



Cyclicalty, Innovation & Pricing

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INTRODUCTION

As I explore in my book, *Reality Reviewed*, repeated patterns of behavior or, as I came to call them, "choreographies" shape the realities that we observe and experience.

- A choreography of *plasma behavior* shapes [convection cells](#) on the sun's surface.
- A choreography of *molecule behavior* shapes the Earth's 20-odd tectonic plates.
- A choreography of *flapping behavior* shapes the V-formation of migrating geese.
- A choreography of *human behavior* (of people in different roles) shapes a company.

Mind you, these choreographies cannot simply be switched on. They grow over time in response to external conditions.

External Conditions

Choreographies do not emerge without reason.

- A temperature gradient fosters the flow of molecules.

- The annual drop in temperature triggers the migration of geese.
- The needs of people trigger choreographies of human behavior that deal with them.

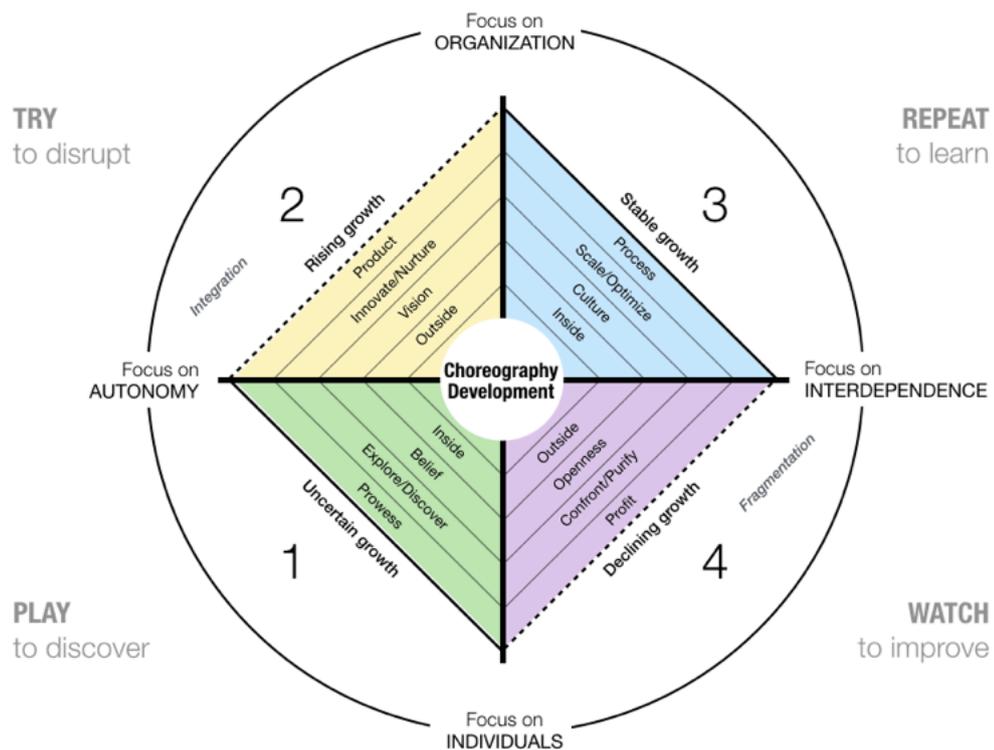
Here are two examples of the latter.

- People who wanted to get from A to B without much waiting inspired the founder of Uber, Travis Kalanick, to develop his app.
- Steve Jobs, on the other hand, speculated that people would fancy a phone that can play music, make photos, and do other things.

Identifying the needs of customers and translating these into products or services is not something that comes naturally to everyone. Only some can *and* have the luck of seeing their "translation" sell. In each case, it involves and triggers choreographies.

Local Conditions

When choreographies grow and shape companies, they also shape the local conditions. These shape the development of choreographies again. In point of fact, choreography *growth rates* shape time environments or *seasons* each with specific local conditions.

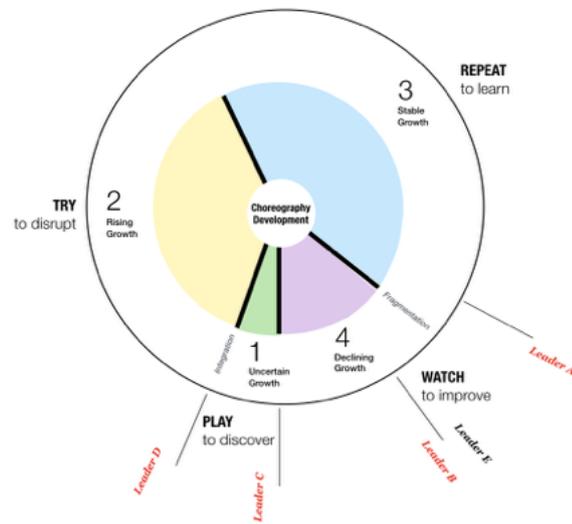


In the conceptual diagram above, I have plotted the "grammar of local conditions" in each choreography growth-rate season (*uncertain*, *rising*, *stable*, and *declining*). On the outside of the circle, I have penciled in the crux of each season for company leaders such as *play to discover*, *try to disrupt*, *repeat to learn*, *watch to improve*.

