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Learning from Your Worst Failure

Welcome!

What lessons are so valuable they're worth $600 million to find out? That's a question former Best Buy CEO Brad Anderson answered last month in riveting detail, as the first speaker at the first conference of the Growth and Innovation Forum, a new initiative Clay Christensen is spearheading to bring academics and business leaders together to improve both the theory and practice of management. The conference was called to examine new thinking Professor Christensen, Innosight partner Andrew Waldeck, and others are developing on applying disruptive innovation and business model innovation to the merger & acquisition process that will be published in the *Harvard Business Review* in March. As a preview, we bring you Brad Anderson's account of what he learned from his failed acquisition of Musicland, as ammunition for innovators looking to demonstrate the value of learning from failure to their organizations.

Just in time for the Super Bowl, we also draw your attention to an article in last week's Forbes.com by Innosight Manager Alex Slawsby and Principal Ned Calder, considering the knotty question of how to lure fans off the couch and into the stadiums. Their classic approach of considering what jobs people need to do that could be done by going to the game applies equally well to NASCAR, the NBA, and a host of other sports franchises.   And from his HBR blog, we highlight Scott Anthony's list of the 31 innovation questions (and answers) to kick off the new year.

Comments and suggestions are always welcome – send them to editor@strategyandinnovation.com.

— Andrea Ovans, Managing Editor

Innosight News & Events

Check out Innosight President Matt Eyring in this "HBR" video discussing why disruptive innovation in developing countries means not just tweaking, but instead rethinking, your business.

Interested in attending Front End of Innovation USA in Boston May 16-18? Use this 25% off discount code **FEI2011INNOSIGHT** and come see Mark Johnson speak on BMI and the Innosight exhibit!

For HBR video:
http://blogs.hbr.org/video/2011/01/a-newmodelfor-emerging-markets.html

For FEI conference:
http://www.innosight.com/documents/FEI_2011_Brochure.pdf

Feature: What Best Buy Learned from Its Worst Failure

How a failed $600 million acquisition led to billions in strategic insight.

Andrea Ovans

Innovators know the value of learning from failure, but it's often a hard sell to the companies they work for. So a story about a CEO who thinks losing $600 million is not too high a price to pay to gain strategic insight is something worth spreading.

The executive in question is Brad Anderson, retired CEO of Best Buy, and the $600 million was the amount Best Buy spent in its all-cash acquisition of Musicland in 2000, which in hindsight, Anderson could confidently claim was "the worst thing we ever did in the company's history."

Anderson was addressing a packed crowd in one of the large, amphitheater-like classrooms at Harvard Business School. He was the first speaker at the first conference Harvard Business School Professor Clay Christensen convened for a new initiative he's leading, the Forum for Growth and Innovation[1]. Modeled after the Council of Foreign Relations, the forum is intended to revitalize research into general management by bringing together academics and practitioners in a joint effort to develop better management theory that can be more effectively implemented in the real world.

This first conference was convened on December 2 to consider and road test a new application of disruptive innovation and business model innovation theories to the merger & acquisition process, which Professor Christensen is currently developing with Innosight Partner Andrew Waldeck, and former students Rich Alton and Curtis Rising (work that will get its first widespread public airing in an article in the *Harvard Business Review* in March). To that end, the forum had gathered together several executives from companies cited in the research, Best Buy among them.

Much has been written about Geek Squad—the funky little company of 65 people that Best Buy bought for a mere $3 million in 2002, which by last spring the *Minneapolis Star Tribune*[2] went so far as to declare "the world's largest tech-support operation with annual revenue of $1 billion to $1.5 billion." Less well known is the story of the lessons Best Buy learned from its previous acquisition failures that led the company to develop the thinking behind the Geek Squad purchase. Even at only $3 million, the Geek Squad purchase met with a great deal of opposition within Best Buy, Anderson says, and even more resistance as it staffed up to 12,000 people in six months and was given complete control over customer service. It would never have survived, Anderson insists, if Best Buy had not learned how far off the mark were the strategic assumptions that had guided the company in earlier acquisitions, most notably Musicland.

"Everybody looking at it knew it was stupid except us," Anderson quipped. "And the reason we didn't think it was stupid at the time was we were using what we thought were prescriptive hypotheses based on our experience." Those hypotheses didn't just look reasonable. They looked air-tight.

