups of companies along dimensions that are often thought to be related to a company's potential for growth. Did private companies grow more quickly than public ones? What was the impact on companies of the overall growth of their industry? Did entrepreneurial start-ups have an edge over established incumbents? Were companies led by creative, young radicals likely to grow faster than those run by older managers?

We found that none of those factors mattered in a systematic way. High growth was achieved by both small and large organizations, by companies in high-tech and low-tech industries, by new entrants and incumbents, by private and public companies, and by companies from various countries.

What did matter—consistently—was the way managers in the two groups of companies thought about

strategy. In interviewing the managers, we asked them to describe their strategic moves and the thinking behind them. Thus we came to understand their views on each of the five textbook dimensions of strategy: industry assumptions, strategic focus, customers, assets and capabilities, and product and service offerings. We were struck by what emerged from our content analysis of those interviews. The managers of the high-growth companies—irrespective of their industry—all described what we have come to call the logic of value innovation. The managers of the less successful companies all thought along conventional strategic lines.

Intrigued by that finding, we went on to test whether the managers of the high-growth companies applied their strategic thinking to business initiatives in the marketplace. We found that they did.

Furthermore, in studying the business launches of about 100 companies, we were able to quantify the impact of value innovation on a company's growth in both revenues and profits. Although 86% of the launches were line extensions—that is, incremental improvements—they accounted for 62% of total revenues and only 39% of total profits. The remaining 14% of the launches—the true value innovations—generated 38% of total revenues and a whopping 61% of total profits.

Bert Claeys installed oversized seats with individual armrests and designed a steep slope in the floor to ensure everyone an unobstructed view. At Kinopolis, screens measure up to 29 meters by 10 meters and rest on their own foundations so that sound vibrations are not transmitted from one screen to another. Many viewing rooms have 70-millimeter projection equipment and state-of-the-art sound equipment. And Bert Claeys challenged the industry's conventional wisdom about the importance of prime, city-center real estate by locating Kinopolis off the ring road circling Brussels, 15 minutes from downtown. Patrons park for free in large, well-lit lots. The company was prepared to lose out on foot traffic in order to solve a major problem for the majority of moviegoers in Brussels: the scarcity and high cost of parking.

Bert Claeys can offer this radically superior cinema experience without increasing the price of tickets because the concept of the megaplex results in one of the lowest cost structures in the industry. The average cost to build a seat at Kinopolis is about 70,000 Belgian francs, less than half the industry's average in Brussels. Why? The megaplex's

location outside the city is cheaper; its size gives it economies in purchasing, more leverage with film distributors, and better overall margins; and with 25 screens served by a central ticketing and lobby area, Kinopolis achieves economies in personnel and overhead. Furthermore, the company spends very little on advertising because its value innovation generates a lot of word-of-mouth praise.

Within its supposedly unattractive industry, Kinopolis has achieved spectacular growth and profits. Belgian moviegoers now go to the cinema more frequently because of Kinopolis, and people who never went to the movies have been drawn into the market. Instead of battling competitors over targeted segments of the market, Bert Claeys made the competition irrelevant. (See the chart "How Kinopolis Achieves Profitable Growth.")

Why did other Belgian COs fail to seize that opportunity? Like the others, Bert Claeys was an incumbent with sunk investments: a network of cinemas across Belgium. In fact, Kinopolis would have represented a smaller investment for some COs than it did for Bert Claeys. Most COs were thinking—implicitly or explicitly—along these lines: The

industry is shrinking, so we should not make major investments—especially in fixed assets. But we can improve our performance by outdoing our competitors on each of the key dimensions of competition. We must have better films, better services, and better marketing.

