Expand market reach

Connecting fragmented buyers and sellers—wherever, whenever

A pattern study from the Center for the Edge's *Patterns of Disruption* series

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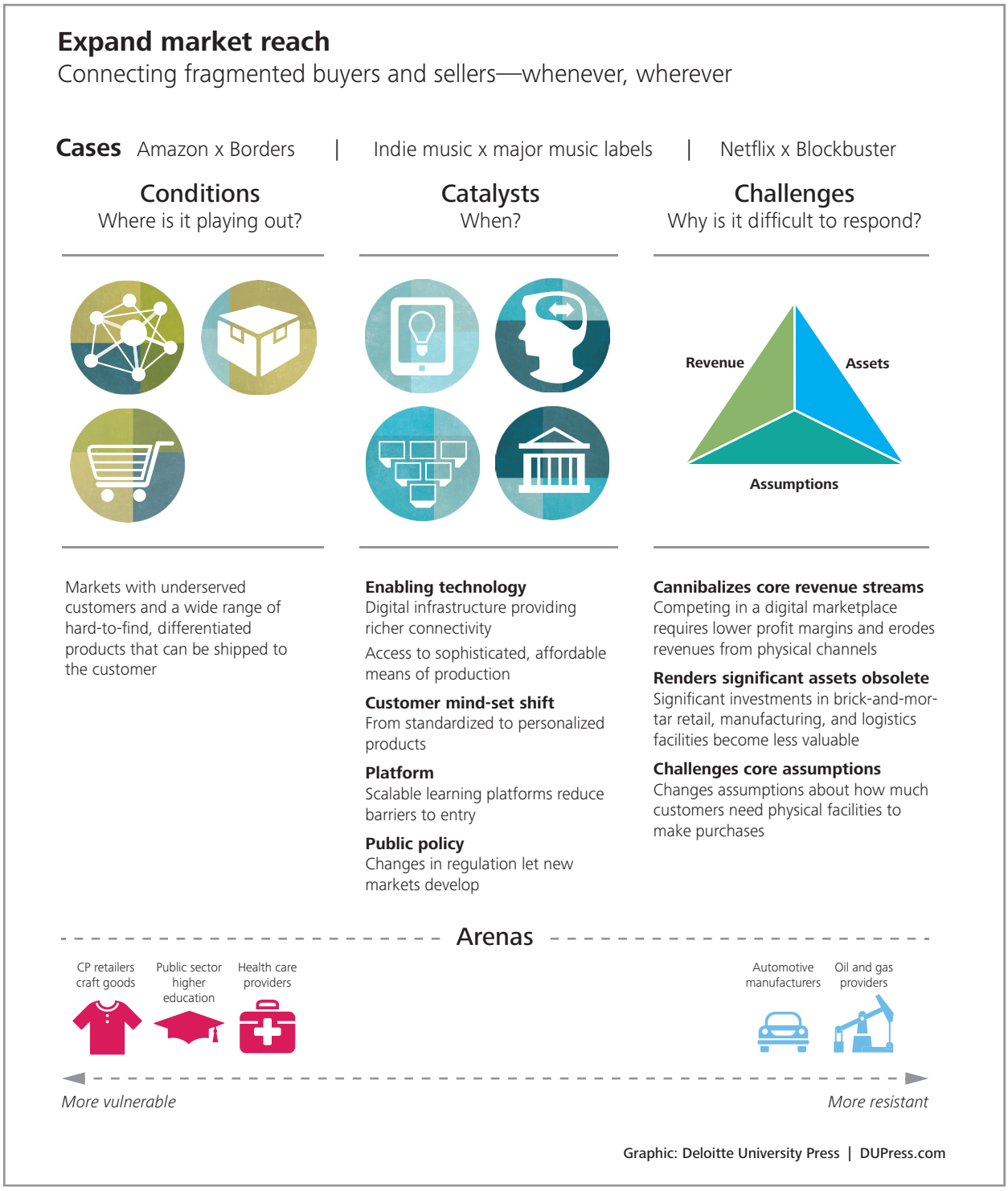
Def. **Significantly expand market reach via a marketplace (typically digital) that allows customers to access a broader range of producers and suppliers**

New distribution channels make it possible to reach more customers with a wider range of products than was previously available. New producers and sellers can take advantage of emerging distribution channels to transcend geographic proximity, leading to an increasingly fragmented producer market that is no longer limited by the scarcity of shelf space.

