

Strategic Management

CB4303

WEEK 6: BUSINESS LEVEL STRATEGY II

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Announcements

Group project proposal next week (October 19th): 3 to 4-minute presentation per team

- No need to present your analyses or framework
- Introductory presentation to present your topic of interest
- Be prepared to access your team's presentation online

Quiz grades will be released next week

Recap

What Is Business Level Strategy?

Goal of business-level strategy:

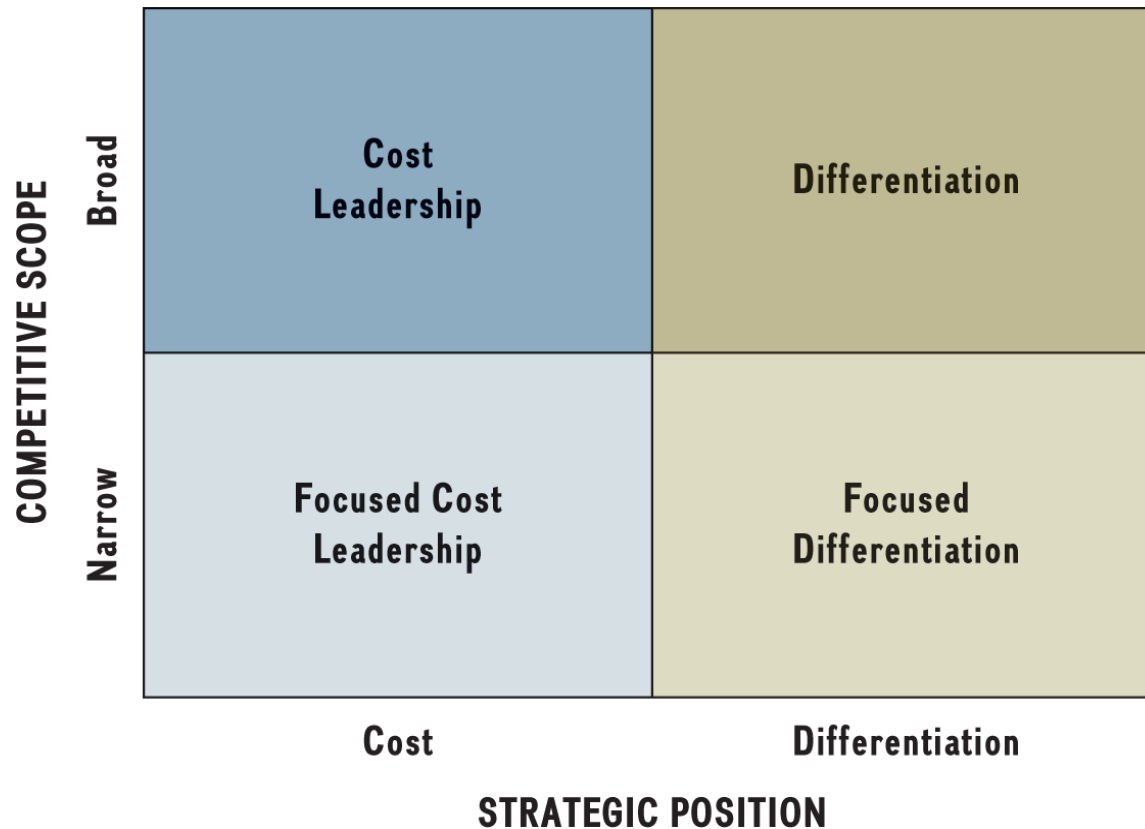
- To achieve competitive advantage in a single product market

“How should we compete?”

- **Who:** which customer segments?
- **What:** customer needs will we satisfy?
- **Why:** do we want to satisfy them?
- **How:** will we satisfy our customers' needs?

Strategic Position and Competitive Scope: Generic Business Strategies

Exhibit 6.2



Source: Based on M.E. Porter (1980), *Competitive Strategy. Techniques for Analyzing Industries and Competitors* (New York: Free Press).

Differentiation Strategies: Summary

Focused on adding value:

- Unique features
- Customer service
- Effective marketing

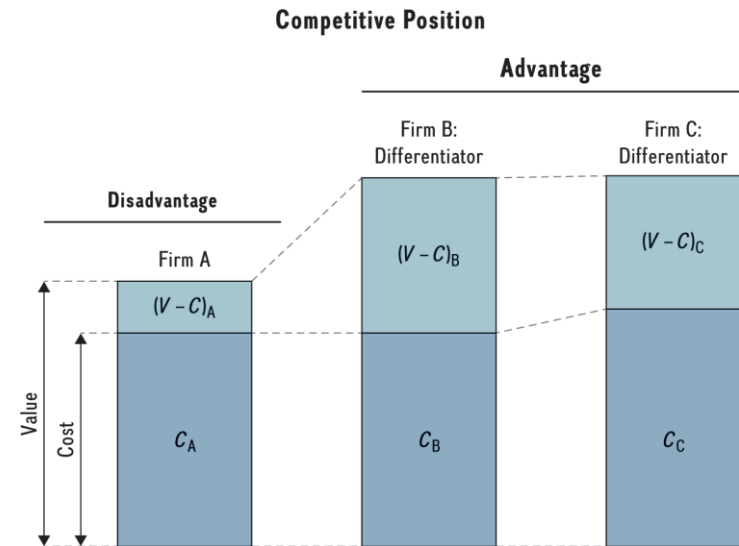
Can increase costs, for example, if innovative R&D activities are needed

Customers willing to pay a price premium

Differentiation Strategy

Firm A vs. Firm C

- Even if a firm fails to achieve cost parity it can still gain a competitive advantage
- Higher value creation often requires higher costs
 - Higher-quality raw materials
 - Research and development
 - Employee training to provide superior customer service
- Economic value creation can still exceed that of its competitors
 - $(V - C)_C > (V - C)_A$
 - Allows company to charge a premium price



Cost Leadership Strategies: Summary

Focus on:

- Offering lower costs than competitors
- Maintaining acceptable quality

Appeals to the bargain-conscious buyer:

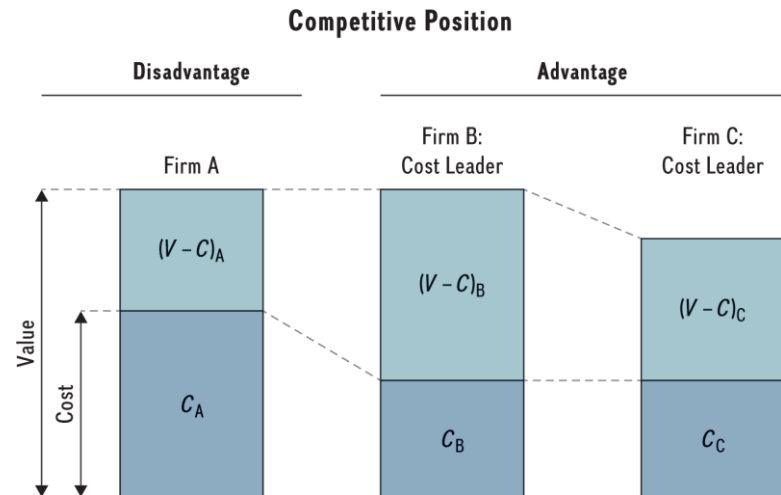
- Attracts increased sales

Can be profitable over a long period of time

Cost-Leadership Strategy

Firm A vs. Firm B&C

- Firms that can keep their cost low while offering acceptable value are able to gain a competitive advantage
- Two types of cost-leadership strategies
 - Charge similar prices to its competitors and benefit from a greater profit margin per unit
 - Charge lower prices than its competition and gain higher profits from higher volume
 - Both variations of a cost-leadership strategy can result in competitive advantage



Economies of Scale And Scope

Economies of **Scale**:

- Decreases in cost per unit
- Achieved as output increases

Economies of **Scope**:

- Savings that come from producing a variety of products at less cost
- Shares the same resources or technology

Agenda for Today

- Topic: Business Strategy & Innovation
 - ✓ Outline blue ocean strategy
 - ✓ Outline the four-step innovation process from idea to imitation
 - ✓ Categorize different types of innovations in the markets-and-technology framework
 - ✓ Outline the four stages of industrial revolutions and derive implications for expected changes in the future
 - ✓ Describe the competitive implications of different stages in the industry life cycle

Business-level Strategy II

What Is Blue Ocean Strategy?

A strategy that combines both differentiation and cost-leadership activities.

