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The Networked Idealist's Advantage

Alex Lowy and Phil Hood

Introduction:

A new type of innovator is revolutionizing marketplaces around the world. Called Networked Idealists (NIs), they combine the rascal-like idealism of Robin Hood with the network-based business models of early Internet businesses like Priceline and Netscape. These innovators are initially non-profit entrepreneurs who develop organic, cellular, distributed network structures to accomplish their work. They use financial, transportation and communications networks in novel ways to circumvent normal barriers to market entry. With the proliferation of networks, Networked Idealism is on the rise. Even networks that seem relatively benign—PayPal, GPS, Wi-Fi—may soon serve as launching pads for some new NI business assault.

Niklas Zennstrom is a modern-day practitioner of the economic theories of Robin Hood. His business models—digital versions of the concept of “expropriate from the rich and give to the deserving”—make him a direct intellectual descendent of the hero of Sherwood Forest. Where Robin challenged the control of church bishops and of politicians like the Sheriff of Nottingham, Zennstrom’s peer-to-peer software programs, such as the Kazaa file-sharing service and Skype’s voice-over-internet-protocol telephony service, attack the profit models of powerful corporations—such as the giants of the telephone and entertainment industry. And, though he is accused, like Robin Hood, of sometimes skirting laws, Zennstrom is admired by many, for using technology to meet real needs that existing businesses could not.

Competitors like Zennstrom are a new kind of business innovator called network idealists (NIs). NIs can inflict quick and sometimes lasting damage on market leaders before they are even aware they have competition. NIs flout the rules of business engagement and sow chaos by upsetting market expectations. As adversaries, they hit and run like guerillas and are tough to attack directly.

Networked idealists go beyond traditional innovators in a number of key ways. They depend on the spreading web of global networks to route around barriers to market entry. They create a loosely coupled networked architecture for the organization. And, frequently, they rely on charismatic appeal. Their viral growth is fueled by deep-seated populist sentiments, which their marketing can draw upon. They not only want market share, they—or their customers—want to change the world.

NI #1 Open Source Open source software is free in the sense that anyone may have access to the source code and modify it, but not copyright their innovations. Linux, the foremost example of open source, now runs a third of the world’s web servers and is invading other areas of computing, phones and other devices. It’s an ideally structured NI business. It’s global, distributed, and cellular, and its leaders almost all work for other companies, rendering them invulnerable to direct business attack.

The network is the key

Networks today are electronic and fast; and anyone can access them. The most obvious are two-way media like telephones and the Internet; an open global banking system; and international courier drop boxes in every neighborhood. It’s a mix that is spawning uprisings such as Howard Dean’s use of the

Internet to upset political power balances, and the Open Source software movement's attack on the traditional software computer businesses.

NI #2 Napster, Kazaa et al. These communities of song thieves began as idealists (let's share our CD collection with everyone on campus!) and then morphed into something like Internet terrorists, when VCs helped them attack the recording industry in its area of strength—distribution. The success of peer-to-peer file sharing broke Hollywood's resistance to new digital technologies.

What are the methods of NIs?

NIs tap into customers' needs or desires that traditional economic and social arrangements can't fulfill. They may offer services like free phone calls, free classified ads, or illicit music sharing. For example, Howard Dean's Internet-based campaign for the Democratic Party nomination articulated an anti-war view that party leaders had tried to muffle.

It is not quite correct to refer to NI users as "customers." They are more like fanatical converts who provide powerful word-of-mouth testimony. By connecting users into communities, NIs such as MoveOn, Skype, Friendster and Linux tap into

deep-seated emotional desires for belonging. Howard Dean's campaign ignited participation, rather than just soliciting votes.

