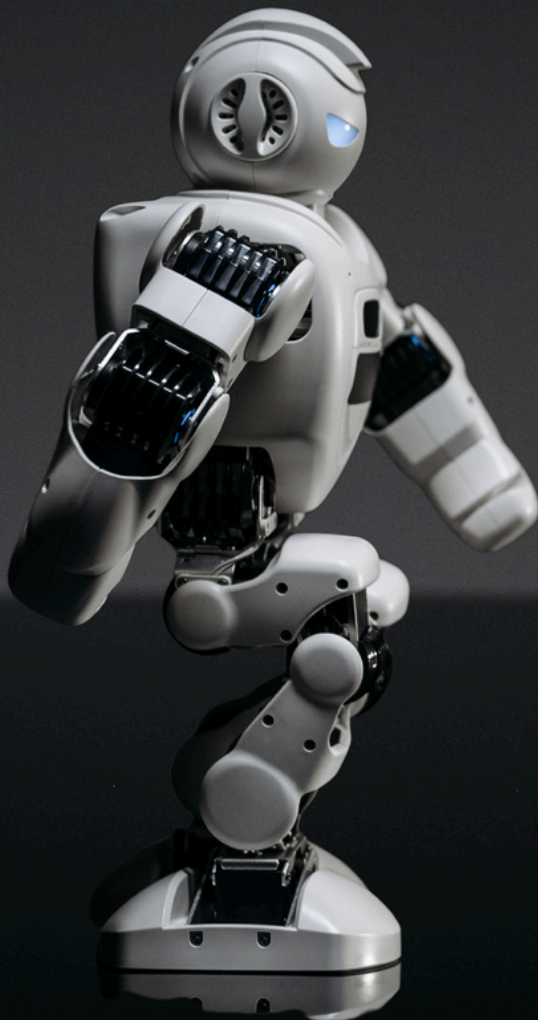


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AI AND CREATIVE DESTRUCTION:

Why Incumbents Struggle and Startups Win



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AI and Creative Destruction: Why Incumbents Struggle and Startups Win

Manoj Tavarajoo | AI Essentials for Leaders Series – Article 10



The Austrian economist Joseph Schumpeter famously described capitalism as a process of “**creative destruction**.” New innovations dismantle old industries, replacing them with new ones. In the age of AI, this cycle moves faster and strikes harder than in any previous era.

Creative destruction describes the cycle, but it does not fully explain why incumbents so often fail while startups thrive. To understand AI-driven shifts, we must also consider Henderson and Clark’s **architectural innovation**, Clay Christensen’s **disruptive innovation**, and the **collision** of operating models described earlier in this series in [Article 7: When AI-Driven Firms Collide with Traditional Businesses: The Nokia Lesson](#) and [Article 8: Is Your Organisation Ready for AI: Rethinking Operating Models in the Age of Collision](#).

1. Creative Destruction in the Age of AI

AI is accelerating the cycle of renewal and replacement. Entire industries are being reshaped as digital-first entrants challenge incumbents with entirely new models of competition.

- **Media:** Netflix overtook Blockbuster by treating streaming as a data-driven learning product.
- **Retail:** Amazon displaced Sears by building a digital-first, customer-obsessed platform.
- **Finance:** Ant Group scaled faster than traditional banks by embedding AI into payments and lending.

Where incumbents once had decades to adapt, today the cycle of creative destruction can play out in just a few years.

