

**How Buyer Behavior Changes
in the Transition from Innovation to Commoditization**

Ellis S. Nolley
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Carlson School of Management, University of Minnesota, Minneapolis Minnesota

Introduction: Innovation and Commoditization – words of power and misunderstanding! They create conflict and tension that provide a fulcrum to drive the engines of economic growth and progress that fulfill our hopes for a better future. To the innovative seller, innovation implies value creation and commoditization implies loss of profitability and failure.¹ To the mainstream buyer, innovation is laden with risk and commoditization simply means buy and use, with little value seeking effort required. Schumpeter notes that the fundamental economic trend of spectacular decline in long-term real price cannot be understood simply by price competition.² It can only be understood over time, such as decades and centuries. Second, it is organic and can only be understood through the process of destruction (change) and not during stability, which is what is usually described. Therefore, price competition is not significant, but rather competition in quality, production, organization, and technology are the primary levers of change that are reflected in price over the long-term. This competition is ever present in the mind, affecting before its effect is apparent. “It disciplines before it attacks.” He concludes that any description of economics or business without this is like Hamlet without the prince.

The consequences of innovation are apparent in increase production, higher income and more leisure. However the innovation also entails greater expense, more need for capital and less equitable distribution of resources.³ Furthermore, Arnould notes that innovation and risk are at the heart of marketing in persuading people to change their attitudes, asking consumers to be innovative and asking them to buy in new ways.⁴ Also, Christensen claims that too often innovators destroy their companies by creating the

conditions of commoditization and this can be avoided so that commoditization never occurs.⁵

In this paper, we address how consumer behavior changes when industries transition from innovation to commoditization. We introduce an analysis framework, review theories, describe buyer behaviors, discuss our analysis, identify a critical dilemma, and provide our conclusions. Because so much of the literature focuses on firm innovative behavior as well as buyer behavior, we have adopted the assumption that successful firm behavior reveals the underlying buyer behaviors implicitly. This provides us with a rich panorama of behaviors to compare.

Framework: Innovations change buyer behavior through the process of diffusion of innovation. Diffusion is understood as a social change, defined as a process by which alteration occurs in the structure and function of a social system. An innovation is an idea, practice, or object that is perceived as new by a unit of adoption, such as an individual or organization.⁶ Key characteristics of innovations affect the rate of diffusion: it increases with greater relative advantage, increases with greater compatibility, decreases with greater complexity, increases with trialability, and increases with observability.⁷ Rogers introduces his innovation adopter categories within an innovation adoption cycle framework, which we *adopt* for analyzing buyer behavior: innovator, early adopter, early majority, late majority and laggard.⁸ Moore identifies a chasm between the early adopter and early majority categories, which he defines as the boundary between early market and the main stream market.⁹ We identify this chasm as the transition bridge between innovation and commoditization. Kotler identifies the four main categories of introduction, growth, maturity, and decline.¹⁰ He observes that the

differences between each category of successful firm behaviors center around sales, costs, profits, customers, competitors, marketing objectives, product, price, distribution, advertising, and sales promotion, and we assume that these reveal underlying differences in buyer behavior. Arnould notes that the spread of an innovation begins in introduction when consumers have little knowledge about the new product, promotional expenses are high, consumers rely on promotion for information, and profits are typically negative.¹¹ In growth, sales increases dramatically, new customers and competitors enter the market, prices fall, and brand loyalty can be so high that buyers find it difficult to switch. In maturity, sales begin to flatten. In decline, industry sales begin to drop as customers lose interest in the product category, and new products may be developed to satisfy customer needs that were formerly met by the declining industry.

Types of innovations include continuous (minor changes, unimportant), dynamically continuous (major changes & unimportant, or minor changes & important) and discontinuous (major changes, important).¹² Alpert divides buying behavior into three categories: embracing innovations, innovation satisfaction, and innovator no more.¹³ Gregan and Moreau describe typical buyer learning in terms of analogy, categorization and structure mapping.¹⁴ They conclude that categorization is most effective in generating attribute inferences, and applying them synergistically is applicable in very limited arenas. This reinforces and aligns learning within categories of buyers such as early market and main street market, and differentiates their mapping structures. Eisenman observes that technological innovation with its attendant theories of resource partitioning and technology evolution do not address industry commoditization

in non-technological ways and she applies ecology theory to describe situations where only niche firms will target peripheral markets that prefer aesthetics to lower costs.¹⁵

Utterback notes that discontinuous products typically come from outside the industry while discontinuous processes come equally from within and without the industry.¹⁶ Some discontinuities enlarge a market, enabling new firms to enter and sustain, while existing firms are more likely to fail; discontinuities that do not enlarge a market favor incumbents and reduce their number, and discontinuities that create new market niches encourage many new entrants since existing firms do not usually enter or succeed.