In the report ***Patterns of disruption: Anticipating disruptive strategies in a world of unicorns, black swans, and exponentials***, we explored, from an established incumbent's point of view, the factors that turn a new technology or new approach into something cataclysmic to the marketplace—and to incumbents' businesses. In doing so, we identified nine distinct patterns of disruption: recognizable configurations of marketplace conditions and new entrants' approaches that can pose a disruptive threat to incumbents. Here, we take a deep dive into one of these nine patterns of disruption: **expand market reach**.

Figure 1. Pattern snapshot



Throughout history, technological advances in transportation and distribution have spurred market expansion. For example, in the 1890s, the combination of robust rail service and the Sears, Roebuck and Co. mail-order catalog enabled a broader assortment of goods to reach rural farmers. The same railroad infrastructure helped bring a broad product array together under one roof in the department store until widespread use of the automobile led to the creation of the shopping mall and the discount store. Today, technological advances in the form of platforms and digital distribution channels are creating even more direct links between buyers, sellers, and producers. The resulting cost structure is such that a significantly broader product array can be offered to a significantly larger audience.

In recent years, we have seen this pattern play out in two phases. First, new distribution channels that aggregate niche supply and demand (such as Amazon, eBay, or app stores) challenge traditional brick-and-mortar distributors. These new channels feed the growing demand for personalized products and are enabled by advances in digital platforms, shipping, and payment systems. As these digital marketplaces grow, they rapidly consolidate as a result of network effects—the more likely customers are to turn to a specific site, the more likely sellers are to use its digital storefront services.

Secondly, fragmentation occurs on the supply side. Increased access to sophisticated tools of production enables many new producers to create personalized products. Producers then use the new distribution channels to connect with buyers in markets that were previously not economically viable to serve without aggregated demand. Etsy's 1.4 million small businesses[1] and the near-doubling of music artists in the last decade illustrate this trend.[2] With lower asset and inventory requirements than traditional stores,[3] these new marketplaces enable producers to build businesses around personalized products and create new value for customers by providing them with greater access to personalized products while reducing their total cost (time and money).

Brick-and-mortar incumbents struggle to respond in part because they cannot compete with the lower margins of hybrid or pure digital distributors. Digital catalogs allow the new channels to offer an almost unlimited product selection while the nature of the marketplace eliminates the need for large inventory or physical storefronts. Incumbents, on the other hand, tend to be heavily invested in physical assets—such as real estate, employees, inventory, and the systems for managing them—that are required to serve the customer base. If the incumbent moves to a digital channel, these costly assets become less relevant and may have to be written off. Such write-offs are not appealing and imply significant changes

Key stats

- Network effects: By 2020, nearly 60 percent of the world's population will be online, increasing the global connectivity of buyers and suppliers.[4]
- 40 percent of Amazon's sales come from inventory it does not own.[5]
- By March 2008, 25 percent of Netflix revenues were coming from products not available in the largest offline retail stores.[6]

> "The Internet made it possible to banish geography, enabling anyone with an Internet connection and a computer to browse a seemingly limitless universe of goods with a precision never previously known and then buy them directly from the comfort of their homes."
>
> —Steve Wasserman, "The Amazon effect"[8]

throughout the organization. However, without writing those assets off, incumbents are burdened by them and have to maintain higher prices. For example, some analysts estimate that leading digital-only retailers operate at a 15 percent price markup compared to an average 65–80 percent markup for apparel-centric retailers.[7]

For some incumbents, the idea that customers would prefer a digital distribution channel over the physical in-store experience challenges their core assumptions about sales, marketing, and the degree to which customers need physical facilities to make a purchase. Incumbents that do consider transitioning to a new model are often immobilized by the thought that this new channel would cannibalize revenue from their existing marketplace.

