POLITECNICO DI MILANO

SWOT Analysis – The environment (Part 1)

External and Internal Strategy Analysis at a Business level

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Three level:
corporate
business
functional

How to build a SWOT table?

S W

O T

The competition

The environment

Vision => Long-term view of evolution of the BA
Mission =>
Objective => SMART

1. specific, since they shall be relatable to what they are focused on and they shall convey a clear message on what's to achieve.
2. measurable by means of one or more clear indicators, since you can't improve what you can't measure.
3. appropriate or aligned, they must be consistent with the company's overarching vision and mission.
4. realistic: goal setting theory tells managers to set objectives that are challenging, but not perceived as neither impossible nor too easy (because both ways lead to demotivation).
5. timely, they must be related to a clear deadline to achieve them.

difference between Ex & In => perspective
Ex : Average Player in the market
In: One Firm compared to competitor

Business Strategy level

* Narrow the Market

The strategic decision making process at SBU level

Vision/Mission/objectives
Economic value creation

Orientation

EXTERNAL ANALYSIS

OBJECTIVES

Evaluation of the attractiveness of a business area and identification of the main threats and opportunities

METHODOLOGY

Porter's Five Competitive Forces model

PEST model

INTERNAL ANALYSIS

OBJECTIVES

Assessment of the SBU competitive advantage concerning cost and value (strengths and weaknesses)

METHODOLOGY

Porter's Value Chain model

Core Resources and Competencies

Strategic alternatives generation

5 Porter forces => competition
PEST Analysis => Macro Trend

talk about why using a model

Business Strategy level:

External Strategy Analysis

How to build a SWOT table?

S W

$\boxed{\text{O T}}$

The competition

The environment

Business strategy

EXTERNAL ANALYSIS

OBJECTIVES

Evaluation of the attractiveness of a business area and identification of the main threats and opportunities

Valid for all the player of the market
For all the competitor

METHODOLOGY

Porter's Five Competitive Forces model
PEST model

Attractiveness of the Business area

Attractiveness of the Business Area

⇓

Average profitability and growth of the companies operating in the BA

(both present and future)

Porter's 5 Competitive Forces Model

It is referred to a specific Business Area

Basic assumptions:

Competition is driven by industry structure use the checklist

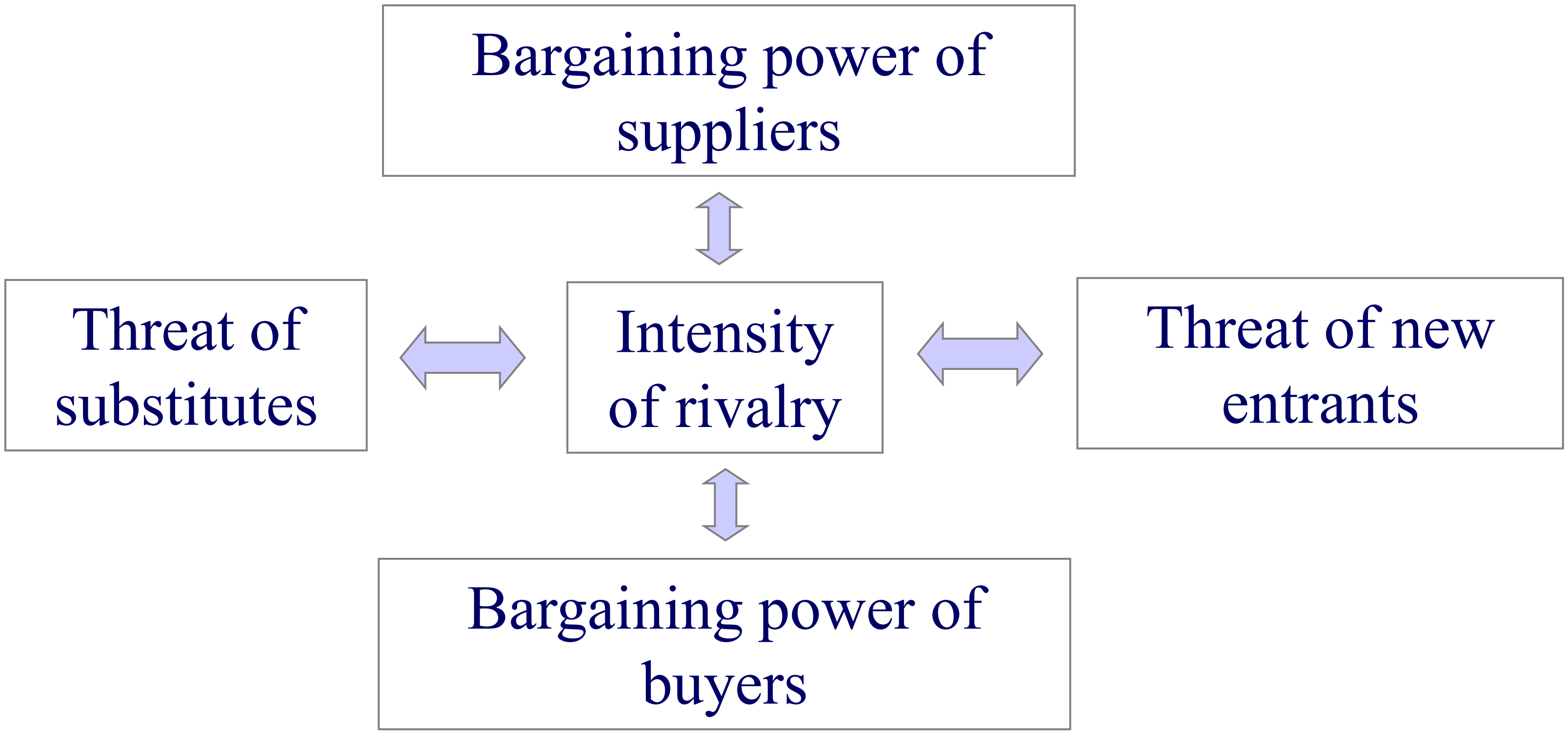
companies' positioning

Business Area's attractiveness is inversely proportional to the level of competition of the competitive environment

Competition in an industry goes well beyond established players: → concept of *extended rivalry*

Porter's 5 Competitive Forces

read example



Exam => choose a market area that you like, not one of the project work. drop quickly main elements of external analysis. (in 2 minutes)

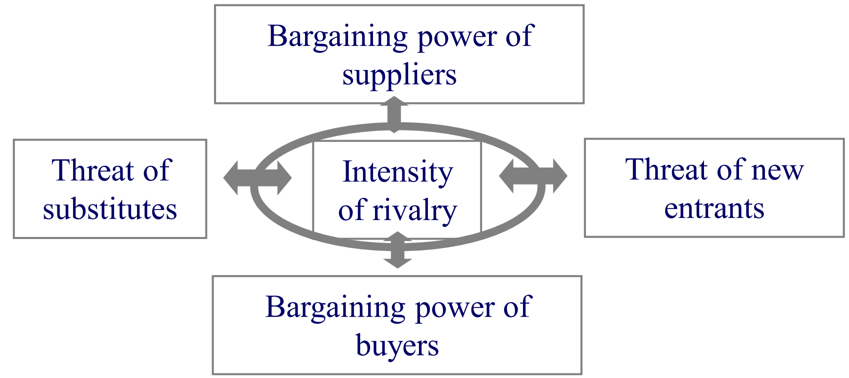
smart phone industry (Can't!)

Intensity of internal rivalry

all the players
Similar to you

Direct competition

Structural determinants:



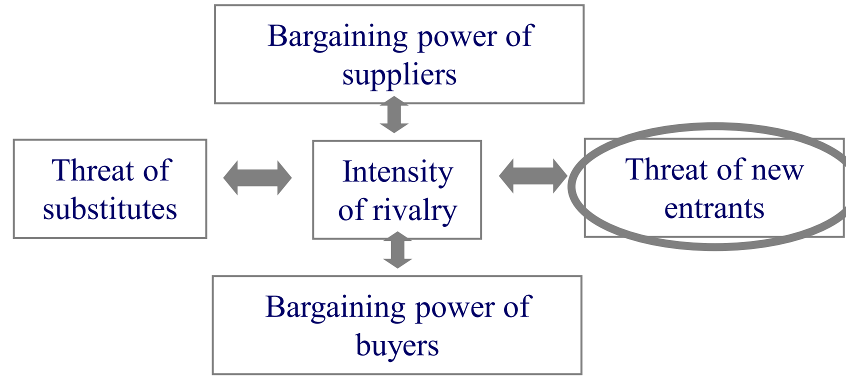
- Concentration and balance
  number of competitor
- Diversity of competitors
  products are different
- Industry growth
  CAGR, Overall value, revenue
- Product differentiations
  like diversity
- Switching costs
  Customer has to pay in general to change the product
  not money, Efforts!! (ecosystem & Comparability)
- Fixed costs impact
  cost of machines, storage, manufacturing
- Storage costs
  food and supermarkets
- Exit barriers
  exiting is easy or no?

Exit barriers:

- Specialized assets
- Fixed costs of exit
- Strategic interrelationships
- Emotional barriers
- Government and social restrictions

Threat of new entrants

Potential competition



Structural determinants:

Entry barriers

- **Economies of scale** *decrease of unitary cost if we increase the production*
- **Capital requirements**
- **Brand identity** *strong brand and potential brand leverage*
- **Switching costs** *entrant persp. / switch to new entrant*
- **Access to distribution channel**
- **Cost advantages independent of size**
- **Legislation or government actions**

Proprietary product technology

Favourable access to raw materials

Favourable location

Learning curve

Government subsidies

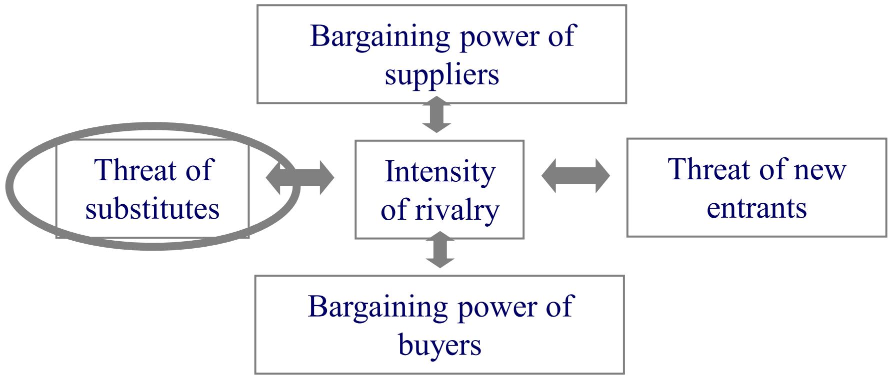
Incumbent's expected reactions (retaliation)

Threat of substitutes

Indirect competition

Substitutes = Products able to satisfy the same needs

product technically different



The existence of substitutes sets some constraints to the behaviour of firms belonging to a specific Business Area

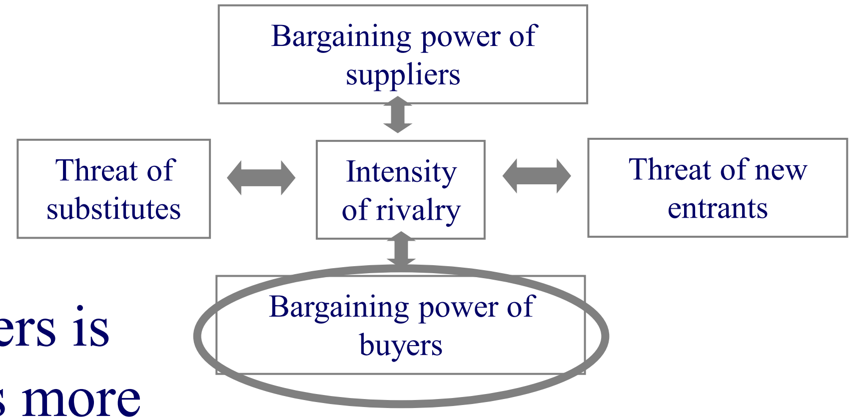
In particular, such constraints are referred to price definition: substitutes limit the potential returns of a BA by placing a ceiling on the prices internal firms in the BA can set

The more attractive the price/performance ratio of substitutes, the higher the risk to lose customers to the advantage of substitutes

Bargaining power of buyers

Downstream competition

It can derive from:



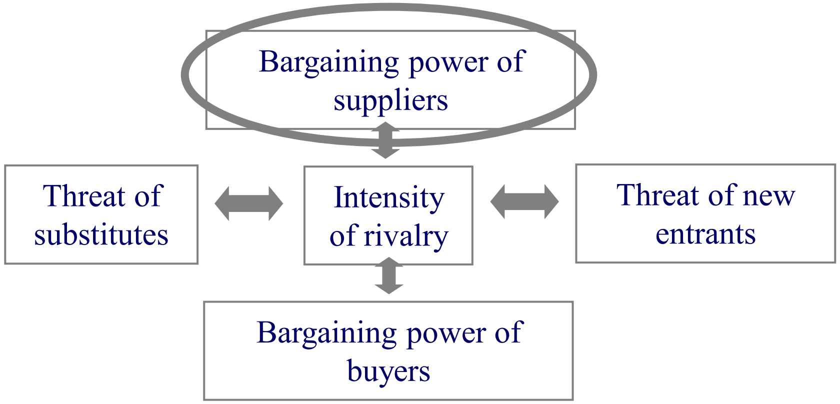
low number of customers

- **Relative concentration**
  - The bargaining power of buyers is higher if their business area is more concentrated than that of suppliers
- **Product's features**
  - The bargaining power of buyers increases if:
    - product differences are low product similar to each other
    - switching costs are low easy to change?
    - product's impact on the final performance is weak (only for intermediate products) plastic

Bargaining power of buyers - continue

- Buyer's characteristics
  - The bargaining power of buyers increases if:
    - they are not very profitable will be price sensitive
    - they are able to integrate themselves backward
    - they have clear information about the product
    - the component or material cost is a high percentage of the total cost most of the budget

Bargaining power of suppliers



Upstream competition

The structural determinants of bargaining power of suppliers are dual to those influencing the bargaining power of buyers

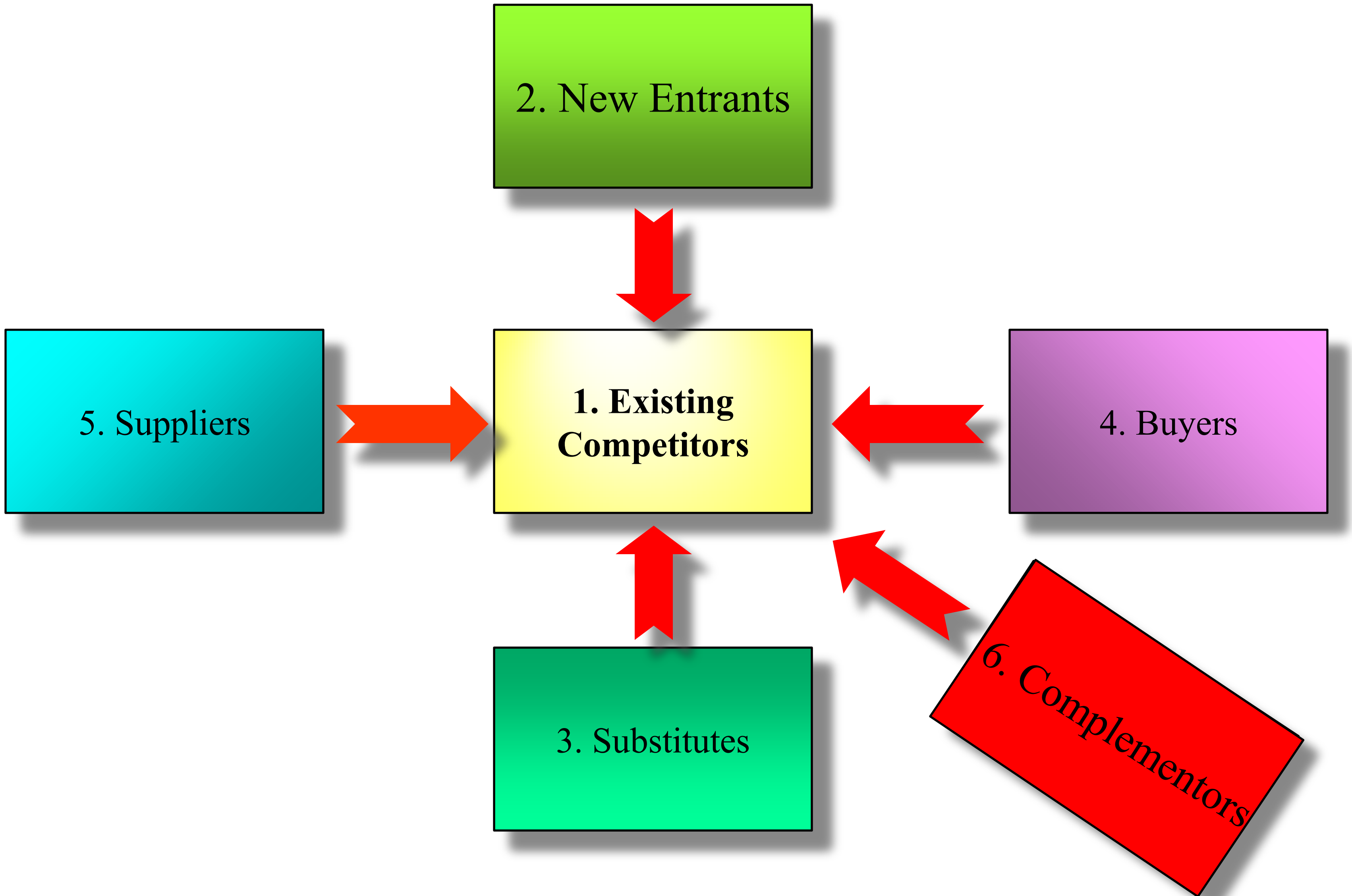
A sixth force: complementors

digital world

product that are complementary to the product analyzing.
bundle, platform offer

- While substitutes have a negative impact on value, complements have a positive impact.
- Unlike the other five forces, complementors are not a competitive force
- Complements are always important in affecting the overall demand for an industry's product
- Example: in the video game industry the producers of software (games) are complementors to the producers of hardware (consoles)

The five forces model plus "complementors"



Understanding industry structure

- "Understanding the forces that shape competition in an industry is the starting point for developing strategy.
- …Most importantly, an understanding of industry structure guides managers towards possibilities for strategic action, including (1) positioning the company vis-à-vis the current competitive forces; (2) anticipating shifts in the forces and exploiting them: (3) shaping the balance of forces to create new more favourable structure or one that favours the company."

M. Porter, HBS, 2006

Five forces analysis: key questions and implications

- What are **boundaries of the business area** to which the model is applied? poor infromative
- What are the **key forces** at work in the competitive environment?
- Are there **underlying forces** driving competitive forces?
- Will **competitive forces** change?
- How **attractive** is this industry?
- Can **competitive strategy** implemented by players influence competitive forces (e.g. by building barriers to entry or reducing competitive rivalry)?

PEST Analysis

The results coming from the 5 Competitive Forces analysis can be integrated by studying which **macro-environmental factors** can have a significant influence on the Business Area under scrutiny, so to identify a more comprehensive set of external opportunities and threats.

In particular, **Political, Economic, Social** and **Technological** influences can be very important

Hence, the **PEST analysis** aims at analysing environmental influences' trends

PEST Analysis

EU with gasoline engine is banned

Political/legal

- Monopolies legislation
- Environmental protection laws
- Taxation policy
- Foreign trade regulations
- Employment law
- Government stability

Economic

- Business cycles
- GNP trends
- Interest rates
- Money supply and Inflation
- Unemployment & av. income
- Energy availability and cost

Socio-cultural

- Population demographics
- Income distribution
- Social mobility
- Lifestyle changes
- Attitude to work and leisure
- Levels of education

Technological

- Govn. spending on research
- Govn./industry focus on technological effort
- New findings/developments
- Speed of technology transfer
- Rates of obsolescence

PEST Analysis

PESTE model/analysis/framework for an educated approach to cover important environmental factors

A practical way of carrying out this analysis is to:

- Identify each possible factor
- Give each factor a probability of occurrence in % and a rating for their impact in the coming 3-5 years where:
  - -5= extremely negative impact
  - +5= extremely positive impact
- Map the factor as an opportunity/threat to include in the OT portion of the SWOT analysis

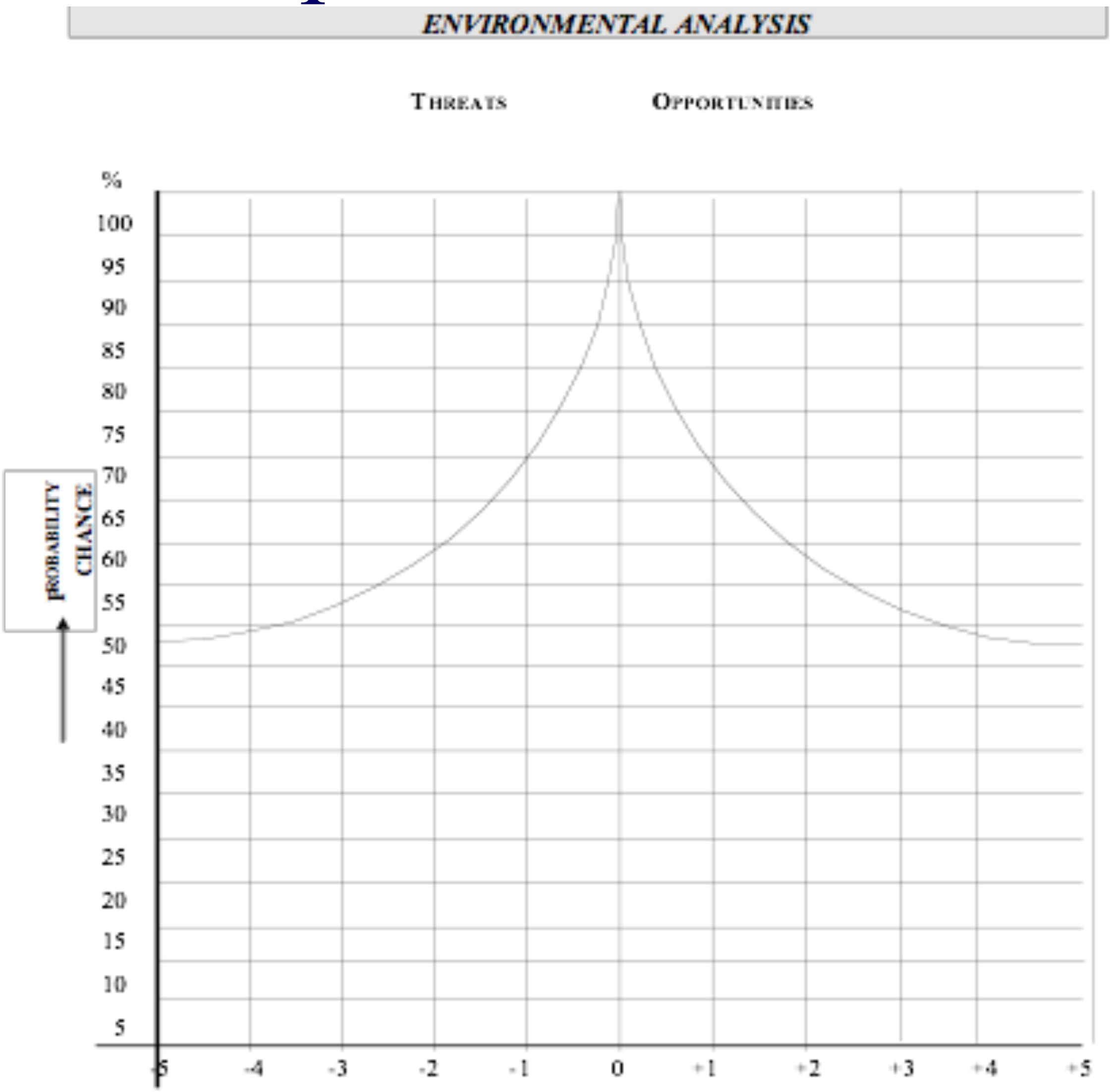
PEST Analysis – example of representation

ENVIRONMENTAL ANALYSIS				
FACTOR	**IMPACT**	**RESPONSE**	**Prob.%**	**Imp. (-5 to +5)**
1. *SOCIAL:*				
2. *TECHNOLOGICAL:*				
3. *ECOLOGICAL:*				

PEST Analysis – example of representation

ENVIRONMENTAL ANALYSIS				
FACTOR	IMPACT	RESPONSE	Prob.%	Imp. (-5 to +5)
4. *ECONOMIC:*				
5. *POLITICAL:*				

PEST Analysis – example of representation



Business Strategy level:

Internal Strategy Analysis

perspective is the specific company

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How to build a SWOT table?

