

THE STAR PRINCIPLE

BY RICHARD KOCH

CHAPTER 1

WHAT WILL MAKE YOU SUCCESSFUL?

What is a star venture? It has two qualities. One, it operates in a high-growth market. Two, it is the leader in that market.

CHAPTER 2

SO WHAT EXACTLY IS A STAR BUSINESS?

A star business has two attributes:

- it is the leader in its market niche; and
- the market niche is growing fast, at least 10 per cent a year

A STAR BUSINESS IS THE LEADER IN ITS MARKET NICHE

To be the leader simply means that it is bigger in the niche than any other firm. We measure size by sales value (also known as revenue or turnover). If the venture has sales of \$1 million and there is nobody whose sales in the same niche reach \$1 million, then it is the leader. Note that 'leadership' is objectively defined by sales, and has nothing to do with competing claims about 'being the best' or being most highly rated by customers, which are difficult to judge and is not as important anyway. The thing that matters most is how customers in the niche vote with their money.

For a niche to be a separate market, it must have different customers, different products or services and a different way of doing business from the main market or other market niches.

A firm has a separate market niche if it is number one in the niche market. It has sustainable niche leadership if it can hang on to that number-one position, against actual or possible competition from the leader in the main market.

There is another clue as to whether or not a niche market is viable, and it is simply this: is the niche highly profitable? Does it generate a lot of cash? Leadership in a niche is not valuable unless, sooner or later, the niche is very profitable and gushes out cash.

THE NICHE MARKET MUST BE GROWING FAST

Why do we take the growth rate of the market niche, rather than the growth rate of the market niche, rather than the growth of the new venture itself? Because the latter is affected not just by market growth but also by whether it is gaining or losing market share within the niche. It is vital that a star business should at least maintain its lead over its nearest competitor in the

niche, and highly desirable for the venture to increase its lead. But this is a separate consideration from the niche market growth, and it is simpler and clearer to start with that.

WHY IS A STAR BUSINESS SO ATTRACTIVE?

It is the *combined effect* of niche leadership and high niche growth that makes a star venture so wonderful. Leadership means that the company and its products are preferred by the niche's customers. The business should therefore be more profitable than the one that's not a leader. A leading firm should have higher prices, or lower costs, than a similar business that is a follower. Why higher prices? Because the customers prefer the product. Why lower costs? Because the firm can spread its fixed costs over a much greater volume of business than competitors can. Upshot: a leader should be very profitable, and, the further the venture is ahead of its competitors in the niche, the more profitable it should be.

ARE THERE PITFALLS FOR A STAR VENTURE?

Only one, but it's huge. The trap is that a star stops being a star by losing leadership in its niche. If that happens, a venture worth a fortune can suddenly become almost worthless.

CHAPTER 3

THE POWER OF THE STAR IDEA

It is scarcely an exaggeration to say that every significant innovation, every new product and service that made it into the world and multiplied greatly, gave rise to a star business. And those stars that held their position for a long time have been responsible for creating the greatest wealth individuals have ever known.

Know only one thing, so that you can't ever forget it. Know the power of stars. Believe it. Act on it.

Once you know this one thing, all the rest of your professional life is tactics-- how to find your star before anybody else how to ensure it stays a star, how to work in a star as one of the early star-mongers, how to get the most out of your star, these tactics depend upon believing in the star.

CHAPTER 4

STARS ARE FOR EVERYONE

'But that doesn't apply to me,' people I met often say, 'because I don't have any spare money, and I don't have what it takes to become an entrepreneur.'

'It doesn't matter,' I always reply. 'Do you work for a living?'

'Yes.'

'Then it applies to you. You can change your life by working in a star venture.'

'Why would I do that? What difference would it make?'

'Because working in a star business is much more fun and you will earn more money.'

'Why?'

'Well, before long, if not already, a star business will be coining money hand over fist. It can afford to be generous. It will reward loyalty and skill much more than an ordinary firm. It will be successful. And there is nothing in business -- I know from first-hand experience -- that's so much fun as working in a burgeoning, hugely successful small venture. It's easy to be a star in a star. It's easy to get promoted. It's easy to get fat bonuses. And, if you get a few shares or share options, you may end up with a surprisingly large nest egg. Even more important, you get a massive high from accomplishing something, from changing a market, from thrilling customers, from being a key part of a winning team

'It doesn't stop there. Scrape some cash together and invest in a star business, and you'll likely multiply your money. Take your "winnings" and invest in another star, before long, you'll be rich.

'It is *so much better to work in a star business*, rather than in a non-star business. Somewhere between 95 and 99 percent of businesses are not stars, so the chances are that you're not working in one right now. Think how much better life would be if you found a star to work in.