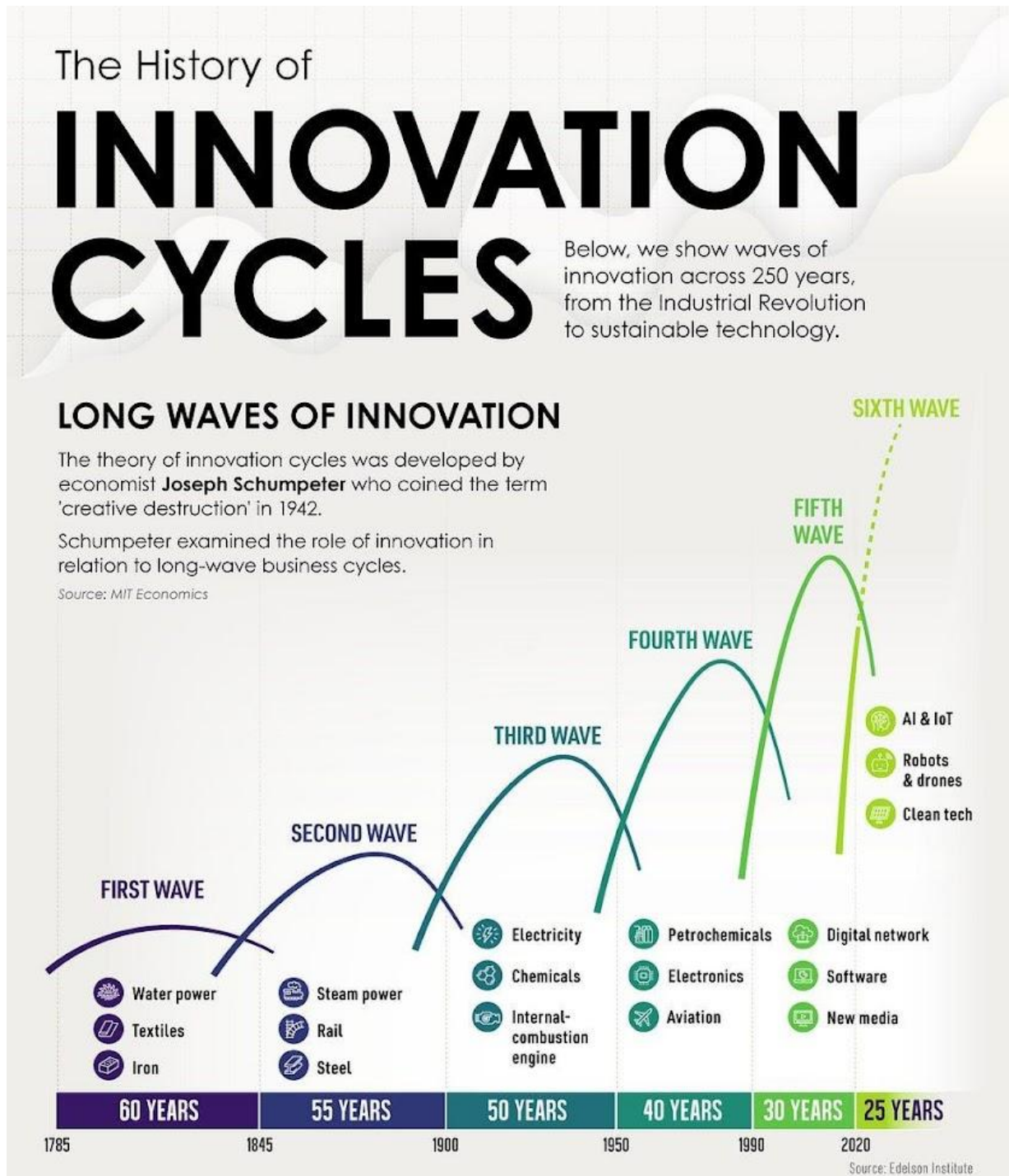


Figure 1: Creative Destruction Cycle (Source: Edelson Institute)

Schumpeter defined CD as a process of industrial transformation, altering the economic structure from inside, i.e. through constant destruction of the old one and creating a new one.

2. Why Incumbents Miss the Shift: Architectural Innovation

Henderson and Clark (1990) showed that incumbents often fail not because they cannot innovate at the component level, but because they miss **architectural innovation**, which refers to changes in how components fit together.

- **Nokia:** Optimised phone hardware, but missed the ecosystem architecture of smartphones.
- **Kodak:** Invested in digital cameras, but could not pivot its business model away from film.

AI represents a profound architectural shift. Instead of relying on physical assets and linear processes, AI-first firms operate with **data pipelines, digital cores, and learning loops**. Incumbents who continue optimising the wrong “parts” of their system risk missing the bigger picture of architectural change.