In practice, the duration of these seasons usually differs. When it comes to companies, for example, seasons 2 and 3 - of *rising* and *stable choreography growth* - typically last longer than seasons 4 and 1 - of *declining* and *uncertain growth* - when shareholders

tend to become increasingly nervous.

As a last point, the season of a company often differs from the season of one of its (sub)divisions. Propelled by its own choreographies, a (sub)division may well travel through another season than the company as a whole.

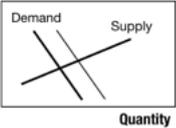


Beyond Season Conditions

The above four choreography growth-rate seasons not only come with conditions that remind of climatic season conditions but, as I will discuss from here, they also hint at how *innovation* and *pricing* unfold in companies over time. To show how this plays out in practice, I have included a diagram with *Apple* as an example. I'll conclude with a comment on *how this will affect the selection of human resources*.

INNOVATION & PRICING

In the following diagram, you'll find my conclusions *for the world of business*. Keep in mind that these *seasons actually refer to the growth-rate of choreographies behind outcomes that we qualify as results, such as revenue- and profit-growth*. Moreover, the wheel of seasons does *not* represent a company's lifecycle. Rather, it's *the wheel of choreography development that drives a company as it spins*.

Season 1 PLAY TO DISCOVER	Season 2 TRY TO DISRUPT	Season 3 REPEAT TO LEARN	Season 4 WATCH TO IMPROVE
INNOVATION			
Stumbling onto a novel idea Satoshi Nakamoto	Informed trial and error Create until realizing product fate Steve Jobs, Jeff Bezos, Elon Musk	Incremental innovation Add functionality, broaden niche and organization Tim Cook	Copy competition Satya Nadella
PRICING			
Whatever people are prepared to pay for the idea Bitcoin	Singular patent: Price high Nurture niche Xerox, Nespresso, Pharmaceuticals <hr/> Disrupting functionality: Cost + profit target Prepare for volume Apple, Amazon Echo, Tesla <hr/> Unique functionality: Price low + spin-off sales Design for volume Google, Facebook, Uber, Airbnb	Play the Price-Elasticity game Increase demand and capacity, sustain price Apple, Tesla, Uber, Airbnb 	Undercut competitive products and services within reach Microsoft Cloud
CUSTOMER NOTIONS			
Beyond their world	Clueless until seeing the product 'Don't know what they want until shown'	Expectations to be managed Surveying quality/service levels	Grow on greed Penny/pound wise

Season 1 - A pattern of behavior unexpectedly emerges on the back of a novel idea.

In 2009, the individual or group that identifies himself/itself as Satoshi Nakamoto kicked off a repeated pattern of behavior or choreography based on an idea that rewarded software developers for helping to expand a decentralized digital network that keeps track of crypto-

currency transactions. Software developers earn or mine bitcoins by running an algorithm that creates a unique code or hash that confirms *and* preserves the authenticity of a block of transactions. Since the launch of this idea, the chain of blocks has rapidly grown and its growth is accelerating still, as I write. The idea has caught on to the extent that people are willing to pay an enormous amount of money to get bitcoins. As many in the financial world forecast, the rapidly increasing value of the bitcoin, which is driven by demand only, is a bubble that might eventually burst. However, the idea of *the blockchain* as a way to process transactions incorruptibly and cost-effectively without a "middleman" (banks, insurance companies, government institutions, etc.) has a great future. As one article suggests, *the blockchain is pumping new life into old-school companies like IBM and Microsoft that are making the transition to cloud services*. When these companies help realize decentralized blockchain solutions across the world for improving health care, food safety, logistics, and money transactions, the underlying choreography growth will enter the next season.

Customer notions - Of course, such paradigm-shifting ideas are beyond the usual world of customer thinking. This explains why these ideas are initially belittled and denied until they are triggering patterns of behavior that repeat themselves, no matter what.

Season 2 - Ideas and technologies are combined to shape products and services.