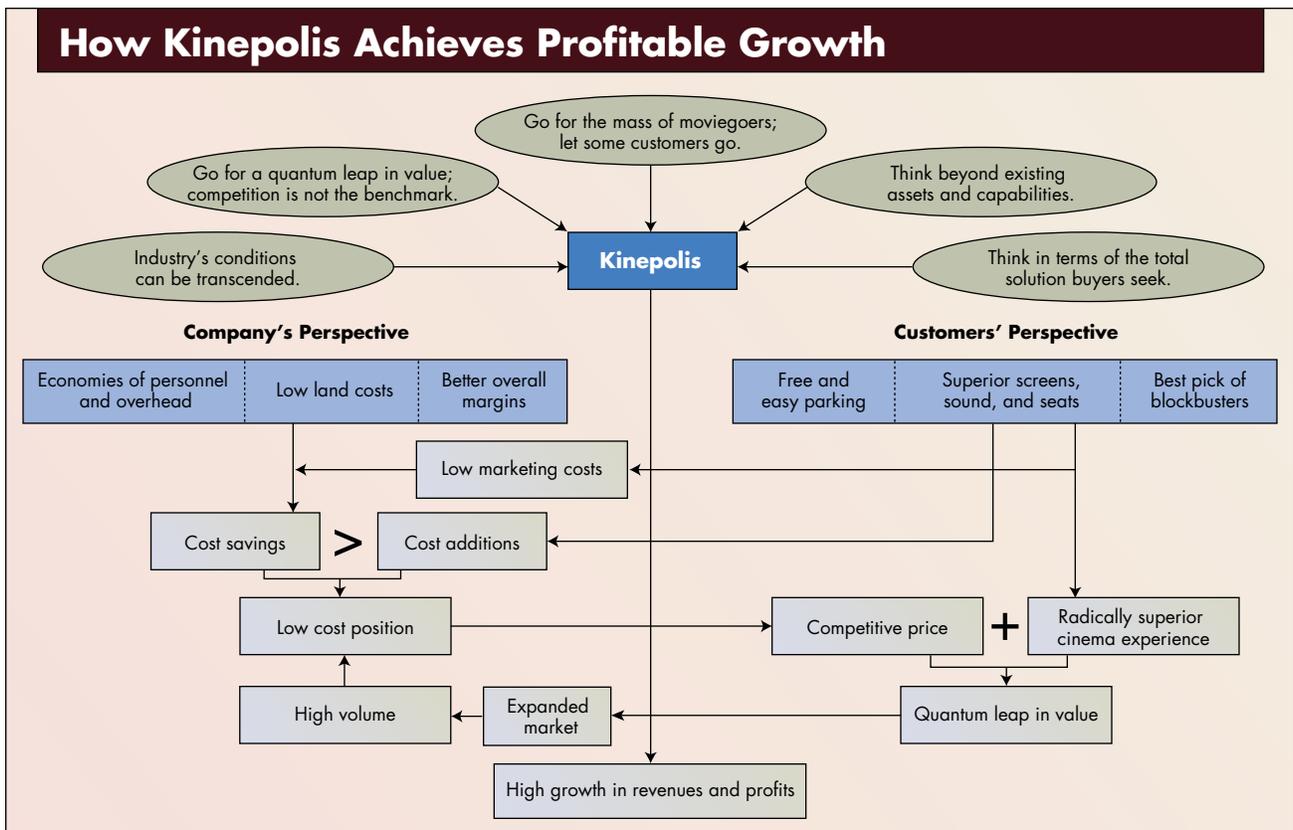
Bert Claeys followed a different strategic logic. The company set out to make its cinema experience not better than that at competitors' theaters but completely different—and irresistible. The company thought as if it were a new entrant to the market. It sought to reach the mass of moviegoers by focusing on widely shared needs. In order to give most moviegoers a package they would value highly, the company put aside conventional thinking about what a theater is supposed to look like. And the company did all that while reducing its costs. That's the logic behind value innovation.

### Conventional Logic Versus Value Innovation

Conventional strategic logic and the logic of value innovation differ along the five basic dimensions of strategy. Those differences determine which questions managers ask, what opportunities they see and pursue, and how they understand risk. (See the table "Two Strategic Logics.")

**Industry Assumptions.** Many companies take their industry's conditions as given and set strategy accordingly. Value innovators don't. No matter how the rest of the industry is faring, value innovators look for blockbuster ideas and quantum leaps in value. Had Bert Claeys, for example, taken its industry's conditions as given, it would never have created a megaplex. The company would have followed the endgame strategy of milking its business or the zero-sum strategy of competing for share in a shrinking market. Instead, through Kinopolis, the company transcended the industry's conditions.

**Strategic Focus.** Many companies let competitors set the parameters of their strategic thinking. They compare their strengths and weaknesses with those of their competitors and focus on building advantages. Consider this example. For years, the major U.S. television networks used the same format for news programming. All aired shows in the same time slot and competed on their analysis of events, the professionalism with which they delivered the news, and the popularity of their anchors. In 1980, CNN came on the scene with a focus on creating a quantum leap in value, not on competing with the networks. CNN replaced the networks' format with real-time news from around the world 24 hours a day. CNN not only emerged as the leader in global news broadcasting—and created new de-



