

# CHAPTER 2

**FOUR  
ENTREPRENEURSHIP  
STRATEGIES THAT  
DRUCKER USED TO  
BUILD HIS CAREER**

*The entrepreneur always searches for change,  
responds to it, and exploits it as an opportunity.*

– **Peter F. Drucker**

**D**rucker was known as the consummate “big company man” consulting major corporations until suddenly and surprisingly in 1985, he wrote a bestselling book called *Innovation and Entrepreneurship*.<sup>1</sup> In this book, Drucker demonstrated how small organizations could not only be successful over their regular competitors, but how these small ‘David’ companies could also best the ‘Goliaths’ they competed against. As it turned out, Drucker had the knowledge, passion, and credibility for such a book as he was one of the first to teach an academic course in entrepreneurship for New York University in the early 1950s.

Drucker recognized that small companies have important advantages over larger competitors and that these can be very effective if used properly. One enormous advantage is speed of decision-making and action. To assist ‘buy-in’ of their employees, large organizations take much longer to make decisions or to respond to a competitor’s actions and initiatives. In addition, because of other simple facts of strategy, a smaller competitor could concentrate in markets less attractive to a large corporation where it was less worthwhile for a larger competitor to invest. For example, in the early days of computers a small 96-person, relatively unknown company, ICS, Inc., specializing in computers for education was able to take on mighty IBM head to head. In comparison to IBM, ICS, Inc. was minuscule, yet IBM withdrew from the marketplace. Sure, IBM could have rolled over ICS, Inc. But IBM had better things to do with its resources: other markets, where it could make more money, a lot easier if it abandoned this small and less important market to its tiny competitor.

Drucker set out to think through special strategies which small companies could put to good advantage. He organized his results into four systematic entrepreneurial approaches. They can work for larger organizations as well. In fact, they can work for any entity as a winning strategy under the right conditions.

Consider this: entrepreneurship requires application of specific skills which most organizations already have but frequently fail to take advantage of. These include the willingness to analyse the situation, access the risks, and then the courage to assume these risks when necessary

in the implementation of the strategy. The successful practice of entrepreneurship also requires the moral courage to avoid procrastination, and to make decisions followed by action. Drucker certainly had this ability. However, moral courage and overcoming hesitation also require systematic actions. Drucker developed four such strategies and numerous substrategies that he applied in his own career as a management consultant. You can apply them too.

## DRUCKER'S FOUR BASIC SYSTEMATIC STRATEGIES FOR ENTREPRENEURSHIP<sup>2</sup>

- Dominance of a new market or industry
- Development of a market which is currently unserved
- Finding and occupying a specialized niche
- Changing the financial calculations of the situation.

Drucker used all four in his own career. He pointed out that these strategies are not mutually exclusive and all four can be used simultaneously, just as he did himself.

### **DOMINANCE OF A NEW MARKET, NEW INDUSTRIES, OR UNSERVED MARKETS**

The basic idea here is very simple. You enter and dominate a market or industry before anybody else does. While an unserved market may not be new, serving it properly or better may well be new and different.

Drucker began to write about business and management when he got involved in a major study for GE (General Electric) immediately after World War II. No doubt his analytical work, presented in an earlier book he had written on industrial markets, helped him to get this assignment. In this study and the resulting book, *Concept of the Corporation*,<sup>3</sup> he discovered that management was considered almost an accidental activity. One worked in finance, accounting, personnel, production, sales, etc. but there was no department of management and there still is not. The function of management is needed in all departments, although a few of these subfunctions were collected under what was then called the Personnel Department and more frequently today, Human Resources.

As a result, Drucker did think deeply about management as a specialized function that needed to be mastered across all departments.

When Drucker went to a bookstore to buy books on management to help him with this early research, the shelves, unlike today, bore only a couple volumes. Drucker decided to fill that space. After several years of study, practice, and analysis, he began to write his own books and soon dominated the market for books about management. In doing this, he reasoned, either consciously or unconsciously, that to really have an impact, his books had to supply something that was missing. He wrote books such as *The Practice of Management* and *The Effective Executive*.<sup>4</sup> His books essentially established the field of modern management and spawned many others to write books in this relatively unserved field. He developed a market which was not being served effectively.

## CREATING A NEW MARKET BY SUPPLYING SOMETHING THAT IS MISSING

Drucker thought that there were two basic ways to supply any missing ingredient, whatever that missing ingredient was.