- A firm offers a differentiated product/service at low cost.
- Examples: IKEA, Muji

Uses value innovation to reconcile trade-offs

Blue oceans represent:

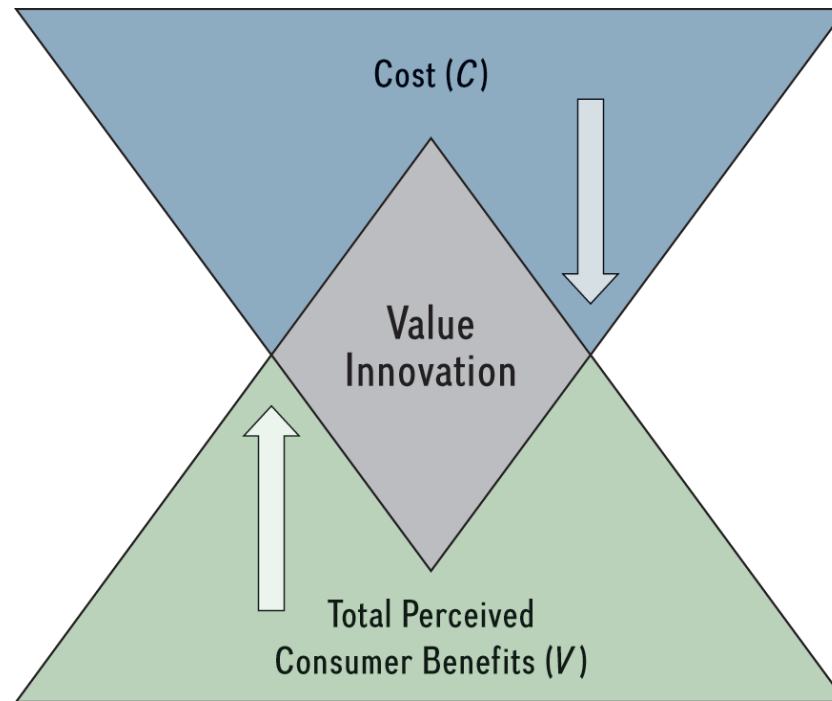
- Untapped market space
- Creation of additional demand
- Opportunities for highly profitable growth

(Red oceans are the known market space of existing industries.)

Value Innovation

Exhibit 6.9

Accomplished through Simultaneously Pursuing Differentiation ($V \uparrow$) and Low Cost ($C \downarrow$)



Source: Author's adaptation from C.W. Kim and R. Mauborgne (2005), *Blue Ocean Strategy: How to Create Uncontested Market Space and Make Competition Irrelevant* (Boston: Harvard Business School Publishing).

To Achieve Successful Value Innovation

Lower costs:

- **Eliminate**: Which of the factors should be eliminated?
- **Reduce**: Which of the factors should be reduced?

Increase perceived consumer benefits:

- **Raise**: Which of the factors should be raised?
- **Create**: Which factors should be created?

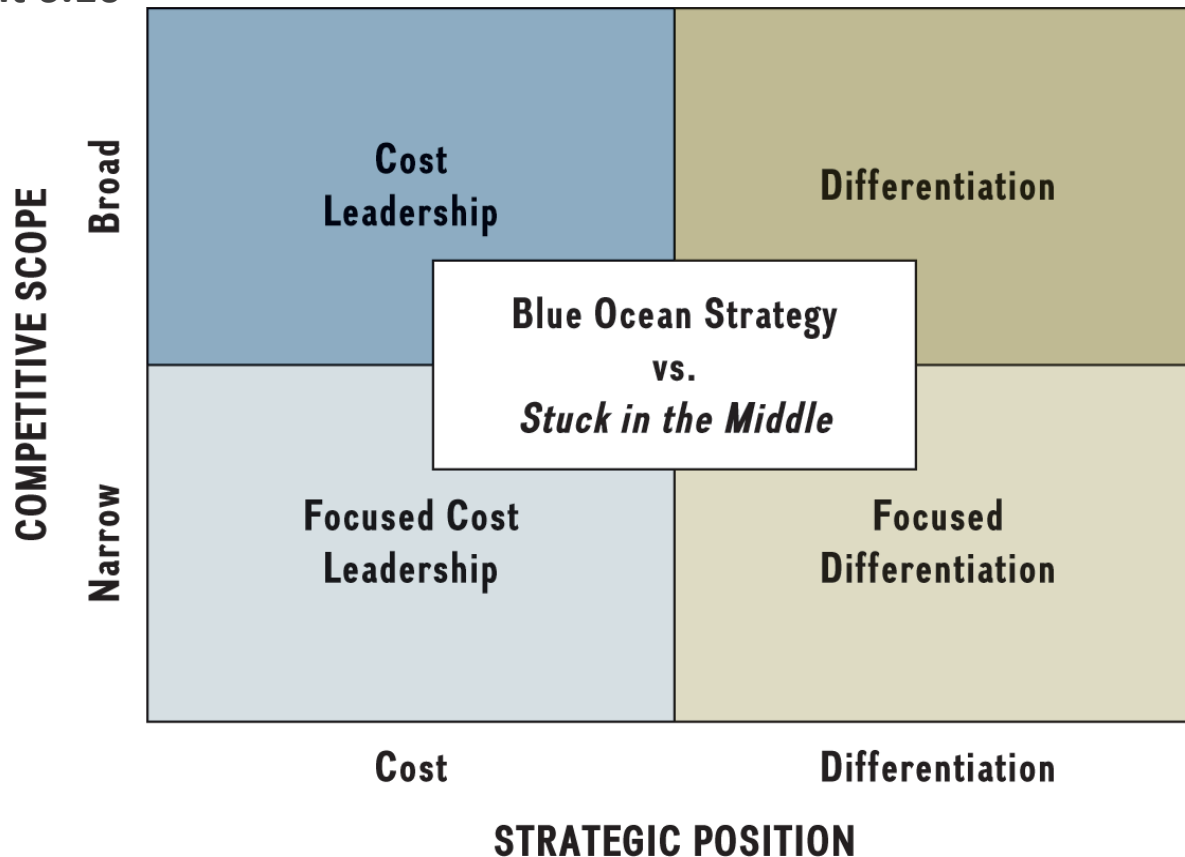
It is difficult to succeed at value innovation

Success example: IKEA

- Eliminate, reduce, raise, create

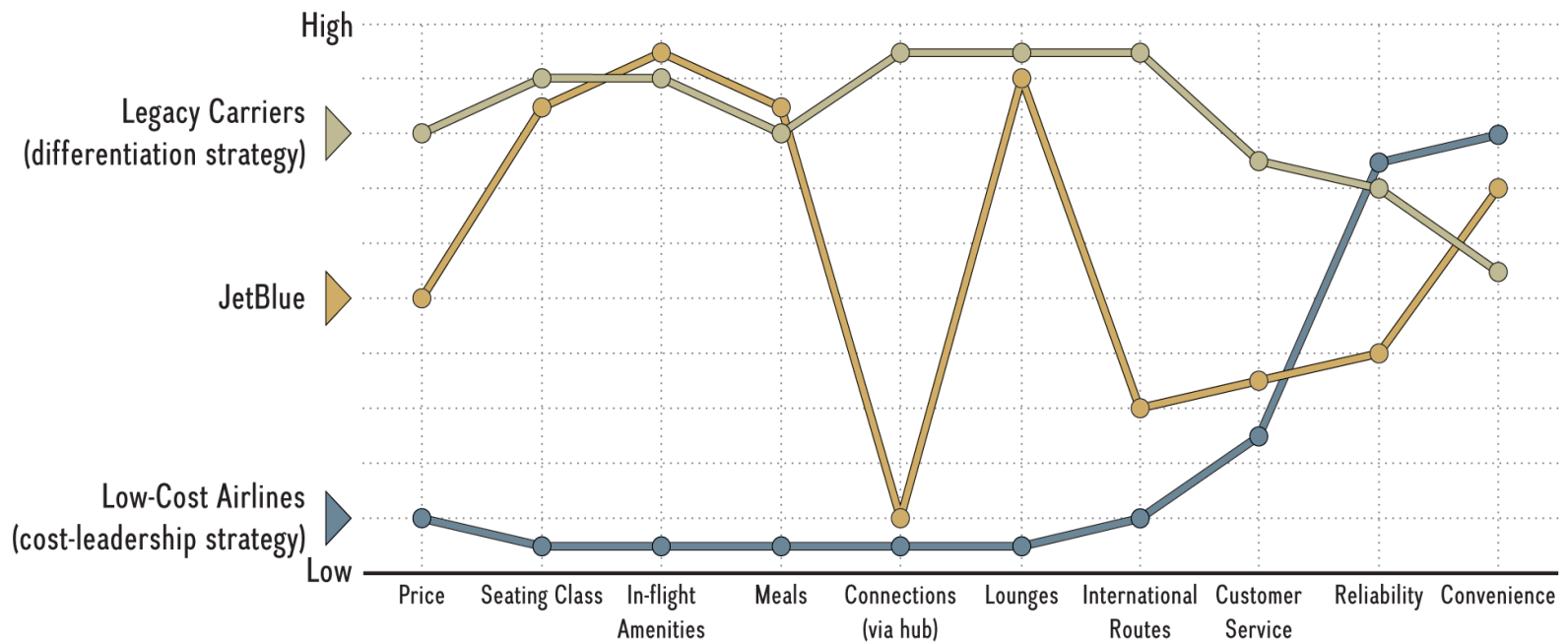
Value Innovation vs. Stuck in the Middle