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The environment

Business strategy

Logic pattern of the strategic decision making process at SBU level

Mission/objectives
Economic value creation

EXTERNAL ANALYSIS

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Strategic alternatives generation

Business strategy

INTERNAL ANALYSIS

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METHODOLOGY

Porter's Value Chain model less suitable for service company

Core Resources and Competencies approach

Competitive advantage at SBU level

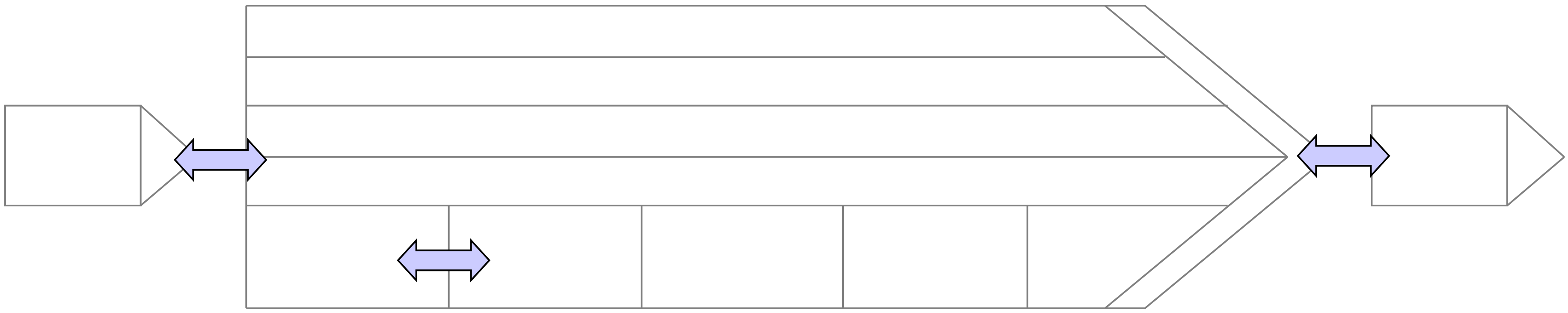
It is not possible to analyse the SBU’s competitive advantage considering the SBU as a “black box” transforming inputs in outputs and separated from customers and suppliers

The Value Chain model can be used to analyse the SBU’s competitive advantage

Porter's Value Chain

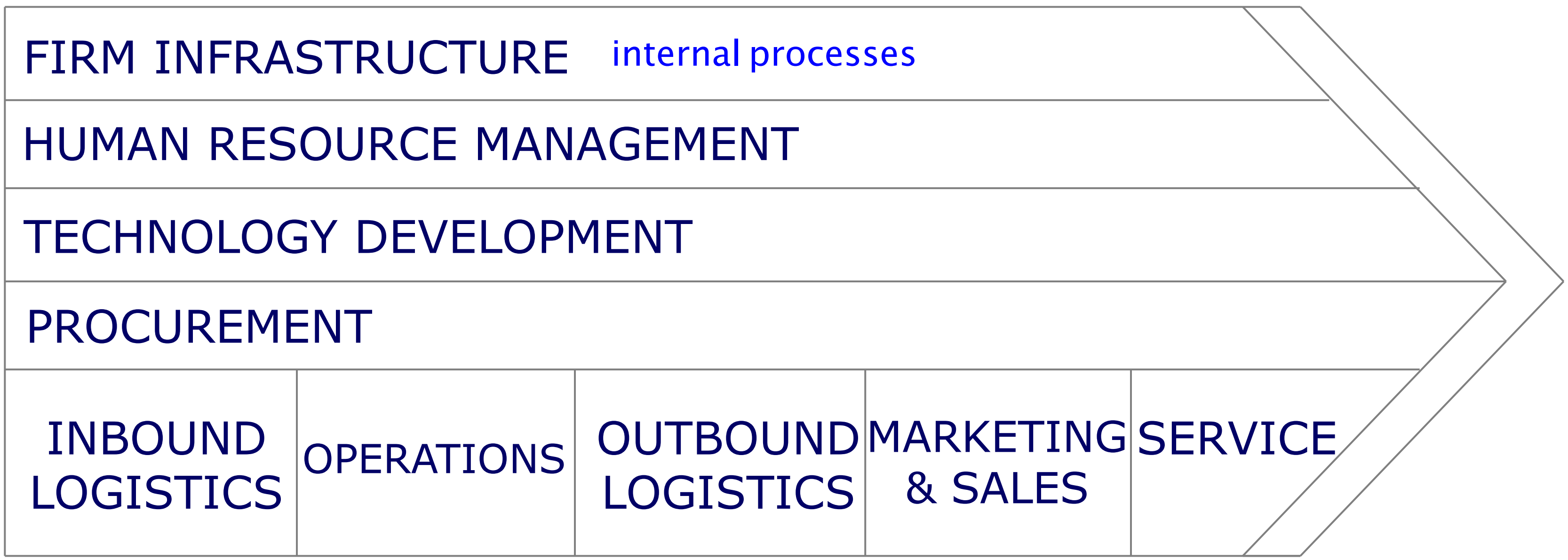
A company's sources of cost/value competitive advantages depend on:

- **The overall system of activities (boundary)**
- **The single significant activities**
- **The links between activities**



- **The Value Chain is referred to a specific SBU**

Porter's Value Chain:
an example of a manufacturing company



Primary activities

They are directly responsible for value creation through the Value Chain

- *Inbound logistics*: activities related to the receipt, storage, transport and distribution of the inputs
- *Operations*: activities related to the conversion of inputs into outputs
- *Outbound logistics*: activities related to the storage of the finished products and to their distribution
- *Marketing and sales*: activities aimed at promoting and selling the products (advertising, promotion, managing of the distribution and sales channels, …)
- *Service*: for instance set up, technical assistance, maintenance, …

Support activities

They allow the continuative execution of primary activities

- *Procurement*: activities related to the acquisition of all the input (raw materials, components, equipment, technologies, services, …) needed by the firm (for instance: suppliers selection, negotiation, qualification, …)
- *Human resource management*: activities related to the recruitment, training, incentive and evaluation of employees
- *Technology development*: R&D, engineering, …
- *Firm infrastructure*: administration, finance, planning, quality control, …

Focus: **Cost** competitive advantage

The sources of cost competitive advantages depend on:

- Single activities
- Links between activities
- Overall system of activities

Two main porter strategy: cost leadership & Differentiation

Cost Leadership : Selling with lower price like Sugar
Differ. : Charge for more price due to a better value Like Smart phones

Cost competitive advantage: Analysing specific activities

- Competitive advantages may depend on the way the company runs the specific activity. Main steps of the analysis:
  - Identification of the activities considered "significant" for what concerns costs in terms of:
    - High impact on the overall costs
    - Different causes
    - Different behaviour of competitors
  - Evaluation of the specific activities' costs.

    Main problems:
    - Cost accounting registrations not consistent
    - Shared activities
  - Identification of the costs' specific **determinants**

Benchmark to competitors:

Relative positioning

Cost competitive advantage: Analysing specific activities - continue

- Each activity has a specific cost structure and hence its costs' determinants may be different

- Examples of **determinants of costs** are
  - Economies of scale
  - Economies of learning
  - Degree of saturation of the production capacity 80 Pcs / 1000 pcs
  - Localisation closing thing to you
  - Preferential access to distribution
  - Institutional factors
  - Product/process design

Cost competitive advantage: Analysing links between activities

- Competitive advantages may depend on the way the company manages the links between:
  - its activities (internal links)
  - its activities and those of customers and suppliers (external links)

In the last years several techniques (as "just in time", concurrent engineering and design for manufacturing) have been introduced in order to "optimize" both the internal and external links

Cost competitive advantage: Analysing overall system of activities

- Competitive advantages may depend on Make or Buy choices

internally or externally

"Make" decision

Advantages

- Less transactional costs
- Gain of supplier's margin
- Learning and controlling core competence
- More independence from suppliers

Disadvantages

- Less efficiency than suppliers
- Low motivation
- Less flexibility
- More capital equipment
- Co-ordination costs

Cost competitive advantage and economic value

Decisional levers

⇩

Cost competitive advantage

⇩

Economic value creation

Costs decrease, but the price remains unchanged =>

- **Contribution margin increases (Δm)**
- **Sales level does not change (Q)**
- **ΔNCF = Δm * Q**

Costs decrease and price decreases accordingly =>

- **Contribution margin does not change (m)**
- **Sales level increases (ΔQ)**
- **ΔNCF = m * ΔQ**

Focus: **Value** competitive advantage

It aims at making the product/service "unique" for the customer
Example of value competitive advantages are:

- **Quality**: product's nominal performances, but also effective performances
- **Time**: both for what concerns delivery time and time to market
- **Service**: both incorporated with the product or complementary
- **Variety/customisation**: fullness of the array of products and level of personalisation
- **Reputation**: both of the firm and of the brand

Focus: **Value** competitive advantage

The sources of value competitive advantages depend on:

- Single activities
- Links between activities
- Overall system of activities

Value competitive advantage and economic value

Decisional levers

⇓

Attractiveness competitive advantage

⇓

Economic value creation

Price increases =>

- **Contribution margin increases (Δm)**
- **Sales level does not change (Q)**
- **ΔNCF = Δm * Q**

Price does not change =>

- **Contribution margin does not change (m)**
- **Sales level increases (ΔQ)**
- **ΔNCF = m * ΔQ**

Examples of value chain’s application

- **Xerox**, by developing the value chain analysis, has discovered that its service competitive disadvantages were linked to the high complexity of its copy machines’ design that made difficult the ex-post individuation of problems
- **Caterpillar**, comparing its value chain with that of competitors has individuated a cost competitive disadvantage. In order to reduce costs it has decided on the one hand to increase its array of products and on the other hand to sell its diesel engines to competitors aiming at better exploiting economies of scale (in production, but also in marketing, sales and service).
- **Volkswagen**, analysing the value chain of its Brazilian plant has verified how some activities could not be managed effectively in-house. Hence it has involved more deeply its suppliers that now are responsible of all logistics activities to the very installation of components on the assembly line.
- **Compaq** has utilised the value chain analysis in order to understand why it was unable to provide the desired value to customers. The results of the analysis have pushed Compaq towards the development of different links with its customers.

Business Strategy level:

Resource and competence-based View

-- select a company you like, highlight the source of competitive advantages

-- the different resources and competencies the company has, apply 5 core test, understand if they are core or not, able to leverage to create competitive advantage or not

it's only about the company! internal analysis ... company can influence or leverage

A critique of the Positioning School

- The «Positioning School» focuses on:
  - spotting the most attractive business area (external analysis) and
  - Shaping the right competitive positioning in such business area (internal analysis)
- However:
  - Competitive advantage does not come from competitive positioning alone
  - The focus of strategy cannot be largely placed outside of the company's boundaries («outside-in» approach)
  - The Positioning School leads to a distorted vision of the company's organizazional structure, where SBUs are separated and fully devoted to cover the business areas where the company chooses to locate the products and services it offers in its portfolio: this results in a static and disjointed view of the company, identified as the «tyranny or the SBUs» (Hamel, Prahalad, 1990)

An alternative theory for internal analysis: the Resource & Competence-based View (1/2)

- According to the RCBV, companies are a unique collection of tangible and intangile resources and competencies (Barney, 1991; Collis, Montgomery, 1995)
- Those resources and competencies that influence the achievement of competitive advantage are labelled as «core»
- A core resource or competence is **an area of specialized expertise within the company, resulting from specific the harmonization of complex technology streams and working activities, and which:**
  - **offers benefits to the customer**
  - **is hardly imitable by competitors, and**
  - **you can leverage in a multitude of products and/or markets** (Hamel, Prahalad, 1990)
- Two companies cannot be totally alike, as each and every company possesses its own and unique asset of experiences, its own acquired resources and competencies, its own organizational culture.
- Such core resources and competencies determine how efficiently and effectively a company carries out its functional activities, and ultimately influence its ability to achieve and sustain competitive advantage.

resources & competencies
I. Core
=
Competitive adv.
II. Non-Core
=

An alternative theory for internal analysis: the Resource & Competence-based View (2/2)

- Valuable resources can take different forms:
  - Tangible, physical assets;
  - Intangible asset – e.g. brand, know-how;
  - derive from an organizational skill resident in the firm's routines, processes or culture.
- Notwithstanding the nature of these resources and competencies, the RCBV holds that the very possession of such distinctive assets constitutes the basis of a company's competitive advantage.
- Instead of a portfolio of products, a company should be seen as a portfolio of competencies.

The available resources and competencies

Tangible assets		Intangible assets		
Physical	**Financial**	**Human**	**Technological**	**Reputation**
• characteristics production facilities • location • production flexibility • capacity surpluses • property and equipment	• receivables from clients • cash and cash equivalents • liabilities • equity	• knowlegde and expertise • adaptability • loyalty • availability • performance	• patents, copyright, company secrets • R&D facilities • qualifications of employees	• brands • corporate image • corporate identity • relationship with suppliers • customer satisfaction

The RCBV approach (1/2)

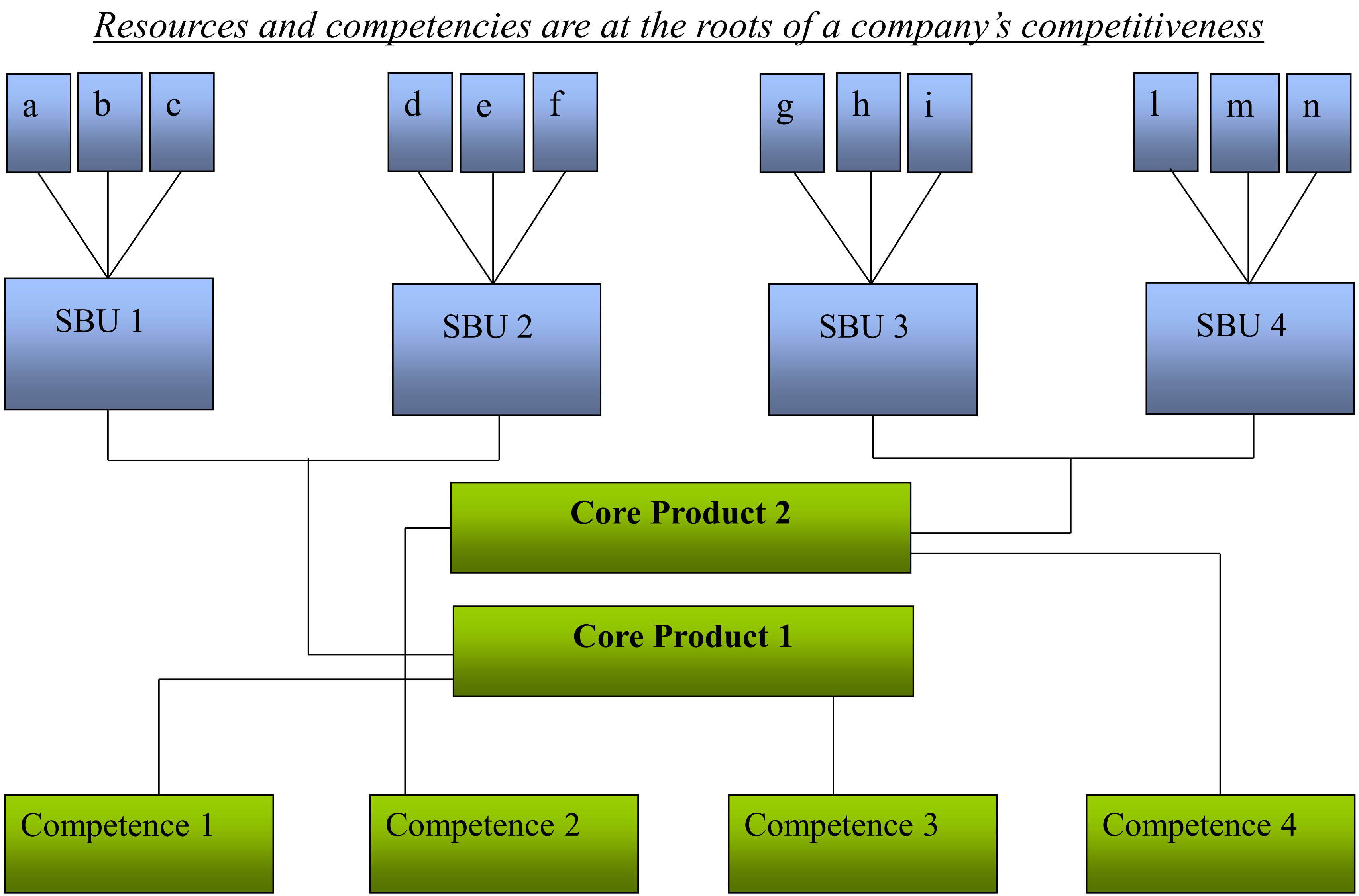
Hamel & Prahalad (1990)

*"The diversified corporation is like a big tree. The trunk and the main branches represent the **core products**, the smallest branches are the **business units**, while the leaves, flowers and fruits are the **end products**.*

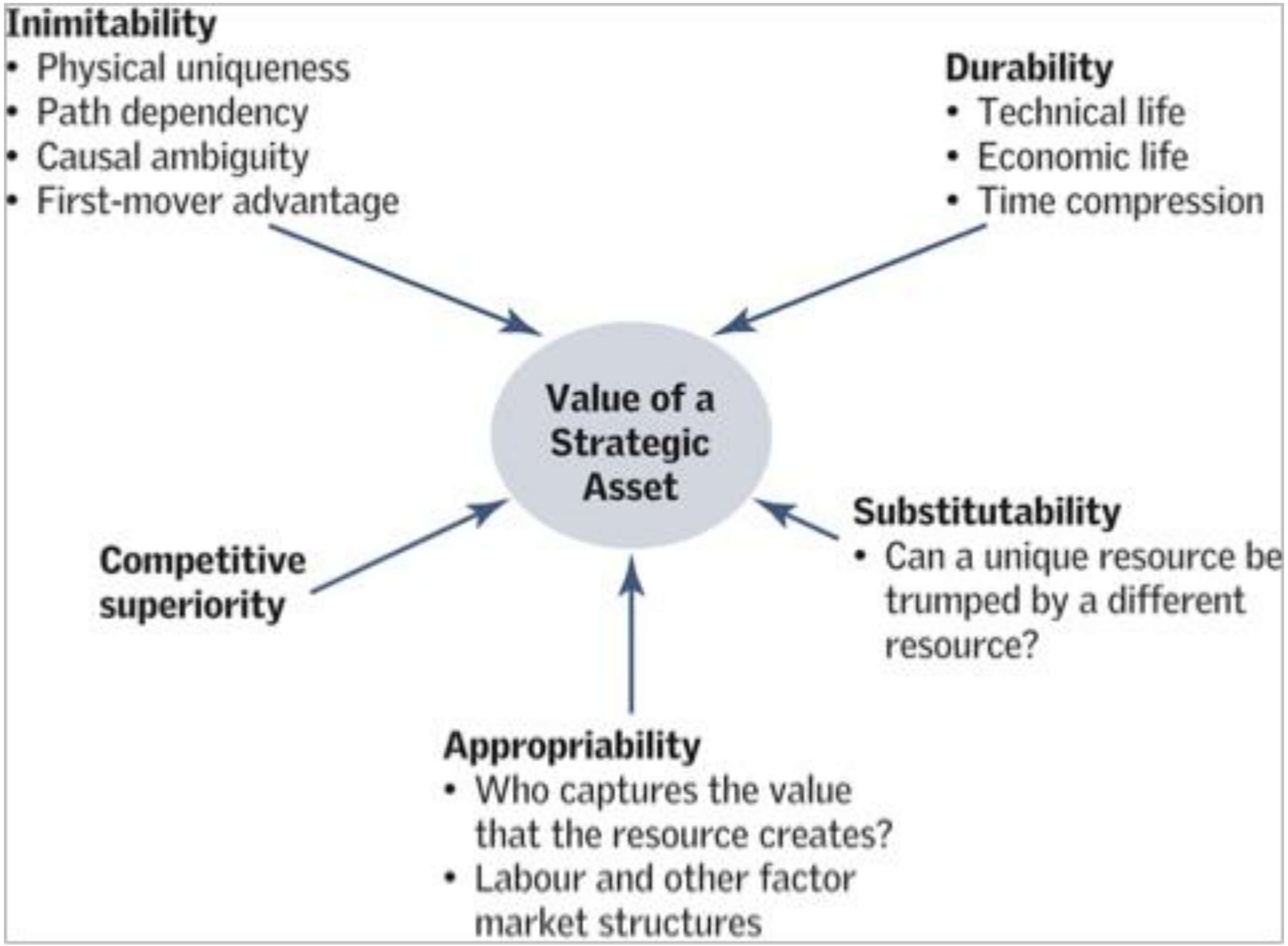
*The system of roots providing nourishment and stability are the **core competencies."***