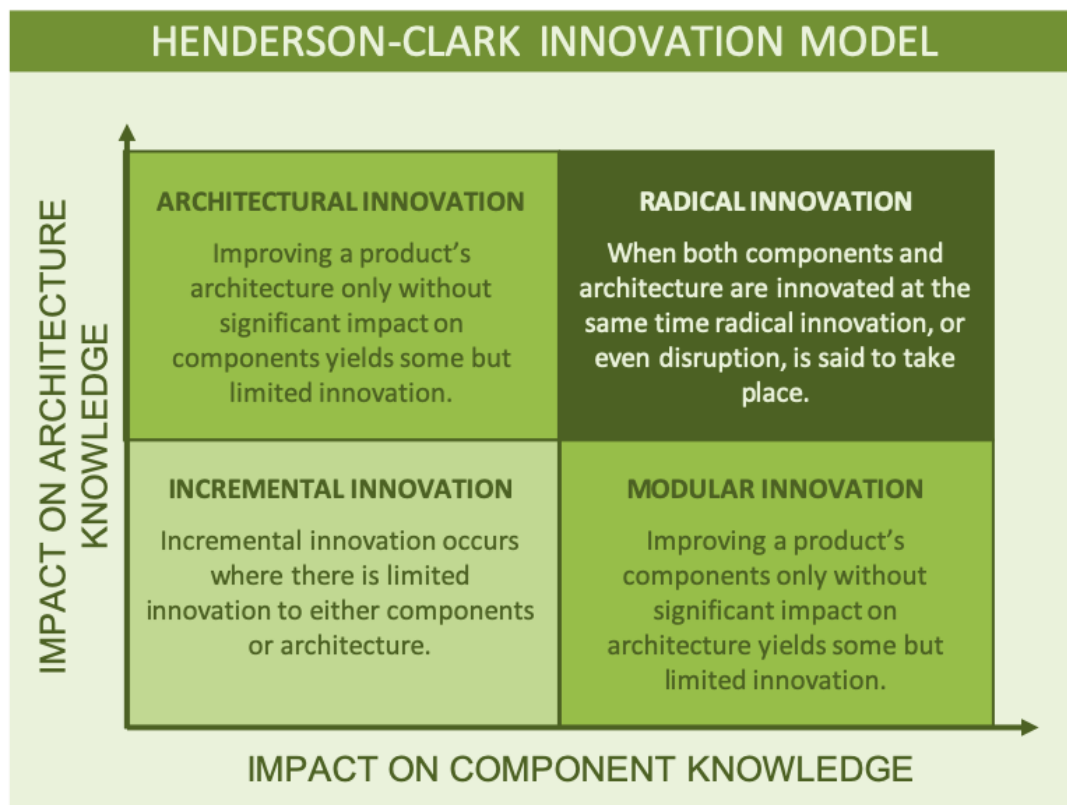


Figure 2: Henderson & Clark's Architectural Innovation Matrix (Source: People Shift)

This illustrates why incumbents miss system-level shifts even when they innovate at the component level.

3. Why Startups Climb: Disruptive Innovation

Clay Christensen's theory of **disruptive innovation** explains how entrants succeed by starting small. They target underserved or low-end segments with simpler, cheaper AI-driven solutions. Over time, they move upmarket to challenge incumbents head-on.

- **Fintechs:** Began with micro-loans and digital wallets, now compete with full-service banks.
- **Ride-hailing platforms:** Started with simple app-based booking, now invest in AI-driven logistics and autonomous driving.
- **Healthcare startups:** Began with AI-enabled triage tools, now move toward comprehensive clinical platforms.

Disruption matters because incumbents focus on sustaining innovation for their most profitable customers, leaving the door wide open for agile entrants.