Anyone who's worked in a new business knows this. Only the myth of the entrepreneur -- so beloved by journalists and academics, who've rarely worked in a new venture -- stops us from recognising this obvious truth.

How can new ventures thrive, against the odds? A star business revels in the new niche it creates. But if the star makes it in the long haul, it is not just the idea for the new category that counts. What's also essential is that somebody translate the idea into intelligent action. Somebody has to win business from sceptical customers. Somebody has to deliver the product or service and please the early customers so much that they come back for more. Somebody has to improve the product so that competitors can't catch up. Somebody has to organise the ship. Somebody has to hire great new people and make them understand what the firm is all about, why it is different and better.

Who is 'somebody'? Maybe one of the founders. But, more often than not, most of the really valuable work in the early days is done by other employees, the first people through the star venture's door. These are the people who make the business take off. These are the people who make it valuable. And very often they do it *despite* the founder or founders, not because of them. These 'somebodies' are real entrepreneurs, real value creators.

IF YOU ARE OR COULD BE AN INVESTOR

- Invest only in a star business. Check it really is a star - see chapters 8 and 12 -- before you part with your money.
- Encourage the founders to take a broad perspective of the many-headed entrepreneur.

If you are going to work for a living, you might as well work as one of the first 20 people in a new star venture. You can be Somebody. It will be the time of your life.

PART 2

CHAPTER 5

THE ART OF CREATING STARS

THE STAR IDEA IS UNUSUAL AND SPECIFIC, AND STOPS YOU WASTING TIME

If somebody tells you, 'Find a terrific new venture that will become very profitable', that's not a lot of help. It doesn't tell you where or how to look. But, if the advice is 'Find a star business', that's much more helpful and concrete. In fact it excludes the great majority of new ventures that survive and manage to make a living.

Recall what a star business is. It is the *largest company* in its niche. That niche must also *grow fast*, at least 10 percent a year over the long haul. Both conditions must apply or it isn't a star.

You have to state *why and how* your business is going to be the leader. If the niche already exists, so too does a leader, Displacing an incumbent leader is always possible, but it is difficult. It's not something to bet on, unless you have a source of competitive advantage that is totally compelling.

To create a viable new niche is tough. The large majority of attempts to create a niche fail. Why? Two conditions must be met.

- **There must be a gap in the market.** All existing players must have overlooked the gap, or judged it too small, too unprofitable or too implausible, for sure, this is possible. But it is not very likely.
- **There must be a market in the gap.** The gap must be large enough to support at least one new venture (yours) profitability. This, too, is not profitable.

Though it goes against everything we like to believe, everything we read in papers and books, the curious truth is that executives have much less influence than they and we like to believe, once a firm's positioning is set. One executive versus another is almost completely irrelevant, unless he or she makes a brave and dangerous decision to try to transform a firm's positioning. This is rare. Even when the attempt is made, it fails more often than it succeeds.

The one time when individuals can dependably make a difference and put themselves in a great position is:

- When they select the positioning for a new or young venture;
- When they realise that success comes from creating a star firm (this is the only general and reliable reason for business success, since nearly all stars are very successful, so long as they stay stars -- and, crucially, the other way round: nearly all very successful firms are stars); and
- When they determine to start a star venture.

CHAPTER 7

STARDOM THRUST UPON THEM

- **A cash cow can be turned into a star** when the *concept of the product category is transformed*
1. **PR is only as good as the reality behind it.** To recover leadership requires real differentiation and added value for the consumer. It's pointless to *claim* you are better: you have to *prove* that you are different, and the difference has to appeal.

LEK CONSULTING: IMITATION PRECLUDES UNI

QUENESS

It is the same with business, except the time to extinction is compressed. Any business that imitates another slavishly will not be successful. The numbers are against it. It will be competing in the same market as the market leader. It will be smaller. It will have less appeal to customers. It will be less profitable and usually loss-making. It will have to do something different, or die.

CHAPTER 8

SEVEN STEPS TO HEAVEN

There are seven steps necessary for creating a star venture. The seven steps give you an easy template for devising your star.

Step 1: Divide the market. This takes an existing market and divides it into two. The baby niche will be tiny relative to the main market. No matter. What you are doing is dividing an existing market into two: everyone else's market and your new niche.

Step 2: Select a high-growth niche. This requires us to estimate future market growth in the possible niche. How confident can we be that it will grow at more than 10 percent a year? Why? If we cannot be confident, we reject the idea and go back to Step 1 to select another niche.

Step 3: Target your customers. This step identifies the target customers' preferences. They must be clearly identifiable and different in profile from the customer needs in the main market. You must be confident that the product or service in the new niche will serve its customers' preferences much better than the existing market.