By 2000, Best Buy was reaching the limits of a growth strategy it had pioneered in 1989 with great success: selling consumer electronics -- computers, TVs, stereo equipment, and the like -- through noncommissioned sales staff in brightly lit, low-cost, free-standing, "grab-and-go" stores. It was a simple idea, borrowed from the big-box general retailers, enabling Best Buy to radically undercut the leading competitors like Circuit City, which were operating according to the industry-standard business model: advertise loss leaders to get people into the stores and then use the talents of commissioned sales people to up-sell to something far more profitable.

Looking for avenues of growth, Best Buy could see potential in malls. Musicland, which sold CDs in malls, looked like a smart entry point. "We sold CDs; Musicland sold CDs," Anderson explained. "We knew CDs were going to disappear; we weren't that stupid. But we also knew an awful lot of product was being sold in malls."

The strategy wasn't nearly that simple, of course. In 2000, Musicland was a $1.7 billion company generating about $100 million in cash. Since everyone knew CD technology was terminal, Best Buy was able to buy the mall retailer for a bargain price of $600 million. At the time, Musicland, like all the other music retailers, turned over its inventory twice a year. But Best Buy had learned to double that rate in its own stores, and sales had gone up. "So we thought, 'Wow, how much cash could we create if we go buy the guy that sells it in the malls and move his turns, which were two, to four?' " If Best Buy could apply its merchandizing skills to Musicland to double its turnover, the theory went, revenue gains would pay back the investment quickly, and as CD demand declined, Best Buy could bring in its other products, which it could sell for far less than they were currently being sold in other mall stores. It looked like a no-brainer.

But, as Anderson put it bluntly: "We misread totally what was going on." Best Buy had increased turnover by decreasing selection, something its customers were apparently tolerating but Musicland customers would not. When the selection declined in the Musicland stores, sales dropped. What's more, Best Buy initially maintained Musicland's CD prices, which were $5 higher than those at Best Buy stores. Customers assumed that if they were paying mall prices for CDs, they were overpaying for all the other merchandize Best Buy brought in, even though in reality the company was selling its other goods for the exact same low prices it was offering in its stores outside the mall. Dropping Musicland's CD prices way down to Best Buy levels didn't shake that impression, nor did rebranding stores under the Best Buy name.

In fact, that just made things worse. But it wasn't until Best Buy engaged in comprehensive customer research – its vaunted "customer-centricity" initiative – that it found out why, and the underlying problem was uncovered. The company was trying to establish a beachhead in malls to gain access to a new range of customers. Best Buy's customer base was very heavily male; the shopper inside the mall was heavily female. But women hated Best Buy, the research revealed, and for a very good reason, Anderson says. When a woman "talked to one of our employees; if she wanted to buy a camera, we would start talking about how many pixels the camera had, while she wanted the camera to take a picture of her child and sent it to her sister. And if she came in with a husband or a boyfriend, we talked to him….We thought we couldn't be that bad but we were, so we knew that with our existing customers we had a job to do."

Much has been written[3] about the fruits of Best Buy's "customer-centricity" program – its new approach to segmenting customers based on their needs and wants rather than on demographics. Not so much segments as archetypes, Best Buy went so far as to give them names, so they would come alive as individuals: Barry, the affluent tech enthusiast; Buzz, the young gadget lover; Ray, a price-sensitive family man, Mr. Storefront, who owns his own business; and, of course, Jill, that mom who hated Best Buy -- and who wouldn't shop in Musicland either. Eventually, that effort lead to a fundamentally new approach to sales and to the acquisition of Geek Squad, the $3 million company that, Anderson hoped, would reinvent customer service, shake Best Buy out of its orthodoxy, and differentiate it from the big-box retailers that were moving into electronics retailing, most notably Wal-Mart.

"What we had with the Geek Squad was this germ of genius in their culture, not ours," Anderson continued. "The founder of the Geek Squad is a nut named Robert Stevens, and he thought he was acquiring Best Buy. I'm the CEO, and I'm looking at this and saying I hope he is, because he's disruptive technology and we're not. And the frame of thinking he comes from, if it could survive would actually give us a future."