Theories: Key theories that reveal differences in buyer behavior are those about the importance of firm pioneering, the underlying process that drives the diffusion of innovation, and the supporting process of commoditization and de-commoditization. Historically, pioneering has been thought to confer favorable market position, especially around ease of recall, brand loyalty, consumer inertia, patent barriers, economies of experience, and resource mobilization.¹⁷ Instead, Tellis notes that five key factors are most indicative of firm success: vision, persistence, innovation, financial commitment, and asset leverage.¹⁸ Vision, which includes understanding current and emerging customer needs, drives all others, and the latter four are iterative. Vision helps entrepreneurs persist in establishing a new business and overcoming barriers to success, it tells them how long to persist, and it helps develop the commitment to sustain huge resource investments. First entry is not indicative of long-term market success and can result in long-term market failure.

There are three theories of the mechanism that drives diffusion of innovation.¹⁹ First, the Trickle-down theory posits status rivalry between social groups as the engine for innovation. High status groups seek to differentiate and are imitated by lower status groups. Second, the Two-Step Model assumes that new ideas flow from the mass media to influential consumers who pass them on to others who are more passive in their information seeking. Last, The Cultural Production System proposes a creative subsystem that anticipates buyer needs and generates new products that express cultural values; a Managerial subsystem that selects and makes tangible new product ideas, producing new categories of personal identity; and a Communications subsystem that distributes the word about what's new, upcoming and popular to various groups of adopters.

Christensen theorizes that the process of commoditization occurs when new proprietary products are disassembled into modular components distributed over multiple companies, price competition leads to standardization with attendant decline in differentiation, and commoditization is complete. De-commoditization can occur when modular features are re-integrated into proprietary designs with significant reliability and price improvement, so that the seller retains attractive margins and creates barriers to competition through economies of scale and experience learning.

Behavior: We apply Rogers' innovation adopter categories and identify cited behavior. Innovators are venturesome.²⁰ They comprise about 2.5% of the market. They are interested in new ideas, leading them from their local peer networks to more cosmopolitan social relationships. Often they have considerable control over financial resources. They understand and apply complex technical knowledge, and cope with significant uncertainty about innovations. Innovators have distinctly different lifestyle

categories.²¹ Emotionals focus on the excitement of the innovation with “I’ve just got to have this!” They are inner directed and don’t care if others see it. They have a high innovation fascination and high cumulative disappointment. Intellectuals focus on novelty, especially understanding how the new benefits will be delivered, and seek mastery of the product class. They are inner directed, have a medium innovation fascination and medium cumulative disappointment. Socials are trendy. They want others to see that they have the latest products, are other directed, have medium innovation fascination, and medium cumulative disappointment. Utilitarians focus on the tangible relative advantage and often on job performance, are inner directed, less venturesome, sometimes must see large advances before buying, have low innovation fascination and low cumulative disappointment. Hengeveld notes that innovation buyers are typically affluent.²²

Early Adopters are respected.²³ They cover about 13.5% of the market. They are more integrated into the social system than innovators. They have the highest degree of opinion leadership, and this is important to them. Others look to them for advice and information. Change agents seek them and use them as local champions to increase the rate of diffusion. They are respected as ideal role models for successful and individual innovation use, and they make careful use of innovations. They function to reduce uncertainty about using an innovation and communicate their evaluation to peers. Inverting Moore’s description of the Bowling Alley, we infer that they are end-users with interest in economical (effective and efficient) results, are comfortable with complexity (e.g. differentiation) for their specific use, are comfortable with complex value-added distribution where they deal with multiple contacts to understand the product, are

comfortable with value-pricing and thus think in terms of benefit-cost trade-offs to maximize their value received, are comfortable being identified with niches, thus different from others, and think of themselves as members of vertical markets associated with application.²⁴ Golder notes that firms often have a lengthy period, six years or more, from introduction to “takeoff” with early adopters which occurs when market penetration reaches a few percent, and price falls to nearly half of its introductory price.²⁵ The time to takeoff is affected by the product’s relative advantage to substitutes and the presence of complementary products. One can expect early adopters to be very sensitive to these factors because they affect their ability to provide differentiated value within their organizations.