Step 4: Define the benefits of the new niche. This specifies the benefits the new category provides over and above existing products in the main market. What is it offering more of? What is it offering that is better for the target customers? What is it offering that is better for the target customers? What is it offering that the main market doesn't provide at all? And also, what does the new product not offer that the existing products do? What is it subtracting from the main markets?

Step 5: Ensure profitable variation. This step works out why the new niche can be more profitable than the existing market. If we aren't confident that varying the main market will be more profitable -- if we don't have good reasons why it will be -- then we reject the idea and start again at step 1.

Step 6: Name the niche you plan to lead. Unless you define your niche carefully, you cannot have a clear idea of who are your niche competitors --the firms you should really worry about -- as opposed to firms in the main market, with which you compete only indirectly. Your profitability will be determined by whether you remain the niche leader and by how much, not by your share of the total market.

CHAPTER 9

HOW TO CREATE YOUR STAR 1 - DREAMING UP STAR IDEAS

The procedure is straight forward, based on the Seven Steps to Heaven. In this chapter we work together to *generate a shortlist of two or three possible ideas* for the star venture by dividing existing markets into two -- the current market and your new star niche, You will recognise this process as step 1 in the Seven Steps to Heaven at the beginning of Chapter 8. In Chapter 9 we go on to *validate the ideas and choose one of them* as your star venture, following Steps 2 to 7.

Start with the markets you and your friends know. How could you turn them upside down, inside out, to create a new category?

TRIGGER 1. YOUR IDEAL PRODUCT DOESN'T EXIST

The first trigger is the simplest. Is there a product or service you really want that is not available?

TRIGGER 2. UPMARKET/DOWNMARKET

Could you create a luxury segment of the market? This is particularly fertile when nobody thinks much of the existing market, when it's a big Cinderella -- dull, unprofitable, flat or declining.

The American retail coffee market used to fit this description to a T.

TRIGGER 3. AFFORDABLE LUXURIES

These are higher-ticket versions of 'affordable indulgences'. Is there a really expensive product where you could create a new category that is much more affordable than the current luxury and yet retains high standards and much of its appeal?

TRIGGER 4. MASS MARKET VERSUS NICHE

You could go a step further and create a genuine mass market where there is currently only a small, select market for rich people.

TRIGGER 5. BIGGER PRODUCT VERSUS SMALLER PRODUCT

New niches can be created by going bigger or smaller. Provide something bigger, more robust or more powerful -- supersized McDonald's, 4x4 utility vehicles, sports cars

Alternatively, make the product smaller --the wrist watch, Dinky cars, Vespa scooters, Honda small motorbikes, personal computers, Volkswagens, Smart cars, mobile phones

TRIGGER 11. FIXED VERSUS MOBILE

Stationary versus on-the-run. Sure, this has been done in fast food and mobile phones, with the Sony Walkman and the Apple ipod. Could it be done elsewhere? Of course it can. Imagination is the only restraint.

TRIGGER 12. UNISEX VERSUS SINGLE SEX

Unisex was seventies. Single sex is noughties and will be 2010s. 1995Curves created a new star venture with health clubs exclusively for women. It's now the world's largest fitness franchise with 10,000 clubs, 4 million members, and revenues of \$2.6 billion. A new Curves opens somewhere in the world every 4 hours -- this star will grow and grow.

How could you create a new star by focusing exclusively on men or women?

TRIGGER 22. TOTAL COST VERSUS INITIAL PRICE

CHAPTER 10

HOW TO CREATE YOUR STAR 2 - VALIDATING AND CHOOSING YOUR STAR VENTURE

STEP 2: SELECT A HIGH-GROWTH NICHE

Do all the ideas on your shortlist promise growth for many years of at least 10 percent a year? If you have doubts, scrub the idea.

STEP 3: TARGET YOUR CUSTOMERS

STEP 4: DEFINE THE BENEFITS OF THE NEW NICHE

CONSTRUCT YOUR COMB CHART

First, define the 'purchase criteria' of the market as a whole -- what, on average, are the important benefits for the customer. Figure 10.1 shows these for the betting market in the UK, using a 1 to 5 scale, where 1 is totally unimportant and 5 is vital:

Now comes the fun part. We create a chart like Figure 10.1, but instead of drawing it for the main market, we draw it for the *target customers* we have in mind.

STEP 5: ENSURE PROFITABLE VARIATION

A new niche is worth creating only if it will be more profitable than the existing market.

STEP 6: NAME THE NEW NICHE

STEP 7: NAME THE NEW BRAND

CHAPTER 14

HOW SOME FAMOUS STARS EVOLVED

WPP Group, now one of the world's leading communications companies, began life as Wire and Plastic Productions Plc, making shopping carts for supermarkets. WPP now owns star business in several advertising, PR and marketing research segments.

BOOK NOTES

Belgo Restaurant?