- It is essential that the management focuses its attention on **developing internal competencies and resources to leverage in order to create the end products**, rather than on assessing the final markets' attractiveness.
- The link between core competencies and end products is defined **core product**, that is, **the physical concretization of one or more core competencies**
- These core products are the components or modules determining the value of the end products springing from them (e.g. engines for Honda, semiconductors for Nec, compressors for Matsushita, data drives & lasers for Sony and Philips)

The RCBV approach (2/2)



Not all assets are core



How to identify the company's core resources and competencies

Five «Core Test» (Collis, Montgomery, 1995):

1. Inimitability – hard to copy, thanks to physical uniqueness, path dependency, causal ambiguity and economic deterrence
2. Durability – slowly depreciating
3. Appropriability – creating value that is easily captured by the firm
4. Non-substitution – not replaceable by alternative resources satisfying the same need
5. Competitive superiority – performing better than competitors' resources

Core resources and competencies: the Disney case (1/3)

- When in 1984 Micheal Eisner became Walt Disney's chairman, the company was facing its fourth consecutive year of decline, enough to attract speculators on the stock market
- A boost in the turnover was registered between 1984 and 1988: net profits went from 98 million to 570 million dollars and the value of the company on the stock market went from 1.8 to US $ 10.3 billion
- Nevertheless, noticeable changes in strategy didn't occur in Eisner's first three years as chairman
- The key success factor was due to the mobilization of the company's huge resource base

Core resources and competencies: the Disney case (2/3)

- Asset profitability improvement:
  - hotels, residential and resort construction
  - increased number of attractions @ Epocot Center;
  - new theme park construction (Disney-MGM studios),
  - Euro Disneyland construction

- Better exploitation of the huge owned film library:
  - new release of the classic movies;
  - sales of licenses for movies to television networks
  - VCR's sales

Core resources and competencies: the Disney case (3/3)

- Disney studios' rebirth:
  - booming of the Touchstone label
  - doubling of the number of films produced
  - Aggressive recruitment of producers, directors, actors and writers

- The management was able to exploit the most powerful available resource: the loyalty of millions of people from different countries and age, linked to the name and characters created by Disney

Strategic Business Unit vs. core resource & competence

	SBU	Core Competence
Basis for competition	Competition among existing products	Competizione among companies to build competencies
Corporate Structure	Portfolio of businesses related in terms of products and/or markets	Portfolio of competencies, core products and businesses
SBU Status	Significant autonomy. SBUs own all of their resources excluding cash	SBUs are potentials pools of core competencies
Resource allocation	Single businesses are the unit of analysis and capitol is allotted to each business	Businesses and competencies are the unit of analysis. Top Management allots both capital and competencies
Value added by the Top Management	Optimize corporate profits by properly managing the trade-offs and synergies among SBUs	Define the strategic architecture and build/share the competencies to support the company's future

The Positioning School and the RCBV: a mediation

- The Positioning School relates competitive advantage to the right strategic positioning of the company and on the chain of activities it performs, thus adopting a perspective that privileges external analysis
- The Resource & Competence Based View sees competitive advantage as stemming from the pool of distinctive core resources and competencies that the company developed, thus focusing on internal analysis
- However, should we decompose these two theories in their key assumptions, what we find is that:
  - When the Positioning School looks within a company's boundary to identify strengths and weaknesses in the value chain (e.g. physical assets, know how, brand image, sound organizational processes, service level and customer relationship), it is actually looking for core resources and competencies
  - The RCBV proposes an approach that has little significance if deprived of a link with the external environment. Resources and competencies cannot be assessed as if they were isolated, since their value is determined by the interaction with the competitive forces: a resource is valuable in a given business area and in a given timeframe

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The competitive advantage

Internal Analysis

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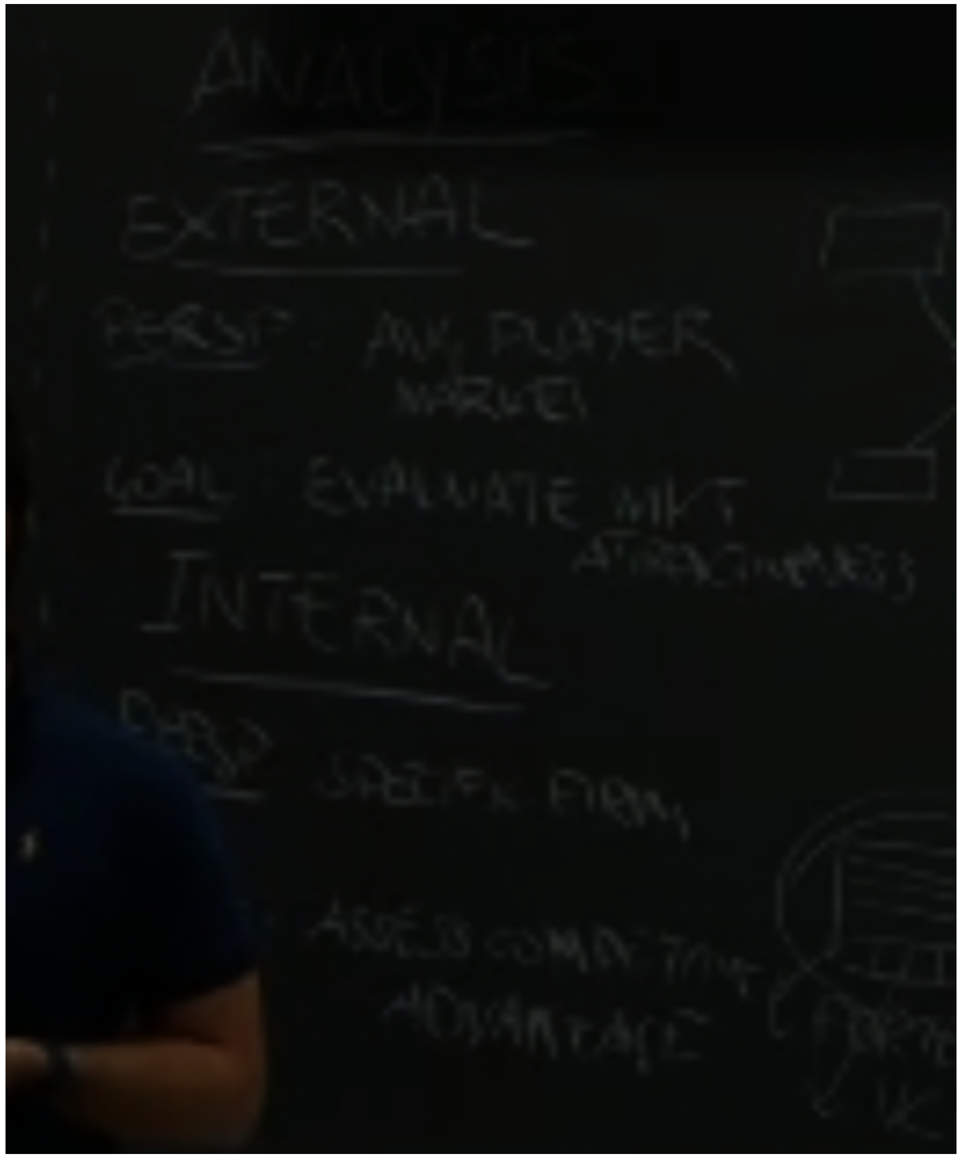
- The traditional approach: Porter’s generic strategies
- The new strategic question
- From upstream competitive advantage to downstream
- The new mantra
- The big picture approach



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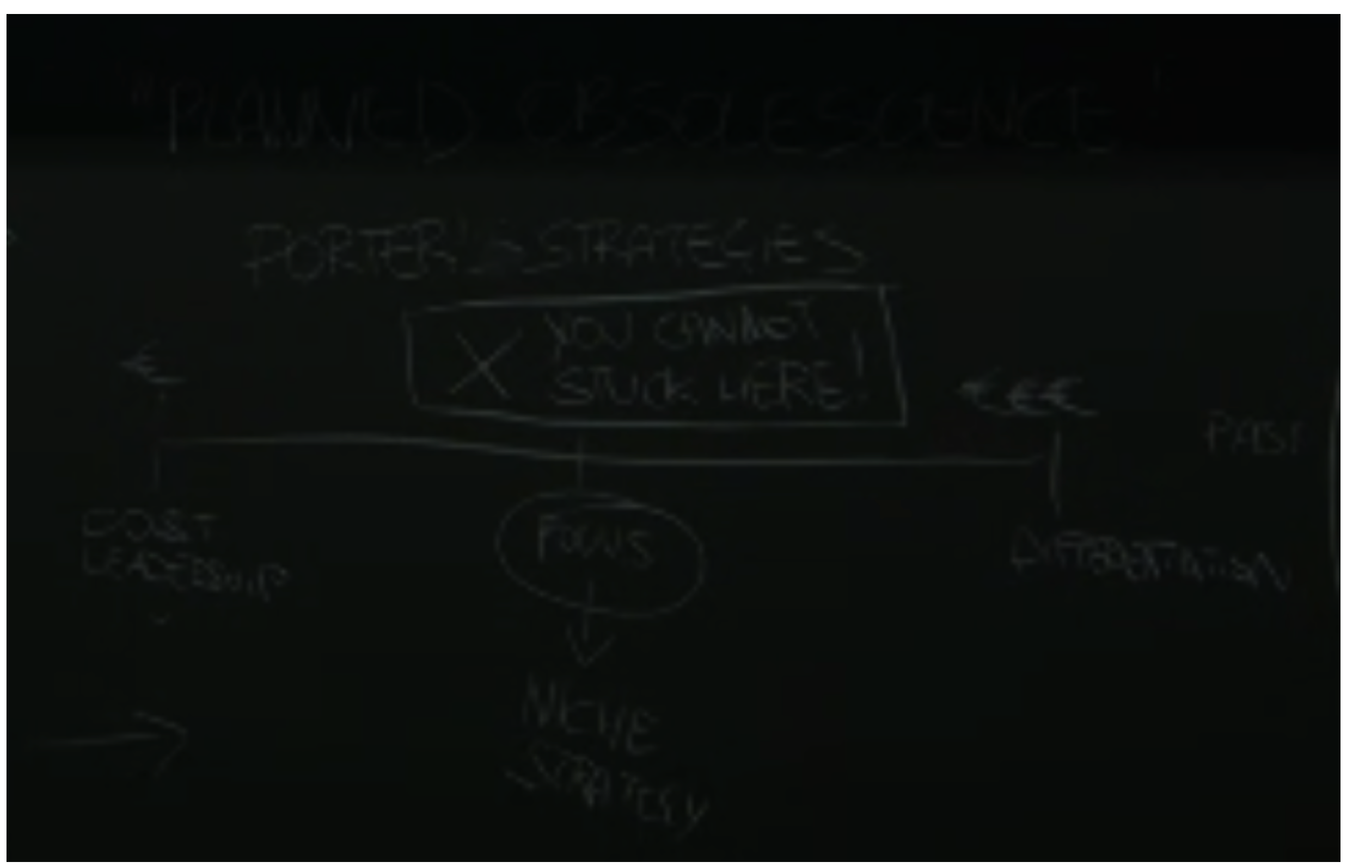
The traditional approach: Porter's generic strategies

- **Cost Leadership:** low cost position achieved through aggressive cost reduction and high market share (e.g. Ryanair)
- **Differentiation:** differentiate the product or service in order to be perceived as unique (e.g. Mercedes)
- **Focus:** concentrate on a particular customer group, segment of product line or geographical market (e.g. Gore-Tex)



with digital inovation staying in the middle is possible!

Cost Leadership: sources of cost advantage

- Economies of Scale
- Economies of Learning
- Process Technology and Process Design
- Product Design modular, 60% of ikea is the same, mass production
- Input Cost
- Capacity Utilization ice cream & crossaint => summer and winter => optimizing
- Managerial Organisational Efficiency corporate strategies

Cost Leadership strategies and the five forces (1/3)

1. Threat of New Entrants

Can frighten off new entrants due to their need to enter on a large scale in order to be cost competitive.

2. Bargaining Power of Buyers

Can mitigate buyers' power by driving prices far below competitors, causing them to exit and shifting power with buyers back to the company.

3. Bargaining Power of Suppliers

Can mitigate suppliers' power by:

- being able to absorb cost increases due to low cost position
- being able to make very large purchases, reducing chance of supplier using power

4. Substitutes

Cost leader is well positioned to:

- make investments to be first to create substitutes
- buy patents developed by potential substitutes
- lower prices in order to maintain value position

5. Existing Competitors

Can use cost leadership strategy to advantage since competitors avoid price wars with cost leaders, creating higher profits for the entire industry

Risks of cost leadership

- Technological change that nullifies past investments or learning (e.g., smartphone vs satellite GPS).
- Low-cost learning by new players (or followers) through imitation (e.g., website design).
- Inability to see required products or marketing change because of attention placed on cost (e.g., low-end fast food chains vs high-end fast food chains).
- Inflation in cost that narrows the price differential.

Differentiation strategy

your sources

- Value provided by **unique features and value characteristics**
- Command premium price
- High customer service
- Superior quality
- Prestige or exclusivity
- Rapid innovation iphone

Tangible vs. intangible differentiation

- **Tangible differentiation** is concerned with the observable characteristics of a product or service that are relevant to the customers (i.e. size, shape, color, weight, design, material, technology, reliability, consistency, taste, speed, durability, safety…)
- Where a product or service is meeting complex customer needs (e.g. cosmetics, medical services and education) differentiation choices involve the overall image of the company's offering. **Intangible differentiation** concerns the social, emotional, psychological considerations that affect customers' choices (i.e. status, exclusivity, individuality, security…)

Factors that drive differentiation

- Unique product features
- Unique product performance
- Exceptional services
- New technologies
- Quality of inputs
- Exceptional skill or experience
- Detailed information
- Extensive personal relationships with buyers and suppliers

Differentiation strategy and the five forces (1/3)

1. Threat of New Entrants

Can defend against new entrants because:

- new products must surpass proven products **or**,
- new products must be at least equal to performance of proven products, but offered at lower prices.

2. Bargaining Power of Buyers

Can mitigate buyer power because well differentiated products reduce customer sensitivity to price increases.

3. **Bargaining Power of Suppliers**

   Can mitigate suppliers' power by:

   - absorbing price increases due to higher margins

4. **Substitutes**

   Well positioned relative to substitutes because brand loyalty to a differentiated product tends to reduce customers' testing of new products or switching brands and technologies.

5. Existing Competitors

Can defend against competition because brand loyalty to differentiated product offsets price competition.

Risk of differentiation

- Cost differential with low-cost competitors becomes too great undermining brand loyalty (e.g., Bimby vs other kitchen robots).
- Customers become more sophisticated and their need for the differentiating factor falls (e.g., high-end smartphones).
- Imitation narrows perceived differentiation (e.g., SmartTV).
- Makers of counterfeit goods may attempt to replicate differentiated features of the company’s products (e.g., football shirts, original vs non-original).

Focus strategy

- The focus strategy rests on the premise that the company is able to serve its narrow strategic target (customer segment, geographic market, “niche”), more effectively or efficiently than its competitors.
- The company achieves either **differentiation** from better meeting the needs of the particular target or **lower cost** in serving the target, or **both**.
- The focus strategy always involves a **trade-off** between profitability and sales volume.

Risks of focus

- The cost differential with broad-range competitors widens and…
  - … it eliminates the cost advantage of serving a narrow target; **or**
  - … it offsets the differentiation achieved by focus.
- The differences in desired products (or services) between the strategic target and the market as a whole narrows.
- Competitors find submarkets **within** the strategic target and outfocus the focuser.

Three key principles:

1. Strategy is the creation of a **unique and valuable position**, involving a different set of activities.

2. Strategy requires you to make **trade-offs** in competing - to choose what not to do.

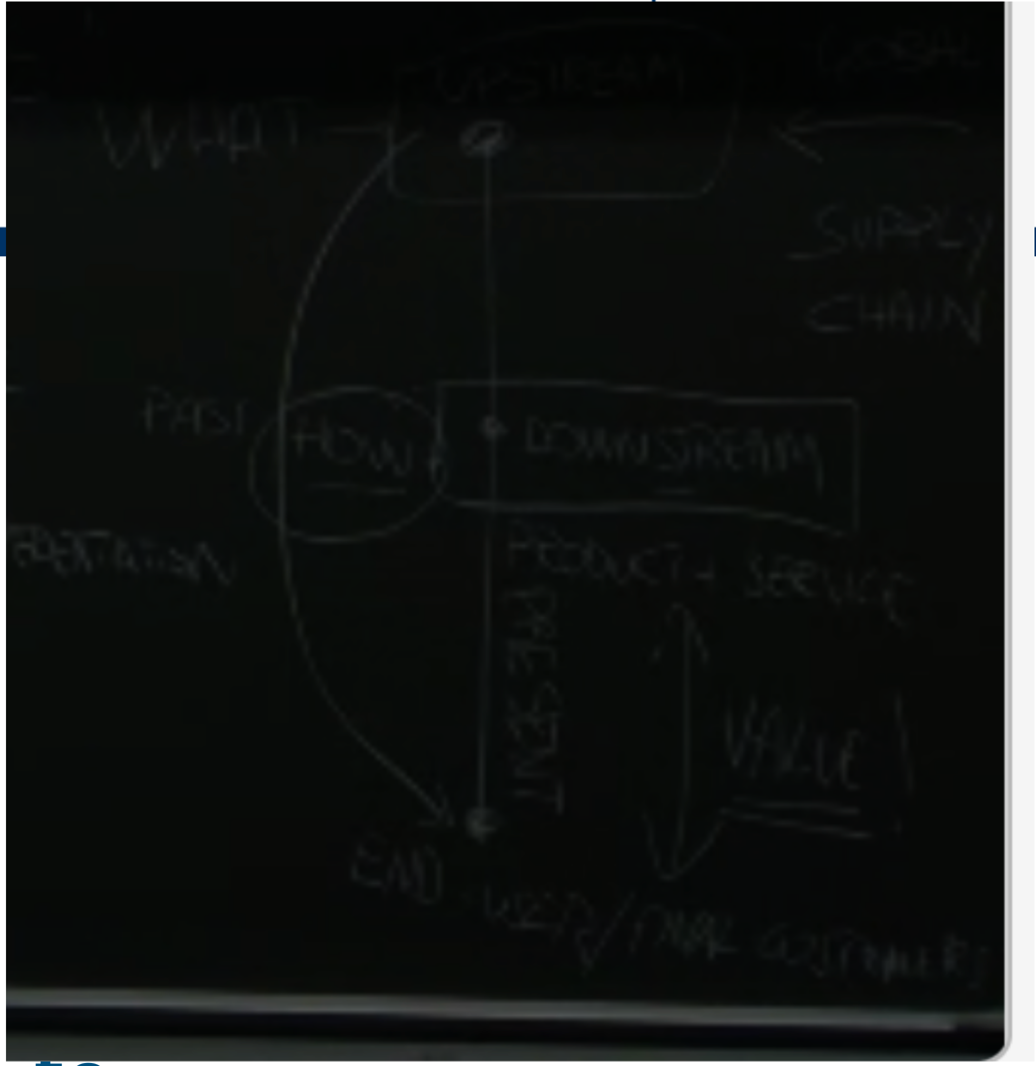
3. Strategy involves creating **fit** among a company's activities.

(Michael Porter, **HBR**, 2000)

The new strategic question

The new strategic question

- For too long the business world has been obsessed with the notion of building a sustainable competitive advantage.
- The dominant idea in the field of strategy has been always to establish a unique competitive position, sustained for long periods of time
- The most common strategies coming from a product, or production facilities-centric approach
- Firms continue to spend inordinate amounts of time, effort and resources on their products
- **but is this center of gravity still sustainable?**



From upstream competitive advantage to downstream’s

Upstream value: a successful strategy in the past

- **Businesses have traditionally sought competitive advantage in the upstream**- the value creation activities related to production and products

- The upstream has been **historically very profitable**:
  - **Ford** built such a huge and streamlined factory that it drove per-unit cost of production for the Ford Model T far below that of competitor's cars
  - **Walmart** built an unbeatable network for moving inventory between its global supply chain and its stores, allowing the company to underprice competitors due to efficiency savings
  - **De Beers** pulverized its competitors as regard diamond market by gaining control of much of the world's supply of diamonds….
  - …

Value shifts downstream

- But **now the business world is suffering from the erosion of upstream competitive advantage**
- Why?
  - Rapid **commoditization** of products and production
  - **Outsourcing** of the upstream activities
  - **Short product life-cycle**
  - …
- In this **new scenario, value is created in the interactions with customers**, competitive advantage is built and sustained in the marketplace, and the primary costs reside in acquiring, satisfying and retaining customers

POLITECNICO DI MILANO

Many ways of buying a can of Coca-Cola

1)A consumer goes to a supermarket and buys a twenty-four-pack of Coca-Cola. The pack might be priced at $5.99 (0.25$ per can)

2)The same customer, the next day, finds herself in a park on a blazingly hot summer day and pays $2 for a chilled single-serve can of Coke sold at the point of thirst through a vending machine

The premium price is due to a perceived added value in the eyes of the consumer. The product (What) is the same, but the purchase and consumption is different (how)

VALUE = WHAT + HOW

so

VALUE shifts from Product to Experience

Neglecting the change: the case of the music industry

- **The music business has always been "ok"**
  - Each of the major record labels had a **unique stable of artists who gave the label its cachet**
  - **The label were not in direct competition with each other**: they appealed to different segments of the market with different musical tastes
  - Upstream assets: a **lock on the supply of the music and no direct competitors**

- Nevertheless the music industry was unprepared for what happened when the digital and the Internet revolutions hit

Neglecting the change: the case of the music industry

- Suddenly music could be downloaded easily (Napster), shared as easily as sending an e-mail and potentially be shared by millions of people
- The music industry panicked
- Record labels sued to reclaim copyright in a world of global file-sharing: they sued the keepers of music download websites, Internet service providers whose customers shared music online, the developers of file-sharing software, and the freeloading downloaders
- **Between 2003 and 2007, the Recording Industry Association of America launched twenty thousand lawsuits. During the same period, the number of people sharing files online tripled**

Neglecting the change: the case of the music industry

- Before the industry burst, Steve Jobs stepped in; even he came from outside the music sector
- Apple was not wedded to the **upstream assets** the music industry had accumulated (the recording contracts with artists, the decades of music libraries), but Jobs understood that the music industry had lost control over the mode of music distribution and consumption, its downstream activities
- Apple set out to build an organized marketplace that would create downstream value for customer of music and give producers the incentive to continue to produce:
  - value for consumers through searchability, recommendations, playlists, customization, ease of use, ease of storage, legacy, "my music everywhere"…
  - value for the offer side, $ 0.99 for each song
- **The brilliance of this approach was the recognition that the value consumers would pay for was no longer in the what, but in the how!**

The new mantra

Competitive advantage is created by **uncovering** **the costs and risks** the customer incurs in
the buying process and finding ways to **eliminate** or **reduce** them before competitors!

