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

- Innovations (Sustaining & Disruptive)
  - New Entrants:
    - Starbucks
    - Live Nation Inc’s ‘360 Deals’
  - Major Labels:
    - EMI
    - UMG
  - Distribution:
    - Apple’s iTunes Store
    - P2P Networks
  - Indie Labels
    - Artist
    - Companies
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

- Announcement
- Anticipation
- Possibility Scoping
- Information Revelation
- Initial Theories
- Trigger Event
- Judgment
- Noise
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
RIP it UP AND START AGAIN
postpunk 1978-1984

Simon Reynolds
Revisiting #2: Freeconomics

- ‘Buzz’ for digital downloads: NIN’s *The Slip* (2008) closely fits Anderson’s Freeconomics 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 Freeconomics 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 (Fooled 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.”

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?