Competitive characteristics of the NI

The distinction between networked idealists and innovators that exploit networks is sometimes difficult to parse. In fact, businesses of all types are starting to adopt the NI tactics, particularly in their startup phase. There are five strategies or characteristics that tell us when a business is a networked idealist:

1. Guerilla infrastructures and radical architectures. The NI skirts traditional barriers to entry by using guerilla approaches. For example, Skype uses the net to bypass the phone network.
2. Winning by not trying. NIs don't want to succeed by the measures of incumbent firms. This asymmetric competition is characteristic of most innovators but is particularly pronounced in networked idealists.
3. Value-based motivations. NIs are idealistic. Think of open source copyright or Google's injunction—"Do no evil." Many NIs challenge our traditional capitalist experience: they believe that doing good and making money can go hand-in-hand.
4. Attack strengths. Traditional businesses often start by searching for unfilled niches that have been overlooked by mainstream competitors. An example of this is Southwest Airlines' decision to appeal to seniors and consumers. NIs go the other way—they attack incumbent strengths directly. Insulated from direct counter-attack by their low profile, idealism, and sometimes, venture funding, NIs feel free to go for your jugular. Linux attacked Microsoft's monopoly of the OS. Moveon.Org attacked the fundraising advantage of incumbents. Kazaa attacked distribution, the strong suit of traditional record companies.
5. Knowledge from the people. NIs typically involve partners, customers and supporters deeply in value creation, if not decision-making.

NI #3: Howard Dean. Howard Dean is important because like many network idealists, he proved the concept but failed to gain wide acceptance. Dean's candidacy bypassed establishment media and funding, tapping into aspirations and passions that mainstream politicians could not harness, but he became popular too quickly. NIs benefit when they are ignored in their formative stages. They make mistakes in private and learn to grow. Once Dean made the cover of Newsweek, he galvanized opposition. One shrieking fit and he was toast.

Destroy conventional barriers to entry

The NI succeeds by finding a strategy that overcomes barriers to entry and destroys competitors' value at the same time. Lack a market presence? Try viral marketing. Lack the cash to purchase product placement in CompUSA? Give the product away free online. Need resources to finish

website development? Reward customers with recognition instead of cash for contributing to your web site. Want to overcome copyright constraints? Create a free public license for your work.

NIs typically want to accomplish a lot with limited resources, and have an impact they couldn't achieve in traditional ways.

Traditional Competitor	Networked Idealist
Attack weaknesses	Attack strengths
Lead with economic argument	Make it free and appeal to ideals
Traditional marketing: Grow arithmetically	Viral marketing: Grow exponentially
Keep control in the center when feasible	Lead from the center; rely on customers for knowledge
Seek attention and publicity to appear large and powerful	Avoid unnecessary limelight to retain credibility

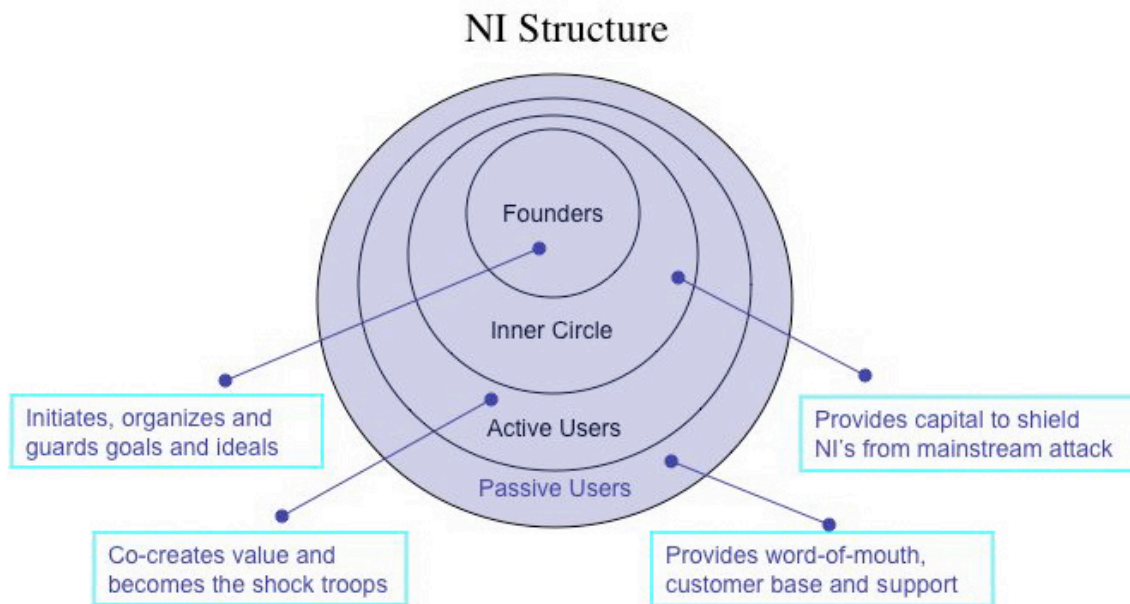
In his landmark book, *Competitive Advantage*, author Michael Porter identified seven barriers to market entry that help incumbents keep new entrants at bay: Economies of scale; product differentiation or branding; capital requirements; switching costs; access to distribution channels; cost disadvantages independent of scale, such as specialized knowledge or access; and government policy.