Exhibit 6.10



Strategy Canvas of JetBlue vs. Low-Cost Airlines and Legacy Carriers

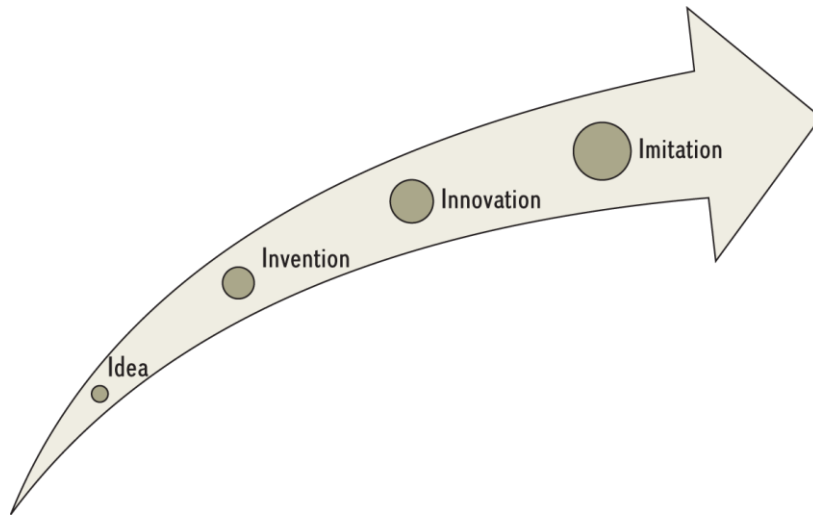
Exhibit 6.12



Innovation

The Four I's: Idea, Invention, Innovation, and Imitation

Exhibit 7.2



Idea:

- Abstract concepts or research findings

Invention:

- Transformation of an idea into a product
- The modification and recombination of products

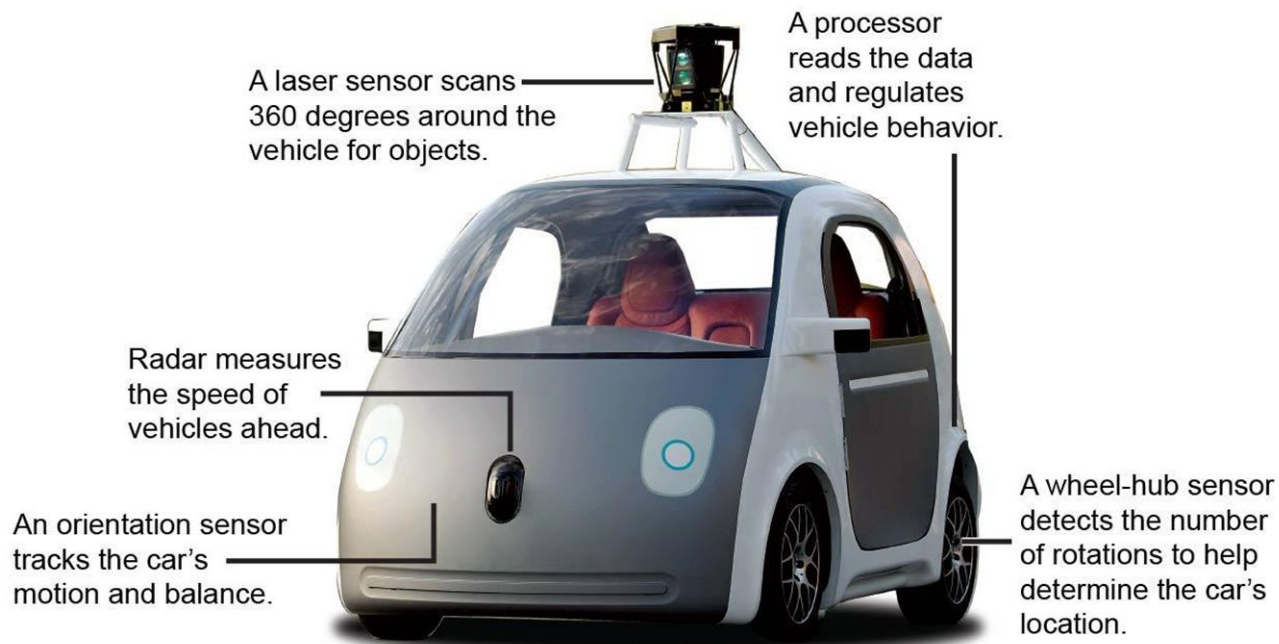
Innovation:

- Commercialization of an invention

Imitation:

- Copying a successful innovation

Self-Driving Car: Invention vs. Innovation

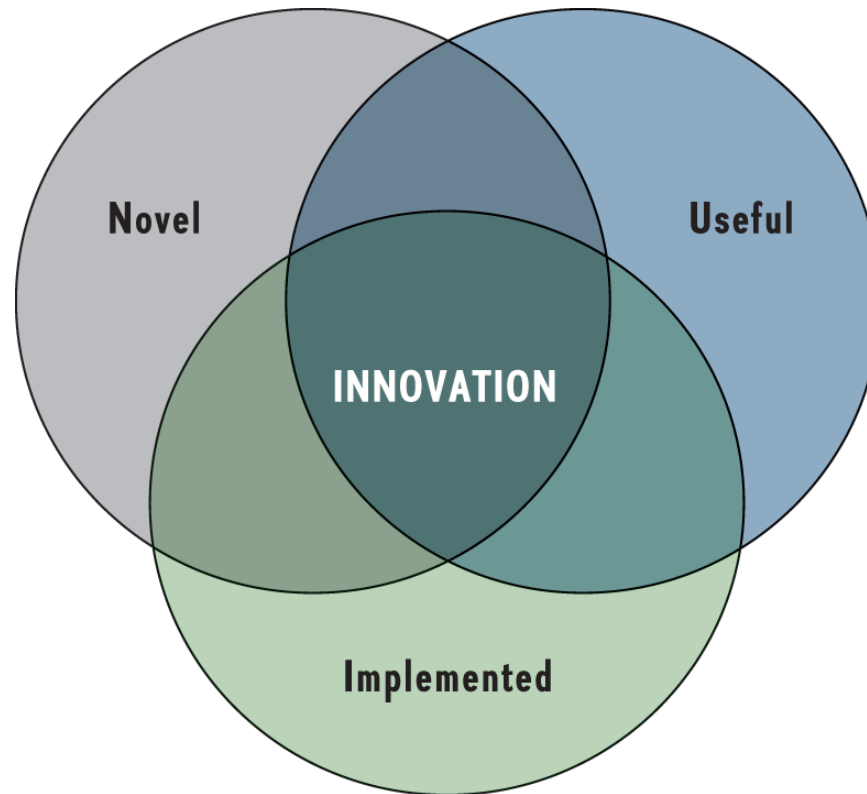


Source: Google

Raoul Rañoa / @latimesgraphics

Innovation: A Novel and Useful Idea That Is Successfully Implemented

Exhibit 7.3



The Four Industrial Revolutions

1st industrial revolution

- Steam power and mechanization in 1780s

2nd industrial revolution:

- Electricity, mass production, assembly line in the 1870s

3rd industrial revolution:

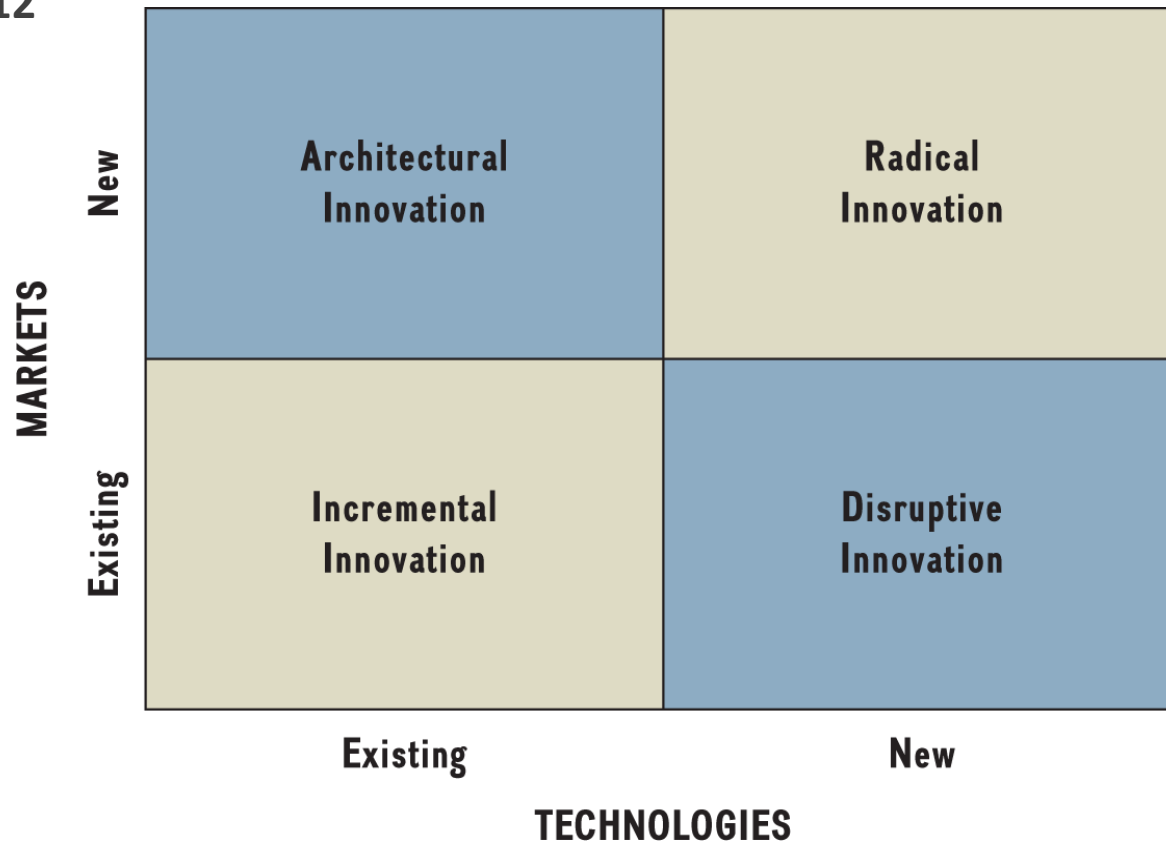
- Computers, electronics, automation in the 1970s

