

CREATIVE DESTRUCTION AND SCHUMPETER'S GALE

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In the early 1900s, the economist Joseph Schumpeter coined the term Creative Destruction (also known as Schumpeter's Gale). Basically (and I am probably upsetting a few 'real' economists here) creative destruction describes an economic order that can only develop out of the destruction of some prior economic order. [1]

We can draw the conclusion that (although I have probably drawn it to its limit), that there is no such thing as a generic winning formula, because the market is in a constant state of flux. That means, what worked for company X may not work for company Y, especially in a different time and space. Also, with the exception of a few companies (so far), profitability of the individual firm itself does not endure, due to the erosive forces of imitation, competition and profit-taking that continuously change the landscape. What Creative Destruction then infers, is that you can never get the same result as a successful competitor by just copying that competitor – unless you are that successful competitor.

Feelosophy

The previous sentence is somewhat reminiscent of the philosophical debate that has been raging since 1270 on the question "How many angels can dance on the head of a pin?"

Dorothy L. Sayers, the noted novelist and humanist, kinda puts us out of our misery.

She proposes that angels are pure intelligences, not material substance. So, the question then becomes "How many people's thoughts can be concentrated upon a particular pin at the same time?" She concludes that an infinite number of angels can be located on the head of a pin, since thoughts do not occupy any space there. [2]



When Lego let go

In January 2004 Paul Ploughman* was fired. This was the result of miserable sales (even around Christmas when childhood blackmail reaches its peak), resulting in Lego's worst loss in history: US\$230m. But human nature being what it is, we don't just want to hear that there was a loss – we want an explanation, dammit!

After the firing, the chief executive decided it was time to return to basics – Lego had strayed too far from its core – it had lost sight of its roots. Phil Rosenzweig, the author of *The Halo Effect*, states that this is a typical reaction to how we think about success or failure – we want some basic reason that sounds logical and could apply to any situation – making life safer for ourselves.

Lego is a Danish company, so Ploughman was at the mercy of the fall of the US dollar against the kroner hurting its North American sales which comprised half of Lego's revenue. Also missing from the explanation was that a strong new rival Mega Bloks was chipping away at their market share and other toy brands were struggling – even Barbie sales had fallen 13%. The explanation ignores these; it remained that they had 'strayed from their core'. [3]

It also ignored the fact that after the spectacular success of Harry Potter and Star Wars, there were no new blockbusters to drive theme-related sales. And even Kmart went bang.

However, these facts were identified by management, who took the appropriate steps which included: selling off Legoworld, retrenching a substantial number of employees and outsourcing some of its manufacturing. The results have been spectacular: revenue has more than doubled between 2008 and 2012. (4,5)

But it was the 'outsiders' that held another perspective.

Stay or stray?

Although management had a sober perspective on the situation, people outside the company had a different view. In the weeks following Ploughman's departure, the UK magazine *Brand Strategy* reported that Lego's problems stemmed from focusing on new products such as the Star Wars and Harry Potter range to the detriment of its core business. But what is its core business? Surely making the standard blocks leverage the aura of the latest popular stories would be smack bang inside their core? With the advent of electronic games, even the Lego



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Robot (which was produced) was also a core activity? But no, the business press put the problem in a neat box: it had strayed from its core. Imagine if it hadn't taken advantage of the new trends and the company still suffered a loss, would the headlines not read "Lego ignores tie in with Harry Potter – the most popular children's book of all time – with disastrous results"?

Maybe if they went into children's clothing or even financial services (RA's for children), that might be considered straying, but surely not tie-ins with blockbusters or competing for market share with the latest in electronic entertainment? [3]

Phil Rosenzweig quotes from Brand Strategy, a statement by the marketing manager at one of London's largest toy store:

"Lego mustn't lose sight of what it's become known for – reliable, colourful construction toys. Its marketing is impressive but Lego needs to continue having the 'wow' factor."

That's the best of both worlds: on the one hand to remember the basics, and on the other hand to be 'wow'. So, if the company succeeded, this marketing manager would claim the gift of powerful foresight no matter what the company did.

Outside the core

Focusing on your core business is a nebulous concept. 'Sell non-core assets' peppers the vocabulary of many annual reports, but is it just a convenient description of an activity that either sells off poorly performing subsidiaries or to free up cash flow demands (brought on by the remaining entities not performing)? Some ventures outside the core, so to speak, have been extremely successful. General Electric, with core competence in light bulbs and refrigerators, decided to go into financial services in the 1980's. Yes, financial services. Today, this 'non-core' activity is responsible for a major part of its revenue. [3]

So, in certain cases doing one thing might be correct, and in other circumstances doing the very same thing might be incorrect. We tend to neglect that the market is not immune from the Butterfly Effect, and that all around us every day we are the victims – or benefactors – of Creative Destruction.



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* Although Ploughman had tolerated certain inefficiencies in the business, and his firing might very well have been justified, we will not focus on these, as it does not add to the gist of this article: Creative Destruction.

References

1. http://en.wikipedia.org/wiki/Creative_destruction

Although made popular by Schumpeter, the German Marxist sociologist Werner Sombart has been credited with the first use of these terms in his work *Krieg und Kapitalismus* (“War and Capitalism”, 1913).

2. http://en.wikipedia.org/wiki/How_many_angels_can_dance_on_the_head_of_a_pin%3F

3. Phil Rosenzweig. *The Halo Effect...and the Eight Other Business Delusions That Deceive Managers*. Free Press, a division of Simon and Schuster, 2009.

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5. Gerry Robinson, Richard Whittington, Kevan Scholes. *Exploring Strategy, Text and Cases*. Prentice Hill, Ninth Edition 2011.

About the author

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