NIs seek to undermine at least four of these. They use networks to ramp up scale quickly. They differentiate by appealing to idealistic or radical impulses, often creating a charismatic brand in the process. They overcome capital requirements by using contributed labor

and public infrastructures. And, they skirt the regulations that restrict innovation in many industries.

More diversity, better strategies

NI businesses have one unique advantage: As idealists they are free to express non-mainstream, often subversive impulses that established corporations can't. And they can meet customer needs that established businesses find unprofitable or socially undesirable.



NIs quickly become diverse and sophisticated by accessing community resources. In systems thinking terms, they innovate by enabling parallel streams of creativity. They tap the diverse hearts and minds of customers and partners to do this.

NI leaders are cognizant of the need to incorporate followers into decision-making and value creation processes. Like political leaders of popular movements they tap into powerful feelings of alienation, addressing philosophical conflicts with established power, as well as needs for personal identity and recognition. Doing business with an NI is often experienced as positive, hopeful and fun by those involved.

The networked idealist architecture

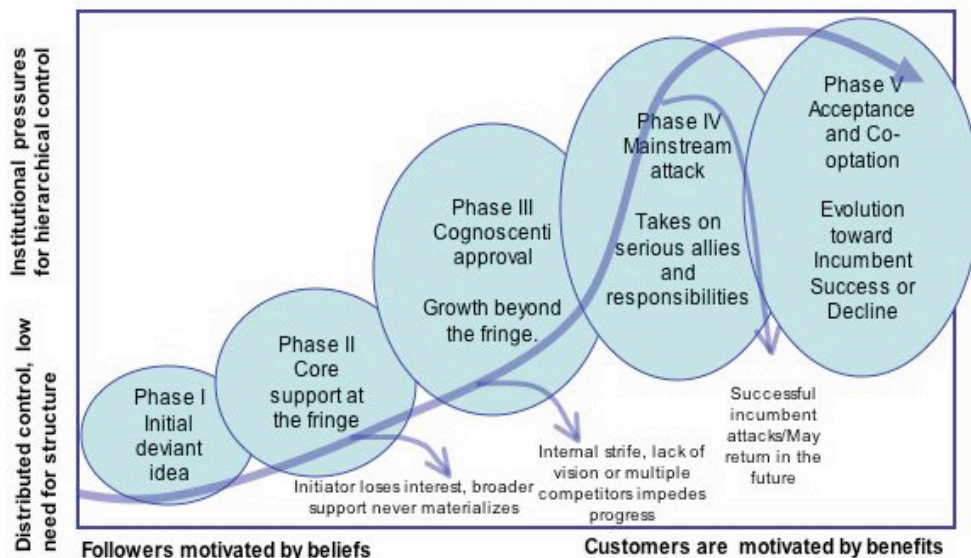
NIs are organized like the networks on which they move: organic, cellular, distributed, and intelligent at the peripheries. They arise out of genuine needs and they proliferate rapidly across barriers such as borders.