The most vulnerable arenas are typically those in which customers have diverse preferences for products across a wide range of contexts (whether or not that has translated into demand), and the products have short, frequent purchasing cycles, few shipping limitations, are subject to limited regulation, and are easily evaluated by the customer without testing. Arenas that have traditionally relied on physical storefronts are also more vulnerable to low fixed-cost distribution channels. Mass-market producers that have relied on their influence and control over distribution channels as a competitive advantage are also likely to be vulnerable.

Digging deeper

Does this pattern only apply to digital marketplaces and digital products?

This pattern has historically played out through a variety of non-digital distribution channels—from mail-order catalogs to the department store, from the mall to the discount retailer. Customers have always sought greater breadth and depth across product categories. While the Internet is the most common and obvious enabling technology we see today, we can expect future waves of technology to enable this pattern to play out in in new and unexpected ways. Just as it would have been difficult to predict the invention of the car, predicting the next wave of enabling technology can pose challenges.

When it comes to product type, more digitized products have been affected by this pattern simply because digital products are generally easy and cost-effective to distribute. However, other typically easy-to-distribute products, such as physical books and small arts-and-crafts goods, are also conducive to this pattern as evidenced by companies like Amazon and Etsy. The purses, cutting boards, cell phone cases, and home goods sold in these marketplaces are physical products, yet the platform is still experiencing success.

Isn't the long tail a myth?

One challenge to Chris Anderson's theory of the long tail (describing a cultural and economic shift away from a relatively small number of mainstream products and markets and toward a larger number of niche products and markets) came from Anita Elberse in her *Harvard Business Review* article "Should you invest in the long tail?" Elberse claims that blockbuster products are gaining share to niche products and that the long tail is in reality flattening and lengthening. In the online music market, she discovered that the top 10 percent of Rhapsody's titles account for 78 percent of plays, and that the top 1 percent accounts for 32 percent of plays.[9] To put these numbers in perspective, 1 percent of Rhapsody's titles is roughly equivalent to the music inventory held in a large retail superstore.

The nuance between Elberse's research and Chris Anderson's theory is that they employ different definitions for the "head" and the "tail." Anderson's definition accounts for the absolute number of products being sold—the head is "the selection available in the largest brick-and-mortar retailer in the market," whereas the tail accounts for "everything else, most of which is only available online."[10] Using this definition, the head of the online music market actually accounts for 32 percent of all plays and the tail accounts for 68 percent.