4th industrial revolution:

- Artificial intelligence, cyber-physical systems in the 2020s

Types of Innovation: Markets & Technologies

Exhibit 7.12



Incremental vs. Radical Innovation

Incremental Innovation:

- Builds on established knowledge
- Results from steady improvement

Radical Innovation:

- Novel methods & materials
- Entirely new knowledge base or recombination of existing knowledge
- Targets new markets and technology
- Gillette (1903), airplane, iPhone, genetic engineering

Why Incumbent Firms Tend to Focus on Incremental Innovation

Economic Incentives:

- They must defend their position

Organizational Inertia:

- They have formalized processes and structures

Innovation Ecosystem:

- They rely on certain suppliers, buyers, complementors

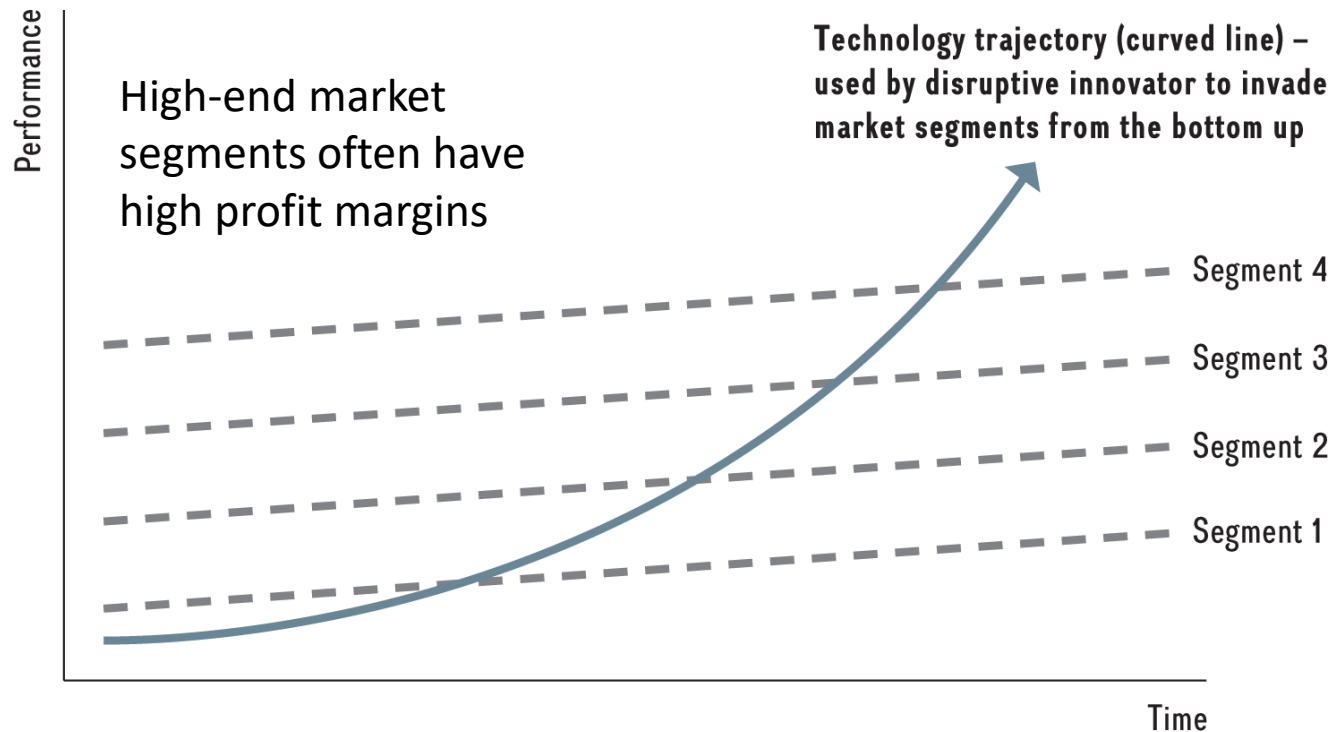
Architectural vs. Disruptive Innovation

Architectural Innovation: Disruptive Innovation:

- Existing technology leveraged into a new market
- Known components, existing technology, used in a novel way
- Example: Canon (architectural innovation) vs. Xerox
- Leverages new technologies in existing markets
- New product / process meets existing customer needs
- Examples: digital photography, laptops

Disruptive Innovation: Riding the Technology Trajectory

Exhibit 7.13



Innovation Is a Competitive Weapon

Innovation can **create** and **destroy** value

Innovation often comes in waves:

- Many firms dominated an early wave of innovation, and are challenged by the next wave
- Traditional networks vs. cable and satellite providers
- Cable providers vs. streaming content

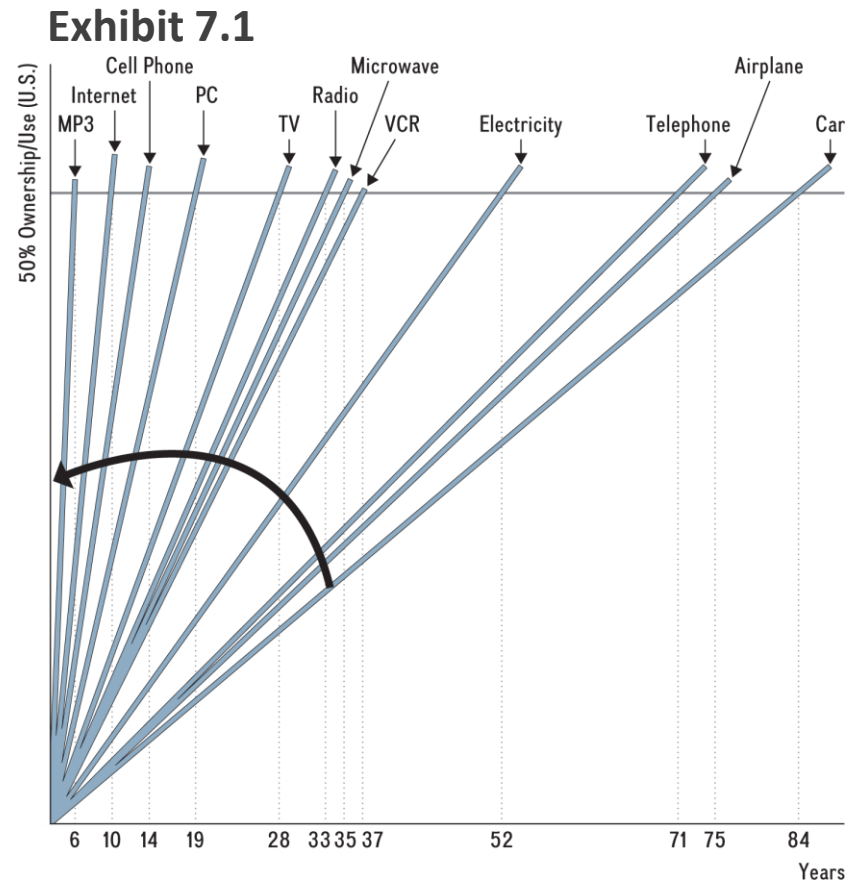
Initial innovations are foundational for other rapid innovation

Industry Life Cycle

Accelerating Speed of Technological Change

Diffusion Rate

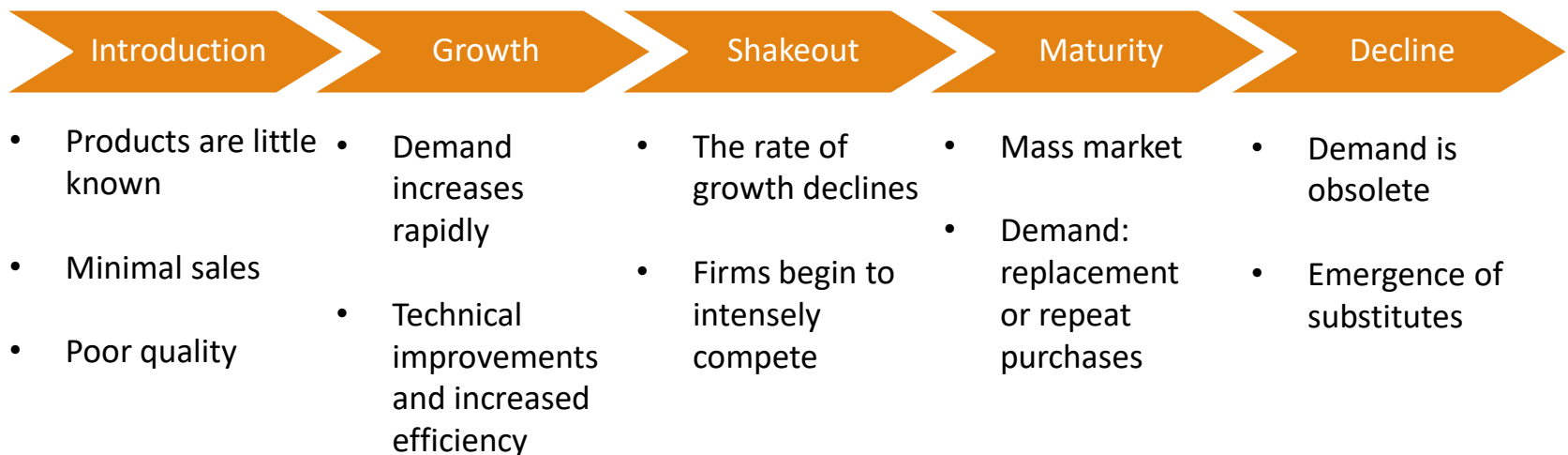
- How many years it took for different technological innovations to reach HALF of the U.S. population (ownership or usage)
 - Car: 84 years
 - Airplane: 75 years
 - Electricity: 52 years
 - TV: 28 years
 - PC: 19 years
 - Internet: 10 years
- Telephones: 74 years
- Cell phones: 14 years