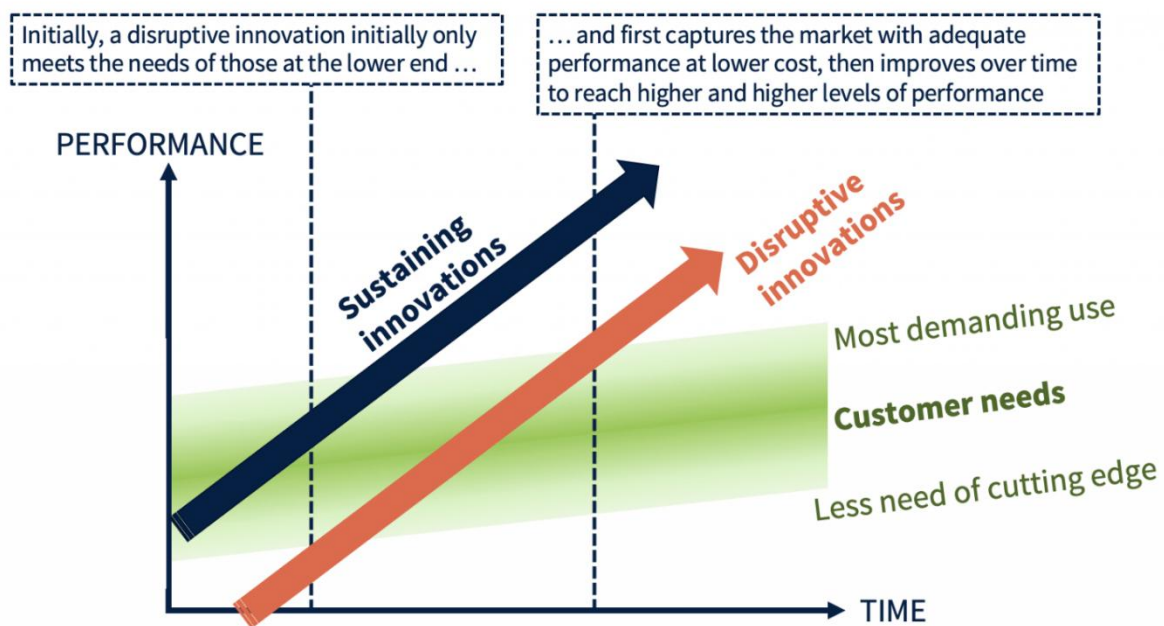


Figure 3: Disruptive Innovation Curve (Source: Harvard Kennedy School)

This highlights how disruptive entrants begin in low-end or underserved segments before moving upmarket to overtake incumbents.

4. When Theories Collide: The Operating Model Clash

Disruption ultimately culminates in **collision**, the point at which AI-first firms and traditional incumbents meet head-to-head in the same market. This is not a normal competitive battle. It is a clash between fundamentally different operating models.

- **Incumbents:** Asset heavy, reliant on physical infrastructure, hierarchical structures, and governance processes that prioritise control and predictability.
- **AI-first firms:** Built on digital cores, with data at the centre, agile teams, and rapid experimentation that prioritises learning and adaptability.

History shows that when these two models meet, the speed, scale, and adaptive architecture of AI-first firms decisively overwhelm the slower, rigid structures of incumbents.

Examples include:

- **Blockbuster vs. Netflix:** One optimised a store-based business, the other built a streaming platform powered by data and recommendations.
- **Nokia vs. Apple:** One perfected hardware, the other built a software-driven ecosystem.
- **Traditional banks vs. Ant Group:** One relied on paper heavy processes, the other scaled AI-driven credit and payments through a digital first platform.

Collision is the moment when **creative destruction, architectural innovation, and disruptive innovation converge**. The result is decisive. Incumbents collapse not because they lack assets, but because their operating models cannot keep pace.