## Two Strategic Logics

The Five Dimensions of Strategy	Conventional Logic	Value Innovation Logic
<b>Industry Assumptions</b>	Industry's conditions are given.	Industry's conditions can be shaped.
<b>Strategic Focus</b>	A company should build competitive advantages. The aim is to beat the competition.	Competition is not the benchmark. A company should pursue a quantum leap in value to dominate the market.
<b>Customers</b>	A company should retain and expand its customer base through further segmentation and customization. It should focus on the differences in what customers value.	A value innovator targets the mass of buyers and willingly lets some existing customers go. It focuses on the key commonalities in what customers value.
<b>Assets and Capabilities</b>	A company should leverage its existing assets and capabilities.	A company must not be constrained by what it already has. It must ask, What would we do if we were starting anew?
<b>Product and Service Offerings</b>	An industry's traditional boundaries determine the products and services a company offers. The goal is to maximize the value of those offerings.	A value innovator thinks in terms of the total solution customers seek, even if that takes the company beyond its industry's traditional offerings.

mand around the world – but also was able to produce 24 hours of real-time news for one-fifth the cost of 1 hour of network news.

Conventional logic leads companies to compete at the margin for incremental share. The logic of value innovation starts with an ambition to dominate the market by offering a tremendous leap in value. Value innovators never say, Here's what competitors are doing; let's do this in response. They monitor competitors but do not use them as benchmarks. Hasso Plattner, vice chairman of SAP, the global leader in business-application software, puts it this way: "I'm not interested in whether we are better than the competition. The real test is, will most buyers still seek out our products even if we don't market them?"

Because value innovators do not focus on competing, they can distinguish the factors that deliver superior value from all the factors the industry competes on. They do not expend their resources to offer certain product and service features just because that is what their rivals are doing. CNN, for example, decided not to compete with the networks in the race to get big-name anchors. Companies that follow the logic of value innovation free up their resources to identify and deliver completely new sources of value. Ironically, value innovators do not set out to build advantages over the competition, but they end up achieving the greatest competitive advantages.

**Customers.** Many companies seek growth through retaining and expanding their customer

bases. This often leads to finer segmentation and greater customization of offerings to meet specialized needs. Value innovation follows a different logic. Instead of focusing on the differences among customers, value innovators build on the powerful commonalities in the features that customers value. In the words of a senior executive at the French hotelier Accor, "We focus on what unites customers. Customers' differences often prevent you from seeing what's most important." Value innovators believe that most people will put their differences aside if they are offered a considerable increase in value. Those companies shoot for the core of the market, even if it means that they lose some of their customers.

**Assets and Capabilities.** Many companies view business opportunities through the lens of their existing assets and capabilities. They ask, Given what we have, what is the best we can do? In contrast, value innovators ask, What if we start anew? That is the question the British company Virgin Group put to itself in the late 1980s. The company had a sizable chain of small music stores across the United Kingdom when it came up with the idea of mega-stores for music and entertainment, which would offer customers a tremendous leap in value. Seeing that its small stores could not be leveraged to seize that opportunity, the company decided to sell off the entire chain. As one of Virgin's executive puts it, "We don't let what we can do today condition our view of what it takes to win tomorrow. We take a clean-slate approach."

This is not to say that value innovators never leverage their existing assets and capabilities. They often do. But, more important, they assess business opportunities without being biased or constrained by where they are at a given moment. For that reason, value innovators not only have more insight into where value for buyers resides – and how it is changing – but also are much more likely to act on that insight.

**Product and Service Offerings.** Conventional competition takes place within clearly established boundaries defined by the products and services the industry traditionally offers. Value innovators often cross those boundaries. They think in terms of the total solution buyers seek, and they try to overcome the chief compromises their industry forces customers to make – as Bert Claeys did by providing free parking. A senior executive at Compaq Computer describes the approach: “We continually ask where our products and services fit in the total chain of buyers’ solutions. We seek to solve buyers’ major problems across the entire chain, even if that takes us into a new business. We are not limited by the industry’s definition of what we should and should not do.”

## Creating a New Value Curve

How does the logic of value innovation translate into a company’s offerings in the marketplace? Consider the case of Accor. In the mid-1980s, the budget hotel industry in France was suffering from stagnation and overcapacity. Accor’s cochairmen, Paul Dubrule and Gérard Pélisson, challenged the company’s managers to create a quantum leap in value for customers. The managers were urged to forget everything they knew about the existing rules, practices, and traditions of the industry. They were asked what they would do if Accor were starting fresh.

In 1985, when Accor launched Formule 1, a line of budget hotels, there were two distinct market segments in the budget hotel industry. One segment consisted of no-star and one-star hotels, whose average price per room was between 60 and 90 French francs. Customers came to those hotels just for the low price. The other segment was two-star hotels, with an average price of 200 francs per room. Those more expensive hotels attracted customers by offering a better sleeping environment than the no-star and one-star hotels. People had come to expect that they would get what they paid for: either they would pay more and get a decent night’s sleep or they would pay less and put up with poor beds and noise.