Industry Life Cycle

Over time:

- The number and size of competitors change
- Different types of consumers enter the market
- The supply and demand sides of the market change



Introduction Stage

Initial market size is small, growth is slow

Barriers to entry are high

Strategic objective: market acceptance & future growth

Core competency: research and development

- Necessary to create a product category that will attract customers
- Can be very capital-intensive (high costs)

The emphasis is on uniqueness and performance

Growth Stage

Demand increases **rapidly**

- First-time buyers rush to purchase
- Proof of concept has been demonstrated

Product / service standards **emerge**

- A common set of features and design choices
- Emerges from competition, government, or agencies

Product innovation:

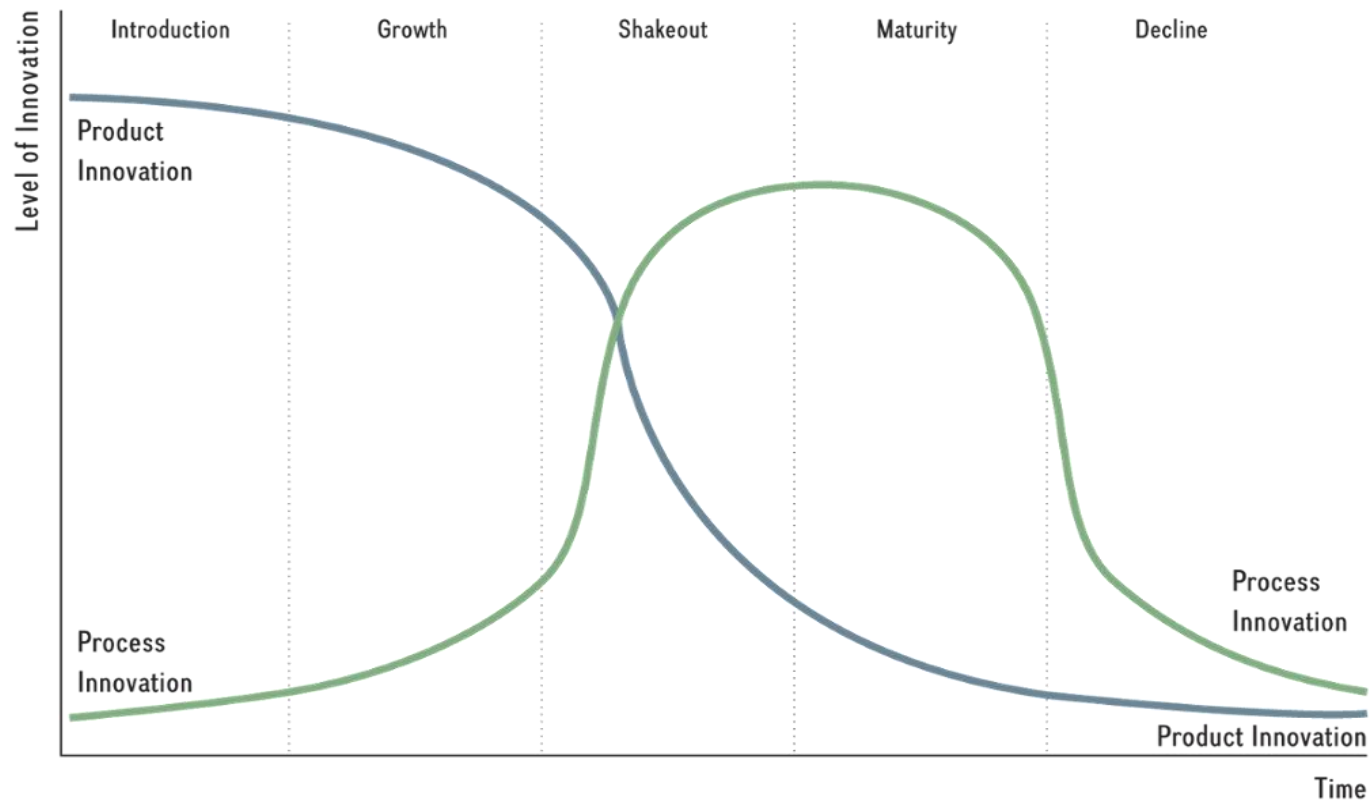
- New / recombined aspects of a product

Process innovation:

- New ways to produce a product
- Core competencies of focus during this stage: manufacturing and marketing

Product and Process Innovation throughout an Industry Life Cycle

Exhibit 7.8



Shakeout Stage

The rate of growth declines

Firms begin to intensely compete

- Weaker firms forced out
- Industry consolidation: only the strongest competitors survive

Price is an important competitive weapon

- The winners are often firms that stake out a strong position as cost leaders

Key success factors at this stage: manufacturing and process engineering capabilities

- The importance of process innovation further increases (albeit at diminishing marginal returns)
- The importance of product innovation further declines

Drivers That Keep Costs Low

Cost of input factors:

- Raw materials, capital, labor, and IT services.

Economies of scale:

- Decreases in cost per unit as output increases.

Learning-curve effects:

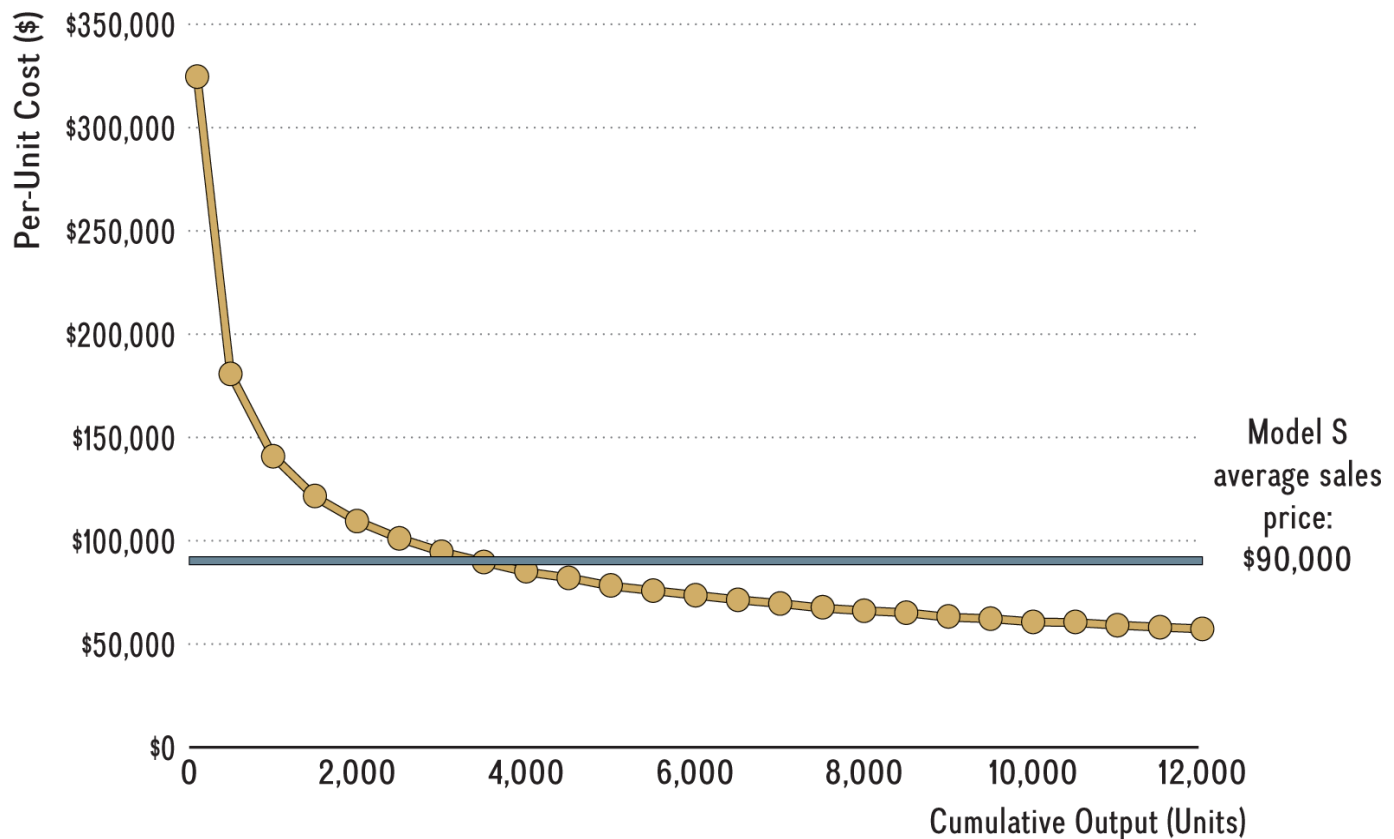
- Less time to produce output with experience.