Case studies

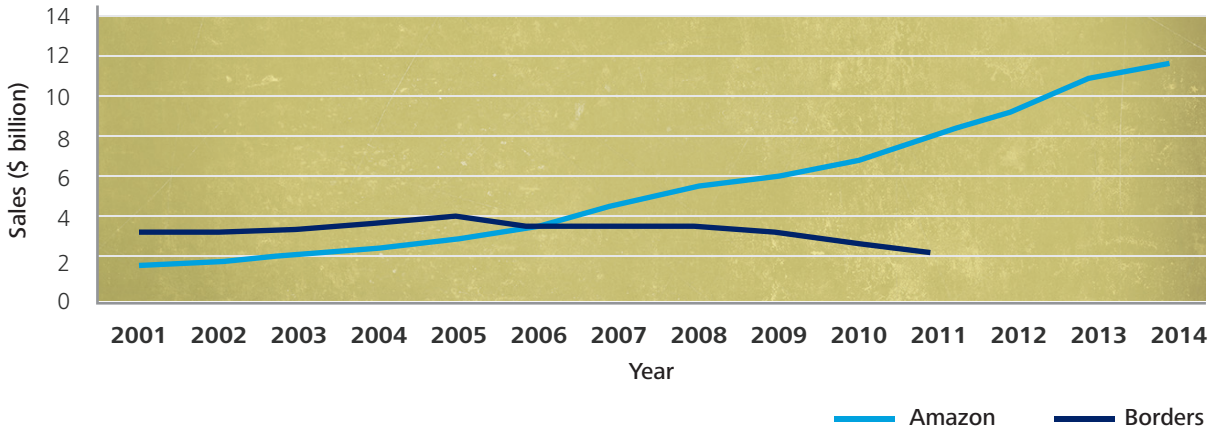
Amazon displaces Borders

Retail giant Amazon began as a bookstore in 1995, just five years after the introduction of the Internet. Over the next decade, Amazon capitalized on the rapid growth of the Internet to scale and displace leading brick-and-mortar bookstores, including Borders—the second-largest book retailer in the world at the time.[11] Improvements in shipping (for example, speed, cost, and parcel tracking) and digital payment systems enabled Amazon to create a digital marketplace that addressed the long tail of the book market and fed customers' growing expectations for personalized products.

Historically, the diversity of the book market made it hard for a bookstore to serve all customers—almost more overwhelming than the number of books available from publishers is the wide range of customer demand, spanning backlist and new products. The long tail of demand was poorly served by the big-box book retailers because it was difficult and unprofitable to stock and maintain inventory across the vast range of niche titles across multiple brick-and-mortar locations. Amazon's online retail platform simplified inventory management by allowing inventory to be held against an aggregate demand and reduced the overhead costs to offer a much wider range of books than its brick-and-mortar counterparts. By 2008, 30 percent of Amazon's book sales came from titles that were not available in even the largest offline retail stores. Amazon amplified its market reach by using on-demand fulfillment and leveraging third parties to sell inventory it didn't even own.

Unmet customer needs may have fueled Amazon's digital marketplace, but its viability was initially based on the characteristics of the book market. The book was the perfect product for e-commerce—the book was durable, easy to ship, and didn't require hands-on interaction prior to purchase. Books, as with other media, are frequently purchased and quickly consumed, which allows for the low

Figure 2. Amazon overtakes Borders (as measured in sales)



Sources: Amazon.com Inc. and Borders Group, Inc. 10-K reports, https://www.sec.gov.

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margins, yet high turnover required for profit in an online marketplace. All these advantages point to the viability and the success that brought millions of customers to Amazon's digital marketplace.

The shift in the way customers approached book buying mirrored their growing familiarity with the Internet and online purchases elsewhere in their lives. Over time, customers gained trust in online reviews, which disintegrated the in-store customer experience that was traditionally the pride and focus of brick-and-mortar retailers. As customers gained access to more niche products, those who had previously settled for mainstream products began to expect products that better fit their personal needs. But this wasn't the only customer mindset shift—lowered barriers to entry opened up new options for producers. By facilitating discovery and transactions between customers and niche publishers, Amazon reduced barriers to entry for smaller publishers, leading to fragmentation in the publishing market. In 2013, a quarter of Amazon's top 100 Kindle books were written by self-published "indie" authors.[12]

> "Crucially, there are far too many books, in and out of print, to sell even a fraction of them at a physical store. The vast selection made possible by the Internet gave Amazon its initial advantage, and a wedge into selling everything else."
>
> —George Parker[13]

Borders paid little attention to the threat of Amazon. It may be that Borders did not see online marketplaces as a threat to the in-store experience it assumed its customers preferred. In 2001, Borders handed over its online operations to the very competitor that would later be its downfall, citing that its online marketplace "will continue to be utilized as a convenience retail channel."[14] In turn, Borders focused on driving more revenues by investing in store real estate and inventory, a strategy it would later cite as "problematic" in its 2011 bankruptcy filing.[15]

By focusing on brick-and-mortar assets such as real estate, inventory, and employees, Borders overinvested in what soon became liabilities as more and more customers turned online to fulfill niche needs. What Borders was unable to see is that the market for books not sold by its stores was larger than the market for those that were—the average Borders superstore carried an inventory of just 81,000 titles;[16] yet by October 2004, more than half of Amazon's book sales came from outside its top 130,000 titles.[17] In addition, while Amazon leveraged on-demand fulfillment and third-party inventory to cut down on its infrastructure needs, Borders's needs continued to increase with its brick-and-mortar expansion.