1. Imitate an established success, but to do so in a creative way that supplies what is missing. He called this “creative imitation”, a term based on an original idea by marketing professor Theodore Levitt, then at Harvard.
2. To find a product that already existed, but was currently unsuccessful. He gave this the rather imaginative term of “entrepreneurial judo”.

It was always interesting to me that one of these strategies targeted a successful product, while the other targeted one that was not successful.

Drucker did this very effectively with his management consulting. His consulting was like no other. He asked questions of his clients and forced them to think the issue through to provide the right answer. Almost all consultants are asked questions by their clients and they assume it's their duty to provide the answers through the expertise

they have gained through their studies and experiences. Drucker felt that asking the right question was the key for him. He took the view that the client was always in a better position to analyse their own situation and provide the right answer. After all, his client was the expert, with the experience in their business and industry. The consultant was not. How could he be? Was the consultant supposed to be an expert in all businesses and all industries? So, Drucker consulted, but he did so by adding the missing element of using the expertise of the client to solve the issue after he had identified the problem through his questions. As he famously asked *Fortune's* 'Manager of the Century', Jack Welch, shortly after he became CEO of GE. "Are there businesses that GE would not be in if it were not already in them, and if so, what are you going to do about it?"

Drucker told his students that rather than bring his knowledge and experience to an industry in his consulting assignments, he brought his ignorance and lack of specific experience. This was clearly no bar to his effective consulting advice. He was able to charge as much as \$10,000 for a few hours per day of using his "ignorance".

### **HOW IBM USED CREATIVE IMITATION TO STEAL APPLE'S MARKET**

Life isn't fair, and neither is what goes on in business. IBM had opted out of even considering the personal computer market because of an error in assumptions made in its market research. It had assumed that a personal computer must be the size and cost of the huge industrial computers that it was already producing. So, IBM calculated that the size of the demand was only 1,000 computers a year. Steve Jobs at Apple, on the other hand, had made no such limits in his assumptions of demand. He recognized the need for personal computers, took the risks, somehow got together the resources that didn't exist and created the entire personal computer industry without having a PhD, with limited investment, and almost no resources. But mighty IBM was still mighty, and the mighty IBM empire struck back. It did this after Apple had proved the market by developing a computer operating system and a computer that became the standard in the industry for a sizable part of the market. Given IBM's challenge as a classroom problem,

many students would have guessed that IBM would have created something of the nature of a technical breakthrough. However, the ingredient IBM added was not technical superiority. What IBM did was to create a reliable machine that worked well, and capitalized on the IBM name, and distribution system, and most importantly, it allowed anyone to write software for its system, something Apple didn't allow for its computers. With this strategy, IBM took over much of the market within two years. So, supplying the missing ingredient works, but so does creative imitation.

### **HOW CREATIVE IMITATION FREQUENTLY WORKS AGAINST INNOVATORS**

Drucker thought entrepreneurial judo was a minimal risk strategy because innovators frequently make mistakes with the products that they themselves originally introduce. So sometimes it is relatively easy to take a market away from someone who actually got in the market first. One might argue that IBM's strategy combined elements of both creative imitation and entrepreneurial judo since Apple had erred in trying to control the software for their system. Could be. Understand that in the martial art of judo, the secret is to use your opponent's own strength against him. In Drucker's terms, this might mean that the innovator might even inadvertently ignore a product he invented.

The Japanese picked up the transistor and its radio application and ran with it this way. Even the term 'transistor' was coined by an American, John Pierce. It was invented by Bell Labs but was ignored because Bell Labs didn't think that the technology existed to really make it work in production, Sony did!

Some innovators are confident that they can do pretty much as they please without fear of competitive action. Innovators make this mistake all the time with price. They've come up with an excellent product but persist in charging 'whatever the market can bear' in the mistaken belief that no one else can get in the market. However, maintaining a very high price is almost certain to attract competitors, and the higher the price the more competitors are attracted.

The innovator may also mistake what constitutes value and quality for the buyer. It is always the user that determines what is or is not of



value to them, not the supplier. Or, the supplier may try to maximize profits rather than optimize the product. That's what Henry Ford did after successfully innovating and producing the everyman's car in the Model T and famously (or infamously) maintaining that buyers could have any colour they desired so long as it was black. That rather arrogant statement typified the notion that cost Ford leadership of everyman's car for more than 40 years as General Motors (GM) introduced both many colours and options unavailable in the Model T, but at competitive prices also attractive to prospects seeking an economical automobile.