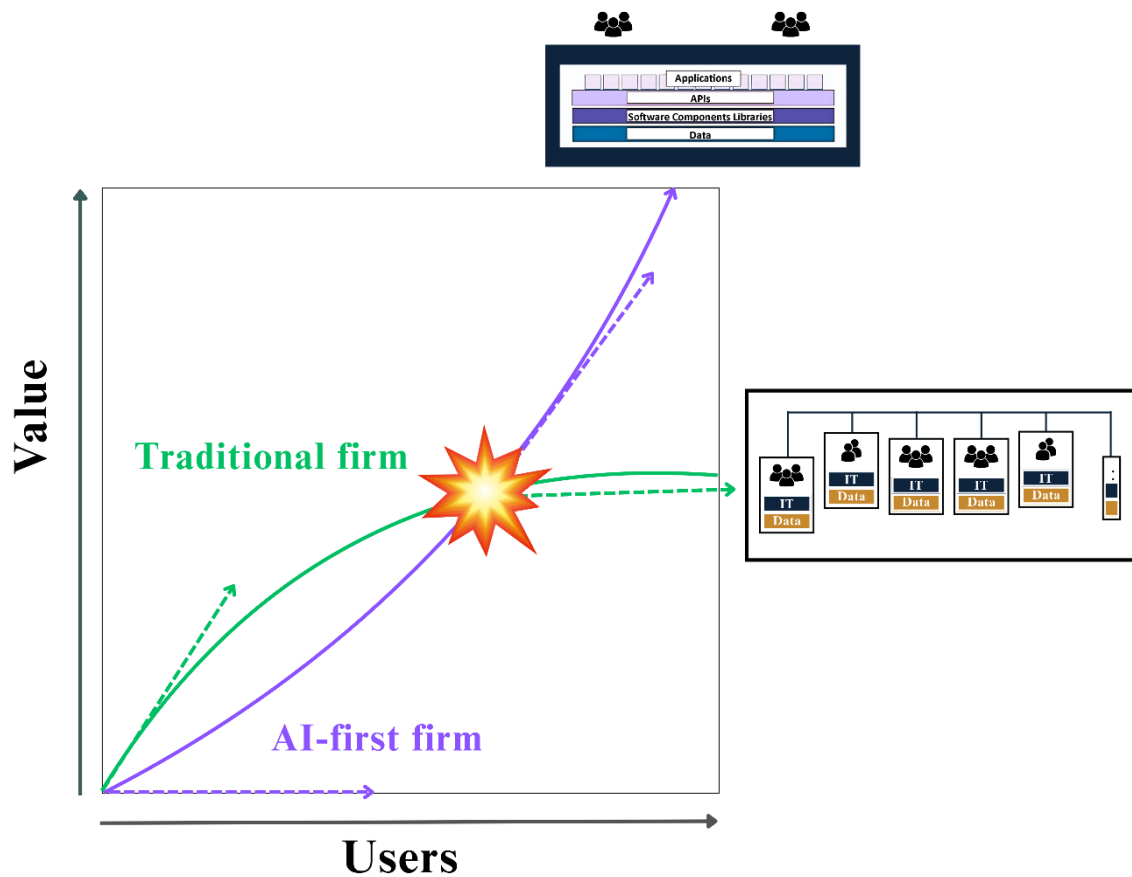


Figure 4: Collision Between AI-First and Traditional Firms (Source: Adapted from HBS)
This illustrates how differences in speed, scale, and adaptability create decisive outcomes when incumbents and AI-first firms compete.

5. The Takeaway for Leaders

AI does not simply create better products. It reshapes the very foundations of competition.

- **Creative destruction** explains the cycle of renewal and collapse.
- **Architectural innovation** explains why incumbents miss shifts in how value is created.
- **Disruptive innovation** explains how startups scale from the edge.
- **Collision** explains why incumbents ultimately fall when operating models clash.

Leaders must decide whether to reinvent their operating models or risk becoming the next cautionary tale of AI-driven creative destruction.

Leader questions:

- Are we recognising the architectural shifts AI is creating in our industry?
- Are we vulnerable to disruption from entrants starting at the edge?
- Do we understand how our operating model would perform in a collision with AI-first firms?
- Are we prepared to disrupt ourselves before others do it for us?

Up next:

The Ethics of AI: Tackling Bias, Privacy, and Digital Amplification Risks



Driving Digital Transformation and AI Readiness Across Enterprise

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