In this season, leaders, at every level of society, arise with a gift for second-guessing what customers need. Often in a tedious process of trial and error that is generally not acknowledged enough (we typically see the success side of the coin only), they combine and tinker with ideas and technologies to bring products and services to the market *that sell* - anything from carbon-dioxide trading solutions, people assessment tools, and mobile apps to electric vehicles and smart phones. The biographies of *Steve Jobs, Elon Musk, and Jeff Bezos* tell the stories of their failures, persistence, early success, and, in the end, growth from strength to strength. The hordes of admirers that now look up to them too easily forget how these icons emerged on the blunt edge of inspiration, perspiration, and chance. Successful leaders in this season often unwillingly bring about the rising complexity and growth of choreographies inside their companies and beyond. By and large, when it comes to pricing products and services, leaders in this season have three options.

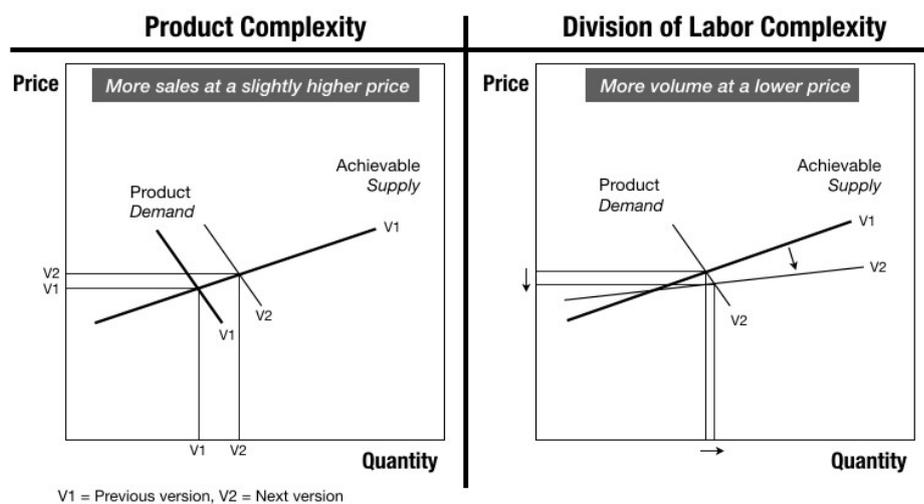
1. Companies that own a patent, which prevents competitors from entering the market, have the luxury of pricing their products high and milking their market all by themselves. Xerox, for example, owned the dry-copying technology patent, which provided it with a dominant position until its patent expired. Nestlé patented the aluminum capsule for instant espressos. It allowed Nestlé to build a coffee empire that is now beleaguered by new entrants since its patent ran out. Backed by patents, many a pharmaceutical *feasts on the needs of patients, often unreasonably so*.
2. Companies that offer a disrupting product that is not sufficiently protected by one or more patents establish price based on cost and a profit target. For one, Apple justifies its profit target by getting to market first (iPhone, iPad), by the quality of its design, and by its near-flawless implementation of hardware and software features. Amazon followed a similar approach when it introduced the Amazon Echo, yet it targeted for a lower profit as newcomer to the speech-recognition market.

- The product-version costs of software companies, such as Google and Facebook, are typically made up front. Hence, they have the opportunity of offering their products for free or at a low price and to bank on spin-off sales in the shape of advertisement income and/or by charging for the use of certain features.

Customer notions - As Steve Jobs said, when it comes to customers, "they don't know what they want until we've show them". It requires someone like Jobs who can identify hidden needs and translate these into products and services that customers want to buy.

Season 3 - *Success is repeated over and again by broadening a proven niche.*

Once a product catches on, companies have the beginning of a brand that can be exploited and grown. By playing, what I call, the *Price-Elasticity game*, companies broaden their niche and sustain the price of their products by adding "features".



The above conceptual diagram shows how this game is played in 2 steps, left to right.

After launching a product (v1), a company will eventually see its sales peak and taper. Companies can create new, even more demand by *incremental innovation*, that is, by adding functionality (product complexity) and by launching it as a next version (v2).

The diagram on the left shows the first step. It shows two left-leaning lines that represent the demand potential of the first version (v1) and the next version (v2). It also shows a right-leaning line, that is, the supply capacity realized for the first version (v1).