During this period, Amazon also benefitted from tax laws that exempted online purchases from state sales taxes, allowing it to be a low total-cost option, in addition to its already low product margins, further challenging incumbents whose profits had to cover infrastructure assets.[18]

Borders declared bankruptcy in 2011 after severe loss of market share and half a decade of unprofitability.[19] Other incumbents have been similarly challenged—independent bookstores decreased in number by over half from 1994 to 2014 and now command less than 10 percent market share by units sold.[20] Those bookstores that have survived have maintained market share by investing in online and e-book marketplaces or by finding niche demand in a market where they can still compete.

Short story

Netflix displaces Blockbuster, 2000–2010

Between 2000 and 2010, Blockbuster Entertainment went from being a movie rental giant with 9,000 stores across the United States to declaring bankruptcy, as Netflix expanded the reach of the movie rental marketplace, first with physical movie rentals, and then with streaming services in 2007.[21] Rather than replicate Blockbuster's focus on "hit" movies, Netflix brought unique films to viewers searching for niche titles, such as documentaries and Bollywood films. As of March 2008, Netflix had an inventory of 90,000 DVDs, and 25 percent of Netflix's sales were from products not available in even the largest offline retail stores.[22] Blockbuster did not go down easy. In an effort to match the appeal of Netflix, Blockbuster began to discontinue late fees and invest in a digital platform—this move cannibalized two core revenue streams, hurting profitability and resulting in the ousting of CEO John Antioco.[23] Unable to compete, Blockbuster fell from boasting a company value of $5.9 billion in 2003, to holding a value of just $24 million immediately prior to filing Chapter 11 bankruptcy in 2010.[24]

Indie music labels displace major music labels

Between 2004 and 2014, as digital tools for production, marketing, and distribution matured, the major US music labels (Universal, Warner, Sony, and EMI) lost 29 percent market share—from 82 percent in 2004 to only 53 percent in 2014. They were displaced by non-major labels, who tapped into the long tail of supply and demand in the music industry and brought niche artists and genres to customers via a growing digital distribution channel.

The music market was rapidly transforming during this time as digital distribution channels disrupted brick-and-mortar record stores. Customers have a diverse range of music tastes, and there were large segments of the market that were underserved due to both brick-and-mortar inventory limitations and the lack of niche offerings represented on radio stations, which are often controlled by major music labels. Digital distribution channels, enabled by the switch from analog to digital consumption, expanded the reach of the market and brought the long tail of music to customers, resulting in a diversification of what is "popular." Consider that most of the top 50 albums of all time were created in the 1970s and '80s, with none made after 2000.[26] The last decade has seen a fragmentation of preferences, which makes smaller players sustainable in a way that was not previously possible without the aggregated demand from digital channels.

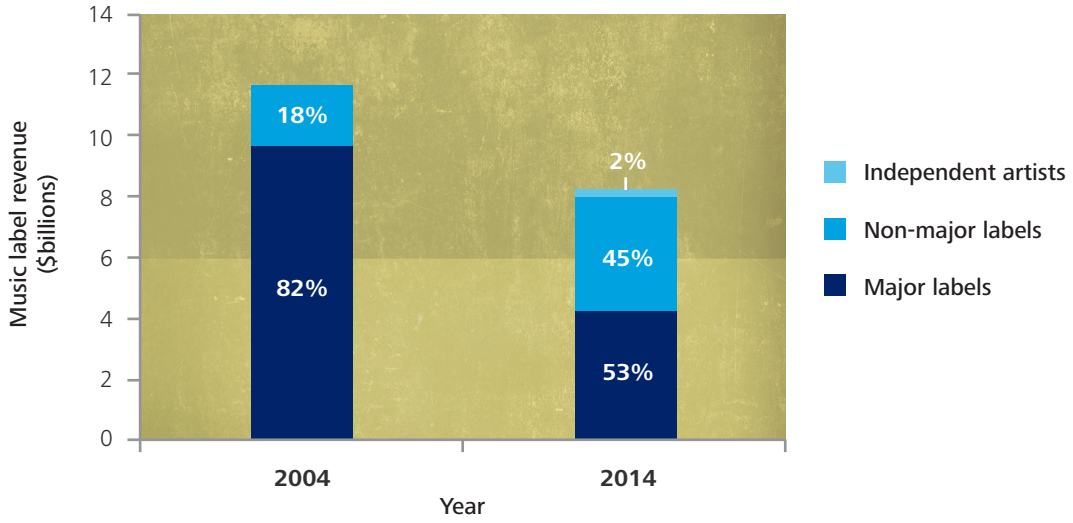
> "We don't have to work with major labels anymore, because the digital economy is creating new ways to distribute and market music."
>
> —Courtney Love[25]