Accor’s managers began by identifying what customers of all budget hotels – no-star, one-star, and two-star – wanted: a good night’s sleep for a low price. Focusing on those widely shared needs, Accor’s managers saw the opportunity to overcome the chief compromise that the industry forced customers to make. They asked themselves the following four questions:

- Which of the factors that our industry takes for granted should be eliminated?
- Which factors should be reduced well below the industry’s standard?
- Which factors should be raised well above the industry’s standard?
- Which factors should be created that the industry has never offered?

The first question forces managers to consider whether the factors that companies compete on actually deliver value to consumers. Often those factors are taken for granted, even though they have no value or even detract from value. Sometimes what buyers value changes fundamentally, but companies that are focused on benchmarking one another do not act on – or even perceive – the change. The second question forces managers to determine whether products and services have been over-designed in the race to match and beat the competition. The third question pushes managers to uncover and eliminate the compromises their industry forces customers to make. The fourth question helps managers break out of the industry’s established boundaries to discover entirely new sources of value for consumers.

In answering the questions, Accor came up with a new concept for a hotel, which led to the launch of Formule 1. First, the company eliminated such standard hotel features as costly restaurants and appealing lounges. Accor reckoned that even though it might lose some customers, most people would do without those features.

Accor’s managers believed that budget hotels were overserving customers along other dimensions as well. On those, Formule 1 offers less than many no-star hotels do. For example, receptionists are on hand only during peak check-in and check-out hours. At all other times, customers use an automated teller. Rooms at a Formule 1 hotel are small and equipped only with a bed and bare necessities – no stationery, desks, or decorations. Instead of closets and dressers, there are a few shelves and a pole for clothing in one corner of the room. The rooms themselves are modular blocks manufactured in a factory – a method that results in economies of scale in production, high quality control, and good sound insulation.

Formule 1 gives Accor considerable cost advantages. The company cut in half the average cost of building a room, and its staff costs dropped from between 25% and 35% of sales – the industry’s average – to between 20% and 23%. Those cost savings have allowed Accor to improve the features customers value most to levels beyond those of the average French two-star hotel, but the price is only marginally above that of one-star hotels.

Customers have rewarded Accor for its value innovation. The company has not only captured the mass of French budget-hotel customers but also expanded the market. From truck drivers who previously slept in their vehicles to businesspeople needing a few hours of rest, new customers have been drawn to the budget category. Formule 1 made the competition irrelevant. At last count, Formule 1’s market share in France was greater than the sum of the five next-largest players.

The extent of Accor’s departure from the conventional logic of its industry can be seen in what we call a *value curve* – a graphic depiction of a company’s relative performance across its industry’s key success factors. (See the graph “Formule 1’s Value

Curve.”) According to the conventional logic of competition, an industry’s value curve follows one basic shape. Rivals try to improve value by offering a little more for a little less, but most don’t challenge the shape of the curve.

Like Accor, all the high-performing companies we studied created fundamentally new and superior value curves. They achieved that by a combination of eliminating features, creating features, and reducing and raising others to levels unprecedented in their industries. Take, for example, SAP, a business-application-software company that was started in the early 1970s by five former IBM employees in Walldorf, Germany, and became the worldwide industry leader. Until the 1980s, business-application-software makers focused on subsegmenting the market and customizing their offerings to meet buyers’ functional needs, such as production management, logistics, human resources, and payroll.

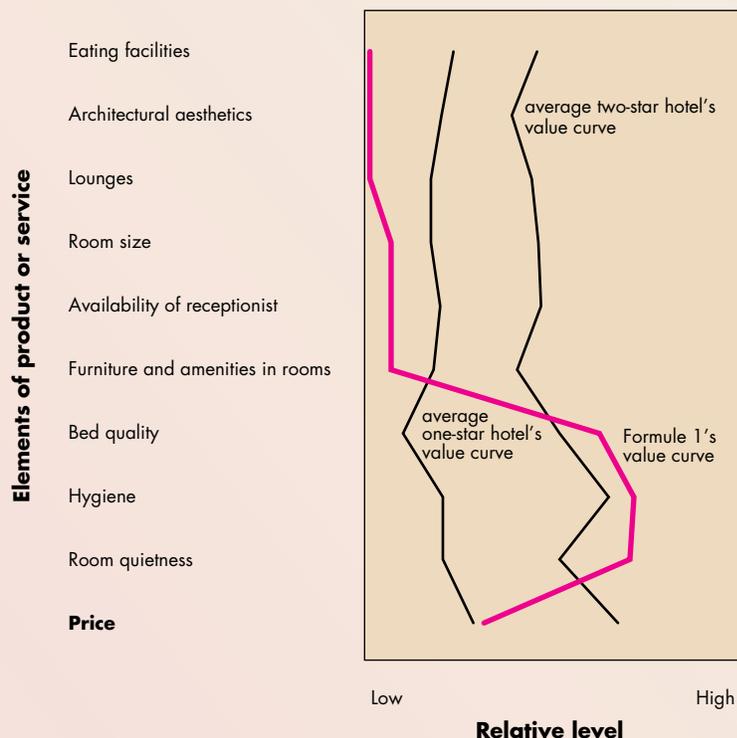
While most software companies were focusing on improving the performance of particular application products, SAP took aim at the mass of buyers. Instead of competing on customers’ differences, SAP sought out important commonalities in

