TOMORROW'S CHALLENGES

# BEWARE OF THE VALUE VAMPIRES

## COMPANIES LIKE AMAZON ARE CREATING A "NEW PARANORMAL" AND SUCKING PROFIT POOLS DRY

By IMD Professor Michael Wade

**IMD**
Chemin de Bellerive 23
PO Box 915,
CH-1001 Lausanne
Switzerland

Tel: +41 21 618 01 11
Fax: +41 21 618 07 07
info@imd.org
www.imd.org

Have you ever wondered how companies like Uber, Amazon and Spotify can offer such low prices, make such low profit margins but still continue to operate? You're not the only one.

In our work at the Global Center for Digital Business Transformation (an IMD and Cisco Initiative) studying hundreds of digital disruptors, three value drivers were identified that we believe underpin how a disruptor disrupts: Cost value, experience value and platform value. We further identified five business models associated with each value driver. For example, a Buyer Aggregation business model, like that practiced by Groupon, is an example of cost value. Similarly, Crowdsourcing is an example of a business model that builds platform value.

In the course of our work, a few examples of digital disruptors that managed to combine all three value drivers and multiple business models into one exceedingly challenging package were identified. We have a special name for such companies: Value Vampires.

Value Vampires are so named because when they enter a new market they do so with the intention of sucking the profit pool dry. They have been known to shrink the overall market size within a sector, leading to lower revenues, margins, or both.

Value Vampires always lead with cost value, offering extremely low prices, or even free products or services. They then add great user experiences through an intense focus on customer satisfaction. Building on this cost and experience value, they eventually construct robust platforms upon which to leverage scale and rapid adoption.

The net result of these efforts is a "new paranormal" for incumbents. Fortunately, we did not encounter many Value Vampires in our study of disruptive marketplaces, but let's look at a couple of prominent examples.

Amazon is a prototypical Value Vampire. It offers extremely low prices, a great user-experience, and an increasingly robust platform. Amazon focuses on the digital value it wants to deliver to customers, not the overall value chain. Take Amazon Prime – for $99 a year, members receive extreme cost value, including free two-day shipping, unlimited streaming of movies and TV shows, free e-books and more. Amazon is expanding into more areas to build experience and platform values. Amazon Echo, for instance, is a useful, interactive and fun internet-connected speaker that listens and talks. Amazon Web Services, meanwhile, is fast becoming the dominant cloud solutions provider.

In Value Vampire-like fashion, Amazon is trying to build the casino you never want to leave. As a result, it is sapping the strength of established competitors like Walmart, which - once a Value Vampire to main-street retailers - is now closing hundreds of stores.

In response to the threat Amazon poses, Walmart recently purchased another Value Vampire: Jet.com. Jet.com built its business model on offering prices even lower than Amazon on top of a fast and responsive ecommerce platform. The company made no margin on the products it sold, and had no ambitions to turn a profit for at least five years. Walmart needs to beef up its online marketplace to take on Amazon, and by acquiring Jet.com it is hoping to do just that.

A second example of Value Vampires can be taken from the music industry. In the late 1990s, the music industry was riding high, with global revenues reaching $28.6 billion. CDs sold for $15 to $20 apiece, to the frequent complaints of consumers who felt 20 bucks was too much when they often only wanted a single track on the album. Enter Napster, a peer-to-peer file sharing service, in 1999. Its original aim was to connect music fans so they could share and download music, but it quickly disrupted the whole industry. First, the service was free, providing strong cost value for customers. Second, it delivered experience value by unbundling individual songs from the CD, so customers could download only the tracks they liked. Finally, it offered platform value by connecting fans with one another, and peer-to-peer sharing allowed it to quickly scale the number of songs and albums.

Most music retailers were afraid of Napster's business model, but did not think of adapting their strategy. HMV sued Napster and won, and Napster was eventually shut down. The Value Vampire was destroyed, but consumers had developed a taste for digital music. Thus, while HMV rested on its laurels, other players, including Microsoft (Zune), rushed in to try to occupy the space vacated by Napster.

ITunes initially won that battle by combining cost value – $0.99 per song; experience value – well-designed devices; and platform value – as an all-content provider. Because HMV had been unwilling to disrupt its own value chain, it was forced to retreat into a declining market niche, focusing on vinyl and CDs.

Although iTunes was supremely successful at disrupting the music industry for a while, their occupancy of the value vacancy did not last. New Value Vampires, focused on streaming media, like Spotify and Pandora have been further reducing the profit pool in the music industry. Apple, in response to these new threats, launched its own subscription service, Apple Music. It remains to be seen how successful this service will be.

Value Vampires are destructive forces within industries. They often do not have short- or even medium-term aspirations for profitability. They enter a market with a scorched-earth strategy to drive out the traditional competitors, hoping that they eventually can raise prices, once they have control of a market. Value Vampires can appear anywhere, but are more likely to succeed in markets suffering from a dearth of innovation, where customers frequently express dissatisfaction with product, price or service levels, and where incumbents have become complacent and used to high margins over a long period of time.

Take a look around you. Are you at risk?

*IMD Professor Michael Wade is author of the new book Digital Vortex: How Today's Market Leaders Can Beat Disruptive Competitors at Their Own Game. He is Director of the Global Center for Digital Business Transformation and co-Director of IMD's new Leading Digital Business Transformation program (LDBT).*

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