

Impact Assessment in Disruptive Innovation Markets

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1. Two Market Events



10th October 2007 5:30 GMT

Radiohead's **In Rainbows**



“This one’s on me.”
— NIN’s Trent
Reznor

5th May 2008

Nine Inch Nails’ **The Slip**

2. Four Initial Reactions

Reaction #1: Web 2.0

“Yes, **it's pay what you want**, including free. Really.”

— Radiohead, *InRainbows.com* (2007)

Radiohead & NIN were ‘early adopters’ of Web 2.0 platforms: MySpace, Facebook, social network sites, user-generated content

Reaction #2: Freeeconomics

“Offering free music proved successful for Radiohead, Trent Reznor of Nine Inch Nails, and a swarm of other bands on MySpace that grasped the audience-building merits of zero.”

— Chris Anderson, “Free! Why \$0.00 Is the Future of Business”, *Wired Magazine* (25th February 2008)

Reaction #3: Disruptive Innovation

“Early estimates pegged the group’s **first day take** at around **\$10 million** from sales of **1.2 million albums**.”

— Scott Anthony, “Radiohead’s Disruptive Innovation”, HBS ‘Conversation Starter’ blog (10th October 2007)

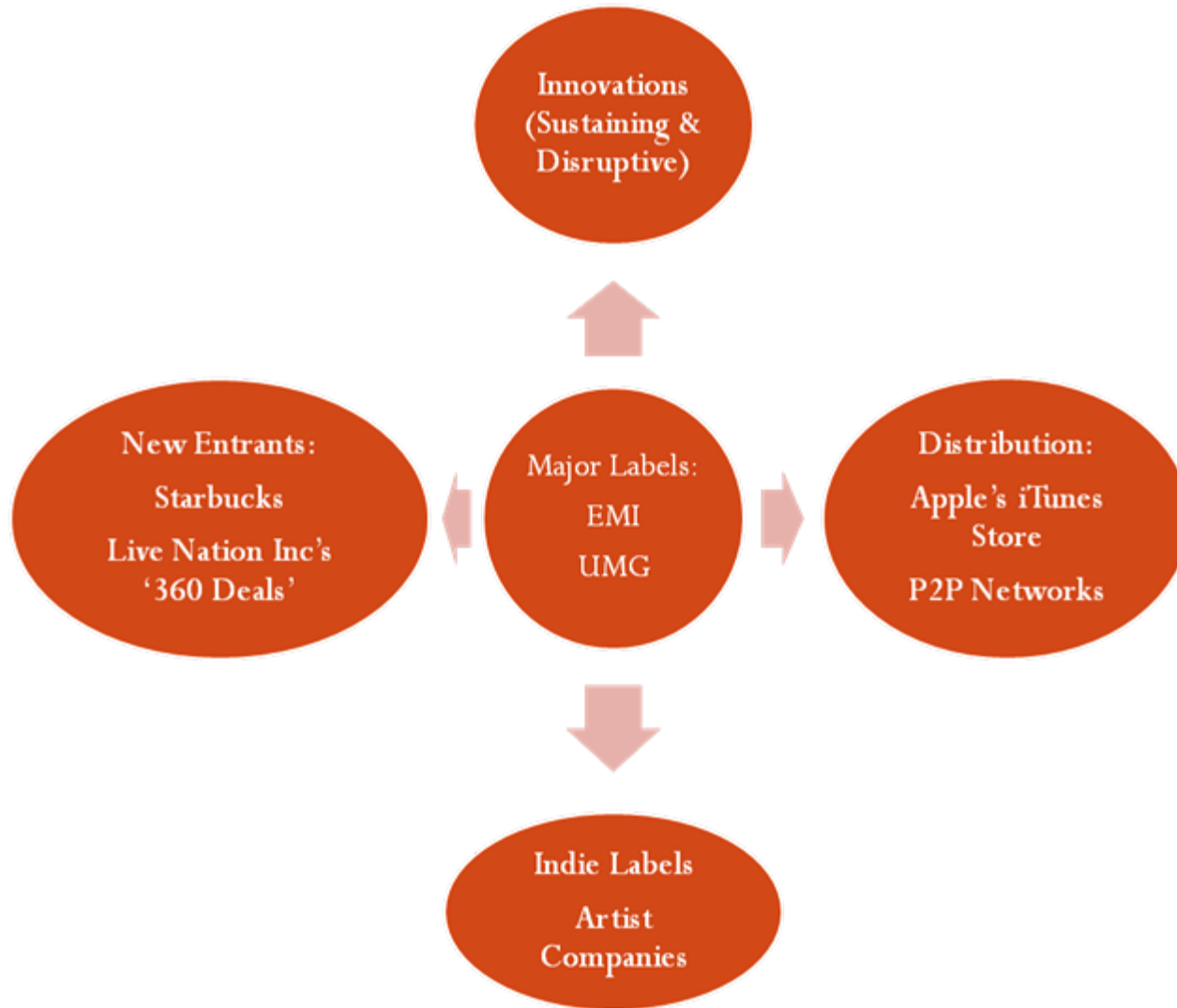
Reaction #4: Label Shopping

“Radiohead are **currently without a recording contract** with a major label . . . [*In Rainbows*’ release strategy] puts the band in a **better negotiation position.**”

— Alex Burns, “Commentary on [*NYT* article] ‘In Radiohead Price Plan, Some See a Movement’”, Disinformation® (11th October 2007)

3. Conceptual Frameworks

Music Industry Challenges



"Lucid, analytical—and scary."

—Dr. Andrew S. Grove
Chairman and CEO, Intel Corporation

Revised,
Updated,
and with a
New Chapter.

The Innovator's Dilemma

When
New Technologies
Cause Great Firms
to Fail

CLAYTON M. CHRISTENSEN

Sustaining vs. Disruptive Innovations

Sustaining

- Ancillary markets
- Licensing/Merchandising
- Bonus DVD content
- Dualdisc format
- Recording Industry Association of America's campaign against digital piracy