what customers value. The company correctly hypothesized that for most customers, the performance advantages of highly customized, individual software modules had been overestimated. Such modules forfeited the efficiency and information advantages of an integrated system, which allows real-time data exchange across a company.

In 1979, SAP launched R/2, a line of real-time, integrated business-application software for mainframe computers. R/2 has no restriction on the platform of the host hardware; buyers can capitalize on the best hardware available and reduce their maintenance costs dramatically. Most important, R/2 leads to huge gains in accuracy and efficiency because a company needs to enter its data only once. And R/2 improves the flow of information. A sales manager, for example, can find out when a product will be delivered and why it is late by cross-referencing the production database. SAP’s growth and profits have exceed-

### Formule 1’s Value Curve

Formule 1 offers unprecedented value to the mass of budget hotel customers in France by giving them much more of what they need most and much less of what they are willing to do without.



ed its industry's. In 1992, SAP achieved a new value innovation with R/3, a line of software for the client-server market.

## The Trap of Competing, the Necessity of Repeating

What happens once a company has created a new value curve? Sooner or later, the competition tries to imitate it. In many industries, value innovators do not face a credible challenge for many years, but in others, rivals appear more quickly. Eventually, however, a value innovator will find its growth and profits under attack. Too often, in an attempt to defend its hard-earned customer base, the company launches offenses. But the imitators often persist, and the value innovator – despite its best intentions – may end up in a race to beat the competition. Obsessed with hanging on to market share, the company may fall into the trap of conventional strategic logic. If the company doesn't find its way out of the trap, the basic shape of its value curve will begin to look just like those of its rivals.

Consider the following example. When Compaq Computer launched its first personal computer in 1983, most PC buyers were sophisticated corporate users and technology enthusiasts. IBM had defined the industry's value curve. Compaq's first offering – the first IBM-compatible PC – represented a completely new value curve. Compaq's product not only was technologically superb but also was priced roughly 15% below IBM's. Within three years of its start-up, Compaq joined the *Fortune* 500. No other company had ever achieved that status as quickly.

How did IBM respond? It tried to match and beat Compaq's value curve. And Compaq, determined to defend itself, became focused on beating IBM. But while IBM and Compaq were battling over feature enhancements, most buyers were becoming more sensitive to price. User-friendliness was becoming more important to customers than the latest technology. Compaq's focus on competing with IBM led the company to produce a line of PCs that were overengineered and overpriced for most buyers. When IBM walked off the cliff in the late 1980s, Compaq was following close behind.

Could Compaq have foreseen the need to create another value innovation rather than go head-to-head against IBM? If Compaq had monitored the industry's value curves, it would have realized that by the mid to late 1980s, IBM's and other PC makers' value curves were converging with its own. And by the late 1980s, the curves were nearly identical. That should have been the signal to Compaq that it was time for another quantum leap.

Monitoring value curves may also keep a company from pursuing innovation when there is still a huge profit stream to be collected from its current offering. In some rapidly emerging industries, companies must innovate frequently. In many other industries, companies can harvest their successes for a long time: a radically different value curve is difficult for incumbents to imitate, and the volume advantages that come with value innovation make imitation costly. Kinopolis, Formule 1, and CNN, for example, have enjoyed uncontested dominance for a long time. CNN's value innovation was not challenged for almost ten years. Yet we have seen companies pursue novelty for novelty's sake, driven by internal pressures to leverage unique competencies or to apply the latest technology. Value innovation is about offering unprecedented value, not technology or competencies. It is not the same as being first to market.