Early Majority buyers are deliberate.²⁶ Shortly after they adopt the product innovation, the average user adopts it. They are the most numerous category, comprising about 34% of the buyers.²⁷ They ponder lengthily before adopting, with often a long trial period. Rogers notes that later adopters (early majority) differ from early adopters as they have fewer years of formal education, are less likely to be literate, and are less upwardly mobile.²⁸ In personality, they are less empathetic, more dogmatic, less able to deal with abstractions, less rational, less able to cope with risk, less intelligent, less favorable to change and science, more fatalistic, and have lower aspirations.²⁹ In communication behavior, they have less social participation in innovation adoption, are less connected with interpersonal networks, are more locally oriented, have less exposure to mass media and interpersonal communication, are less actively seeking knowledge about innovation and have a lower opinion leadership within their organizations.³⁰ In the sense of prospect theory they are far more sensitive to loss than early adopters and Gourville’s rationale for

why new products fail is that sellers do not adequately serve their needs for, and frame product benefits around, increased gains instead of reduced losses.³¹ Rogers notes that the irony is that the ones with the most need are the last to adopt.³² This is possibly because they have less access to discretionary resources. Inverting Moore's viewpoint from the seller's perspective to the buyers' perspective, we find that buyers in "main street markets" (early and late majority, and laggard) look for products that refer to users like them, focus on their individual needs, are interested in the product's secondary characteristics which encompass the whole product including its associated other products that deliver the complete customer benefit they seek.³³ They are receptive to branding and simplicity through brand diversity.³⁴ Replacement demand becomes important.³⁵

Late Majority buyers are skeptical.³⁶ Like the early majority buyers, they include about 34% of the buyers.³⁷ They are cautious, tending to purchase after the average buyer.³⁸ Peer pressure is an essential ingredient in their buying process, partly because they have fewer resources and most of the risk must be eliminated before they will purchase. They have lower capacity for complexity and are very sensitive to losses.

Laggards are traditional.³⁹ They encompass about 16% of the buyers.⁴⁰ They have no opinion leadership in their organizations.⁴¹ Of all of the buyer categories, they are the most isolated. Their reference point is the past. They typically interact with other laggards, and are distrustful of innovations and change agents. They will most likely change when alternatives are eliminated. They are the least educated, least literate, least communicative, most dogmatic, most irrational and fatalistic, and have the lowest aspirations. They cannot tolerate risk and have the fewest discretionary resources.

So, what is going on in the transition from early adopter to early majority? Moore describes it in terms of seller behavior, but we can invert it into buyer behavior. Early adopter buyers are focusing on their economic need, ROI, their individual needs, the complexity of value-added partners to provide a whole product, value-based pricing associated with their internal value propositions, solving their problems within their niches, and meeting the needs of their vertical markets.⁴² The product is associated with the seller, risk is relatively high, and trust is sought and developed. Meanwhile, the early majority buyer becomes aware because of the extraordinary communicability and respect of the early adopter champions.⁴³ Diffusion rate across this chasm depends on the interconnectedness of their communication, the presence of complementary products, and penetration rate, i.e. lots of others they can see using the product. This equates to risk reduction. It helps greatly that prices have declined significantly since introduction. Often, there is a price saddle to push it along, which occurs when production capacity grows but the transition from early adopter to early majority buying is lengthy, and sales volume behaves as though it comes from two distinct markets.⁴⁴ As buying increases beyond takeoff, early majority buyers seek a simple way to buy it but the sellers haven't modified their distribution infrastructure to serve their very different needs. Where early adopter buyers seek seller and product credibility to overcome the innovation's risk, the early majority buyer seeks risk elimination in the product itself. The development of this infrastructure within the buying frenzy is Moore's Tornado. Jackson notes this difference as relational marketing versus transactional marketing.⁴⁵ She points out that identifying where customers are located on the relationship-transaction spectrum can be accomplished by determining their tolerance for switching costs. Similarly, managing the