Customer's costs and risks

- Customer's costs and risks can be explicit, or hidden:
- EXPLICIT
  - Monetary costs and monetary risks
- HIDDEN
  - COSTS: defined in terms of "effort"
    - time spent to buy the product
    - difficulty in processing the product characteristics
    - difficulty in understanding what are the most relevant information in the buying process
    - …
  - RISKS: defined in terms of "poor choice"
    - what if my girlfriend doesn't like my gift
    - what if this product is not the best solution for me
    - what if next year I won't use this product anymore
    - …

Customer's costs and risks

EXPLICIT COSTS AND RISKS → EACH COMPETITOR SEE THEM!

↓

PRICE WAR

↓

CONTRIBUTION MARGIN CONTRACTION

POLITECNICO DI MILANO

HIDDEN COSTS AND RISKS

NO ONE SEE THEM!

COSTS AND RISKS FIRMS IMPOSE ON CUSTOMERS ARE INDUSTRY WIDE PRACTICES, AND BECAUSE EVERYONE IMPOSEs THEM, THEY ARE WIDELY ACCEPTED AND INVISIBLE

EVEN IF THEY ARE INVISIBLE, THEY'RE STILL A PAIN FOR CUSTOMERS

REDUCING THEM I CAN CREATE VALUE FOR THE CUSTOMERS WHERE NO ONE MORE CREATES VALUE

COMPETITIVE ADVANTAGE

The big picture approach

digital world

Seeing customers' hidden costs and risks

Firms have access to the **big picture** and can see different things in the marketplace than what customers can. Firms can see problems that are likely to arise, because the have arisen elsewhere, or they can see solutions to problems that plague a particular customer or subgroup of customers, because they have seen solution successfully implemented elsewhere

How to see customers' hidden costs and risks

- Each customer holds a piece of hundreds-piece jigsaw puzzle
- While each piece is unique, when assembled the pieces reveal a larger meaning
- In most instances, that piece of the puzzle remains forgotten in a drawer, in a database, untouched, and unused because customers fail to realize its possible role in the larger context
- Being able to bring together all the pieces of information that lie dispersed with customers, firms can see patterns they've never seen before
- These patterns can help the customers make different and better choices that add valued to themselves and to the company

The big picture as Business Model

- In twenty-first century information businesses, the "big picture" (the puzzle assembled) is rapidly becoming an indispensable tool
- **Some businesses go farther: the big picture is their business**
- **Bluefin Labs**, for example, is a recent Cambridge Massachussets start-up launched by an MIT professor. The company aims to **understand how the "Twitter-sphere" responds to television programming advertising.** By analyzing patterns in the tweets that appear in reaction to TV commercials, Bluefin is able to tell advertisers which if their ads had the greatest **social media impact and whether that impact was positive or negative**
- Bluefin Labs' social media analysis and technology was deemed so valuable that the company was acquired by Twitter in February 2013 and Twitter declared Bluefin's products would not be sold to any new clients

- There are three main ways in which marketplace information can create value for your customer:

  ا تقال دادن

  - **relaying and connecting**
  - **benchmarking and mirroring**
  - **predicting**

Relaying and connecting

- The main idea is to take information from one location and apply it in another, to **learn from one customer and use the learning to help another**
- The company therefore sees ideas and solutions that have been implemented or tried, and knows those that worked and those that did not
- The **Amazon**'s huge success is due to this value proposition: not only does Amazon allow the customer to shop online at any time he or she chooses, in any time zone, but **the customers also gets extensive information and advice unavailable in a traditional store**, for instance browsing through what other readers think of the book

Benchmarking and mirroring

- Benchmarking provides customers with the all-important “you are here” location on dimensions that are relevant to them. This **information allows them to pinpoint their own position relative to the peers on crucial metrics**
- Benchmarking is a special case of a more general use of the big picture: **mirroring** (to aggregate and feed back to individuals information about groups of customers)
- The value and availability of benchmarking data has increased with the growth of the third-party benchmarking industry, as well as in social comparisons on social networking sites such as Facebook and Linkedin
- **Nike +**, for instance, allows runners to measure running performance and upload their running data to Facebook. **Benchmarking against other runners and their own past performances motivates Nike’s customers to maintain a training regimen**

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- **The most sophisticated use of marketplace data lies in discerning patterns that can help predict future trends**
- In this perspective, **Google Flu Trends** is a relevant business case
- A rapidly spreading worldwide flu-like epidemic is considered one of the greatest dangers facing humanity. It's not surprising that doctors and researchers know a lot about influenza viruses and health authorities devote considerable effort tracking and preventing outbreakes
- They know when influenza will strike, what strain of influenza will strike in a given year, how the disease progresses and who will likely develop complications, however, they do not know where flu outbreaks will occur
- This is where Google Flu Trends comes in: Google reasoned that when people feel ill, they tend to turn to the Internet for information before heading to the doctor. Thus Google extracts the value by aggregating the searches and plotting the data over geographical locations

POLITECNICO DI MILANO

Corporate strategy and portfolio analysis

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Corporate Strategy

The main goal of Corporate Strategy is to manage financial resources allocation to the portfolio of different Strategic Business Units the overall company is made of

The key issues to deal with are:

1. **To analyze and compare the competitive positioning of each business, and of the overall business portfolio**
2. **To suggest a generic strategic orientation to each business (that will be further specified at a Business Strategy level)**
3. **To define criteria and priorities for financial resource allocation to each business (cash generating vs. cash absorbing SBU), looking for an overall portfolio's financial equilibrium**

Diversification strategy

- **Diversification is a Corporate level strategy aimed at entering new business areas which the corporation is not currently serving (and create new SBUs to serve such new business areas)**
- **Diversification is hence a choice of "hierarchy", that is, internalizing a new business within the corporate portfolio**
- **Diversification is more favorable than other alternatives (e.g. brand franchising) when the following criteria are met:**

1. **Scope economies (i.e. scale economies applied to a wider range or family of activities performed) are present**
2. **Transaction costs (i.e. costs to bear to set up an agreement with the "market") are high**

About diversification strategies

The history: from the era of diversification (1950-80) to refocusing. Why?

- Emphasis on shareholders value
- Turbulence → Specialisation
- Sharing resources and capabilities as real source of advantage

When diversification creates value ?

- Attractiveness test (the industry must be attractive)
- The Cost-of-entry test
- The better-off test (is the combination more profitable?)

The meaning of relatedness in the "digital" era

- Industry boundaries are growingly "fuzzy"
- More and more business areas may be loosely related

Corporate competitive advantage

Two main typologies of business portfolios exist:

"Non correlated portfolios"

"Correlated portfolios"

in a correlated portfolio, the business areas show similarities in the customer needs satisfied, and the products and services sold are operationally related.
In a non-correlated portfolio, such correlation becomes blurred, and products and services offered are apparently unrelated.

Usually real-world cases of business portfolios do not strictly belong to one of these categories

Real portfolios are a mix of the two extreme solutions

Corporate competitive advantage - continue

General electric
- material
- utitlity/energy
- health
- GE for aviation
- ...

Non correlated portfolios

ADVANTAGES

- **"Bank effect"**

"bank effect", as cash-generating SBUs will be used as an internal bank to feed cash-absorbing SBUs within the corporate portfolio;

- **Better use of top human resources**
- **Risk diversification**
- **Sharing of infrastructural activities**

DISADVANTAGES

- **Very complex organisation**
- **Cultural heterogeneity** ذ همگونی
- **Few synergies**

Corporate competitive advantage - continue

Correlated portfolios

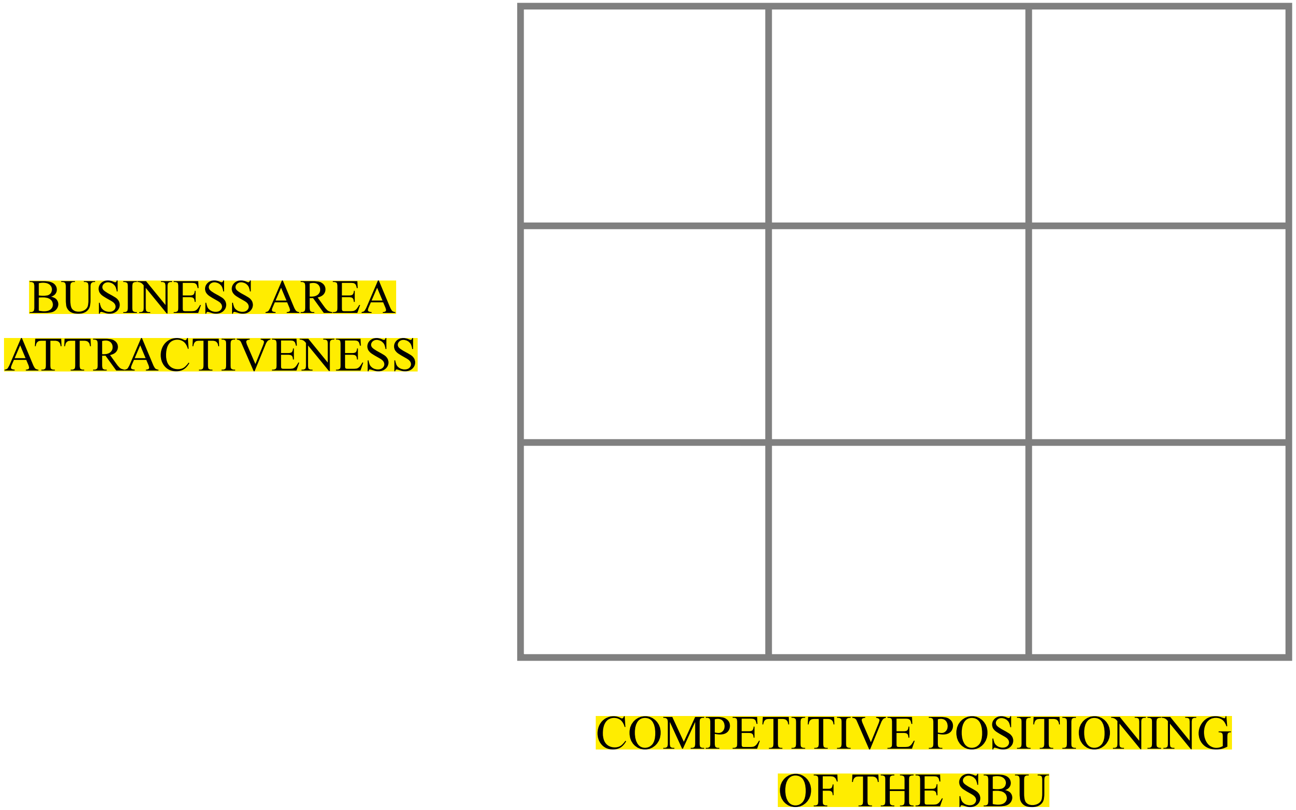
ADVANTAGES

- **Sharing of resources (economies of scale, of scope, critical mass, …)**
- **Sharing of competences**
- **Similar markets**

DISADVANTAGES

- **High risk**
- **High managerial complexity**

Matrixes for portfolio analysis



Basic idea: to represent a diversified company's BA in a simple graphical model to support Corporate Strategy definition

Matrixes for portfolio analysis

Key assumption

Long-term profitability of a SBU depends on:

1. **Business Area attractiveness**

2. **SBU competitive positioning in the Business Area**

Matrixes for portfolio analysis

Main objectives

- **To analyse the competitive advantage coming from the managing of a SBU's portfolio**
- **To support the choice of a business portfolio (Corporate Strategy definition)**

status quo to the desired space!

- **To provide some guidelines to SBUs for the definition of their own strategy**
- **To analyse the strategies of competitors**

Boston Consulting Group (BCG) Matrix

- **The growth-share matrix - developed by The Boston Consulting Group in 1968 - describes products in terms of just two factors: market growth rate and relative market share.**

- **Positions in the product portfolio chart typically correspond to a business's cash flow characteristics. Generally, participation in a high-growth market requires cash, and high relative market share generates cash.**

Boston Consulting Group (BCG) Matrix

Main objectives

- **To verify the "bank effect"**
- **To shape a business portfolio that is well balanced from a financial point of view**
- **To define a "virtuous circle" strategy**
- **To analyse the strategies of competitors**

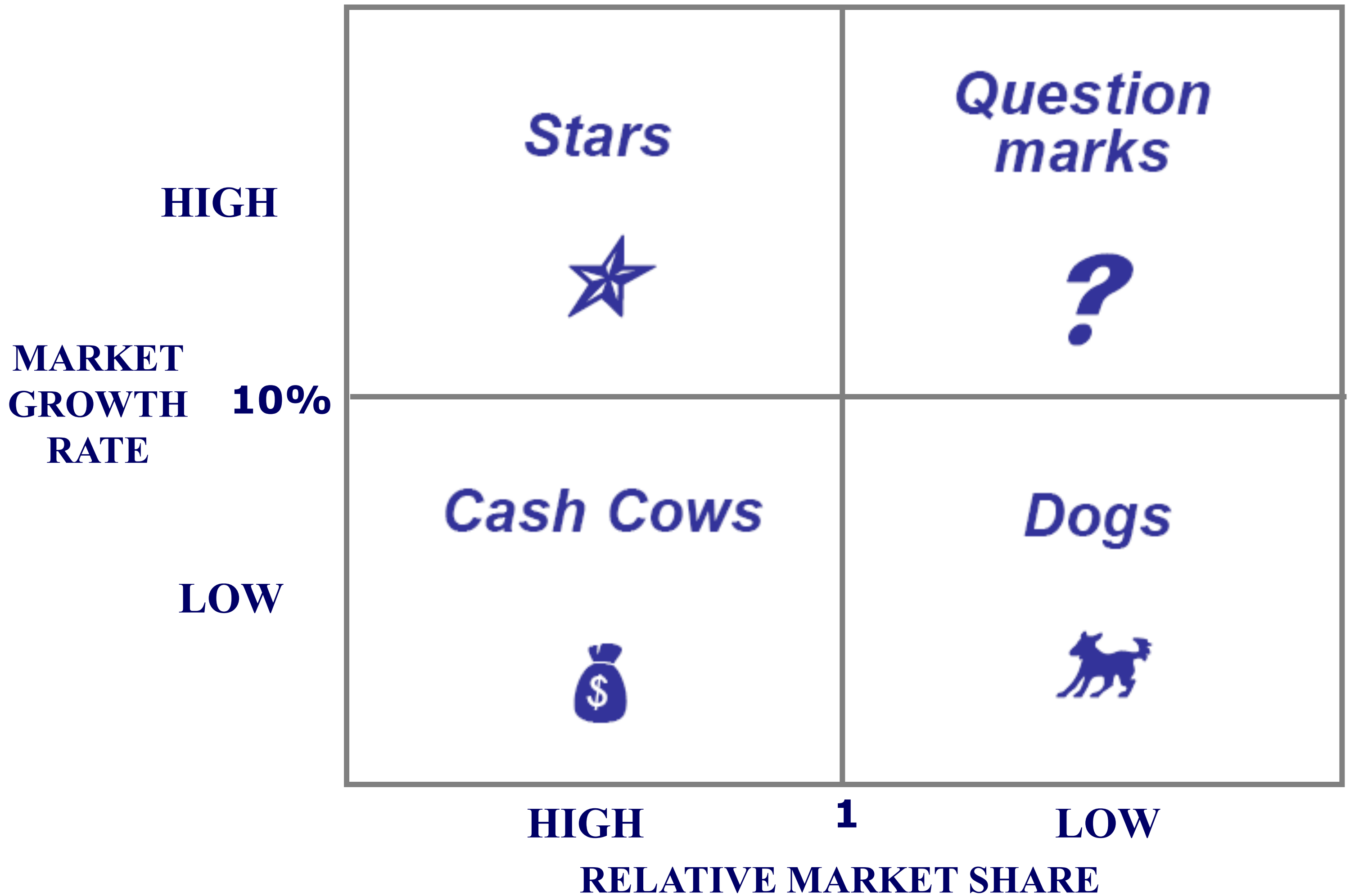
Boston Consulting Group (BCG) Matrix

Basic assumption

1. **Business Area attractiveness can be measured through "Market growth rate":**
   - **Price wars are less likely**
   - **Customer base expands, and offer can catch up with demand**

2. **SBU competitive positioning can be measured through "Relative market share":**
   - **SBU can benefit from cost advantages depending on size (for instance, economies of scale and experience, production capacity saturation, etc.)**

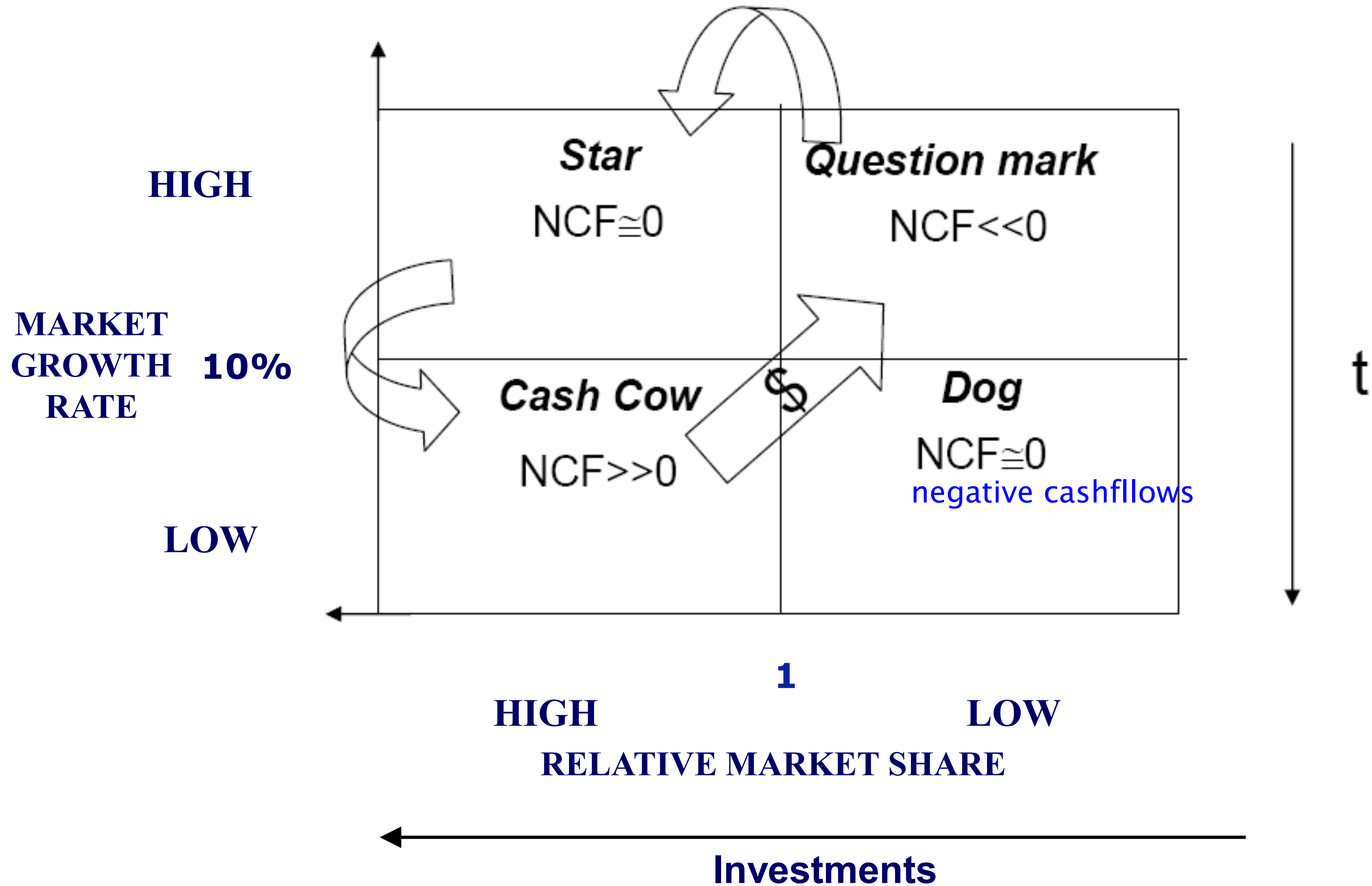
Boston Consulting Group (BCG) Matrix



Boston Consulting Group (BCG) Matrix

- **Stars** are high-growth, high-share products which may or may not be self-sufficient in cash flow.
- **Cash Cows** are products with high market share and slow growth, which characteristically generate large amounts of cash.
- **Question Marks** are products with high growth but low share. They require large amounts of cash to mantain market share, and still larger amounts to gain share.
- **Dogs** are product with low market share and slow growth, which neither generate nor require significant amounts of cash. Mantaining share usually requires the reinvestment of any profits as well as additional capital. These products are often called «cash traps».

Boston Consulting Group (BCG) Matrix



BCG Matrix: recommended strategies

• **Stars:**	**Hold or Build Share**
• **Cash Cows:**	**«Milk» for cash**
• **Question Marks:**	**Build Share or Divest**
• **Dogs:**	**Harvest or Divest** if there were any positive sinergy creates the value

Divesting means selling or spinning off the business unit to another entity, while harvesting means reducing or stopping the investment in the business unit and extracting as much cash as possible from it.