When a company's value curve is fundamentally different from that of the rest of the industry – and the difference is valued by most customers – managers should resist innovation. Instead, companies should embark on geographic expansion and operational improvements to achieve maximum economies of scale and market coverage. That approach discourages imitation and allows companies to tap the potential of their current value innovation. Bert Claey's, for example, has been rapidly rolling out and improving its Kinopolis concept with Metropolis, a megaplex in Antwerp, and with megaplexes in many countries in Europe and Asia. And Accor has already built more than 300 Formule 1 hotels across Europe, Africa, and Australia. The company is now targeting Asia.

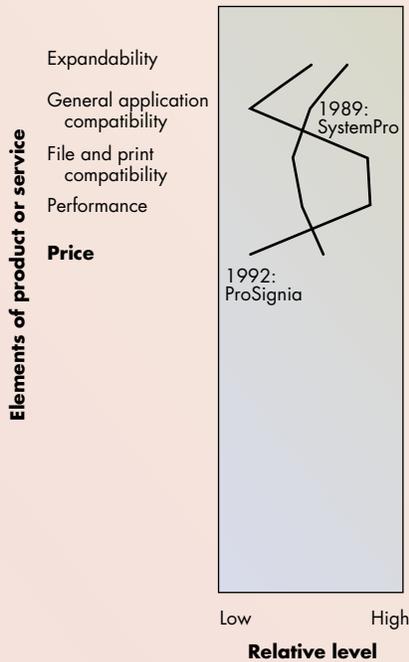
## The Three Platforms

The companies we studied that were most successful at repeating value innovation were those that took advantage of all three platforms on which value innovation can take place: product, service, and delivery. The precise meaning of the three platforms varies across industries and companies, but, in general, the product platform is the physical product; the service platform is support such as maintenance, customer service, warranties, and training for distributors and retailers; and the delivery platform includes logistics and the channel used to deliver the product to customers.

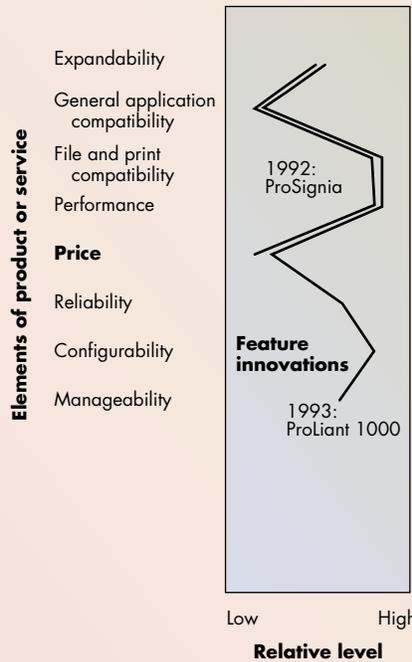
Too often, managers trying to create a value innovation focus on the product platform and ignore the other two. Over time, that approach is not likely to yield many opportunities for repeated value innovation. As customers and technologies change, each

## How Has Compaq Stayed on Top of the Server Industry?

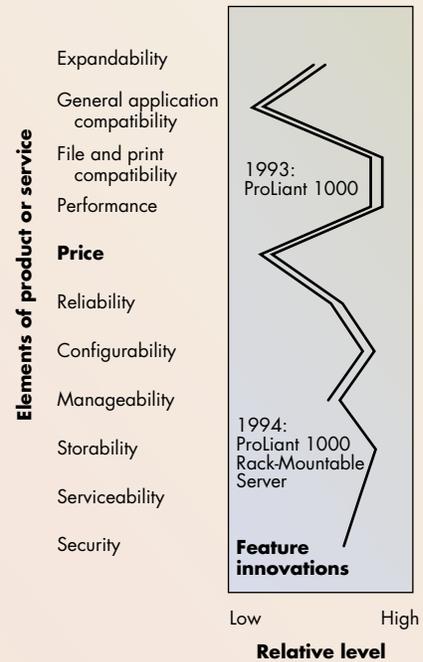
By following its first value innovation...



...with another



...and then another



platform presents new possibilities. Just as good farmers rotate their crops, good value innovators rotate their value platforms. (See the insert "Virgin Atlantic: Flying in the Face of Conventional Logic.")

The story of Compaq's server business, which was part of the company's successful comeback, illustrates how the three platforms can be used alternately over time to create new value curves. (See the graph "How Has Compaq Stayed on Top of the Server Industry?") In late 1989, Compaq introduced its first server, the SystemPro, which was designed to run five network operating systems—SCO UNIX, OS/2, Vines, NetWare, and DOS—and many application programs. Like the SystemPro, most servers could handle many operating systems and application programs. Compaq observed, however, that the majority of customers used only a small fraction of a server's capacity. After identifying the needs that cut across the mass of users, Compaq decided to build a radically simplified server that would be optimized to run NetWare and file and print only. Launched in 1992, the ProSignia was a value innovation on the product platform. The new server gave buyers twice the SystemPro's file-and-print performance at one-third the price. Compaq achieved that value innovation mainly by reducing general application compatibility—a reduction that translated into much lower manufacturing costs.