Modern NIs are shaped like concentric circles, with founders at the center. While power tends to be hierarchical as in most traditional firms, there are some important differences. Decision-making authority is granted based on expertise, rather than position. They create systems and structures to be highly responsive to customers and the active users who create great value. Closest to the founders are an inner circle of advisors, mentors and often, funders. In business NIs, these may be VCs or innovative customers. The next circle consists of active users who co-create the content of the organization. These are the letter-writers and event hosters in Moveon.org or the Kazaa users who put huge libraries of songs up on the net. In the outer circle are the public supporters or customers of NI ventures. They provide funding to the enterprise and passionate word of mouth support. Business NIs typically are chatterboxes, relying on a porous organizational structure that enables leaders to set direction, while actors at the periphery can remain relatively autonomous. Each circle in the structure is linked by available public networks and connected using the simplest tools and applications

The NI cycle

The cycle starts in Stage I with an idea, generally crystallizing in a way to use the network to meet unfulfilled needs. Support for the core idea grows in Stage II, as the creator receives encouragement, and a small community forms. Successful NIs count on being overlooked by their potential opponents. Netscape had all but conquered the net when Microsoft woke up to its existence. Technology executives like Bill Gates, Steve Ballmer, or Scott McNealy tried to dismiss Linux with ridicule. When incumbent power is incapable of understanding or responding deftly, advantage shifts to the NI. In Stage III the NI message reaches beyond the inner circle as the full potential of the

Five Phases of Networked Idealism



organization becomes evident to founders. In Stage IV the NI forces becomes visible and begin to attack the market head on. At this point, the movement starts to institutionalize itself, building the foundation for long-term viability. Assuming an NI survives to Stage V, it is absorbed into the mainstream. In most cases, NI initiatives die a natural death at earlier stages of the developmental journey.

NIs are a growth industry

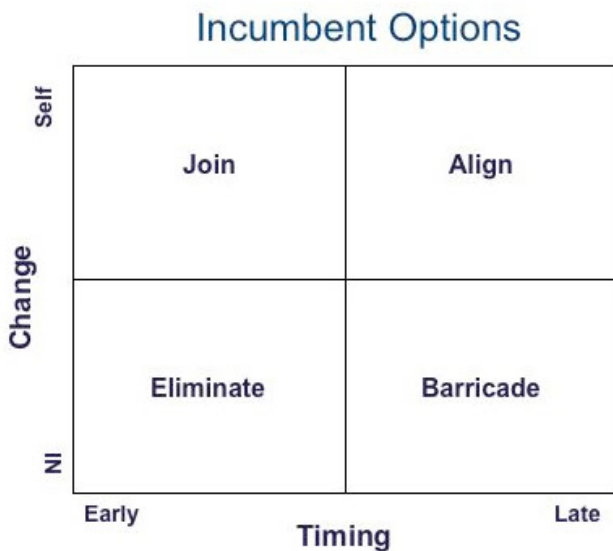
So far, business NIs have shown up most often in pure technology industries, like computing. But all fields of endeavor are becoming more technology driven and prone to sudden shifts in the desires of their constituencies. As society shifts from an economy based on choices limited by the time and resource constraints of a manufacturing system ("You can have it in six weeks.") to one based on meeting the instantaneous needs of customers (speed dating), customers and citizens feel entitled to more input and control. They seek to support companies, and politicians, who reflect their ideals. They become perfect targets for NIs.

Incumbent options

What options does an incumbent firm (or political candidate) have when confronted with a networked idealist opponent? Whether you are a government or a corporation, the best defense against NIs is to improve your own strategic responsiveness. Even firms who score well on customer satisfaction surveys might ask themselves, "What makes my customers passionately unhappy?" Becoming aligned with the needs of your constituency at an organizational and process level makes you better able to adapt. Organizations that promote a diverse group of people and viewpoints, that listen to input from inside and outside the core, and are prepared to accept the facts as they are and move on, have far more success adjusting to challenges.