BCG Matrix: the balanced portfolio

All products eventually become either cash-cows or dogs. The value of a product is completely dependent upon obtaining a leading share of its market before the growth slows.

The balanced portfolio has:

-**stars** whose high shares and high growth assure the future;

-**cash-cows** that supply funds for that future growth;

-**question marks** to be converted into stars.

Dogs need dedicated strategies.

Bruce Henderson, BCG Founder, 1970

GE-McKinsey Matrix

- The GE/McKinsey matrix was developed in 1971 by McKinsey at the request of GE. It uses two dimensions - **market segment attractiveness and business strength -** each of which is built up from a large number of variables.
- Systematically weighting those variables, each business (or product) is classified into one of nine cells in a 3 x 3 matrix.
- Like the BCG matrix, this approach aims to compare investment opportunities. The difference is that multiple measures are used to assess market attractiveness and competitive position.

GE-McKinsey Matrix

Main objectives

- **To allocate resources correctly**
- **To choose the businesses to invest in, to maintain and to divest**
- **To analyse the strategies of competitors**

GE-McKinsey Matrix - continue

BUSINESS AREA ATTRACTIVENESS

I	I	C
I	C	D
C	D	D

COMPETITIVE POSITION

Multi attribute methods

LEGEND

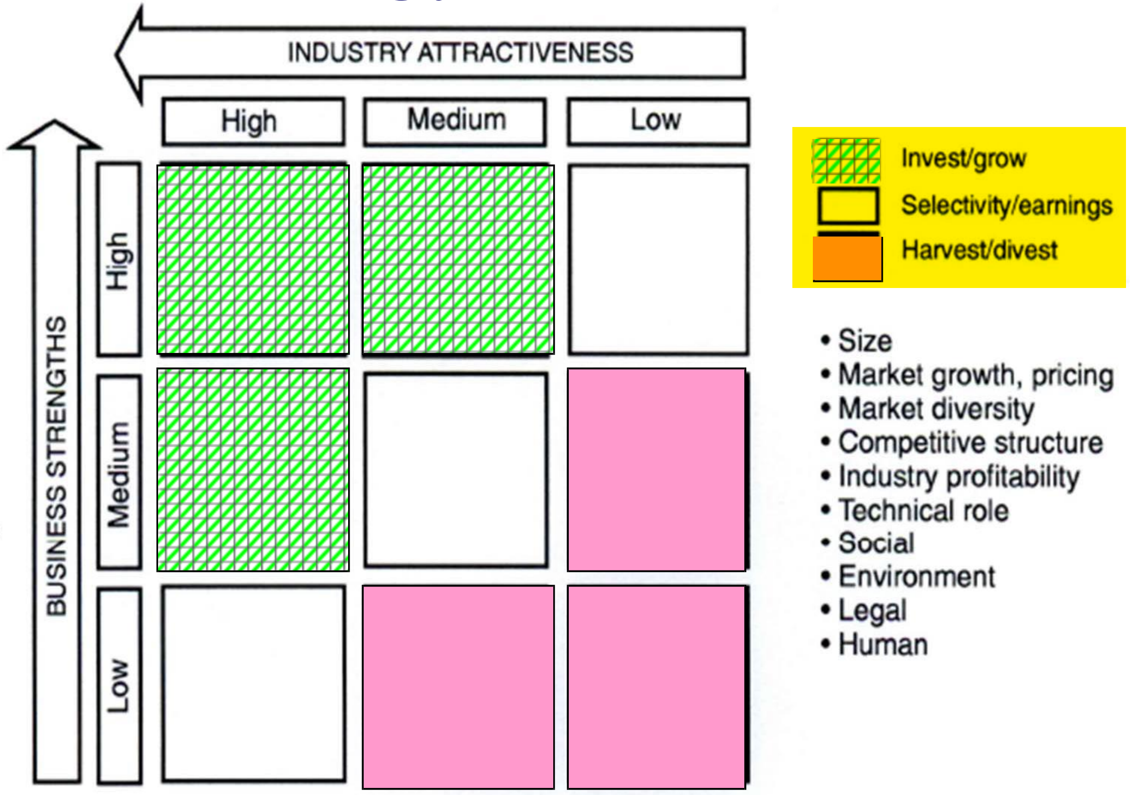
I = TO INVEST IN ORDER TO INCREASE THE MARKET SHARE

C = TO CONSERVE, BALANCING FINANCIAL SOURCES AND INVESTMENTS

D = TO DISINVEST IN ORDER TO ACHIVE CASH

GE-McKinsey Matrix: the nine-cells strategy scheme

- Size
- Growth
- Share
- Position
- Profitability
- Margins
- Technology position
- Strength/weaknesses
- Image
- Pollution
- People



- Size
- Market growth, pricing
- Market diversity
- Competitive structure
- Industry profitability
- Technical role
- Social
- Environment
- Legal
- Human

Source: McKinsey & Co.

Industry attractiveness

	Weighting factor	Rating (1-10)	Score
• Market size	% x	=	
• Growth rate	% x	=	
• Profit margin potentials	% x	=	
• Competitive intensity	% x	=	
• Cyclical or seasonal sales	% x	=	
• Position on learning curve	% x	=	
			100%

Business Strenghts

	Weighting factor	Rating (1-10)	Score
• Relative market share	% x	=	
• Price competitiveness	% x	=	
• Product or service quality perception	% x	=	
• Marketer's knowledge of customers and the market	% x	=	
• Sales effectiveness	% x	=	
• Geography coverage	% x	=	
	100%		

GE-McKinsey Matrix: recommended strategies

Market segment attractiveness

Business strengths	High	Medium	Low
High	**1** Premium invest/ Grow	**2** Selective invest/ Grow	**4** Protective selectivity/ Earnings
Medium	**3** Challenge invest/ Grow	**5** Prime selectivity/ Earnings	**7** Restructure harvest/ Divest
Low	**6** Opportunistic selectivity/ Earnings	**8** Opportunistic harvest/ Divest	**9** Harvest/ Divest

Source: D. W. Craven, Strategic Marketing, 1991

Desirable: Invest/Grow strategy
In between: Selective strategy
Undesirable: Harvest/Divest strategy

if you have solid data this model is better
it's from past data
we need to define the BA accurately

GE-McKinsey Matrix: recommended strategies

1. **Premium Invest / Grow**. These businesses are a target for investment, they have strong business strengths, are in attractive markets and they should therefore have high returns on investment and competitive advantage. They should receive financial and managerial support to maintain their strong position and to continue contributing to long-term profitability.

2. **Selective Invest / Grow**. Businesses in this box have good business strength in an industry that is losing its attractiveness. They should be supported if necessary but they may be self-supporting in cash flow terms.

3. **Challenge Invest / Grow**. Businesses here are in very attractive industries but have average business strength. They should be invested in to improve their long-term competitive position.

GE-McKinsey Matrix: recommended strategies

4. **Protective Selectivity / Earnings**. Strong businesses in unattractive markets should be net cash generators and could provide funds for use throughout the rest of the portfolio. Investment should be aimed at keeping these businesses in a dominant position of strength but over-investment can be disastrous especially in a mature market.
5. **Prime Selectivity / Earnings**. Businesses with average business strengths and in average industries can improve their positions by creative segmentation to create profitable segments and by selective investment to support the segmentation strategy. The business needs to create superior returns by concentrating on building segment to differentiate themselves.
6. **Opportunistic Selectivity / Earnings**. These businesses are in very attractive markets but their business strength is weak. Investment must be aimed at improving the business strengths. These businesses will probably have to be funded by other businesses in the group as they are not self-funding. Only businesses that can improve their strengths should be retained if not they should be divested.

GE-McKinsey Matrix: recommended strategies

7. **Restructured Harvest / Divest**. They have average business strengths in an unattractive market and the strategy should be to harvest the business in a controlled way to prevent a defeat or the business could be used to upset a competitor.
8. **Opportunistic Harvest / Divest**. Businesses with weak business strengths in moderately attractive industries are candidates for a controlled exit or divestment. Attempts to gain market share by increasing business strengths could prove to be very expensive and must be done with caution
9. **Harvest / Divest**. These businesses have neither strengths nor an attractive industry and should be exited. Investments made should only be done to fund the exit.

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Corporate Strategy – Mergers & Acquisitions (M&A)

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Oral Exam!

Corporate Strategy: organic vs. inorganic growth

- Changes in the product scope and/or in the geographical scope can be made by:
  - **Internal (organic) growth**, i.e. the company invests to develop internally (by buying assets and hiring people) the resources and competences needed to launch the new products or to enter in a new geographical market
  - **External growth**, i.e. the company modifies its boundaries by acquiring existing companies **(M&A).**

acquisition : get the majority
merger: merge together to create a new entity

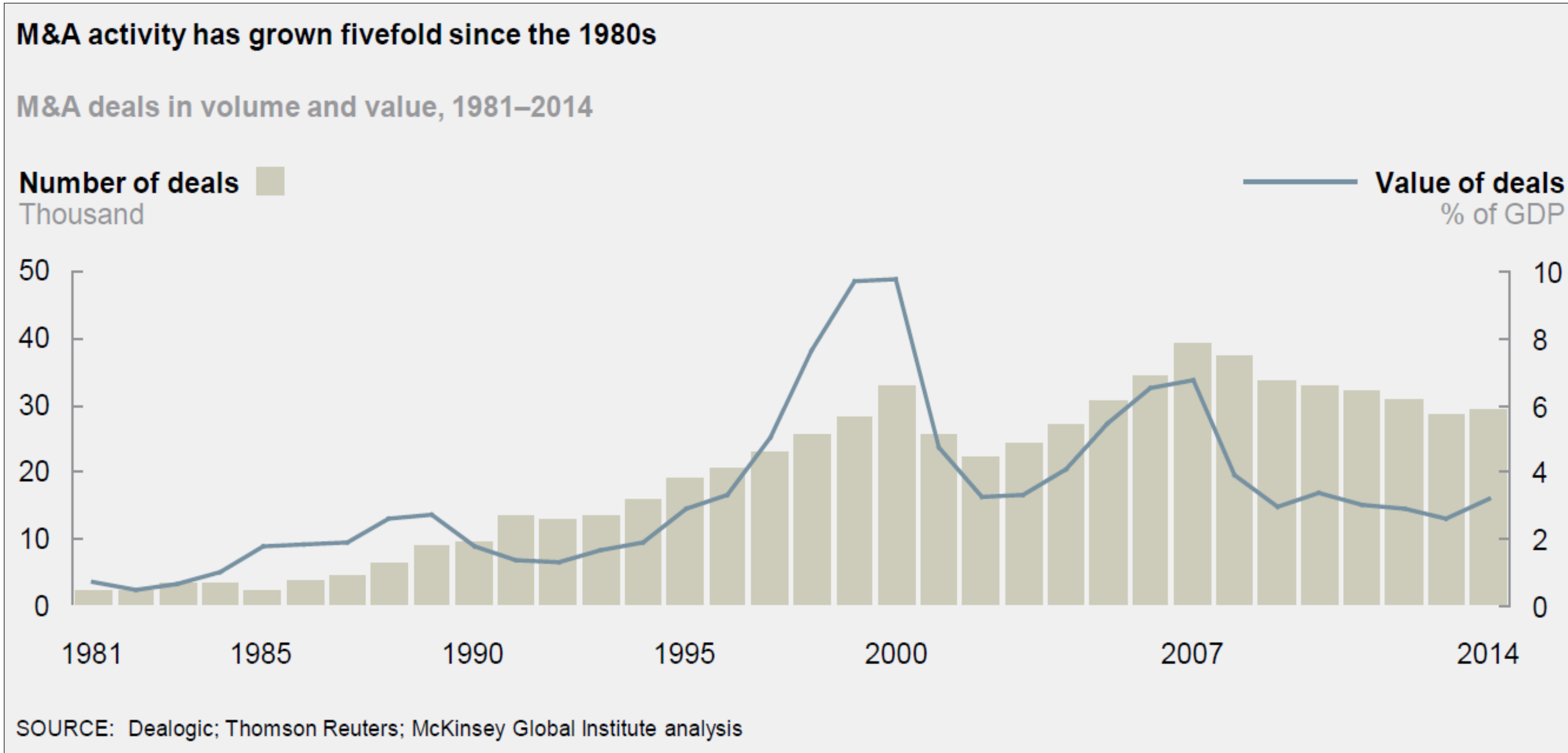
M&A: examples

- Faced with the need to muscle out competitors, companies are increasingly pursuing inorganic growth as a strategy for capturing new markets, adding new business lines, and scaling up quickly. The corporate world has experienced spikes of mergers and acquisitions activity in the past, but nothing compares to the volume of megadeals in the past two decades. In 1990, there were nearly 10,000 M&A deals with a combined value equivalent to 2 percent of world GDP. Since 2008, there have been some 30,000 deals a year totaling roughly 3 percent of world GDP.

- The total value of worldwide deals in 2014 was $3.5 trillion, up 25 percent from the previous year and its highest level since the global financial crisis. Ninety-five deals exceeding $5 billion were announced in that year alone.

Source: MGI Global Competition, Full Report, 2015

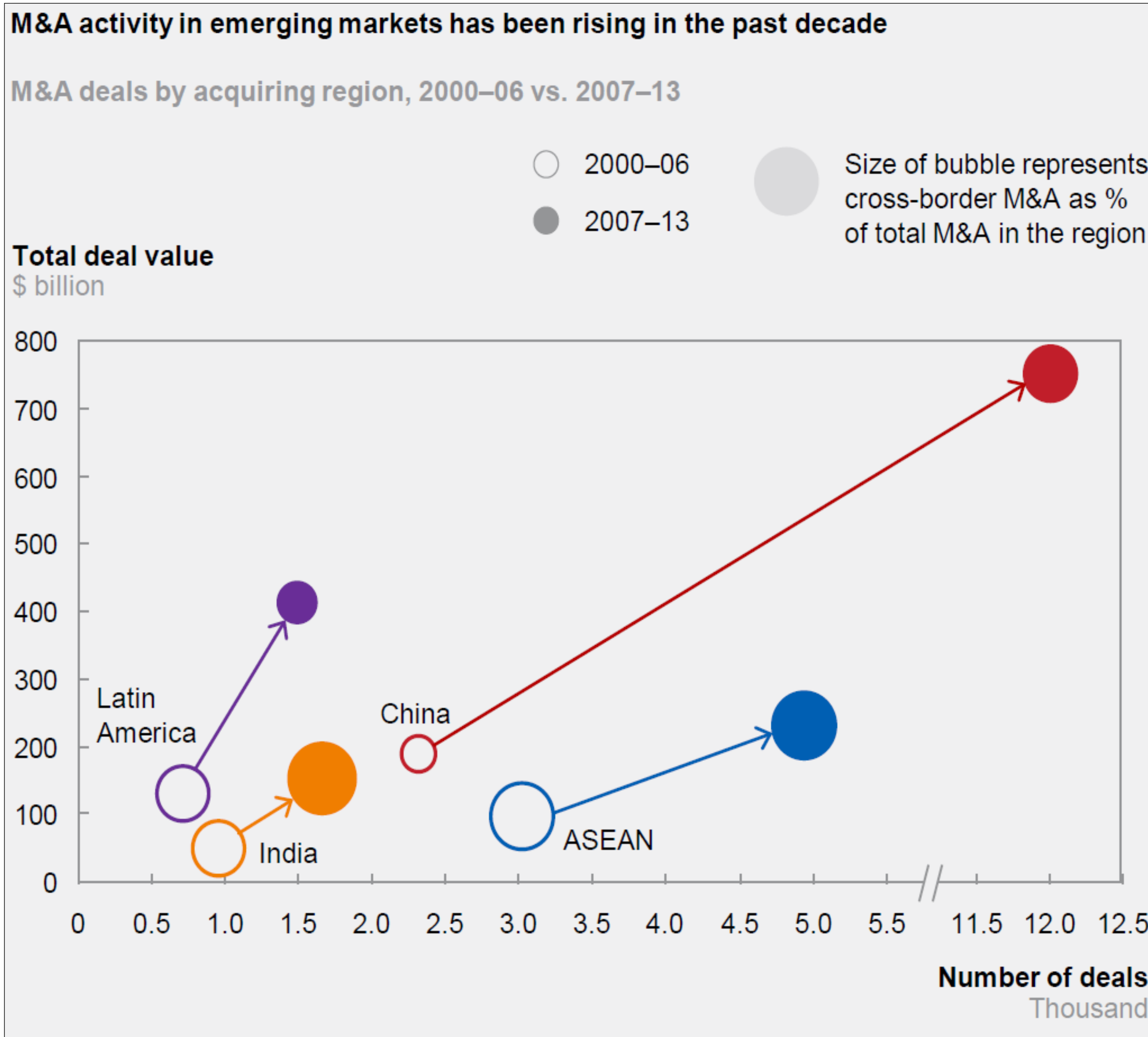
M&A: examples



M&A activity has grown fivefold since the 1980s
M&A deals in volume and value, 1981–2014
Number of deals
Thousand
Value of deals
% of GDP
50
40
30
20
10
0
10
8
6
4
2
0
1981
1985
1990
1995
2000
2007
2014
SOURCE: Dealogic; Thomson Reuters; McKinsey Global Institute analysis

M&A: examples

- Emerging-market companies have been significant players in this trend:



SOURCE: Dealogic; McKinsey Global Institute analysis

M&A: examples

Having grown to significant size at home, Chinese, Indian, and other emerging-market companies are now using M&A strategies to expand their global presence. India's Sun Pharmaceutical, for example, has made a stream of acquisitions since the 1990s to become one of the world's largest generic drug companies. The Tata Group, based in Mumbai, encompasses 19 companies with more than 50,000 workers in the United Kingdom alone, making it one of the country's largest private-sector employers. Brazil's JBS has become the world's biggest meat producer through a series of acquisitions, including the purchase of US-based Swift & Company and Pilgrim's Pride. Chinese firms, in particular, have embarked on a wave of global acquisitions. In 2013, Chinese firms completed 198 overseas deals worth $59 billion, accounting for one-third of their total acquisitions that year. Over the past four years, Chinese firms' share of global deal value has exceeded their share of global revenue by almost 30 percent, an indicator of their aggressive expansion. Consider just a few of the headline deals in recent years: Zhejiang Geely Holding Group Co. acquired Swedish automaker Volvo; Shuanghui International now owns US-based Smithfield Foods, the world's largest pork producer and processor; China National Offshore Oil Corporation bought Canadian oil and gas producer Nexen; and Lenovo recently bought Motorola Mobility.

Source: MGI Global Competition, Full Report, 2015

Types of M&A Transactions

STRATEGY	*ACTION*	*CONSIDER PURSUING IF*
ACQUISITION	ACQUIRE A CONTROLLING STAKE IN A COMPANY (TARGET)	* THE OPPORTUNITY IS NOT GOING TO LAST * THE TARGET IS UNDERVALUED * IT WILL EASE ENTRY TO A NEW MARKET * SKILLS AND COMPETENCIES ARE COMPLEMENTARY * THE TARGET FITS AND ENHANCES THE COMPANY'S PORTFOLIO
JOINT VENTURE	JOIN FORCES WITH ANOTHER COMPANY	* IT WILL EASE ENTRY TO A NEW MARKET * SKILLS AND COMPETENCIES ARE COMPLEMENTARY * YOU ARE NOT READY TO COMMIT TO A FULL BLOWN ACQUISITION * ADDITIONAL RESOURCES ARE NEEDED FOR A COMPELLING PROJECT
DIVESTITURE	SELL A WHOLE BUSINESS UNIT	* THE UNIT NEEDS MORE RESOURCES OR CAPITAL THAN YOU CAN PROVIDE

finance desicion, tax reason, managerial, showing the market,

Advantages of Acquisitions

Once a company has decided to change corporate scope, acquisitions have at least three advantages compared with internal development:

1. They are faster to accomplish than internal development, because the company acquired is typically “up and running”.
2. Compared with internal development, more information is available to the prospective acquirer to evaluate the move.
3. A certain percentage of internally developed new businesses fail. By acquiring a going concern, the acquirer does not need to pay for any of the failures along the way.

Approaching the Deal

Corporate managers can approach acquisition transactions either as buyers or sellers, and in each case they face a number of alternative choices:

- If they are on the **buying side**: they can go for a friendly or for a hostile deal: they can offer to pay the consideration in cash, or in shares (or a combination of the two); they can seek total ownership (100% of the shares) or simple majority.
- If they are on the **sale side**: they can run an auction or pursue a specific buyer; they can sell all the shares or remain as minority shareholders; they can sell to the SBU's management, usually backed up by a financial investor; they can distribute the shares in the SBU to the shareholders ("spin off")

POLITECNICO DI MILANO

Four Critical Decisions

There are four critical decisions that make or break a deal:

1. How should you pick your targets? the portfolio, corporate str.or internal analysis
2. Which deals should you close?
3. Where do you really need to integrate?
4. What should you do when the deal goes off track?

D. Harding & S. Rovit, **Mastering the Merger**, Harvard Business School Press, September 2004

Reasons for Making Aquisition

Acquisitions

- Increase market power
- Overcome entry barriers
- Cost of new product development
- Learn and develop new capabilities
- Reshape firm's competitive scope
- Increase diversification
- Lower risk compared to developing new products

Reasons for making Aquisition:

POLITECNICO DI MILANO

1. Increased Market Power

standard oil =>

Factors increasing market power:

- when a firm is able to sell its goods or services above competitive levels, ***or***
- when the costs of its primary or support activities are below those of its competitors;
- usually it is derived from the size of the firm and its resources and capabilities to compete.

Market power is increased by:

- horizontal acquisitions;
- vertical acquisitions;
- related acquisitions.

- **Horizontal acquisition**: acquisition of a target company that produces other products than the acquiring company.
- **Vertical acquisition:** the target company is related to the acquiring company operation system, like a supplier
- **Related acquisitions:** acquisitions that are strictly related to the business. For example if the acquiring company wants to include a direct competitor within its boundaries

Reasons for making Aquisition: 2. Overcome Barriers to Entry

Barriers to entry include:

– economies of scale in established competitors;
– differentiated products by competitors;
– enduring relationships with customers that create product loyalties with competitors.

Acquisition of an established company:

– may be more effective than entering the market as a competitor offering an unfamiliar good or service that is unfamiliar to current buyers

Cross-border acquisition.