The path to that future ran right over Musicland. When Anderson became CEO in 2002, one of the first things he did was to shut Musicland down. Nothing could look more like a failure, as Anderson starkly sums up the bottom line: "Best Buy buys a company for $600 million; we sell it for nothing." But he adds, "I would do it again if I had to -- if there was no other way to learn how bad our hypotheses were. Because we were going to act on those hypotheses. It was a very expensive way to learn you're wrong, but the other options were worse. I don't even want to tell you the other things we were going to do."

How much is it worth to find out you're going down the wrong path and need to take steps to blow up your existing orthodoxy? In 2002, Best Buy posted annual revenues of $19.5 billion; in 2008, they had risen to $40 billion. That was the year Circuit City, hit hard by the financial crisis, filed for bankruptcy protection, from which it would never emerge.

Source Notes:

1. http://www.thefgi.net/
2. http://www.startribune.com/business/88654892.html
3. http://money.cnn.com/magazines/fortune/fortune_archive/2006/04/03/8373034/index.htm

Feature: Why the NFL Needs to Rethink Its Innovation Game

Trying to compete with that comfy couch and the 42-inch HDTV is not the answer

Alex Slawsby and Ned Calder

It's safe to say that few organizations are as successful as the National Football League. Its games draw more fans on average than any other professional sports league in the world. Its teams earn billions of dollars in revenue from television and radio broadcast rights. Twelve of the top 25 most viewed television programs in U.S. history were Super Bowls; more than 100 million (or one out of three Americans) watched Super Bowl XLIV on Feb. 7, 2010.

Still, the 2010 season brought a dark reminder that not every part of the NFL's business model is functioning smoothly. In 2009, the NFL blacked out 22 games, a 144% rise from 2008. In 2010, 26 blackouts occurred. NFL attendance peaked back in 2007, when more than 17 million tickets were sold. Since then, attendance has dropped each year, down 2.4% in 2009 to 16.7 million tickets sold. In 2010 paid attendance was flat from 2009, but season ticket sales fell 5%.

The reasons are nothing if not obvious--the economy's health, poor team performance, competition from HDTV. And if the causes are obvious, the responses have been nothing if not predictable: Focusing on their most profitable customers, teams are trying to beat HDTV at its own game by offering the TV experience at the stadium to its season ticket holders.

What is not so obvious is why this approach is inevitably doomed to fail and the opportunities the NFL is overlooking as a result. The league's problem getting fans off the couch and into the stadium is a classic case of what Harvard Business School professor Clayton Christensen calls "disruptive innovation."

That's a process set in motion when someone invents an alternative to an established product or service that, in some respects, is not really as good but is nevertheless in some way vastly easier, cheaper, or more convenient. Because it's not as good, it tends to draw off the least loyal customer at first, and so established, incumbent players tend to ignore it, as they continue to focus on their best and most profitable customers. But inevitably, the not-quite-good-enough offering becomes better and better, drawing off more and more customers. Typically, by the time the defenders recognize the threat, they are losing customers quickly.

In this case, NFL teams are the defending incumbents and the at-home, HDTV experience is the disruptor. Watching football on television is clearly far more convenient and infinitely less expensive than going to the game. Ten years ago, it was also vastly inferior to seeing the game live. But HDTV now creates a great home-viewing experience, and it's no wonder that more and more fans would rather enjoy that experience than spend roughly $100 a person to sit high up in the stands, watching tiny players from a single vantage point, with no commentary, waiting through dead moments, sometimes in bad weather, in an often family-unfriendly environment.

To be fair, football is not really a cut-and-dried case of disruptive innovation, since the savvy NFL has shared in--and profited mightily from--the revenues generated by the televised broadcasts. Still, it is not so savvy as to avoid the most common mistake incumbents make when confronted with disruption. When it comes to its efforts to fill those empty seats, the NFL is falling into all the classic traps--focusing on its most profitable customers and competing head-to-head with the disruptor on its own terms.

Just who are these consumer groups? Let's take a look:

The Super Fan

The NFL's most profitable customer is the season ticket holder, the guy--and it is almost always a guy--who loves the emotional high of "being there" and invests heavily in team gear, fantasy football, and specialized TV channel subscriptions. Teams, in turn, invest heavily in keeping this fan happy and for good reason: He represents an up-front, long-term revenue commitment.