seller-buyer relationship is often a matter of adjusting these switching costs. Relationship buying is often all-or-nothing, they expect to be pursued and seek close relationships (monogamous). In contrast, transactional buying is often shared over many sellers (polygamous) as a way of managing delivery, reliability and price. This customer typically does not want a close relationship. Moore refers to this as developing supply infrastructure. Alternatively, on main street in the majority market, the sellers rediscover their customers through their new distribution processes which are adapted to their early and then late majority customers.⁴⁶ Now the product is commoditized. Profits are restored, and customers are happy.

Discussion: The role of innovation and commoditization is an evolving tension between the seller and the buyer, and is characterized by a power shift. In innovation, the seller has higher bargaining power, indicated by the willingness of the customer to accept very high risk and high price premium. The seller provides, and the buyer gets, product *features, seller's promise, and hope* of implementing beneficial change in their business. Over time, the buyer gains more power, requests less risk, and the seller reduces risk in exchange for higher sales volume to sustain its businesses. This causes the seller to change and the buyer to change successively until risk has been eliminated and the product is fully commoditized. At this point, the buyer gets, and the seller provides, *reliability, delivery and price* to sustain its businesses.

Christensen distinguishes between sustaining innovation and disruptive innovation to highlight the risks to the buyer and seller of innovation.⁴⁷ Paradoxically, innovation creates enormous risks for the sellers as well as the buyers, and successful large firms often seek to reduce the risk and thus become commodity sellers. Most sellers

understand the need for innovation and Christensen attempts to provide sustaining innovation as middle ground between innovation and commodity to help them adjust their innovativeness to their risk tolerance, while warning them that they must find a way to do both.

Dilemma: Applying our assumption that successful seller behavior is a window to buyer behavior, we observe with interest Christensen's *Innovator's Dilemma* and his *Innovator's Solution*, and applaud his attempt to solve an important problem. In short, he suggests that innovation can kill a company and an industry by oversupplying newness so that others can compete on price and the industry commoditizes. His solution is to prevent commoditization with proprietary products that that sell for less than the standardized low cost but retain attractive profit margins because they use an integrated architecture with lower costs and higher reliability that commodity sellers with modular standardized architectures cannot match.

Does this repeal the inevitability of commoditization? As an innovation seller, I want to preserve industry innovation as long as possible. I observe Christensen in partnership with Medtronic, seeking to prevent this from occurring in the Cardiac Rhythm Management industry and silently pray that they will be successful.⁴⁸ As a student of technology markets, I appreciate buyers' wish to reduce risk, their increasing bargaining power, and the dynamics of competition. Furthermore, I observe the ancient and continuing wisdom of analysts, including Christensen, who counsel management teams to shift their resources from their successful products to invest in new areas of innovation, including disruptive innovation. As a manager, I realize the difficulty, and cost, of managing risk-taking and risk-averse business cultures within the same

organization. Perhaps, this foreshadows a Schumpeterian revolution in organizations, that can achieve this, of which joint ventures, spinoff-reacquisitions, and spinouts are merely nascent forms. However, I suspect that Christensen errors in underestimating the network effect of modular architectures. They enable firms to divide the whole product problem, collaboratively share the benefits of advances, and create new markets. Proprietary architectures seem appropriate when a firm can apply its unique abilities to provide a unique competitive product. However, they change too slowly, decrease the interaction needed for a high rate of innovation diffusion, and contribute too little to compete with modular architectures in a stimulated industry. HP, IBM and DEC held off the standardization of the computer industry for nearly 25 years. Eventually, the dam burst and a resulting modular PC architecture enabled rapid growth in the information industry. One does not see a way that the incumbents could have prevented this. Buyers wanted it. They funded the gaming community to initially modify their computers to provide it, coming from another industry. Hobbyists purchased the first moderately priced PCs. New entrant Apple was the first to serve the education and business community. Innovators and early adopters, in partnership with sellers, created the market through their needs, abilities and risk tolerance. The main street market began buying and eventually it commoditized.

Commoditization is inevitable. And, so is innovation.

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