This transition not only brought niche artists and genres to customers, but also unbundled the single from the CD. This unbundling decreased overall market revenue, challenging independent record stores, such as Tower Records, which relied on the high-margin CD to support its large inventory and infrastructure requirements.[27]

Using the new digital distribution channels, new artists entered the market, fragmenting the producer marketplace. The proliferation of affordable digital audio workstations and easily accessible learning platforms helped musicians produce and improve the quality of their recordings. Through community organizations and learning platforms, "musicians are providing the same sort of guidance previously offered by major labels—for themselves and for one another."[28] At the same time, digital distribution platforms (such as SoundCloud or YouTube) made non-label artists visible and discoverable by the listening audience. As a result, the number of new albums produced 2011 was nearly double the number produced in 1999.[29]

This proliferation of artists highlights a shift in mindset as more consumers also act

Figure 3. Major music labels have lost market share in a declining market



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Graphic: Deloitte University Press | DUPress.com

as creators who produce and share content.[30] However, large labels have continued to focus on hits that would warrant the management and financial resources for promotion and marketing. This has opened the door for smaller labels to capitalize on the increase in available artists, content, and means for finding, managing, and distributing them. Non-major labels have become increasingly more viable as new digital distribution platforms make it easier for consumers to find and support niche music offerings.

With almost zero marginal cost for adding content, digital channels can maximize the amount of content hosted on their sites and will look outside of major labels for that content. This transition has made major labels' manufacturing and distribution assets, and the advantage they conferred, less essential for success. The weight of their investments in these assets has made them slower to abandon traditional ways of doing business.

In addition, while major labels traditionally had the radio and marketing connections to control access and influence customer taste, the growing popularity of music streaming services means that radio play is less important. Consider that as of 2014, 87 percent of the songs on the radio are from major labels, whereas only 50 percent of the songs people stream on Pandora are from major labels.[31] As digital platforms enable customers to turn away from music stores and traditional radio, customers are able to form their own preferences, limiting labels' control over demand and challenging their core assumptions of oversight

Short story

Etsy

Etsy has grown into the largest handmade marketplace in the world, with over 40 million subscribers, 1.4 million small businesses,[32] and $1.93 billion in merchandise sales in 2014.[33] While Etsy accounts for a small portion of the overall consumer goods market,[34] by meeting the demand for personalized goods, it is further fueling demand for unique and personalized products rather than standardized mass-market products. Aggregation platforms such as Etsy aggregate niche demand and reduce barriers to entry for both producers and sellers, changing the table stakes of retail and allowing for the fragmentation of marketplaces. Low switching costs and low brand loyalty help customers seek out products that meet their needs. In response, some retailers have started to incorporate customized products into their offerings; large producers will likely risk losing shelf space to smaller, homemade players.

and profitability in hits. Furthermore, major labels' assumption that artists need their backing to succeed has been challenged in recent years as artists are becoming frustrated with the rigid rules common to major labels and are turning instead to niche labels.

The music industry is changing, tastes are fragmenting, and artists and non-major labels alike are entering the market in response. Major labels may be in for a tough journey as consumers sit back, turn on their favorite Spotify playlist, and listen to the new song that the band down the street recorded from the comfort of their own home.

Is my market vulnerable?

Do customers use the product in many different ways across a wide range of contexts?