Reasons for making Aquisition:

3. Cost of New Product Development

matel => child toy barbie
invest in educational learning
they bought a ML company

Significant investments of a firm's resources are required to:

- develop new products internally;
- introduce new products into the marketplace.

Acquisition of a competitor may result in:

- lower risk compared to developing new products
- increased diversification;
- reshaping the firm's competitive scope;
- learning and developing new capabilities;
- faster market entry;
- rapid access to new capabilities.

Reasons for making Aquisition:

4. Lower Risk Compared to Developing New Products

Microsoft acquiring game company

An acquisition's outcomes can be estimated more easily and accurately compared to the outcomes of an internal product development process.
Therefore managers may view acquisitions as lowering risk.

Reasons for making Aquisition:

5. Increased Diversification

It may be easier to develop and introduce new products in markets currently served by the firm.
It may be difficult to develop new products for markets in which a firm lacks experience:

- It is uncommon for a firm to develop new products internally to diversify its product lines;
- Acquisitions are the quickest and easiest way to diversify a firm and change its portfolio of businesses.

Reasons for Making Acquisitions:

6. Reshaping the Firms’ Competitive Scope

Firms may use acquisitions to reduce their dependence on one or more products or markets.

Reducing a company’s dependence on specific markets alters the firm’s competitive scope.

Once a company has decided to change corporate scope, acquisitions have at least two advantages compared with internal development:

1. They are faster to accomplish than internal development, because the company acquired is typically “up and running”.
2. Compared with internal development, more information is available to the prospective Acquirer to evaluate the move.

Reasons for Making Acquisitions:
7. Learning and Developing New Capabilities

Dysney & Pixar

Acquisitions may gain capabilities that the firm does not possess.
Acquisitions may be used to:

- Acquire a special technological capability;
- Broaden a firm’s knowledge base;
- Reduce inertia.

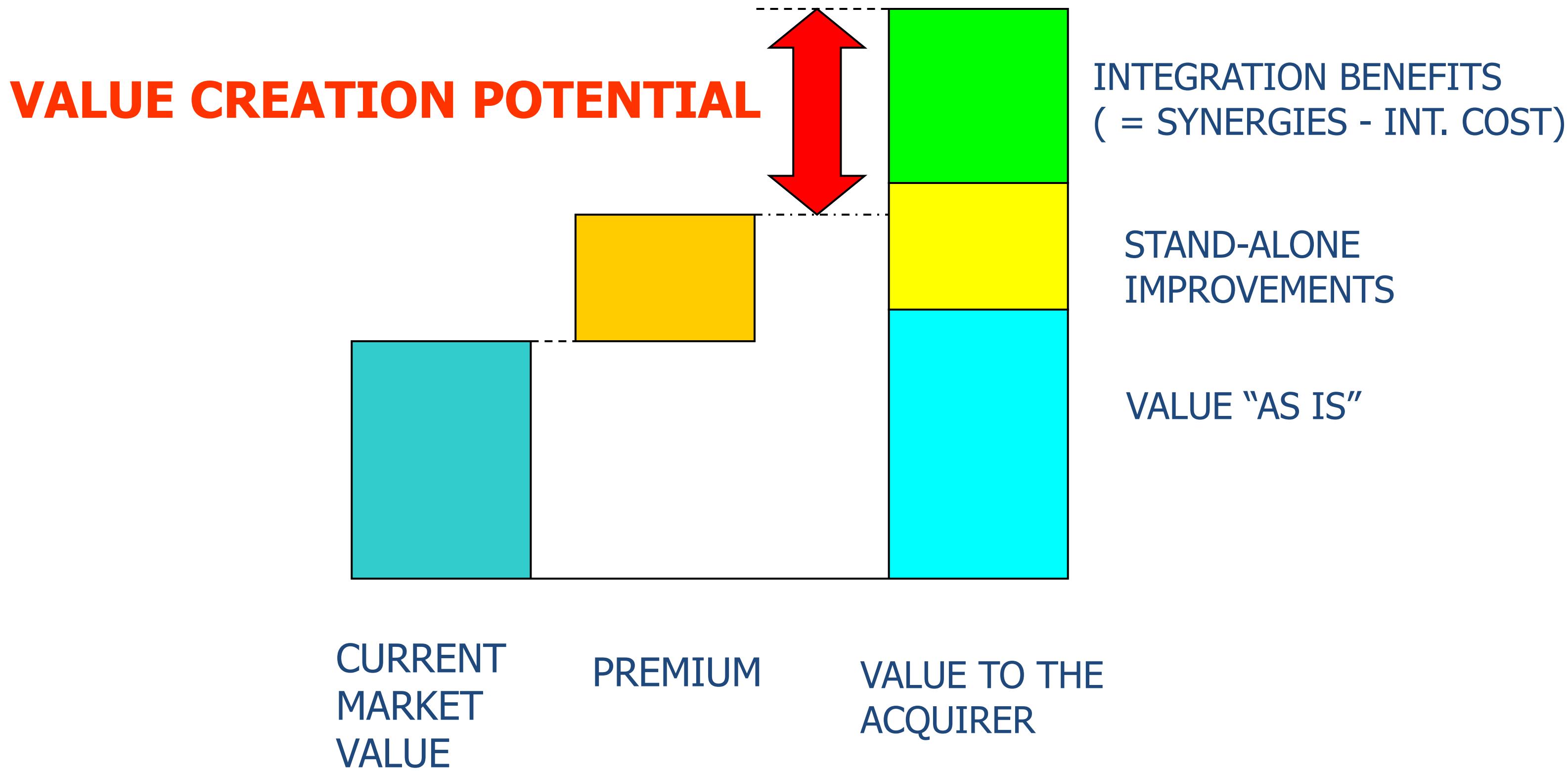
Value Creation in Aquisition

Companies engage in M&A activity with the objective of creating value for their shareholders.

The value can be generated through **stand-alone improvements** and **synergies**.

However the majority of acquisitions fail to create value, and many of them destroy shareholder value.

Value Creation Potential



Main Types of Synergies (1/2)

Cost Saving: this is the most common type of synergy and the easiest to estimate, and they are also labelled as ***"hard synergies"***. They often come from eliminating jobs, facilities, and related expenses that are no longer needed when functions are consolidated, or they come from economies of scale in purchasing. **Revenue Enhancements:** it is sometimes possible for an Acquirer and its Target to achieve a higher level of sales growth together than either company could do on its own. In fact, sometimes the Target brings a superior or complementary product to the more extensive distribution channel of the Acquirer. In other instances, a Target's distribution channel can be used to escalate the sales of the Acquirer's product. Revenue enhancements are notoriously hard to estimate and they are often described as ***"soft synergies"***.

Main Types of Synergies (2/2)

Process Improvements: they occur when managers transfer best practices and core competencies from one company to the other. That results in both cost savings and revenue enhancements. The transfer of best practices can flow in either direction.

Financial Engineering: an example is when a transaction allows the Acquirer to refinance the Target's debt at the Acquirer's more favourable borrowing rate, without negatively affecting the Acquirer's credit rating.

Synergies play a role in: Valuation, Negotiation, Integration

The synergies between the Acquirer and the Target are specific to each Acquirer. The value of synergies is normally «split» between the two as part of the price ***negotiation***.

The quantification of synergies is part of the ***valuation*** process.

Synergies can materialise only through a successful ***integration***.

Problems With Acquisitions

Acquisitions

- Integration difficulties
- Inadequate evaluation of Target
- Large or extraordinary debt
- Inability to achieve synergies
- Too much diversification
- Managers overly focused on acquisitions
- Resulting firm is too large

Problems With Acquisitions
1. Integration Difficulties

Integration challenges include:

- melding two disparate corporate cultures;
- linking different financial and control systems;
- building effective working relationships (particularly when management styles differ);
- resolving problems regarding the status of the newly acquired firm's executives;
- loss of key personnel weakens the acquired firm's capabilities and reduces its value.

Problems With Acquisitions

2. Inadequate Evaluation of Target

Evaluation requires that hundreds of issues be closely examined, including:

- financing for the intended transaction;
- differences in cultures between the acquiring and target firm;
- tax consequences of the transaction;
- actions that would be necessary to successfully melt the two workforces.

Ineffective due-diligence process may result in paying excessive premium for the target company.

Problems With Acquisitions

3. Large or Extraordinary Debt

Firm may take on significant debt to acquire a company. High debt can:

- increase the likelihood of bankruptcy;
- lead to a downgrade in the firm's credit rating;
- preclude needed investment in activities that contribute to the firm's long-term success.

Problems With Acquisitions

4. Inability to Achieve Synergies

Synergies exist when assets are worth more when used in conjunction with each other than when they are used separately.

Firms experience transaction costs (e.g., legal fees) when they use acquisition strategies to create synergies. Firms tend to underestimate indirect costs of integration when evaluating a potential acquisition.

Problems With Acquisitions
5. Too Much Diversification

Diversified firms must process more information of greater diversity.

Scope created by diversification may cause managers to rely too much on financial rather than strategic controls to evaluate business units' performances.

Acquisitions may become substitutes for innovation.

Problems With Acquisitions

6. Mangers Overly Focused on Acquisition

Managers in Target firms may operate in a state of virtual suspended animation during an acquisition. Executives may become hesitant to make decisions with long-term consequences until negotiations have been completed.

Acquisition process can create a short-term perspective and a greater aversion to risk among top-level executives in a Target firm.

Problems With Acquisitions

7. Too Large

Additional costs may exceed the benefits of the economies of scale and additional market power.
Larger size may lead to more bureaucratic controls.

Formalized controls often lead to relatively rigid and standardized managerial behavior.
Firm may produce less innovation.

THE WALT DISNEY COMPANY CASE INSTRUCTIONS

Disclaimer: assigned cases are material reserved only for the lessons. You are not allowed to share them or to post them online under any circumstances.

Objective: perform a Corporate Strategy Analysis on the business portfolio of The Walt Disney Company by means of the BCG Matrix.

Rules: the assignment should be performed in groups of 2-6 students. You have at your disposal: the business case, The Walt Disney Company 2022 Report, Newspaper articles. You are supposed to read this material before the September 17th lesson

You also are encouraged to search for other secondary sources before the lesson. During the September 17th lesson, you will have the opportunity to work in group. At the end of the group works sessions some groups will present their analysis.

STEPS OF YOUR WORK

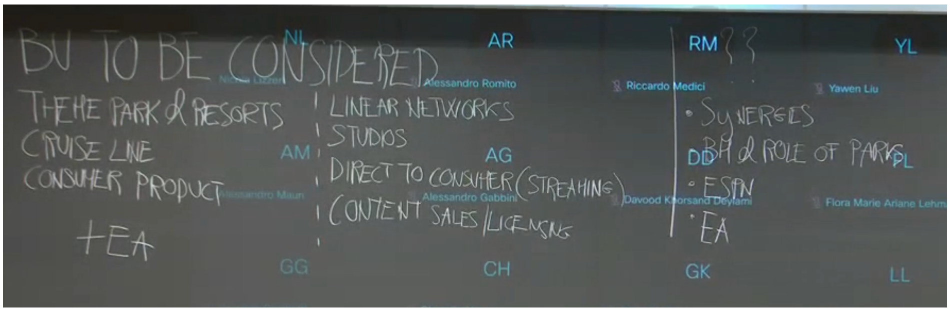
1) Using secondary sources online, determine the market growth rate and the relative market share of the different business units.
2) Build the BCG Matrix, explaining the reasoning behind the positioning of the BU in in the matrix (*Remember! Reasoning is more relevant than positioning)*
3) Develop some strategic considerations stemming from the Corporate Portfolio analysis performed and reading of secondary sources at your disposal.

HINTS

1. We encourage you to make clear assumption from secondary sources to justify your decisions
2. To better and easily develop the case you are supposed to use the following business units. This is a simplified version of the Walt Disney Company.

   A) Disney Media and Entertainment Distribution
   - Linear Networks (Domestic & International Channel – e.g., ABC, ESPN, Freeform, FX, National Geographic)
   - Direct to Consumer (Disney+, Disney+ Hotstar, ESPN+, Hulu and Star+ direct-to-consumer (DTC) video streaming services)
   - Content Sales/Licensing
   - Studios

   B) Disney Parks, Experience and Products
   - Theme Parks & Resorts
   - Cruise Line
   - Consumer Products

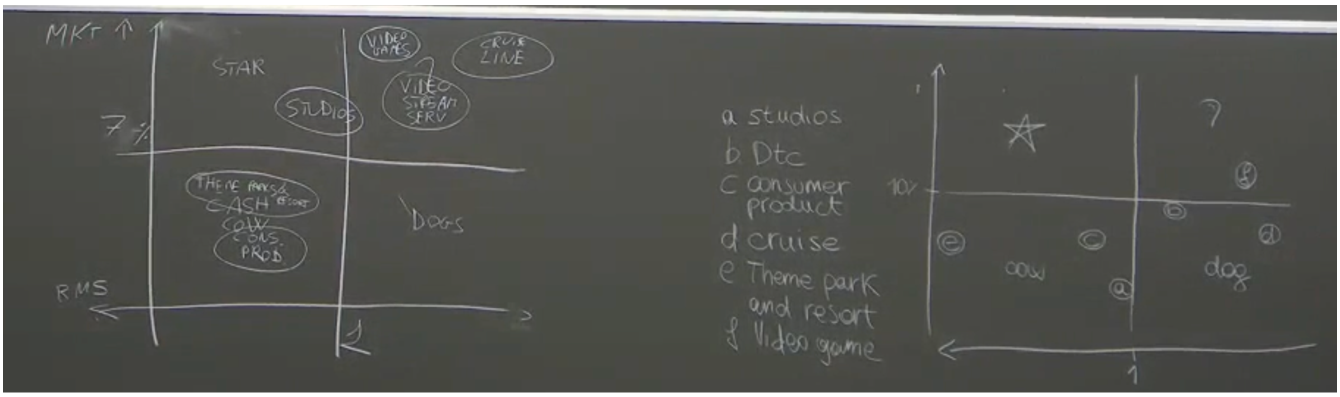


ADDITIONAL QUESTIONS:

- One of the drawbacks of the BCG Matrix is that it does not allow the synergies between different business units to be clearly highlighted from the perspective of a corporate strategy. Does the Disney & Fox M&A created new synergies between business units? What happened in your opinion after the launch of Disney+?
- Disney's business model […] is about getting people to recognize [its brand] and then selling them toys, clothing, [tickets to] theme parks […] As long as Disney is able to capture consumers through streaming but not necessarily make a lot of money, that's okay because they can then monetize those consumers and the brand in other ways." (*Hemant Bhargava, chair in technology management at the University of California at Davis*). Comment this quote.
- According to some press releases, Disney has considered the possibility of an ESPN spin-off. The hypothesis was denied by Bob Iger in early 2023. Considering your analysis, what strategic considerations can you draw?

PLEASE CONSIDER THESE ADDITIONAL PRELIMINARY READING

How ESPN Went From Disney's Financial Engine to Its Problem
The Walt Disney Company Announces Strategic Restructuring, Restoring Accountability to Creative Businesses
Hollywood Makes Way for the Disney-Fox Behemoth
Disney Moves From Behemoth to Colossus With Closing of Fox Deal
Disney Makes $52.4 Billion Deal for 21st Century Fox in Big Bet on Streaming
Disney Plans to Expand Parks Investment, Doubling Capital Expenditures Over 10 Years
Disney Financial Report 2022



DAVID J. COLLIS

The Walt Disney Company: The 21st Century Fox Acquisition and Digital Distribution

In March 2018, the Walt Disney Company's $71.3 billion bid for 21st Century Fox was accepted. The original bid of between $52 and $60 billion had been filed in November 2017, but Comcast intervened with its own bid. When the dust settled in the competitive contest, the 21st Century Fox assets were split three ways (**Exhibit 1**). Disney acquired the film, television and cable entertainment assets of 21st Century Fox. Rupert Murdoch and his family retained Fox Broadcasting, which owned Fox News and Sports and twenty eight local television stations. Comcast acquired Sky TV, the European satellite broadcasting entity which it won for $39 billion in a one-day auction against Disney and Fox.[1]

More specifically, Disney acquired the 20th Century Fox[a] film library, including such franchises as Marvel[b] and Avengers, and classics like *Cleopatra* and *Avatar*, as well as the current film and television studios; the FX and National Geographic cable networks in the U.S.; Star India, the Indian broadcast media company with over 700 million monthly viewers;[2] and Fox's 30% share of the Hulu video on-demand subscription service—making Disney the majority Hulu shareholder with 60% ownership—[3] and a share of Sky TV.

Disney then recouped $15 billion through the sale of Fox's 30% share in Sky TV to Comcast. Regulatory pressure in the U.S. required Disney to divest twenty-one regional sports networks,[4] and in Europe to sell off all its "factual channels," including *History* and *Lifetime,*[5] which collectively recovered another $10 billion of the purchase price. In April 2019, Hulu made a deal with AT&T to purchase AT&T's 9.5% stake,[6] meaning that Disney held a 67% stake and Comcast held a 33% stake.[7] The following month, Disney and Comcast agreed that Disney would assume full operational control of Hulu, effective immediately.[8] The terms outlined that within about five years—as soon as January 2024[9]— Comcast would sell its Hulu share to Disney based on fair market value at the time, but for at least $5.8 billion.[10] When the dust had settled Disney's total net investment to acquire its share of the 21st Century Fox assets and AT&T's stake in Hulu, therefore, came to about $48 billion.

[a] 21st Century Fox was the name of the parent corporation. 20th Century Fox was the original name of the film studio division.

[b] The original Disney acquisition of Marvel had not included the rights to some characters.

Professor David J. Collis prepared the original version of this case, "The Walt Disney Company: The 21st Century Fox Acquisition and Digital Distribution," HBS No. 719-445, which is being replaced by this version. This case was developed from published sources. Funding for the development of this case was provided by Harvard Business School, and not by the company. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

Disney's intent with the acquisition was to enhance its "position as a premier, truly global entertainment company, and . . . [its] ability to offer innovative direct-to-consumer offerings."[11] Specifically, it would make Disney the clear leader in traditional content businesses by owning additional movie franchises (Disney and Fox together would have had 28% of the North American box office between 1995 and 2018[12]); exploit economies in film and television production and generate $2 billion in cost synergies by 2021; broaden the scope of cable channels that could be offered in a bundle to cable networks; and expand its footprint outside the U.S. In early 2020, Disney announced that the "Mouse had killed the Fox" as it renamed the acquired assets "21st Century," dropping the Fox moniker.[13]

The deal would also increase Disney's sales to the final consumer. Historically, less than 25% of Disney's revenue came from a direct relationship with the end-consumer. This inhibited the ability to establish a deep customer relationship and use data to improve services, such as knowing a family's favorite Disney Princess when they booked a stay at Disney World. Acquiring Star India would substantially increase the end customer percentage, as would moving into digital distribution in the U.S.[14]

Indeed, after the acquisition, Disney quickly moved to introduce three video-on-demand subscription channels to be offered direct to the consumer (DTC). It would offer Hulu in direct competition with Netflix and HBO as an entertainment channel for adult audiences. The company then launched the Disney+ channel in late 2019. This featured at least five content channels, including Disney, Pixar, Star Wars, Marvel, and National Geographic, and would show new content, such as a Star Wars universe series "The Mandalorian", as well as movies targeted at the traditional Disney consumer, such as the live action version of "Mulan" available first on Disney+ for a $29.99 premium fee.[15] To support the channel, it pulled all the classic Disney content from Netflix after the end of 2019, even though it had been receiving about $150 million per annum from Netflix for the broadcast rights to that material.[16] Finally, it launched ESPN+, featuring college teams, local sports teams, and those sports that were underrepresented on the ESPN cable channel, such as lacrosse, so that it did not overlap with ESPN's current offerings.[17] The three channels would be offered on the BAMTech platform, which Disney had acquired from Major League Baseball in 2017 for $1.6 billion, and was widely recognized as the best platform for streaming video at scale.

The three streaming channels entered a field that had become crowded by 2020 with more than 400 services available around the world.[18] PC Magazine listed forty video streaming competitors in their annual review, including free services, like Tubi, and alternatives to cable, like YouTube TV[19]. Annual content budgets by major players exceeded $16–17 billion (Netflix), $6 billion (Apple) and $6–7 billion (Amazon). Disney proposed a budget of $3 billion for Hulu and $1.5 to $2 billion for Disney+ (**Exhibit 2**). Nevertheless, the launch of the channels was well received. The day of the announcement, Disney stock rose 12%, while Netflix stock fell by 5%—a net shift in market capitalization of about $50 billion **(Exhibit 3**). By mid-2020, Disney had accumulated over 100 million subscribers across the three channels.[20]

As these moves were announced, Iger reorganized the firm's management structure.[21] Former chief strategy officer Kevin Mayer was named president of a new DTC and international business unit. Bob Chapek, head of theme parks, was moved to chairman of the combined parks and resorts and consumer products business. Media networks and studios were left untouched by the reorganization. Then, in February 2020, Bob Iger announced that he was moving to become Executive Chairman, with Chapek taking over as CEO.[22] Kevin Mayer later left to become CEO of TikTok before stepping down as President Trump forced the sale of its U.S. operation.[23]

In early 2020, Disney's core businesses were badly affected by the Covid-19 pandemic as theme parks and movie theatres were closed during the crisis (**Exhibit 4**).

Exhibit 1 Assets Involved in Acquisition

DISNEY GETS:

Fox Movie Studios

**Including:
Marvel Films: XMen
Other Films: Avatar,
Planet of the Apes…**

Fox TV Studios

FX Network

National Geographic Channel

Hulu Share increased to 60%

Star TV India

FOX KEEPS:

Fox Broadcast Channel

Fox News Channel

Fox

Fox

COMCAST GETS:

SKY Plc., U.K. TV

Source: Casewriter.