Experience-curve effects:

- Improvements to technology and production processes.

Tesla's Learning Curve Producing the Model S

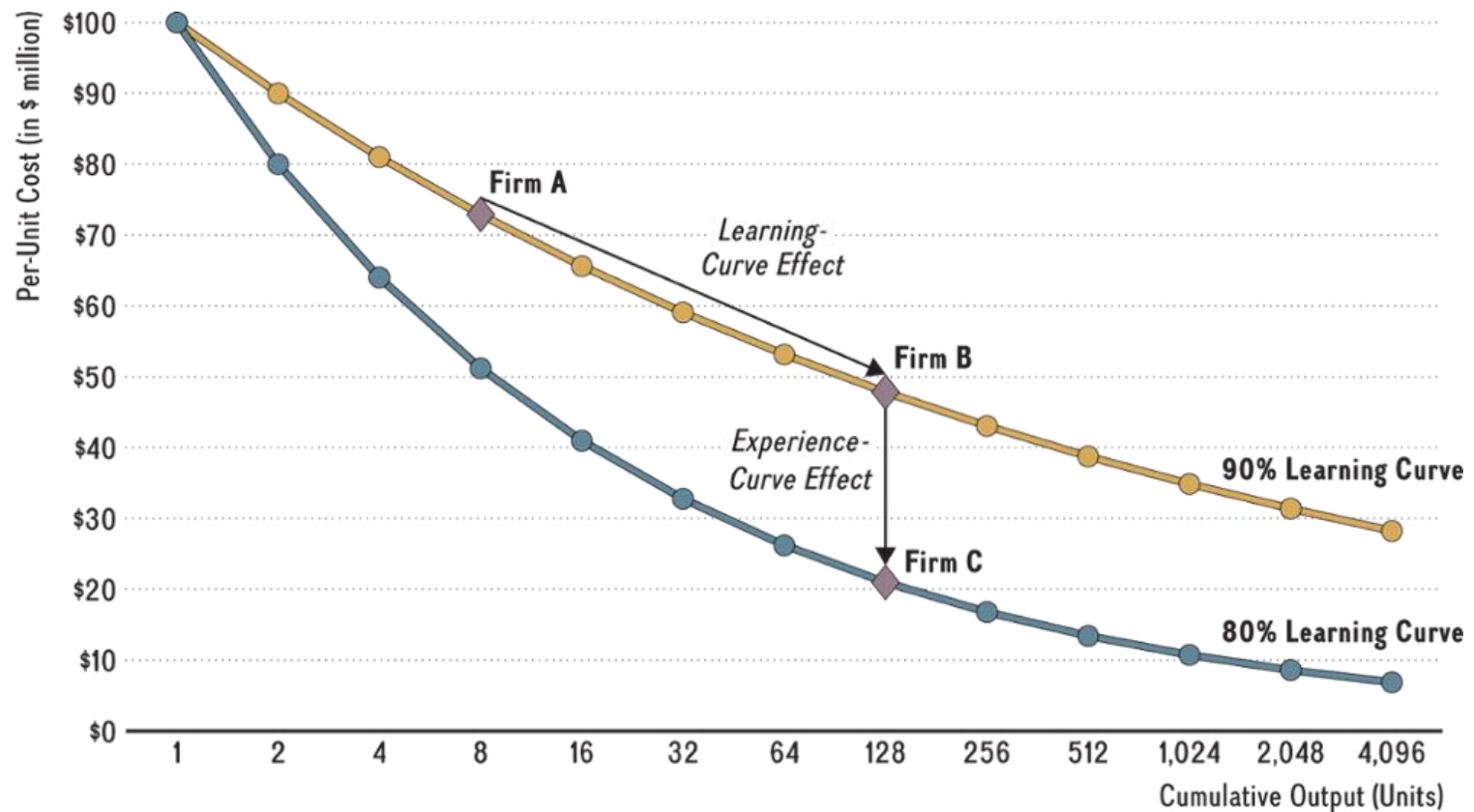
Exhibit 6.6



Source: Author's depiction of functional relationship estimated in J. Dyer and H. Gregersen (2016, Aug. 24), "Tesla's innovations are transforming the auto industry," *Forbes*.

Gaining Competitive Advantage through Leveraging Learning- and Experience-Curve Effects

Exhibit 6.7



Maturity Stage

Only a few large firms remain

- They enjoy economies of scale
- Process innovation has reached a maximum

Demand: replacement or repeat purchases

Market has reached maximum size

- Industry growth is zero or negative

Decline Stage

Demand falls rapidly

- Innovation efforts cease.
- If a breakthrough emerges, it leads to a new industry or resets the life cycle.
- Strong pressure on prices.

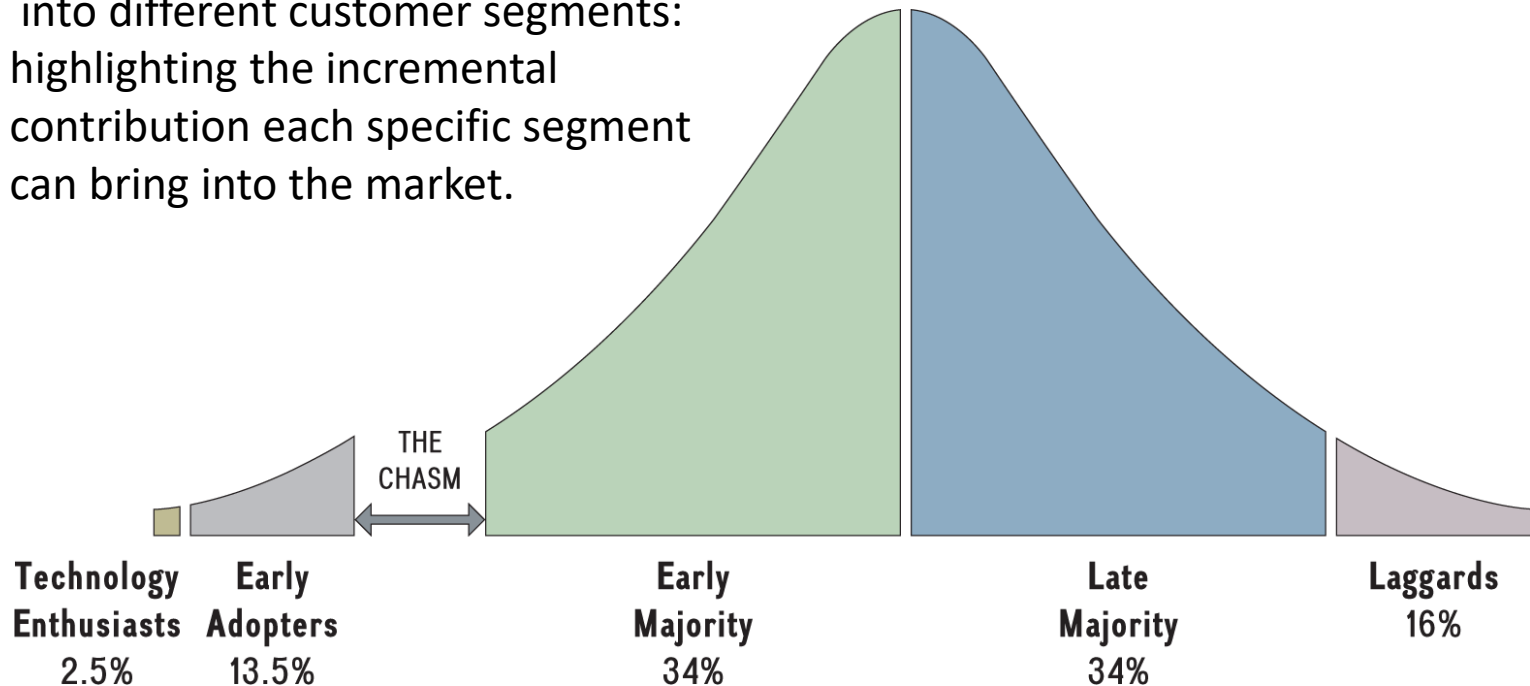
Four strategic options to pursue:

1. **Exit:** bankruptcy / liquidation.
2. **Harvest:** reduce further investments.
3. **Maintain:** support at a given level.
4. **Consolidate:** buy rivals.

Customers: The Chasm Framework

Exhibit 7.9

Breakdown of 100% market potential into different customer segments: highlighting the incremental contribution each specific segment can bring into the market.