Like many organizations in many industries, however, teams are taking the wrong approach to understanding this customer. By installing multimillion-dollar screens (some carrying the same specialized TV channels) and handheld devices, they are trying to replicate the at-home experience in the stadium. Professor Christensen has piles of stats that show that when an incumbent tries to play the game in the same way as a disruptor, it's rarely the incumbent who comes out on top. These fans are not coming to the stadium to get a better home experience. They're coming to find something they can't get at home--unique value that address deeper life motivations.

The Casual Fan

But let's leave the super fan in his seat for a moment because that guy is still coming to the stadium. To fill those emptying seats, the NFL has to move beyond the question of what would make people who already love them love them more and focus on why casual fans and nonfans are increasingly reluctant to come out to the games. The Oakland Raiders, home to five of the blackouts this season, have an estimated base of some 24,000 season ticket holders but a stadium that holds more than 60,000. Each Sunday, then, the Raiders need to attract not only the 24,000 super fans, but also more than 36,000 casual fans to fill the Oakland Alameda County Coliseum and prevent a blackout. Bigger stadiums and better technology won't overcome the growing barriers that matter to these casual fans--the cost, the traffic, the lack of restrooms, and rowdy fans.

To find out what will, NFL teams have to take a broader view of those people's lives and consider what problems and needs they might have (or, as Professor Christensen thinks of it, “what jobs these people have to do") that could be fulfilled by going to see a football game. With this so-called jobs-to-be-done approach, NFL teams can not only stem the stadium exodus but win the hearts and wallets of super fans, casual fans, and nonfans alike.

Winning Strategy

Rather than segment individuals according to gender, age, income, or other traditional demographic category, a jobs-based approach, logically enough, groups people according to the jobs they need to do. For example:

- **“Convince my family to attend a game.”**
- **“Engage my spouse in the game.”**
- **“Feel like I am helping the team win.”**
- **“Feel like I have access that others do not.”**
- **“Demonstrate that I am a super fan.”**
- **“Keep others from knowing that I am just a casual fan.”**

When looked at in this light, it's easier to see that lots of different people have lots of different jobs they need to do (and, in fact, the same person might have more than one job). Consider, for instance, the spouse who wants to share the super fan’s interests but doesn’t know enough about the finer points of game or its players to follow along or become enthusiastic. Or the family decision-maker (perhaps the same person as the spouse in a different circumstance) who’s seeking to "spend time with family" but is concerned about spending too much money and worried about bringing kids to a probably not-family-friendly stadium environment. Or the super fan, who wants to feel as connected as possible to the team and show others the strength of his or her passion. Or the part-time fan, who only attends a few games a year but wants to feel like a super fan and convey to others a higher-than-actual level of commitment to the team.

Grouping individuals by the jobs they need done immediately suggests actions NFL teams could take to fulfill those jobs, suggesting ways to attract people's business that grouping them merely by age, gender, or the like could never do. Some ideas for these segments include:

• Creating more family-friendly experiences through family-only seating, parking, and concessions areas.

• Developing special online publications featuring novice-level explanations of routes and strategies and stories about players' personal interests, hobbies, or workout routines.

• Establishing a service that would give fans a personalized recap of game action.

• Offering interactive phone applications and games through which fans can attain increasing levels of social-networking status by demonstrating their knowledge and commitment to the team.

• Creating an immersive, seat-shaking, "In the Action" section in the stadium to make fans feel like part of the team.

The Two-Minute Warning

Even the most successful enterprises must continue to innovate, identify ways to improve customer engagement, and grow revenue. The "at-home experience" will keep on improving: 3-D video, immersive audio, multiple data streams, and expanded interactivity will make the couch increasingly competitive with the hard, cold stadium seat. This is true not only for the NFL but for basketball, NASCAR, and other sports franchises.

Particularly in a time when owners and players are looking for ways to generate new sources of revenue, NFL teams should follow the approach that has created significant value in many other industries. Get to the root of customers' problems, think more broadly about what motivates not only their most -- but their least -- loyal customers, develop innovative solutions to solve the fundamental problems within those segments, and grow the revenue opportunity for all involved.

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From the InnoBlog:

31 Innovation Questions (and Answers) To Kick Off the New Year

Scott Anthony

One of the simple ways that I try to make experimentation an everyday activity is to always try at least one new thing each time I give a presentation. One such recent experiment I called "choose your own presentation." I looked back at the 20 or so talks that I'd given this past year, and I tried to group material into the questions that I most commonly get asked. I ended up with 31 questions. I thought it would be helpful to provide the list – and my one sentence perspective on each question -- as it dovetails with my current book project (tentatively titled, *The Little Black Book of Innovation*.) Consider it a summary of what's on my mind as 2011 begins.