As competitors tried to imitate the ProSignia and value curves in the industry began to converge, Compaq took another leap, this time from the service platform. Viewing its servers not as stand-alone products but as elements of its customers' total computing needs, Compaq saw that 90% of customers' costs were in servicing networks and only 10% were in the server hardware itself. Yet Compaq, like other companies in the industry, had been focusing on maximizing the price-performance ratio of the server hardware, the least costly element for buyers.

Compaq redeployed its resources to bring out the ProLiant 1000, a server that incorporates two innovative pieces of software. The first, SmartStart, configures server hardware and network information to suit a company's operating system and application programs. It slashes the time it takes a customer to configure a server network and makes installation virtually error-free so that servers perform reliably from day one. The second piece of software, Insight Manager, helps customers manage their server networks by, for example, spotting overheating boards or troubled disk drives before they break down.

By innovating on the service platform, Compaq created a superior value curve and expanded its market. Companies lacking expertise in informa-

tion technology had been skeptical of their ability to configure and manage a network server. SmartStart and Insight Manager helped put those companies at ease. The ProLiant 1000 came out a winner.

As more and more companies acquired servers, Compaq observed that its customers often lacked the space to store the equipment properly. Stuffed into closets or left on the floor with tangled wires, expensive servers were often damaged, were certainly not secure, and were difficult to service.

By focusing on customer value—not on competitors—Compaq saw that it was time for another value innovation on the product platform. The company introduced the ProLiant 1000 Rack-Mountable Server, which allows companies to store servers in a tall, lean cabinet in a central location. The product makes efficient use of space and ensures that machines are protected and are easy to monitor, repair, and enhance. Compaq designed the rack mount to fit both its products and those of other manufacturers, thus attracting even more buyers and discouraging imitation. The company's sales

and profits rose again as its new value curve diverged from the industry's.

Compaq is now looking to the delivery platform for a value innovation that will dramatically reduce the lead time between a customer's order and the arrival of the equipment. Lead times have forced customers to forecast their needs—a difficult task—and have often required them to patch together costly solutions while waiting for their orders to be filled. Now that servers are widely used and the demands placed on them are multiplying rapidly, Compaq believes that shorter lead times will provide a quantum leap in value for customers. The company is currently working on a delivery option that will permit its products to be built to customers' specifications and shipped within 48 hours of the order. That value innovation will allow Compaq to reduce its inventory costs and minimize the accumulation of outdated stock.

By achieving value innovations on all three platforms, Compaq has been able to maintain a gap between its value curve and those of other players.

## Virgin Atlantic: Flying in the Face of Conventional Logic

When Virgin Atlantic Airways challenged its industry's conventional logic by eliminating first-class service in 1984, the airline was simply following the logic of value innovation. Most of the industry's profitable revenue came from business class, not first class. And first class was a big cost generator. Virgin spotted an opportunity. The airline decided to channel the cost it would save by cutting first-class service into value innovation for business-class passengers.

First, Virgin introduced large, reclining sleeper seats, raising seat comfort in business class well above the industry's standard. Second, Virgin offered free transportation to and from the airport—initially in chauffeured limousines and later in specially designed motorcycles called LimoBikes—to speed business-class passengers through snarled city traffic.

With those innovations, which were on the product and service platforms, Virgin attracted not only a large share of the industry's business-class customers but also some full-economy-fare and first-class passengers of other airlines. Virgin's value innovation separated the company from the pack for many years, but the competition did not stand still. As the value curves of some other airlines began converging with Virgin's value curve, the company went for another leap in value, this time from the service platform.

Virgin observed that most business-class passengers want to use their time productively before and be-

tween flights and that, after long-haul flights, they want to freshen up and change their wrinkled clothes before going to meetings. The airline designed lounges where passengers can have their clothes pressed, take showers, enjoy massages, and use state-of-the-art office equipment. The service allows busy executives to make good use of their time and go directly to meetings without first stopping at their hotels—a tremendous value for customers that generates high volume for Virgin. The airline has one of the highest sales per employee in the industry, and its costs per passenger mile are among the lowest. The economics of value innovation create a positive and reinforcing cycle.