Exhibit 2 Streaming Services in 2020

Logos	Streaming Service	2020 Monthly Cost ($)	2020 Worldwide Subscribers million	2020 Content Budget $b
	HBO Max	14.99	4/134[5]	3
	Netflix	12.99[1]	190	16 - 17
	Peacock	9.99	10	1 - 2
	Amazon Prime Video	8.99[2]	150[6]	6 - 7
	Disney+	6.99	61	1.5 – 2.5
	Hulu	5.99	36	3
	Paramount+[3]	5.99	42[7]	2
	Apple TV	4.99	10	6
	ESPN+	4.99[4]	9	N/A

[1]Standard: Basic is $8.99

[2]$9.91 per month for all of Amazon Prime services, i.e., free shipping

[3]Formerly CBS All Access

[4]$12.99 for Disney +, Hulu and ESPN+

[5]134 million is for HBO cable subscribers

[6]Total is for Amazon Prime

[7]Includes cable subscribers for Showtime and Pluto

Source: Casewriter including from https://en.wikipedia.org/wiki/Streaming_service_provider and *Mike Reynolds "Disney leads legacy media companies in boosting streaming revenues," August 26, 2020, https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/disney-leads-legacy-media-companies-in-boosting-streaming-revenues-60076855.*

Exhibit 3 Disney Stock Price vs. S&P 500 (November 2016 to September 2020)

Source: BigCharts, accessed on October 8, 2020, https://bigcharts.marketwatch.com/advchart/frames/frames.asp?show=&insttype=Stock&symb=DIS&time=100&startdate=11%2F1%2F2016&enddate=9%2F30%2F2020&freq=1&compidx=SP500&comptemptext=DIS&comp=DIS&ma=0&maval=9&uf=0&lf=1&lf2=0&lf3=0&type=0&style=320&size=2&x=58&y=13&timeFrameToggle=false&compareToToggle=false&indicatorsToggle=false&chartStyleToggle=false&state=15.

Exhibit 4a Disney Financials 2015—2019

		2019 (1)		2018 (2)		2017 (3)		2016 (4)		2015 (5)
Statements of income										
Revenues	$	**69,570**	$	59,434	$	55,137	$	55,632	$	52,465
Net income from continuing operations		**10,913**		13,066		9,366		9,790		8,852
Net income from continuing operations attributable to Disney		**10,441**		12,598		8,980		9,391		8,382
Per common share										
Earnings attributable to Disney										
Continuing Operations - Diluted	$	**6.27**	$	8.36	$	5.69	$	5.73	$	4.90
Continuing Operations - Basic		**6.30**		8.40		5.73		5.76		4.95
Dividends (6)		**1.76**		1.68		1.56		1.42		1.81
Balance sheets										
Total assets	$	**193,984**	$	98,598	$	95,789	$	92,033	$	88,182
Long-term obligations		**60,852**		24,797		26,710		24,189		19,142
Disney shareholders' equity		**88,877**		48,773		41,315		43,265		44,525
Statements of cash flows										
Cash provided (used) by - continuing operations:										
Operating activities	$	**5,984**	$	14,295	$	12,343	$	13,136	$	11,385
Investing activities		**(15,096)**		(5,336)		(4,111)		(5,758)		(4,245)
Financing activities		**(464)**		(8,843)		(8,959)		(7,220)		(5,801)

(1) On March 20, 2019, the Company acquired TFCF for cash and Disney shares (see Note 4 to the Consolidated Financial Statements). TFCF and Hulu's financial results have been consolidated since the date of acquisition and had a number of adverse impacts on fiscal

Exhibit 4b Disney Financials 2020 (9 months)

	Quarter Ended			Nine Months Ended		
	June 27, 2020	June 29, 2019	Change	June 27, 2020	June 29, 2019	Change
Revenues	$ 11,779	$ 20,262	(42) %	$ 50,681	$ 50,489	— %
Income (loss) from continuing operations before income taxes	$ (4,840)	$ 2,009	nm	$ (1,163)	$ 12,676	nm
Total segment operating income(1)	$ 1,099	$ 3,952	(72) %	$ 7,502	$ 11,422	(34) %
Net income (loss) from continuing operations(2)	$ (4,718)	$ 1,430	nm	$ (2,122)	$ 9,648	nm
Diluted EPS from continuing operations(2)	$ (2.61)	$ 0.79	nm	$ (1.17)	$ 5.97	nm
Diluted EPS excluding certain items affecting comparability(1)	$ 0.08	$ 1.34	(94) %	$ 2.22	$ 4.74	(53) %
Cash provided by (used in) continuing operations	$ 1,162	$ (1,748)	nm	$ 5,949	$ 4,266	39 %
Free cash flow(1)	$ 454	$ (2,925)	nm	$ 2,656	$ 699	>100 %

(1) EPS excluding certain items affecting comparability, total segment operating income and free cash flow are non-GAAP financial measures. The comparable GAAP measures are diluted EPS from continuing operations, income from continuing operations before income taxes, and cash provided by continuing operations, respectively. See the discussion on page 2 and on pages 10 through 13.

(2) Reflects amounts attributable to shareholders of The Walt Disney Company, i.e. after deduction of noncontrolling

Source: Disney 10k for 2019 and 10Q for nine months.

Endnotes

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[10] Edmund Lee, "Disney to Buy Comcast's Hulu Stake and Take Full Control of Streaming Service," The New York Times, May 14, 2019, https://www.nytimes.com/2019/05/14/business/media/disney-hulu-comcast.html, accessed June 2023.

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value chain that is made of our primary and support actvities,is a source of deltas,differentials in costs and values.
the resource bassed is a criticisms to the value chain.
what value chain is propoing to do is to enter the company and understand if you have resources and competencies, and the question you should ask is that resource core?can be the foundation of a competitive advantage?
to assess we use 5 core tests or VRIO frame work.
if it wasnt core,it will be a source of temporary competitive advantage.
bt if you have a core,you can leverage this to enter another Market and would be a pattern to diversification and it connects 2 levels of strategy ,corporate and business ,
what is differentiation? is a business level strategy aiming at making your product be perceived as different and unique.

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value = benefit for customer

the company value ?? architecture

Business Model Design

three main pillars:
- value creation
- value delivery (channel, ...)
- value capture (transform into profit)

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The Business Model "dilemma"

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- The business model concept is perceived as more and more essential by both managers and academics

- However, it is often used as a **buzzword** meaning everything and nothing about the "new economy"

- The authors dealing with the topic have tried to describe the concept in terms of its **components** or **building elements** but the resulting parameters seem to be strongly dependent on the author's field of work.

- Even though the term **Value** is recurrent in business model design theory, within the practitioners community the business model issue is often wrongly associated to a **mere revenue model problem**, reflecting the widespread focus on the quantifiable concept of cost and revenue rather than value.

What is a Business Model?

What a business model is – a collection of literature definitions

"A business model is an ***architecture*** for the **product, service and information flows**, including a description of the various **business actors** and their **roles**, a description of the potential **benefits** for the various business actors, and a description of the **sources of revenues**"

(*Timmers, 1998*)

"A business model is the ***method of doing business*** by which a company sustains itself, that is, **generate revenue**"

(*Rappa, 2000*)

"The essence of a business model is in defining the manner by which the enterprise **delivers value to customers**, entices customers to **pay for value**, and **converts those payments to profit**"

(*Teece, 2010*)

Based on this definition, we can say that **the business model is the value architecture, because it's a structure made of a number of components which harmonically has to build the structure together and keep it up.** If one of the components is removed, the whole structure will not stand up anymore. Why value ? Because the whole architecture will revolve around the notion of value.

What a business model is – a literature overview (1/2)

- As a literature stream, business model design has evolved from a **piecemeal approach** (Tapascott et al., 2000; Amit and Zott, 2001; Rappa 2001; Weil and Vitale, 2001), to one searching for a **clear and unambiguous ontology** – that is, the definition of the basic concepts of a theory – (Osterwalder, 2004), to employ as a generalized tool for **supporting strategy analysis of firms**.

- Business model has become an **extensive and dynamic concept**: its focus has shifted from the single firm to the **network of firms**, and from the sole firm's positioning within the network to its **entire interrelations and hierarchies** (Ballon, 2007; Ghezzi, 2013).

What a business model is – a literature overview (2/2)

- What is widely accepted by literature is that a business model shall be analyzed through a **multi-category approach**, as a **combination of multiple design dimension, elements or building blocks**, not simply restrained to revenue and cost models (Yu, 2001; Hedman and Calling, 2003; Osterwalder, 2004; Morris et al., 2005; Ballon, 2007; Johnson et al., 2008; Amit and Zott, 2009)

- However, the existing body of knowledge concerning Business Model Design shows a **lack of homogeneity** (e.g. Johnson et al., 2008; Ghezzi et al., 2010; Zott, Amit and Massa, 2011), and the issue deserves further academic investigation

- The **relationship between the business model and Strategy** is also debated (e.g. Casadesus-Masanell and Ricart, 2010).

What is value ?

Basic economics claims that value creation means wealth creation (create capital). In management, creating a value, means creating a benefit for the customer.

What are the main components of the value architecture ?

First of all, we have **value creation**: the company needs to explain how it creates value for the customers by means of products and services. **This is a pillar of the business model.**

The other main pillar, is **value delivery**: the company needs to explain how it delivers value to the customers (what are the channels used, the customer relationship, and so on)

Last is **value captured**. By means of value captured, the company is accountable of reaping a share of the value created for customers and transform it into profit. So the company capture part of the benefit generated for their customers, and transform into profit o cashflow for the company **so that the company is economically and financially sustainable**

If you are a startup,which of the 3 elements you are stronger at?creation

Business Model Design:

An overview of the main elements, models and frameworks

business model is not a replacement for strategy, its a part of it not in oral fully all model

Business model affinity diagram (Shafer et al., 2005)

Components of a Business Model

Strategic Choices

- Customer (Target Market, Scope)
- Value Proposition
- Capabilities/Competencies
- Revenue/Pricing
- Competitors
- Output (Offering)
- Strategy
- Branding
- Differentiation
- Mission

Value Network

- Suppliers
- Customer Information
- Customer Relationship
- Information Flows
- Product/Service Flows

Create Value

- Resources/Assets
- Processes/Activities

Capture Value

- Cost
- Financial Aspects
- Profit

Entrepreneur's Business Model (Morris et al., 2005)

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Six questions that underlie a business model

Component 1 (factors related to the offering): How do we create value? (select from each set)
- offering: primarily products/primarily services/heavy mix
- offering: standardized/some customization/high customization
- offering: broad line/medium breadth/narrow line
- offering: deep lines/medium depth/shallow lines
- offering: access to product/ product itself/ product bundled with other firm's product
- offering: internal manufacturing or service delivery/ outsourcing/ licensing/ reselling/ value added reselling
- offering: direct distribution/indirect distribution (if indirect: single or multichannel)

Component 2 (market factors): Who do we create value for? (select from each set)
- type of organization: b-to-b/b-to-c/ both
- local/regional/national/international
- where customer is in value chain: upstream supplier/ downstream supplier/ government/ institutional/ wholesaler/ retailer/ service provider/ final consumer
- broad or general market/multiple segment/niche market
- transactional/relational

Component 3 (internal capability factors): What is our source of competence? (select one or more)
- production/operating systems
- selling/marketing
- information management/mining/packaging
- technology/R&D/creative or innovative capability/intellectual
- financial transactions/arbitrage
- supply chain management
- networking/resource leveraging

Component 4 (competitive strategy factors): How do we competitively position ourselves? (select one or more)
- image of operational excellence/consistency/dependability/speed
- product or service quality/selection/features/availability
- innovation leadership
- low cost/efficiency
- intimate customer relationship/experience

Component 5 (economic factors): How we make money? (select from each set)
- pricing and revenue sources: fixed/mixed/flexible
- operating leverage: high/medium/low
- volumes: high/medium/low
- margins: high/medium/low

Component 6 (personal/investor factors): What are our time, scope, and size ambitions? (select one)
- subsistence model
- income model
- growth model
- speculative model

The previous model was followed by this one, in which there are questions an entrepreneur should ask himself when designing a business model. This is an entrepreneur business model because it provides them a checklist in order to clarify their idea

RCOV Framework (Lecocq et al., 2006)

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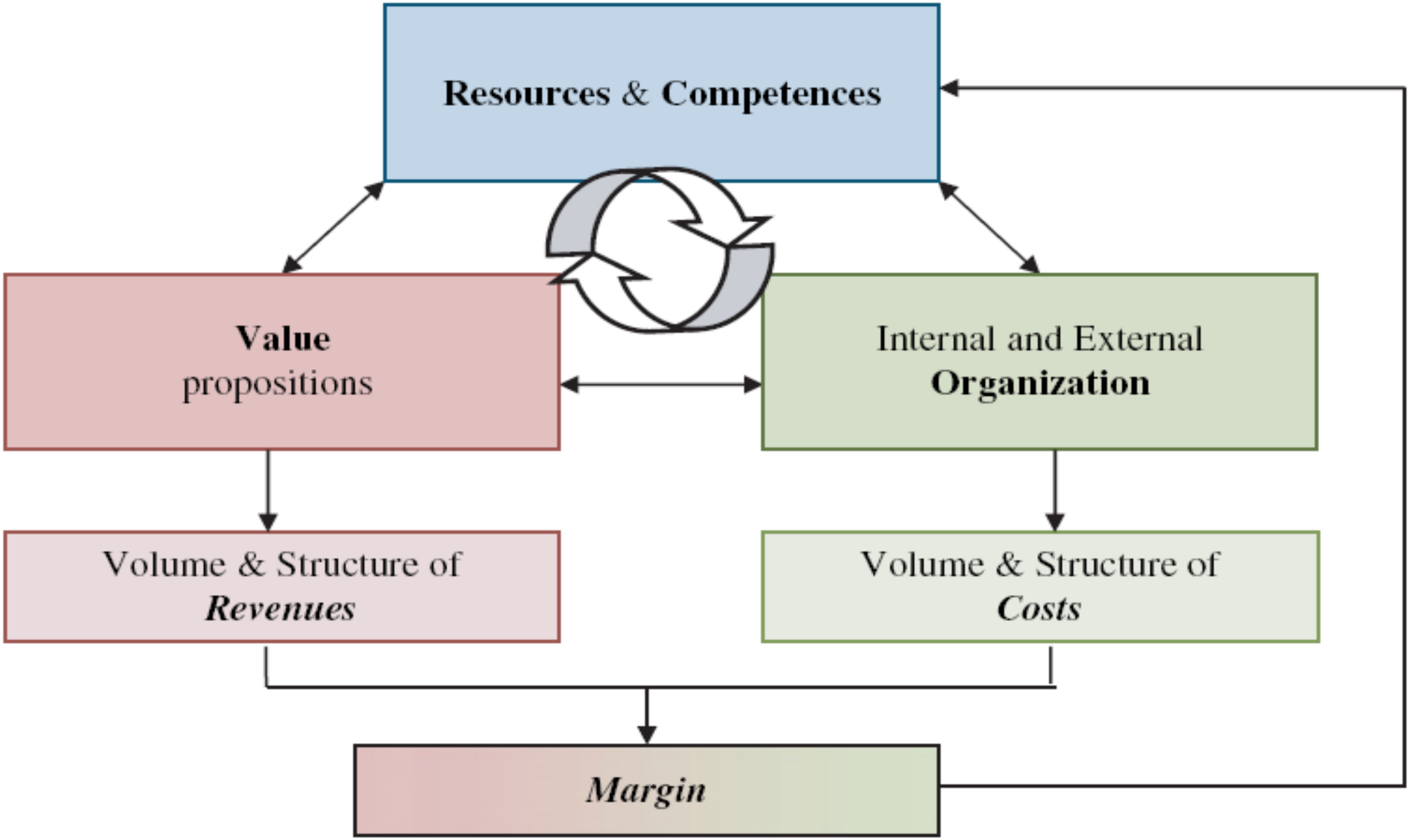


Business model for ICT services (Ballon, 2007) (1/2)

Control parameters

A. Value network parameters	*B. Functional architecture parameters*
A1. Combination of assets	B1. Modularity
A2. Vertical integration	B2. Distribution of intelligence
A3. Customer ownership	B3. Interoperability

Value parameters

C. Financial model parameters	*D. Value proposition parameters*
C1. Cost (sharing) model	D1. Positioning
C2. Revenue model	D2. User involvement
C3. Revenue sharing model	D3. Intended value

Business model for ICT services (Ballon, 2007) (2/2)

Control parameters				Value parameters			
Value network parameters		*Functional architecture parameters*				*Value proposition parameters*	
Combination of assets		Modularity		Cost (sharing) model		Positioning	
Concentrated	Distributed	Modular	Integrated	Concentrated	Distributed	Complement	Substitute
Vertical integration		Distribution of intelligence		Revenue model		User involvement	
Integrated	Disintegrated	Centralised	Distributed	Direct	Indirect	High	Low
Customer ownership		Interoperability		Revenue sharing model		Intended value	
Direct	Intermediated	Yes	No	Yes	No	Price/quality	Lock-in

Business Model Framework (Richardson, 2008)

close to final version

The Business Model Framework

The value proposition—what the firm will deliver to its customers, why they will be willing to pay for it, and the firm's basic approach to competitive advantage.

- The offering
- The target customer
- The basic strategy to win customers and gain competitive advantage (generic strategy and building blocks of competitive advantage)

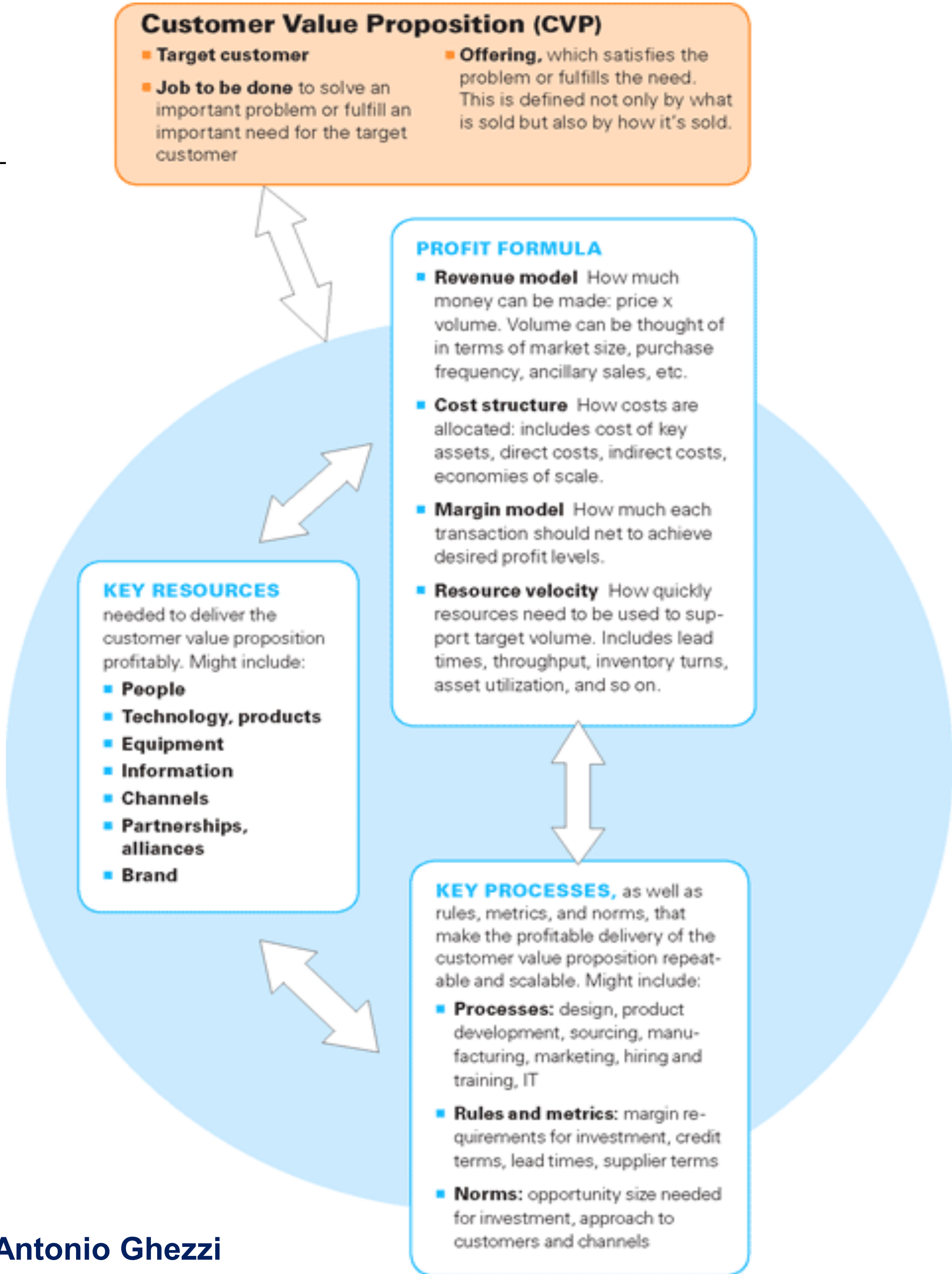
The value creation and delivery system—how the firm will create and deliver that value to its customers and the source of its competitive advantage

- Resources and capabilities (VRIO)
- Organization: the value chain, activity system, and business processes
- Position in the value network: links to suppliers, partners, and customers