Source: Author's adaptation from G.A. Moore (1991), *Crossing the Chasm: Marketing and Selling Disruptive Products to Mainstream Customers* (New York: HarperCollins), 17.

Technology Enthusiasts

Enter the market during the introductory stage.

- Smallest market segment, 2.5% of the total market potential
- Have an engineering mind.
- Proactively pursue new technology.
- Enjoy using beta versions.
- Tinker with product imperfections.
- Provide free feedback and suggestions.

Early Adopters

Enter the market during the growth stage.

- 13.5% of the total market potential

Demand is driven by imagination and creativity.

- Ask themselves, “What can this new product do for me or my business?”

To capture these customers:

- Directly communicate the product’s potential.
- Example: Tesla Model S – thousands of deposits to reserve the model, without having been able to test-drive the vehicle or seen the car.
Significant waiting time to receive the vehicle

Early Majority: Key to Survival

Enter the market during the **shakeout stage**

- 34% of the total market potential
- Decision criteria, a strong sense of practicality

“What Can This Do For Me?”

- Weigh the benefits and costs carefully
- Rely on endorsements of others

This group is key to survival

- Not being able to catch this segment -> fall into chasm

Late Majority

Enter the market during the maturity stage

- 34% of the total market potential

Not as confident in their ability to master the technology:

- Wait until standards have emerged
- Do not like uncertainty

Represent the majority of the market

Buy from well-established firms with a strong brand image

Laggards

Enter the market during the decline stage

- 16% of total market potential

Adopt a new product only if necessary (reluctant)

Generally do not want new technology

Typically not pursued as future customers

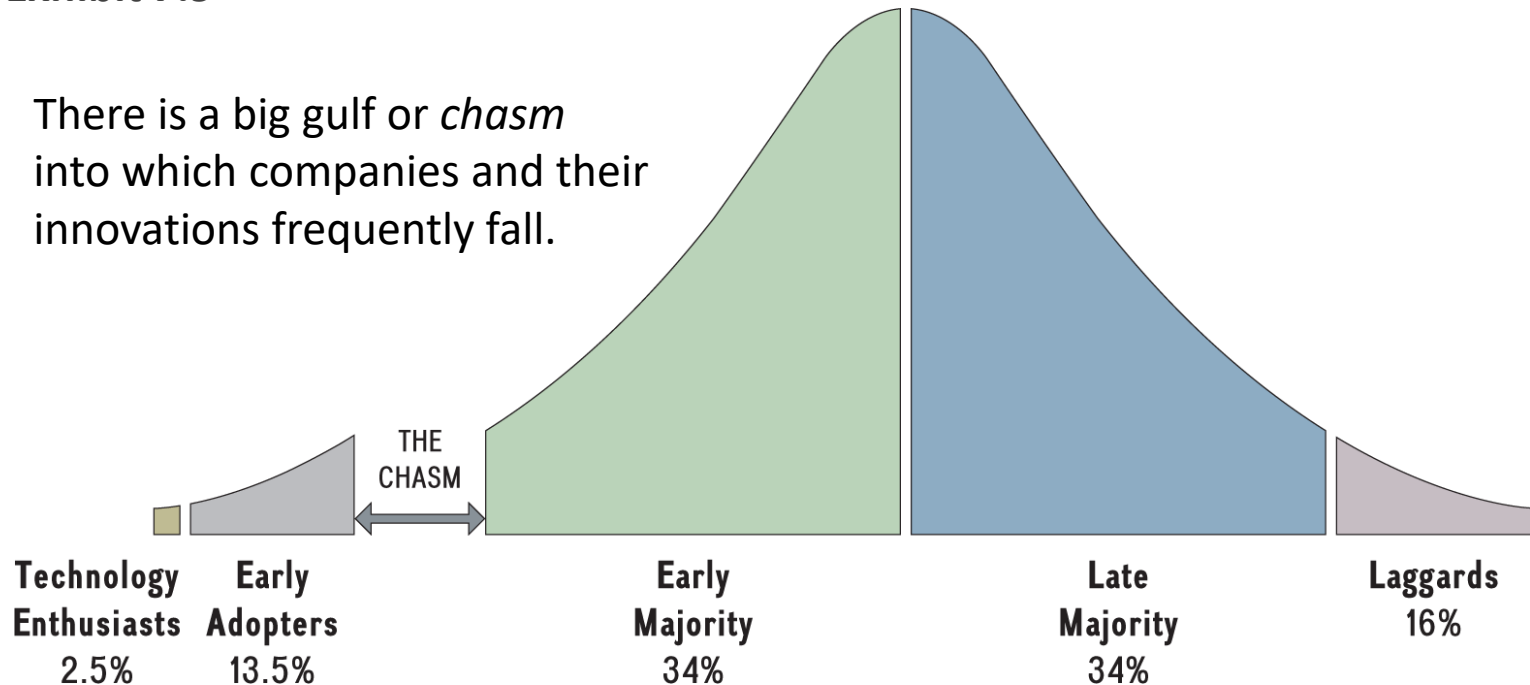
- Demand is small
- Early and late majority are at this time moving on to different products and services

The Crossing-the-Chasm Framework



Exhibit 7.9

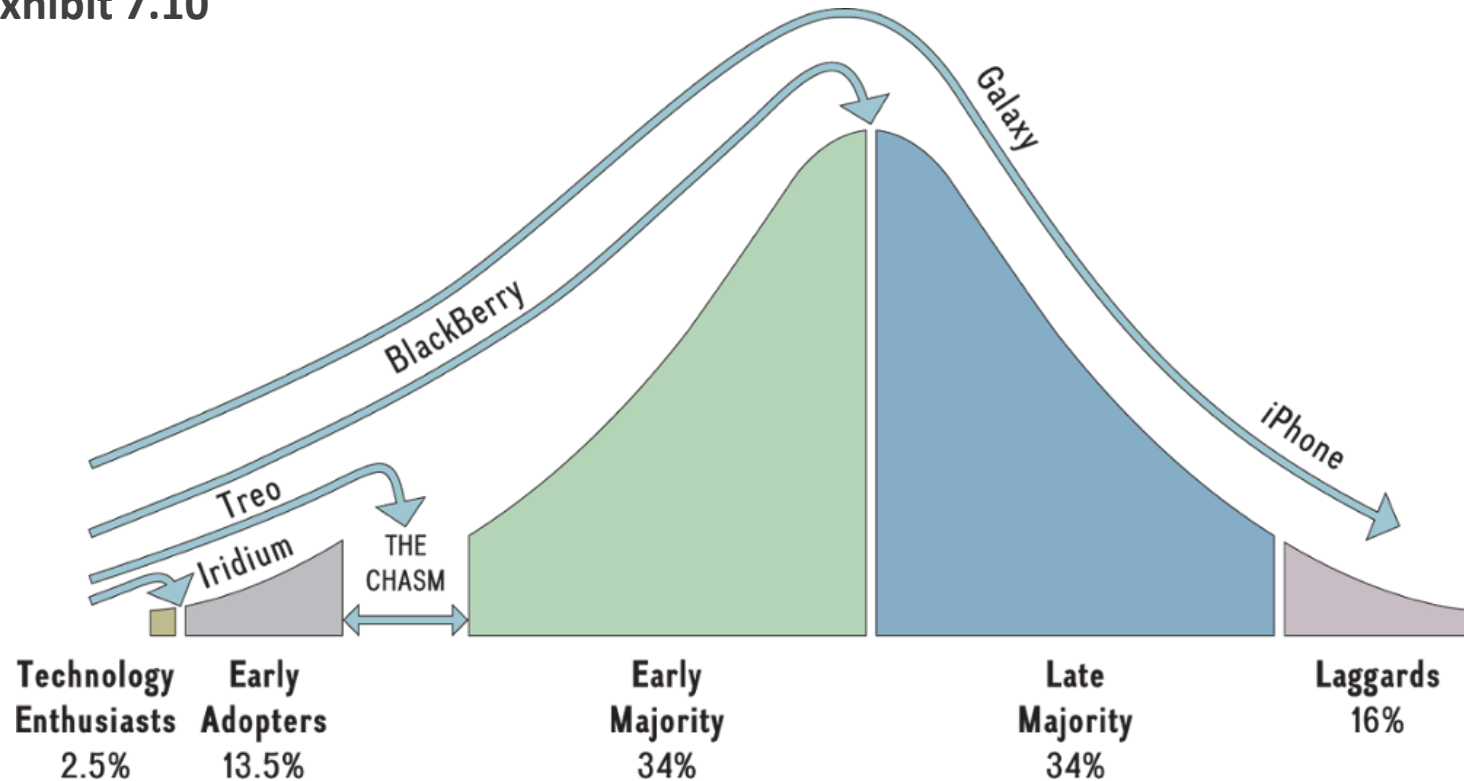
There is a big gulf or *chasm* into which companies and their innovations frequently fall.



Source: Author's adaptation from G.A. Moore (1991), *Crossing the Chasm: Marketing and Selling Disruptive Products to Mainstream Customers* (New York: HarperCollins), 17.