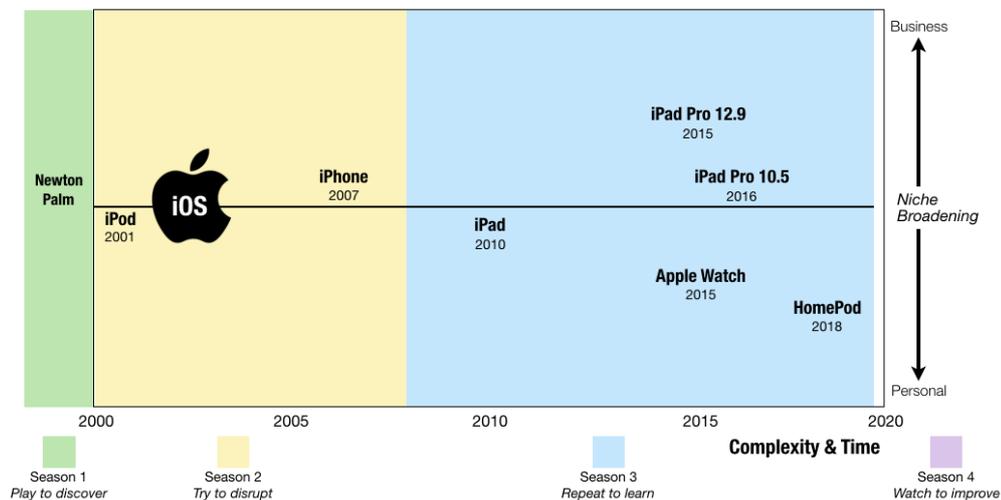
The actual price and quantity (of sales) emerges when "demand meets supply", i.e. where a demand and supply line cross. If you'd leave the supply-capacity line for v1 as is, the quantity of the next version (v2) comes out higher but at a slightly higher price.

In sum, step 1 involves prepping up demand by adding functionality, if not features and, thus, by increasing *product complexity*. As I'll show later in the example of Apple, by following a similar approach, companies can also broaden their market niche this way.

The diagram on the right shows what companies do in step 2. By upgrading their operations,

such as by clever outsourcing and refining the division of labor, companies achieve *more elastic supply* (the quantity of sales can increase without a price penalty). As a result, the supply line for the next product version (v2) flattens somewhat.

Step 2, therefore, means increasing the *division of labor complexity*. This does not simply mean more "complexity". Rather, it means a more refined and better calibrated division of labor throughout the entire organization. The ideal conditions in this season (shown in the diagram at the beginning of this article) help achieve this.



The above diagram shows the outcome of the *Price-Elasticity game* at Apple. Over the last two decades, Apple generated new product versions and broadened its niche through derivative products this way. It increased the complexity of iOS hardware and software and substantially improved its supply capacity, i.e. the elasticity of its supply.

Rather suggestively, I have included the legend for season 4 (Watch to improve) at the bottom right of the above diagram. When an organization keeps on refining its organization, it spins a fine web that serves its purpose of sustaining growth very well. However, at some point, the external conditions may change. For example, competitors may introduce new disruptive products and technologies that make the current business obsolete. Turning a large ship in such times is not an easy task. The fine web of acting and thinking may, in fact, turn into a prison, from which it is hard to escape. This is what happened to Microsoft when competitors, such as Apple and Google, introduced gear that started nibbling at its model and caused the decline of its Windows business. What do you do when that happens? This is what season 4 is about.

Customer notions - In season 3, customers have an opinion about a product version; they are using it! From the media, they even learn what follow-on versions might be expected. So, in this season, companies should seek to manage the expectations of customers by measuring how they use the product and by asking for their feedback.

Season 4 - Finding stopgaps for declining business in proven growth markets.

In this season, when an established business model no longer serves a company no matter what its leadership tries, the company needs to clean up its business. This is what happened to Microsoft and Ford, among others. The Window's business model had served Microsoft

well for a long term. However, disruptive products and services from competitors, such as Apple and Google, had taken wind out of its sails (sales). The same happened to Ford. When Tesla introduced its disruptive electric vehicle, Ford's business started to deteriorate. To prevent the bottom from falling out, companies then look for proven markets that they might quickly enter - hoping to create the time needed to turn their business around. They don't have time to develop a new market through trial and error. Instead, they watch what competitors in their industry do. Ford decided to invest in the Chinese market as a stopgap measure. Satya Nadella of Microsoft decided to grow Microsoft's cloud business (which he led until being appointed as CEO). After all, the cloud business was a proven market established by players, such as Amazon and Google. Microsoft used its clout and now aggressively offers cloud services through a young sales team, often undercutting competitor offerings.

Customer notions - Price-driven as customers can be, they are open to companies who offer what appear to be similar products at a lower price. Microsoft is a formidable name on the market and does not represent a risk in this light. Yet, in other cases, customers might be inclined to save the proverbial penny and overlook a pound of risk.

SELECTION OF HUMAN RESOURCES

As I mentioned early on in the text, the role of translators like Steve Jobs, Elon Musk, and Travis Kalanick doesn't come natural to everyone. These leaders particularly excel in the second season when they *create until realizing their product's fate*. Other seasons require people with other inclinations and gifts. Tim Cook of Apple emerged first as logistics executive. Today, he particularly excels in season-3 leadership, when companies grow the complexity of products and organization to realize and sustain growth. In fact, each season requires particular inclinations and gifts. To ensure the selection of executives and professionals with the right seasonal orientation, we have developed assessment tools to identify their seasonal strengths so as to improve their chances of success in the light of a company's developmental priorities.

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