The less homogeneous the customer base and the product use, the more likely customers are to demand more specialized offerings as it becomes viable to distribute those offerings to customers, wherever they are. Free from the constraints of shelf space and local inventory, digital marketplaces can provide more of those offerings.

Are large segments of those niche markets underserved (geographically, due to inventory constraints, etc.)?

Customers that are underserved through current channels are likely more willing to switch to new marketplaces to satisfy their needs.

Do your current operations (for example, distribution or manufacturing) require a significant investment in assets?

For all the ease of going from an online storefront to physical shop and back again, the economics of operating online are very different from those of operating brick-and-mortar locations. If manufacturing or distribution are not optimized for niche demand, there may be challenges addressing the long tail.

Is the product of high value relative to its size and/or weight?

Online marketplaces necessitate the shipment and delivery of products to customers; the more valuable a product is relative to its ease of distribution, the more vulnerable that product category is to disruption through an expanded market reach.

Are customers comfortable enough with the product and its variations and use cases to purchase the product without first testing or handling it?

Marketplaces that operate without a physical storefront can compensate by employing advances such as rapid (same-day or two-day) shipping, free returns, detailed specifications, customer or expert reviews, and virtual tours to accommodate some need for product testing by customers.

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John Hagel (co chairman, Deloitte Center for the Edge) has nearly 35 years of experience as a management consultant, author, speaker, and entrepreneur, and has helped companies improve performance by applying IT to reshape business strategies. In addition to holding significant positions at leading consulting firms and companies throughout his career, Hagel is the author of bestselling business books such as *Net Gain, Net Worth, Out of the Box, The Only Sustainable Edge,* and *The Power of Pull*.

John Seely Brown (JSB) (independent co chairman, Deloitte Center for the Edge) is a prolific writer, speaker, and educator. In addition to his work with the Center for the Edge, JSB is adviser to the provost and a visiting scholar at the University of Southern California. This position followed a lengthy tenure at Xerox Corporation, where JSB was chief scientist and director of the Xerox Palo Alto Research Center. JSB has published more than 100 papers in scientific journals and authored or co authored seven books, including *The Social Life of Information, The Only Sustainable Edge, The Power of Pull,* and *A New Culture of Learning*.

Maggie Wooll (head of eminence and content strategy, Deloitte Center for the Edge) combines her experience advising large organizations on strategy and operations with her love of storytelling to shape the Center's perspectives. At the Center, she explores the intersection of people, technologies, and institutions. She is particularly interested in the impact new technologies and business practices have on talent development and learning for the future workforce and workplace.

Andrew de Maar (head of research, Deloitte Center for the Edge) leads the Center's research agenda and manages rotating teams of Edge Fellows, focusing on the intersections of strategy and technology in a world characterized by accelerating change. He has worked with a wide range of public, private, and non-profit entities to help executives explore long-term trends that are fundamentally changing the global business environment and identify high-impact initiatives that their organizations can pursue to more effectively drive large-scale transformation.

About the research team

This report and the Pattern write-up series would not have been possible without the hard work of our research team—colleagues who tracked down case studies and cheerfully dug for data and more data on the way to proving and debunking countless possible patterns.

Tamara Samoylova (former head of research, Deloitte Center for the Edge) led the Center's research agenda. Her particular interests include innovation and new growth opportunities, work environment redesign, and how technology and changing consumer preferences are reshaping the retail landscape.

Carolyn Brown (research fellow, Deloitte Center for the Edge) is interested in emerging technologies/innovations, disruption, organizational structures and approaches to innovation, and the impact of government on innovation and vice versa. Brown's consulting experience at Deloitte focused primarily on enterprise strategy for large government agencies, with an emphasis on new technologies such as telemedicine.

Leslie Chen (former research fellow, Deloitte Center for the Edge) is passionate about exploring disruptive innovation in a global context with a focus on emerging markets. As part of Deloitte Consulting LLP's Strategy & Operations practice, she worked on location strategy projects, helping companies determine where to set up their global operations. During her time at the Center, she conducted research to define patterns, and explored how these patterns manifest in international markets.