### FINDING AND OCCUPYING A SPECIALIZED NICHE

The third of Drucker's entrepreneurial marketing approaches is essentially Philip Kotler's strategy of niche marketing. Drucker called it an "ecological niche". An ecological niche is the place or function of a given organism within its ecosystem. Drucker differentiates this approach by contrasting it as emphasizing positional occupation and control versus the previous strategies emphasizing grappling with competition. According to Drucker, occupying an ecological niche can make a marketer immune from competition altogether because the whole point is to be inconspicuous or to be in a market of what appears to be limited potential, despite the product's being essential, so that no one else is likely to compete until it's too late. The marketer places his offering or company in the optimum niche, in its very own ecosystem. I again refer to that little company, ICS, Inc., which once took on mighty IBM early in the computer wars and forced IBM to withdraw because it appeared that competing wasn't worth the effort. In effect occupying a specialized niche is a version of W. Chan Kim and Renée Mauborgne's popular book, *Blue Ocean Strategy*.<sup>5</sup>

Drucker saw three distinct ways for implementing this approach. First, he suggested gaining a tollgate position. In other words, you control an essential piece of something else needed by competitors such that would-be competitors cannot do business without what you supply. Sierra Engineering Company got itself into this position by being

the only company that could manufacture a unique valve for oxygen breathing masks for aviators. If you wanted to sell oxygen breathing masks, you needed that valve.

The other two ways to occupy a specialized ecological niche was to either have a speciality skill, or to work in a speciality market. Life is so specialized today, that it is not so difficult to acquire a speciality in which few can compete in a specific market. Once a chiropractor was a chiropractor, just as a doctor of medicine was a doctor of medicine. This is no longer an accurate description of either of these professions. It's easy to mention oncologists or doctors that specialize in the treatment of cancer or how many physicians are not just surgeons but are cardiologists and how many of the latter perform heart transplants? If you want a board certified upper cervical chiropractor, there are fewer than 100 in all of the US. One man I know drives several hundred miles each way between two major cities several times a year to get these services. If you needed this specialized work, you would probably do the same. ICS, Inc. is as good an example as any of the specialized market. Sure, IBM could have forced ICS, Inc. out of the market had it wanted, but it had other fish to fry, and at that time chose to leave this market without much of a fight.

## CHANGING THE FINANCIAL CHARACTERISTICS OF THE SITUATION

Drucker's final entrepreneurial marketing approach is the only one that does not require the introduction of an innovation. In this approach, the strategy *is* the innovation. These innovation strategies were of four distinct types, all having the ultimate objective of creating a customer, something Drucker had been maintaining since his first explorations into the practice of management. Drucker's four different strategy innovations involved:

- Creating utility
- Pricing in accordance with the customer's needs
- Adapting to the customer's social and economic reality
- Delivering what represents true value to the customer.

## CREATING UTILS

Years ago, when I studied economics at the University of Chicago I learned that the measurement of utils was a shorthand measurement of utility, and that utility in turn was a representation of relative customer satisfaction. Drucker's first strategy with this approach involves changing the product or service to increase customer satisfaction. The ice cream cone might fall into this category. Although stories abound as to who came up with the idea first, the first patent was issued in 1903 to an Italian immigrant by the name of Italo Marchiony. He had come up with the idea as early as 1896 to solve the problem of his customers breaking or walking off accidentally with the glassware that he and every other ice cream supplier used to serve ice cream. He increased the utils of the product by enabling customers to eat what they had formally lost and considered a price of doing business. In this case, the marketer increased his own satisfaction as well, by saving the cost of glassware previously lost. The number of ways to increase utils are infinite. A manufacturer of exercise equipment uploaded exercises online for his equipment and made these available to his buyers. A restaurant added a free glass of wine with each meal, making the experience more enjoyable and romantic. Some cinemas add meals, wine, and reserved seats, and enhance the experience of simply going to the cinema and watching a film. The US Post Office made it easier to ship packages by providing free boxes of numerous sizes for priority shipping and convenience to the shipper and by charging a flat rate price for each box size instead of weight-based fees. Their utils was dramatized by the slogan, "If it fits, it ships" which considerably increased sales. Creating utils is easy. All you need to do is to ask yourself what would truly make things easier, or better for your customers from their point of view.