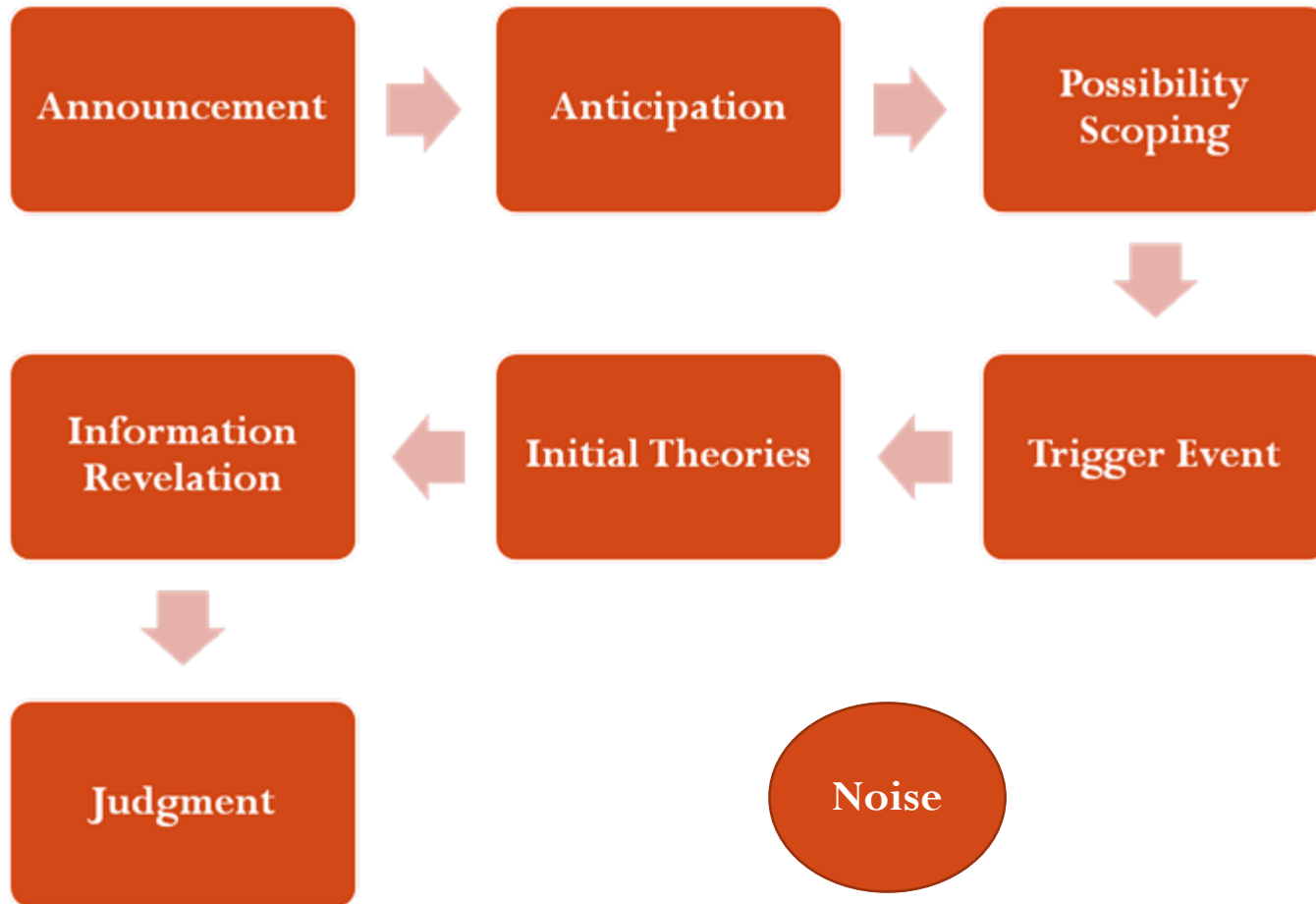
Disruptive

- Authorised 'bootlegs' by King Crimson & Pearl Jam
- Bowie Bonds (1997)
- Live Nation Inc.'s '360 Deals' (Madonna, Jay-Z)
- New market mechanisms
- Freeconomics releases
- Web 2.0 user-generated content adopted by artists
- Artist distribution & micro-labels

Disruptive Innovation Markets

- Implicit in Clayton Christensen & Scott Anthony's research: markets that *coalesce* around disruptive innovations
- Can emerge around new products & services, novel contexts of use, industry white-spaces and strategic foci
- A perturbation in the competitive/strategic landscape
- May differ from existing competitive rules and industry structures
- Examples: healthcare, aviation, semiconductors, global strategy, telecommunications & open source software
- Market challenges still apply: externalities, gridlock, regulatory challenges, adverse selection, information asymmetries, market failure
- Provides a conceptual framework for further analysis and research

Disruptive Information Revelation



Information Revelation

- France's Vivendi SA acquired UMG in 2000 (UMG was NIN's label)
- NIN's Reznor conducts pricing surveillance on UMG during 2007 Australian tour—tells fans to download albums, forms Null Corp.
- EMI backs a buyout by Terra Firma Capital Partners on 21st February 2008; EMI's shareholders approve deal on 1st August 2007
- Radiohead left in first 100 days of Terra Firma Capital Partners' acquisition of EMI:
 - 'Opinion Leader' type who leaves if post-merger integration fails
 - Radiohead faced a career 'strategic inflection point' (Andy Grove)
 - 'Culture clash' between EMI, Paul McCartney, Radiohead & others
 - EMI made errors in 'cultural due diligence' and 'transition planning'
 - EMI's threats created a 'window of opportunity' for Radiohead
 - EMI engaged in 'ambush' marketing for Radiohead's *In Rainbows*