1. **How do you define innovation?** Something different that has impact.

2. **What are different types of innovation?** Innovation is more than whiz-bang technology; consider different strategic intents (e.g., create a new category, extend current business) or innovation mechanisms (e.g., new product, distribution channel, marketing approach).

3. **How do I spot opportunities for innovation?** Go to the source: the customer you hope to target.

4. **Which customers should I target?** Look beyond your best customers to those who face a constraint that inhibits their ability to solve the problems they face in their life.

5. **What should I look for?** As Drucker said, "The customer rarely buys what the business thinks it sells him"; look for a job-to-be-done, an important problem that is not adequately solved by current solutions.

6. **How should I look?** Start with deep ethnographic research; avoid focus groups!

7. **How do I come up with an idea**? Remember the Picasso line "good artists copy, great artists steal;" seek to borrow ideas from other industries or geographies.

8. **What is disruptive innovation?** An innovation that transforms a market or creates a new one through simplicity, convenience, affordability, or accessibility.

9. **What is the best way to disrupt a market?** Embrace the power of trade-offs. Seek to be just "good enough" along historical performance dimensions but introduce new benefits related to simplicity or affordability.

10. **What does "good enough" mean?** Performance above a minimum threshold to adequately solve a customer's job to be done; sacrificing performance along traditional dimensions can open up new avenues to innovate.

11. **What is a business model (and how do I innovate one)?** How a company creates, captures, and delivers value; codifying the current business model is the critical first step of business model innovation.

12. **How can I "love the low end"?** Build a business model designed around the low-end customer's job-to-be-done.

13. **How do I know if my idea is good?** Let patterns guide and actions decide; remember Scott Cook's advice that "for every failure we had we had spreadsheets that looked awesome."

14. **How can I learn more about my idea?** Design and execute "high return on investment" experiments to address critical unknowns.

15. **How can I get other people behind my idea?** Bring the idea to life through visuals and customer testimonials.

16. **How long does it take new businesses to scale?** Almost always longer than initial projections; be patient for growth and impatient for profits.

17. **Why is innovation so important?** The "new normal" of constant change requires mastering perpetual transformation.

18. **Why is innovation so hard?** Most organizations are designed to execute, not to innovate.

19. **Who are your influences?** Academics like Clayton Christensen and Vijay Govindarajan, leading-edge innovative companies like Procter & Gamble and Cisco Systems, and thoughtful writers like Michael Mauboussin and Bill James.

20. **How do I encourage innovation in my organization?** Stop punishing anything that smells like failure, recognizing that failure is often a critical part of the innovation process.

21. **What is "the sucking sound of the core?"** The pull of the core business and business model that subtly influences new ideas so they resemble what the organization has done before.

22. **What is an innovation "safe space"?** An organizational mechanism that protects innovators from the sucking sound of the core.

23. **How should I form and manage innovation teams?** Keep deadlines tight and decision makers focused.

24. **What is in a good innovation strategy?** Overall goals, a target portfolio for innovation efforts, a mechanism to allocate resources to achieve that portfolio, and clearly defined goals and boundaries for innovation.

25. **What is the best way to manage an innovation portfolio?** Make sure you correctly capture current activities and measure and manage different kinds of innovations in different ways.

26. **What does *prudent pruning* mean?** Recognizing that destruction is often a critical component of creation.

27. **What role should senior executives play in innovation?** A big one.

28. **How can I personally become a better innovator?** Practice - innovation is a skill that can be mastered.

29. **How can I find more resources for innovation?** Shut down "zombie projects" that are a drain on corporate resources.

30. **How can I more quickly turn good ideas into good businesses?** Remember what Edison said - genius is "1% inspiration and 99% perspiration"; get ready to sweat.

31. **Has anyone built the ability to innovate at scale?** An increasing number of companies, such as Google, Apple, Procter & Gamble, Amazon.com, Cisco Systems, Godrej & Boyce, and General Electric.

I would love to hear any other questions that are on your minds as I work with my colleagues to think about our research agenda for 2011 and beyond.

Reprinted from Scott's Havard Business Review blog, December 27, 2010.

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