The Incumbent Options matrix describes four strategies available in response to NI activity. These are based on whether the response is early or late in the NIs lifecycle and whether you seek to change the behavior of the NI or of yourself.

Eliminate: Powerful enterprises have a long tradition of calling on their lawyers to attack competitors. Intel, in the '90s, was accused of using lawyers to bludgeon smaller chip companies into relinquishing their rights to intellectual property that might threaten the x86 monopoly. They recently paid off Intergraph in one such case.



A variation on this approach is to Buy and Bury. Microsoft bought several promising video and multimedia companies in the '90s, only to bury them and their formats and standards that threatened Windows future control of computer multimedia. The pharmaceutical companies may have tried a variant of this when they convinced Congress to ban Medicare from negotiating lower drug prices, thwarting the nascent NIs in the health care industry.

Join: Often it's more promising, and certainly more fun for all involved, to join the NI cause. You can try to inoculate yourself by introducing a bit of the NI

virus into your own bloodstream. In 1997 and '98, IBM began investing in open source projects such as the Apache web server. This engendered warm relations with independent programmers and gave IBM visibility into the development of the open source initiative. As it turns out, IBM has perhaps been the biggest beneficiary of open source programming to date.

Barricade: If an NI assault has reached adulthood unimpeded, competitors must find a way to slow it down. Legislation is always a good option for incumbents who may have friends in high places. That's how the entertainment industry historically has attacked new formats that threatened profits.

The regulatory process can also be friendly turf to big firms in fields with heavy government oversight such as medicine or telecommunications. VOIP (telephone via the Internet) is coming under attack in state legislatures and utilities commissions as lobbyists stoke fears of poor service and reduced tax revenue.

Align: Medieval monarchs regularly arranged marriages with other royal families that might threaten them as a way of avoiding or ending nasty wars. Similarly, one can meet the challenge of a mature NI effort through various forms of co-option and cooperation. Microsoft's "embrace and extend" philosophy is one way to leverage and co-opt standards created by others. At some point every successful NI will become part of the establishment and lose its upstart luster. Anything you can do to hasten its acceptance into the mainstream paradoxically may strip it of its power.

The lessons of networked idealism

No matter which course an incumbent takes, it's crucial to have a strategy once a Robin Hood arrives on your patch of the market and defines you as evil or irrelevant. Even NIs that fail can sow chaos that benefits competitors. Firms such as Microsoft, RealAudio and many smaller competitors spent hundreds of millions of dollars trying to make a go of it in the digital audio market. But then Napster, Kazaa, Gnutella and other peer-to-peer file sharing projects threw the whole digital downloads market into chaos. None of the entertainment giants had a clue as to which strategy to pursue or which partners to trust. Apple moved into this unstable situation with integrated software and hardware solutions, plus Hollywood connections no other companies could match. As of this writing, Apple's iTunes music service has more than 80 percent market share, an outcome no one could have foreseen three years earlier.

The frequency of NIs will only increase as new networks are formed. Paypal, Wi-Fi, RFID tags, web logs, GPS and private, shared jet services are but a few examples of proliferating financial, communication and transport networks that are smashing barriers. New competitors will ride these networks, thriving on your inability to meet the needs of your constituencies. Are you prepared for the next generation of NIs?

Biographies: Alex Lowy and Phil Hood are principals of The Transcend Strategy Group consultancy and authors of *The Power of the 2 x 2 Matrix: Using 2 x 2 Thinking to Solve Dilemmas and Make Better Decisions* (Jossey-Bass, 2004).

Located in Toronto, Lowy has co-authored two other best-selling business books, *Digital Capital: Harnessing the Power of Business Webs* (Harvard Business School Press, 2000), and *Blueprint to the Digital Economy* (McGraw Hill, 1998). Hood is a Silicon Valley consultant and researcher.