4. Case Study Findings

Revisiting #1: Web 2.0

- Web 2.0 strategy to build autonomy in key processes: album recording, production and marketing
- Created ‘options and alternatives’ during the ‘label shopping’ phase and artist negotiations with industry music labels
- Cost management as a bargaining tactic—avoid major label contracts which force artists to pay for expense items
- NIN’s *The Slip* as an example of Real Options decisions for projects
- Simon Reynolds’ *Rip It Up & Start Again* (2005): many so-called Web 2.0 innovations developed by ‘new wave’ and ‘post-punk’ artists (1978—1984); NIN & Radiohead used late 1990s as incubation period to develop ‘core competencies’ for Web 2.0 strategies



'Reynolds' passion and
pinpoint accuracy remind us
of the reality and relevance of
the most exhilarating moment
in Britain's pop/rock history.'

Simon Armitage



Simon Reynolds

RIP it

UP AND

START

AGAIN

postpunk 1978-1984 **ff**

Revisiting #2: Freeeconomics

- ‘Buzz’ for digital downloads: NIN’s *The Slip* (2008) closely fits Anderson’s Freeeconomics model: a way to ensure album release was a media ‘event’, a ‘signal’ of Trent Reznor’s break from his major label UMG, and a Real Options decision to delay alternatives
- Spectrum of risk-seeking and risk-averse execution strategies: Radiohead allowed fans to choose a price point for *In Rainbows* (2007); Reznor gave *The Slip* away for free
- Modifications of Anderson’s Freeeconomics model: (1) strategic actors have their own reasons; and (2) have a learning/experience curve for strategy formulation & execution
- Suggests way to view Web 2.0: separate yet overlapping and possibly coevolving markets rather than a Kuhnian paradigm change

Revisiting #3: Disruptive Innovation

- Radiohead & NIN are positioned as a vanguard of *disruptive* innovators in digital downloads, production techniques, live
- Major labels are positioned as *sustaining* innovators
- Clayton Christensen & Scott Anthony's work on Disruptive Innovation Theory predicts Radiohead & NIN would leave their labels
- Provides a framework to distinguish *trigger events* from 'noise' in market announcements (Black-Scholes co-creator Fischer Black)
- Radiohead & NIN's concerns *precede* the emergence of a *Disruptive Innovation Market* as the *sole* reason for a digital download release
- It's still unclear if Radiohead & NIN's actions will create a viable and long-term *Disruptive Innovation Market*

5. Action Outcomes/Future Research

Insights for Journalists

- Self-reflective & practice-based research
- Frame conclusions as *contingent beliefs* — judgments that are revised on the basis of new information, facilitated by blog publishing systems
- Avoid *hindsight* and *survivorship* biases
- Nassim Nicholas Taleb's sceptical epistemology (*Foiled by Randomness, The Black Swan*) on new product/service announcements and other major claims

“Trying to model something that **escapes modelization** is the heart of the problem.”

— Nicholas Taleb, “Fear of a Black Swan”, *Fortune Magazine* (14th April 2008), pp. 60-61

THE INTERNATIONAL BESTSELLER

BLACK THE SWAN

The Impact of the Highly Improbable



**'Great fun ... brash, stubborn, entertaining,
opinionated, curious, cajoling'**

*Stephen J. Dubner, author of **Freakonomics***

Nassim Nicholas Taleb 

Insights for Policymakers

- Regulatory frameworks for Disruptive Innovation Markets:
 - Market design—prevent market ‘failure’
 - Anticipatory regulation
 - Antitrust and competition policy
 - Innovation capabilities
- New forms of industry dynamics & market structure
- Use a more diverse policy ecosystem
- Tap open commons spaces to encourage debate

Insights for Valuation Analysts

- ‘Thought leadership’ in M&A due diligence, event arbitrage & risk management
- *Disruptive* innovations as opportunities (gap between market perception and risk repricing); *Disruptive Information Revelation* provides a framework
- Opportunity to develop new valuation models:
 - ‘Hurdle’ measures for project financing
 - Events & risks in ‘due diligence’ phase of M&A
 - Strategic execution for time-based competition
 - ‘Stress-testing’ for *Disruptive Innovation Markets*

Questions?
