

Two causes of firm disruption

Disruption of established firms is an important phenomenon because it is a big event and has massive impact on firms, industry, suppliers, customers, community and the society. When the US auto industry was at the brink of failure in 2008, a large number of suppliers were also at the brink of extinction at the same time. When the Swiss watch industry was at the brink of destruction back in 1970s, the big banks in Switzerland were also badly hit. In fact, over 50% of employees in the Swiss watch industry lost their jobs due to large scale firm disruption that took place back then.

Some time back, I was visiting St. Johnsbury, Vermont to meet my publisher when I couldn't help notice that that quaint New England town on the border of US and Canada had a schizophrenic character; beautiful Victorian houses stood next to homes in disrepair. My publisher told me that the town was built around a scales company called Fairbank scales in the 19th century. At the height of its business success, it was the source of community vitality. As the business declined, the impact of the firm on the town declined. Over the years, its impact became negligible. This was the reason for the town's character. It reminded me of the impact of decline of tobacco firms on Durham, North Carolina. The impact of disruption of Kodak on Rochester, New York was somewhat similar.

There are dozens of reasons why firms get disrupted and the more I studied disruption the more reasons I found. But when you step back and take a big picture view, all these reasons boil down to two things. When firms fail to innovate or transform themselves when

needed, they get disrupted. The gales of creative destruction that disrupt established firms behave almost like a strong wind against a hard inflexible tree. While the flexible ones bend with the wind and survive the inflexible ones are shattered.

I often use a car race analogy to explain the relationship between disruption, innovation and transformation. Imagine you are participating in a car race where the rules are as follows. After each round, the last 3 cars are disqualified from the race. The remaining cars continue for the next round. Once disqualified, a car cannot come back in the race. A new car can always join the race but it needs to run the already completed rounds and catch up with current participants. As the race goes on the new cars stop coming in as the distance to be covered becomes too great to catch up. The winners are decided when the relative positions of the racers do not change for multiple rounds.

What would you do as a participant in such a race? You will very likely ensure that you find ways to remain ahead of others using many means. You could use superior technology, better skills or even use tactics to remain ahead of the race. You may learn how tire pressure leads to better handling and you may even tweak your engine to become more powerful. Each time you use these measures to stay ahead of competition you are bringing innovation to help you remain in the game. If you did nothing while your competition is innovating or even if you innovate but not as effectively as your competition does, you will soon be in the bottom three ranks and thus out of the race.

Now let's assume that the rules of the game change as follows. The car race moves beyond the race track to busy streets of metropolises, dirt roads of uninhabited places, over water bodies such as lakes and oceans, and even across mountains. To be able to remain in the race, you still need to finish each round without being in the bottom 3 ranks. This shift in rules of the game requires that you be able to change your car to do things that cars are often unable to do. For example, you now need to be able to manage agility at slow speeds in cities, have durability and adequate suspension on dirt track, be able to drive over water and fly over mountains. If you are unable to make these needed adjustments, you will not remain in the race. These requirements ask of you to transform the car into something much more than a car. When rules of the game change in an industry, often firms are also required to transform themselves. If firms fail to transform themselves they end up being disrupted.

In short, firms get disrupted when they fail to do two things - innovate adequately or transform themselves when needed.