## CHANGING HOW A PRODUCT OR SERVICE IS PRICED

Price has long been a tactic used by clever marketers. However, Drucker went further in entrepreneurial marketing. He said that pricing should be done in accordance with the needs of the customer

and what the customer buys, not what the supplier sells. The personal photographic industry provides all sorts of good examples for this approach. Who would have thought that cameras would essentially be given to the customer along with the film? After all, neither is what customers really want. What they really want are the photos. And so, customers today can buy a throwaway camera, film, and developed photos at an economical price. Other companies had the idea to mail you free film. You shot the film and mailed the exposed rolls to the developer in protective envelopes along with a cheque covering the number and types of photos you wanted. When your order was fulfilled, you'd find two more rolls of free film. Of course, you needn't buy photo glossies nowadays. You can also get your pictures on CDs. With the advent of digital cameras and such along with cameras built into our mobile phones, the need now is primarily that of photo storage. Not to worry. Companies will store your digital photos and, in many cases, won't charge you anything. They even facilitate in building your photo albums and emailing these albums out to friends and family. Of course, pricing is calculated so that glossies, CDs, or printing your photos on cards, coffee mugs, or other items can all be accomplished, and that's where these companies profit. The Post Office's pricing by ability to fit your shipment in a particular size of box is also an example of changing the pricing. Notice how the pricing has changed from what the seller provides, camera, film, developing, etc. to what the buyer really wants. That's the key to this strategy.

## **ADAPTING TO THE CUSTOMER'S SOCIAL AND ECONOMIC REALITY**

Many marketers speak of the 'irrational customer'. Drucker said that there was no such thing. He stated that the marketer must assume that the customer is always rational, even though this reality may be a far different rationality from the marketer's. Mary Kay Ash, the famed CEO of Mary Kay Ash Cosmetics who build a multibillion dollar company out of a \$5,000 investment once told the story about saving the money to buy her first new car on her birthday. She did the financial analysis,

looked at the various models from the various manufacturers, checked all the sticker prices, and selected the exact car she wanted. Believe it or not, she even had the money in cash in her purse ready to pay for the car! However, in those days most women didn't buy cars, and she was ignored by the only salesman present selling the car she wanted. Finally, she got his attention, but he was so condescending in his attitude that she asked to speak to the manager. She was told the manager was out to lunch for an hour. Having an hour to kill, she went to the showroom of a competitor nearby. Here the salesman treated her so well, even though she was a woman, that she ignored her previous decision and bought the car he showed her. She didn't return to talk with the manager at the first dealership. Irrational? Maybe, but not in her reality. Similarly, when considering tactical pricing, consider this. If you don't know the best from a selection of products and you need to make an immediate purchase, how do you know which is of the highest quality? Many potential customers go for the most expensive. Irrational? Not in their reality. Remember, it is the customer's reality that counts.

## DELIVERING WHAT REPRESENTS TRUE VALUE TO THE CUSTOMER

True value, like quality, is up to the customer, not the marketer. This is critical because customers, or organizational buyers, don't purchase a product or service. They purchase satisfaction of a want or need. This means they purchase value.

Some companies spend millions providing additions that they think represent more value and are appreciated by the customer. Unfortunately, the customer may not think that these additions represent value. To teenagers, value might be defined primarily by fashion. That is, the fashion of what teenagers wear in their geographical area at that time. Even comfort might come in a poor second. To one teenager's parent, value may be represented by durability. To another parent, it might be price. That's why it's so important to do the research to find out who is using the product or service, who might influence

the purchase decision, and who is putting out the money. It's about what the customer, and whoever might influence that customer (directly or indirectly), consider to be of value, not the supplier or marketer that is important. Some marketers consider this irrational, too. Value, however, is part of the customer's reality.

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1. Drucker, Peter F. *Innovation and Entrepreneurship* (New York: Harper & Row, 1985).
  2. *Ibid.*, 209.
  3. Drucker, Peter F. *Concept of the Corporation* (New York: John Day, 1946).
  4. Drucker, Peter F. *The Practice of Management* (New York: Harper & Brothers, 1954) and *The Effective Executive* (New York: Harper & Row, 1967).
  5. Kim, W. Chan and Renée Mauborgne. *Blue Ocean Strategy: How to Create Uncontested Market Space and Make the Competition Irrelevant* (Cambridge, MA: Harvard Business School, 2005).