When Virgin first challenged the industry's assumptions, its ideas were met with a great deal of skepticism. After all, conventional wisdom says that in order to grow, a company must embrace *more*, not fewer, market segments. But Virgin deliberately walked away from the revenue generated by first-class passengers. And it further violated conventional wisdom by conceiving of its business in terms of customer solutions, even if that took the company well beyond an airline's traditional offerings. Virgin has applied the logic of value innovation not just to the airline industry but also to insurance and to music and entertainment retailing. Virgin has always done more than leverage its existing assets and capabilities. The company has been a consistent value innovator.

Despite the pace of competition in its industry, Compaq's repeated value innovations are allowing the company to remain the number one maker of servers worldwide. Since the company's turnaround, overall sales and profits have almost quadrupled.

## Driving a Company for High Growth

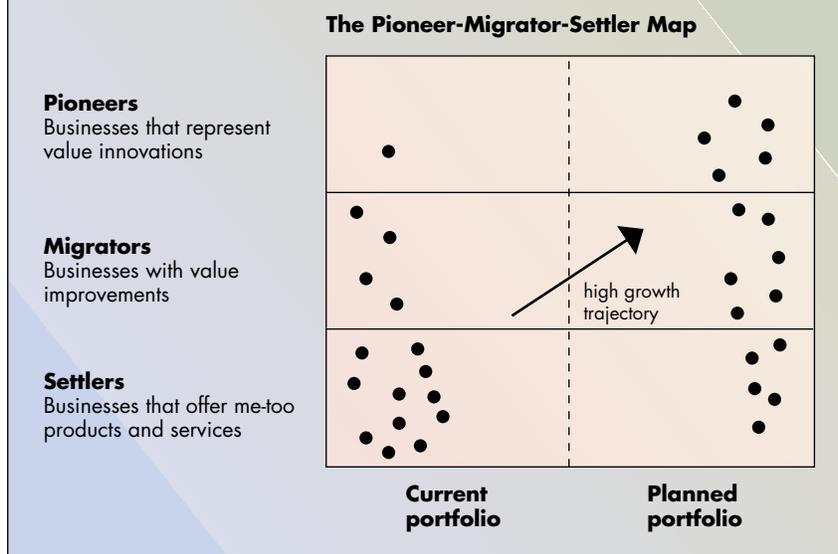
One of the most striking findings of our research is that despite the profound impact of a company's strategic logic, that logic is often not articulated. And because it goes unstated and unexamined, a company does not necessarily apply a consistent strategic logic across its businesses.

How can senior executives promote value innovation? First, they must identify and articulate the company's prevailing strategic logic. Then they must challenge it. They must stop and think about the industry's assumptions, the company's strategic focus, and the approaches—to customers, assets and capabilities, and product and service offerings—that are taken as given. Having reframed the company's strategic logic around value innovation, senior executives must ask the four questions that translate that thinking into a new value curve: Which of the factors that our industry takes for granted should be eliminated? Which factors should be reduced well below the industry's standard? Which should be raised well above the industry's standard? What factors should be created that the industry has never offered? Asking the full set of questions—rather than singling out one or two—is necessary for profitable growth. Value innovation is the simultaneous pursuit of radically superior value for buyers and lower costs for companies.

For managers of diversified corporations, the logic of value innovation can be used to identify the most promising possibilities for growth across a portfolio of businesses. The value innovators we studied all have been pioneers in their industries, not necessarily in developing new technologies but in pushing the value they offer customers to new frontiers. Extending the pioneer metaphor can provide a useful way of talking about the growth potential of current and future businesses.

A company's *pioneers* are the businesses that offer unprecedented value. They are the most power-

## Testing the Growth Potential of a Portfolio of Businesses



ful sources of profitable growth. At the other extreme are *settlers*—businesses with value curves that conform to the basic shape of the industry's. Settlers will not generally contribute much to a company's growth. The potential of *migrators* lies somewhere in between. Such businesses extend the industry's curve by giving customers more for less, but they don't alter its basic shape.

A useful exercise for a management team pursuing growth is to plot the company's current and planned portfolios on a pioneer-migrator-settler map. (See the chart "Testing the Growth Potential of a Portfolio of Businesses.") If both the current portfolio and the planned offerings consist mainly of settlers, the company has a low growth trajectory and needs to push for value innovation. The company may well have fallen into the trap of competing. If current and planned offerings consist of a lot of migrators, reasonable growth can be expected. But the company is not exploiting its potential for growth and risks being marginalized by a value innovator. This exercise is especially valuable for managers who want to see beyond today's performance numbers. Revenue, profitability, market share, and customer satisfaction are all measures of a company's current position. Contrary to what conventional strategic thinking suggests, those measures cannot point the way to the future. The pioneer-migrator-settler map can help a company predict and plan future growth and profit, a task that is especially difficult—and crucial—in a fast-changing economy. 

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