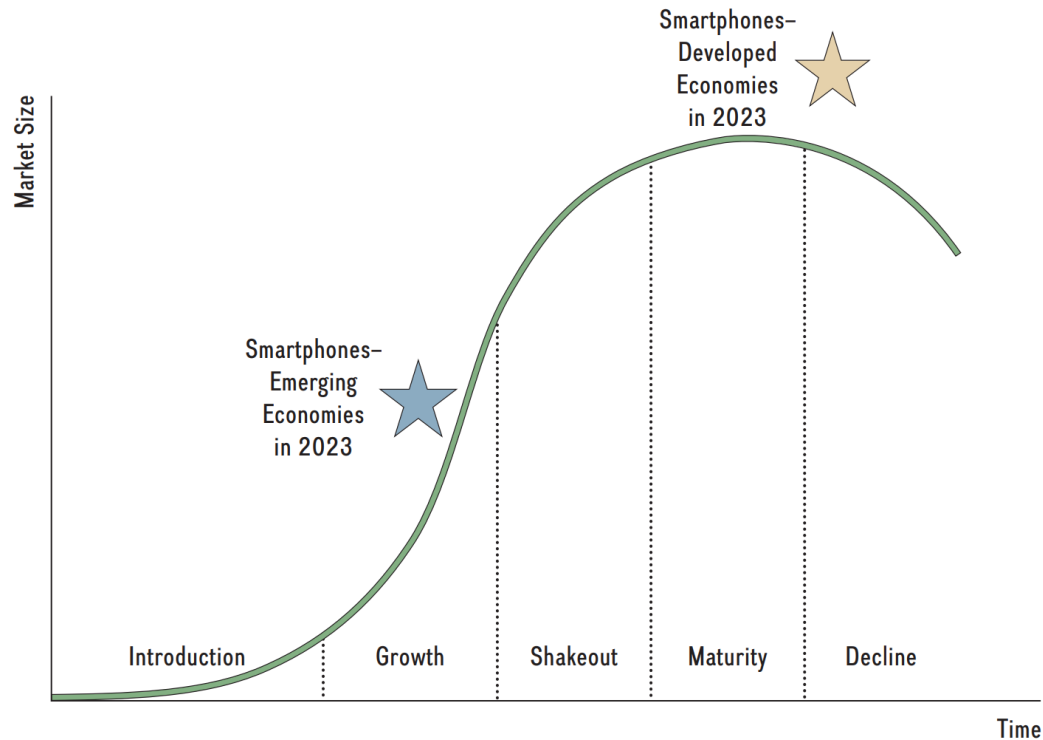
Crossing the Chasm: The Mobile Phone Industry

Exhibit 7.10



Industry Life Cycle: The Smartphone Industry in Emerging and Developed Economies

Exhibit 7.5



How to Respond to Disruptive Innovation

Continue to innovate to stay ahead of the competition

Guard against disruptive innovation by protecting the low end of the market

Disrupt yourself rather than wait for others to disrupt you

In-Class Discussion

Group Project Proposal

Week 7 (October 19th): 3 to 4-minute presentation per team

Prepare slides for a 4-minute presentation (maximum 4 slides total)

- Slide 1: Company description (location, product types, service offerings)
- Slide 2: Industry description
- Slide 3-4: Reason for choosing to study this company and industry
- *These slides may be reused for your main group project presentation*

No need to present your analyses or framework

Introductory presentation to present your topic of interest

1-minute Q&A / comments per team

Designate one or two speaker(s) for the proposal

Be prepared to access your team's presentation online

Uber



- Ride-hailing smartphone app
- Established in 2009
- 3 million drivers
- 15 million rides
- 700 cities worldwide

In-Class Discussion Exercise

Discussion Questions:

1. What are the critical resources and capabilities of Uber? What is unique about Uber's business model?
2. What are some challenges faced by Uber?

Discussion Format:

- Group discussion and preparation among your team (25 mins)
- Debate as a whole class (10 mins)
- Debrief (5 min)

Pipeline vs. Platform Businesses

Pipeline Business:

- Linear transformation through the value chain
- Research and development, then design, then manufacture, then sell

Platform Business:

- Enables interaction between producers and consumers
- Its overarching purpose is to enable matches among users
- Provides infrastructure and sets governance conditions

Uber VRIO Model

1. What are the critical resources and capabilities of Uber?

Type	Resources	VRIO
Brand	Strong brand awareness	V R I O
Human capital	Network of drivers	V
Platform	Connecting drivers and riders	V R
Technology	AI algorithm to place drivers and map routes	V R
Reputation	Comfortable, trusted, safe	V R I O

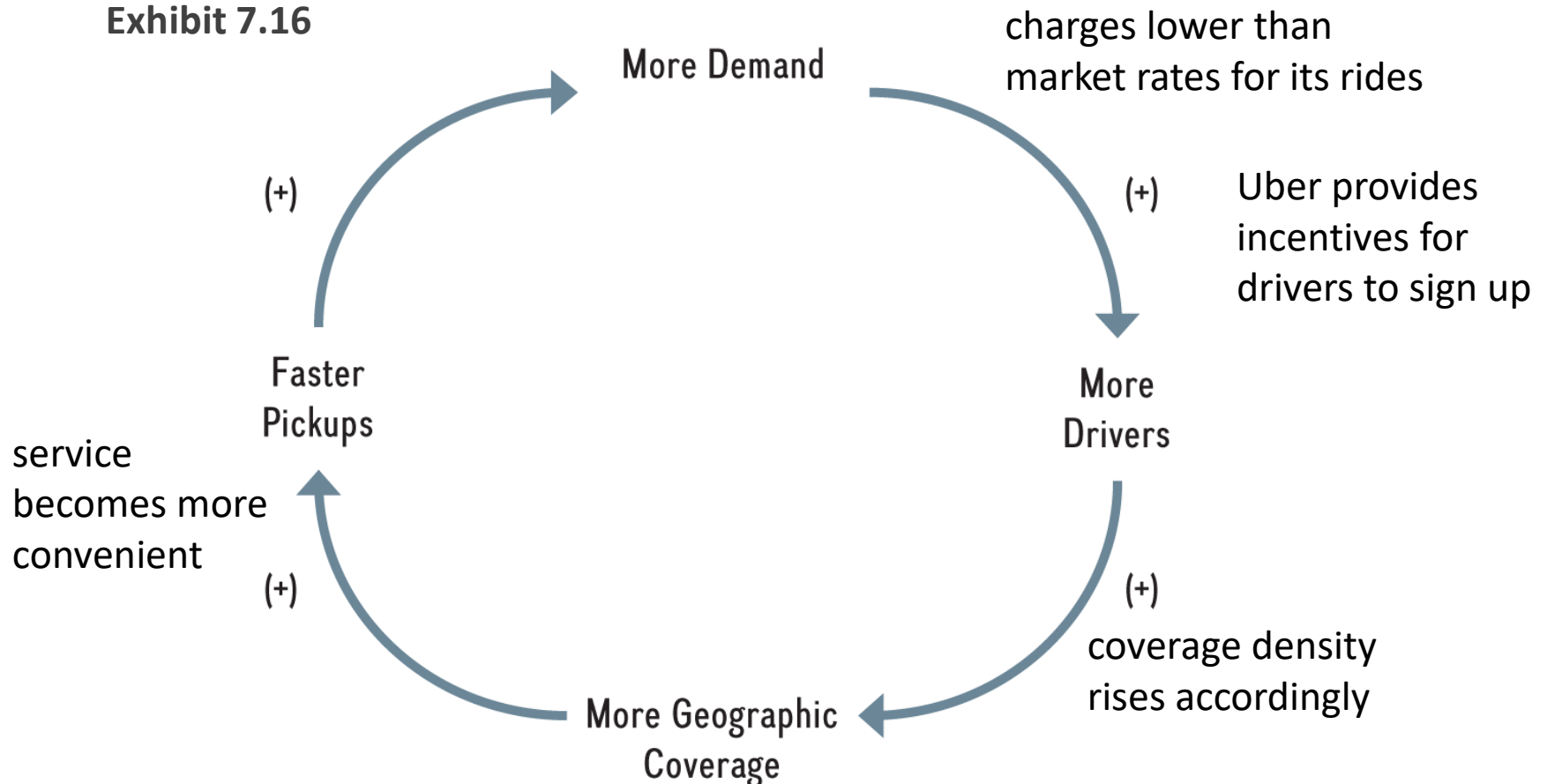
Uber VRIO Model

1. What are the critical resources and capabilities of Uber?

Type	Capabilities	VRIO
Information technology capability	Streamline process of connecting the drivers and riders	V R I O
Pricing analytics capability	Ability to adjust different fare options and calculate real time to attract more riders and drivers	V R I O
HR development capability	Ability to attract and maintain the network of the drivers	V R I O
Product development capability	Marketing to the customers the right products through localization adaptation (in comparison to existing competitors' fees, routes, vehicle options, availabilities)	V R I O

Uber's Business Model: Leveraging Network Effects to Increase Demand

Exhibit 7.16



Uber Challenges

2. What are some challenges faced by Uber?
- External challenges: government regulations on taxi services served as stumbling block (China, Korea, etc.), credit card payment, navigation
 - Uber does not “employ” drivers or “own” vehicles
 - Can both be a resource or a detriment
 - Technology resource has been copied by other competitors offering similar functions
 - Made significant changes to their technology for local adaptation