Andrew Craig (former research fellow, Deloitte Center for the Edge) is passionate about exploring the intersection of technology, design, and social science as a way to understand and influence the drivers of business change. At Deloitte Consulting LLP, he works in the Strategy & Operations practice, helping clients realize growth in the face of dramatic social and technological shifts. At the Center, his research and analysis included the maker movement, the collaborative economy, manufacturing, and macro trends that drive disruptive change.

Carolyn Cross (research fellow, Deloitte Center for the Edge) is interested in finding innovative ways for companies to establish lasting customer relationships and deliver seamless customer service. As a consultant in Deloitte Consulting LLP's Strategy & Operations practice, she has spent the past two years helping clients across a range of industries, including health care and insurance. Cross is passionate about the future of the food landscape as well as blending together business and community to empower small business and non-profit growth.

Austin Dressen (research fellow, Deloitte Center for the Edge) is a self-described catalyst. Although a traditionally trained historian and entrepreneur, he also serves as resident philosopher-in-training. He is interested in the interaction of human beings and machines in our old, new, and unimagined systems.

Brandon Lassoff (research fellow, Deloitte Center for the Edge) is passionate about customer and marketing strategy, particularly in developing cutting-edge and innovative customer engagement plans. As a consultant in Deloitte Consulting LLP's Strategy & Operations practice, he has spent the last three years working alongside leading high-tech and pharmaceutical clients, developing seamless customer experiences to address top CMO priorities.

Andrew Reeves (former research fellow, Deloitte Center for the Edge) is a consultant in Deloitte Consulting LLP's Strategy & Operations group. He has worked with clients across the technology, financial services, and health care industries, focusing on topics ranging from innovation and growth strategy to process optimization, operational redesign, and supply chain innovation. At the Center, Reeves primarily focused on understanding disruption with regard to the development of platforms for accelerated learning, sharing, and product development.

Jay Rughani (former research fellow, Deloitte Center for the Edge) is passionate about developing new technologies that help people enjoy a better quality of life. His interests span issues ranging from resource allocation to cyber security to climate change. Today, he spends his time building technology-driven solutions to improve outcomes and reduce costs within the health care system.

Max Zipperman (research fellow, Deloitte Center for the Edge) is passionate about emerging technologies and their potential impact on the future of business and society. His primary interests revolve around questions of how best to structure public policy in preparation for unprecedented issues resulting from exponential technologies. At Deloitte Consulting LLP's Strategy & Operations practice, he has helped large technology and insurance companies prepare for a dynamic future.

About the Center for the Edge

The Deloitte Center for the Edge conducts original research and develops substantive points of view for new corporate growth. The center, anchored in Silicon Valley with teams in Europe and Australia, helps senior executives make sense of and profit from emerging opportunities on the edge of business and technology. Center leaders believe that what is created on the edge of the competitive landscape—in terms of technology, geography, demographics, markets—inevitably strikes at the very heart of a business. The Center for the Edge's mission is to identify and explore emerging opportunities related to big shifts that are not yet on the senior management agenda, but ought to be. While Center leaders are focused on long-term trends and opportunities, they are equally focused on implications for near-term action, the day-to-day environment of executives.

Below the surface of current events, buried amid the latest headlines and competitive moves, executives are beginning to see the outlines of a new business landscape. Performance pressures are mounting. The old ways of doing things are generating diminishing returns. Companies are having a harder time making money—and increasingly, their very survival is challenged. Executives must learn ways not only to do their jobs differently, but also to do them better. That, in part, requires understanding the broader changes to the operating environment:

- What is really driving intensifying competitive pressures?
- What long-term opportunities are available?
- What needs to be done today to change course?

Decoding the deep structure of this economic shift will allow executives to thrive in the face of intensifying competition and growing economic pressure. The good news is that the actions needed to address short-term economic conditions are also the best long-term measures to take advantage of the opportunities these challenges create.

For more information about the Center's unique perspective on these challenges, visit www.deloitte.com/centerforedge.


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