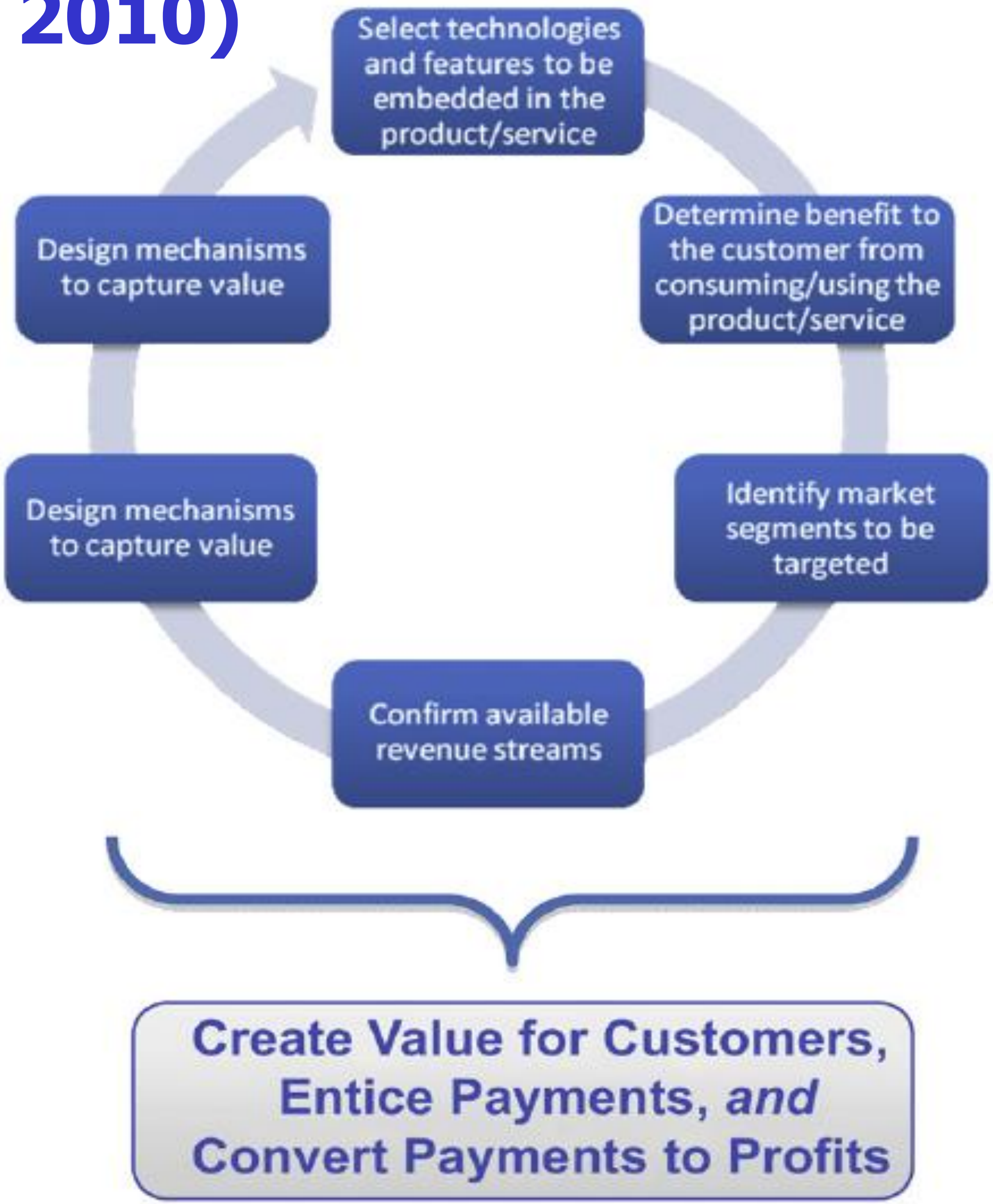
Value capture—how the firm generates revenue and profit

- Revenue sources
- The economics of the business

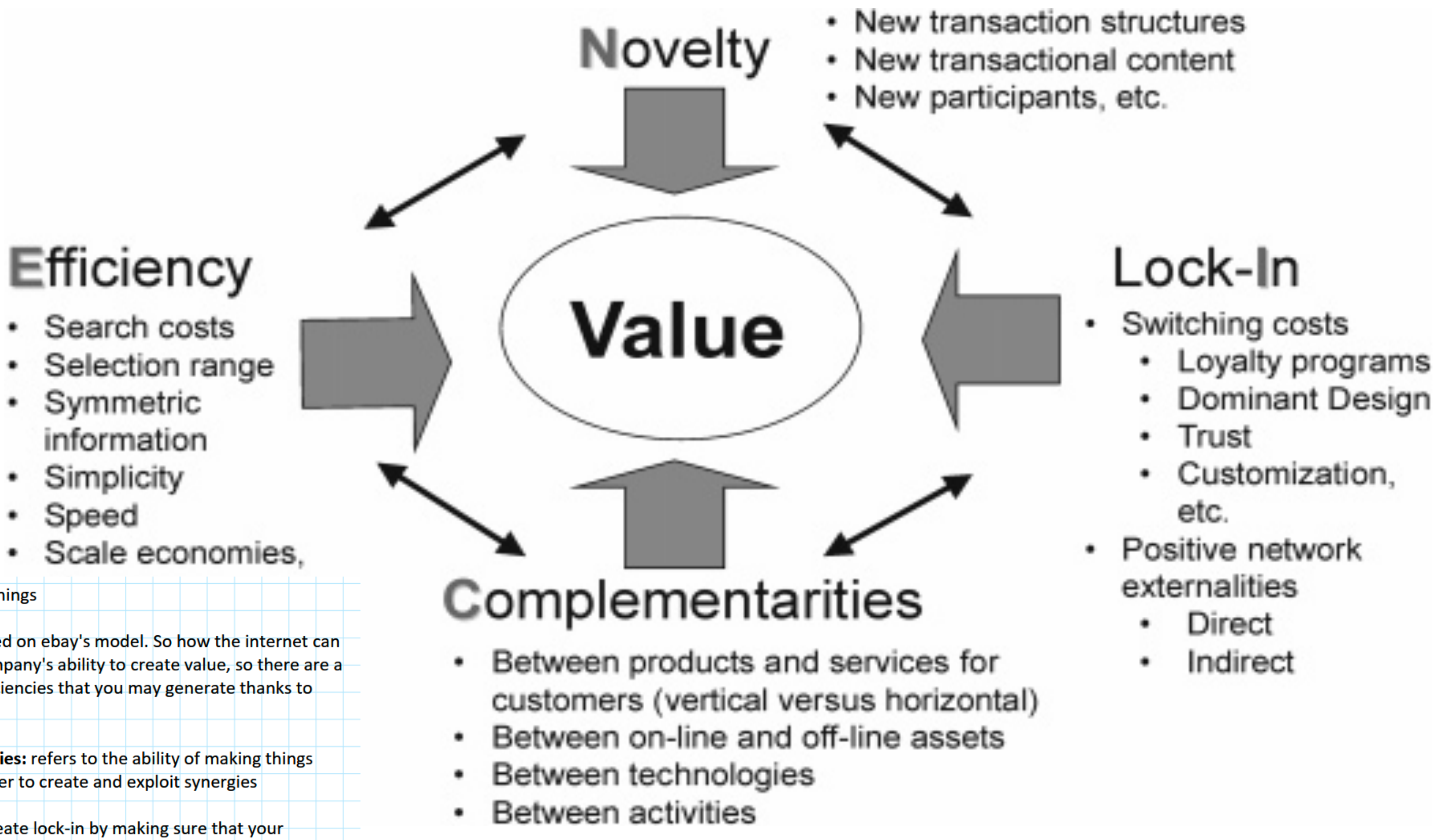
The Business Models reinvented (Johnson et al., 2010)



Elements of business model design (Teece, 2010)



Surces of value creation in e-business (Amit & Zott, 2001)



- **Novelty:** new things
- **Efficiency:** based on ebay's model. So how the internet can influence a company's ability to create value, so there are a number of efficiencies that you may generate thanks to internet
- **Complementaries:** refers to the ability of making things together in order to create and exploit synergies
- **Lock-in**: you create lock-in by making sure that your customers keep buying from you, so relates to the relationship. For example, apple's ecosystem makes difficult for customers to leave it, because they will lose that in switching to another company or a rewarding system.

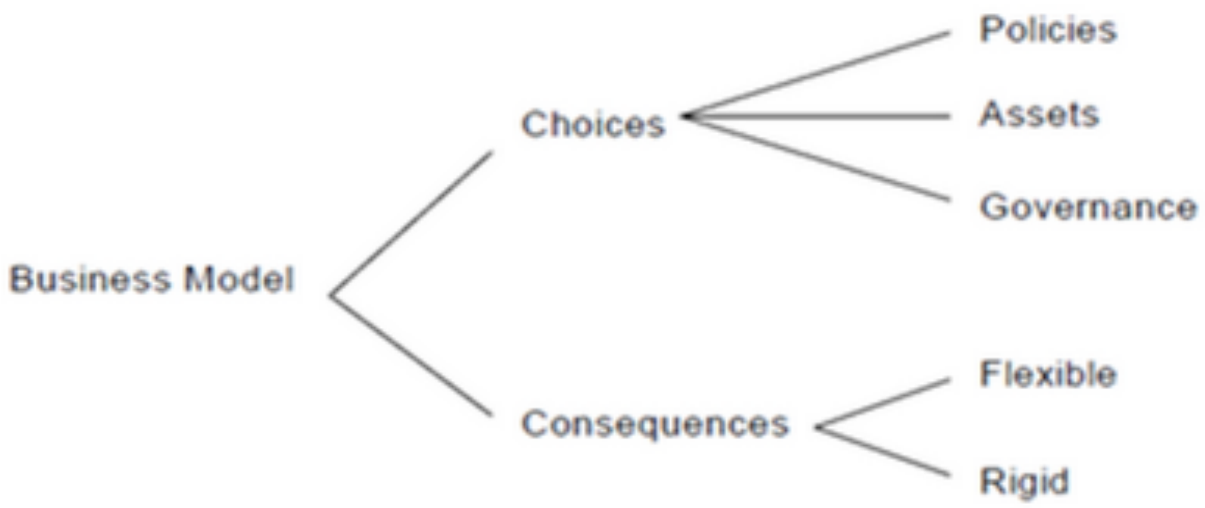
Business model design: an activity system perspective (Amit & Zott, 2010)

- A firm's business model is conceptualized as a system of interdependent activities that transcends the focal firm and spans its boundaries.
- The **activity system** enables the firm, in concert with its partners, to create value and also to appropriate a share of that value.
- Activity system's set of parameters

1. **Design Elements** – ***which describe the activity system's architecture***
   a. Content
   b. Structure
   c. Governance
2. **Design Themes** – ***which describe the source of value creation***
   a. Novelty
   b. Lock-in
   c. Complementarities
   d. Efficiency

Taken the previous model, the authors added some components. The Business model is made of a system of relations and activities between the company and other external parties, so there are some design themes which are how you create value, linked to the previous model, but also design elements that describe the activity system architecture: you have to define what are the relationships and links with the other players in terms of content structure and governance

Business Model as choices and consequences (Casadesus-Masanell and Ricart, 2010)



Business Models are composed of two different sets of elements:
1. the concrete choices made by management about how the organization must operate
2. the consequences of these choices

- **Policies** (Choices) Choices regarding the courses of action adopted by the firm regarding all aspects of its operation
- **Assets** (Choices) Choices regarding tangible resources such as manufacturing facilities.
- **Governance** (Choices) Choices regarding the structure of contractual arrangements that confer decision rights regarding policies or assets

- **Flexible** (Consequences) Consequences that are sensitive to the choices that generate it
- **Rigid** (Consequences) Consequences that does not change rapidly with the choices that generate it

The origins of the Business Model Canvas (Osterwalder, 2010)

- Quite recently (2010) Alexander Osterwalder, in his book «Business Model Generation», developed a framework to represent the business model that goes under the name of Business Model Canvas.

- The canvas results from a deep academic investigation on the business model ontology (i.e. essential concepts and elements)

- However, it is presented in a unified, simple and intuitive way, that enables interaction and iteration, thus being significantly appealing for practitioners (e.g. entrepreneurs and managers)

- The Business Model Canvas is currently the most used tool for representing and implementing strategic decisions in both consolidated companies and startups.

The Business Model Canvas (Osterwalder, 2010)

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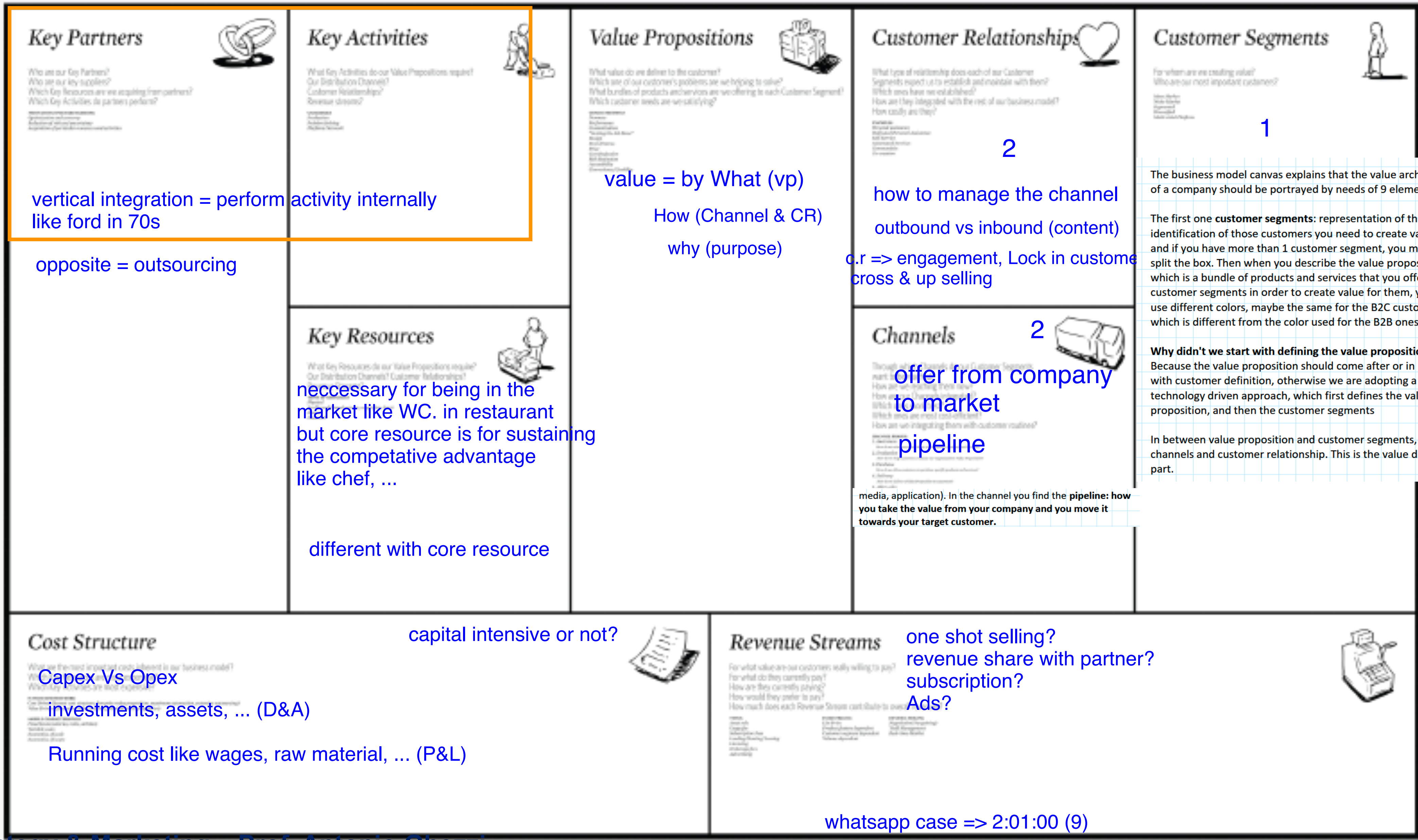


The business model canvas explains that the value architecture of a company should be portrayed by needs of 9 elements.

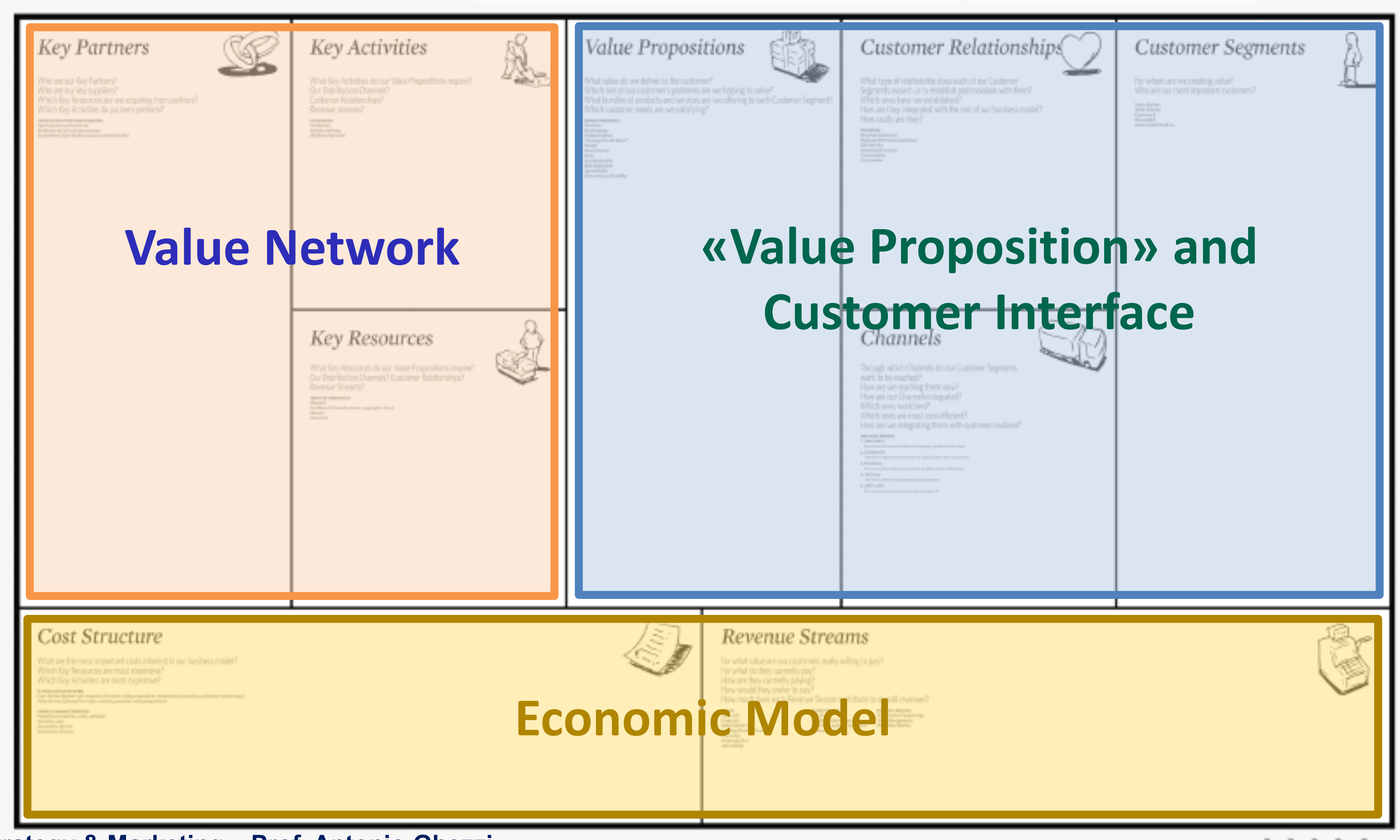
The first one **customer segments**: representation of the identification of those customers you need to create value for, and if you have more than 1 customer segment, you may also split the box. Then when you describe the value proposition, which is a bundle of products and services that you offer your customer segments in order to create value for them, you can use different colors, maybe the same for the B2C customers, which is different from the color used for the B2B ones.

Why didn't we start with defining the value proposition first ? Because the value proposition should come after or in parallel with customer definition, otherwise we are adopting a technology driven approach, which first defines the value proposition, and then the customer segments

In between value proposition and customer segments, we have channels and customer relationship. This is the value delivery part.

media, application). In the channel you find the **pipeline: how you take the value from your company and you move it towards your target customer.**

The Business Model Canvas: an aggregated view (1/2)



The Business Model Canvas: an aggregated view (2/2)

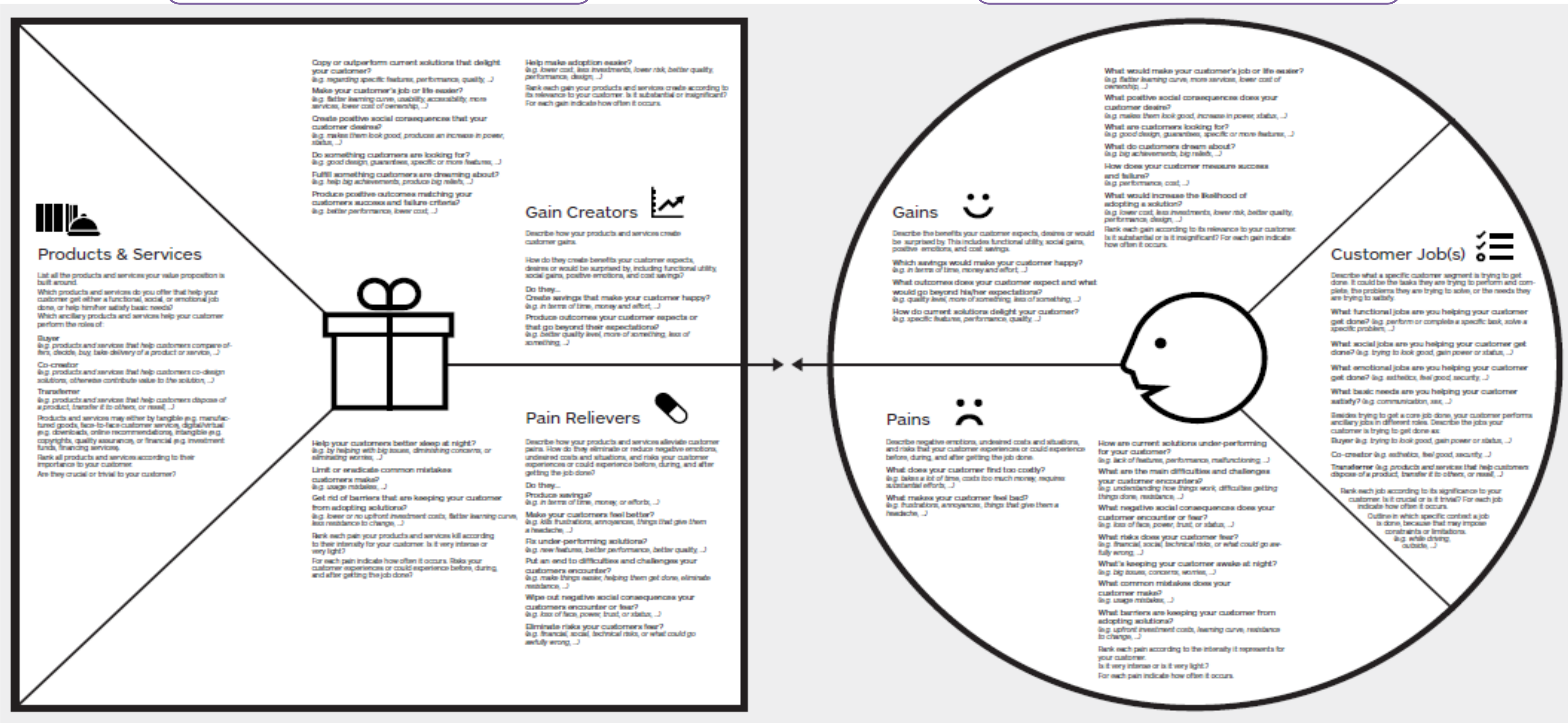
- **Value Proposition**: a selected bundle of products and/or services targeting a group of customers and satisfying well-defined needs
- **Customer Interface**: the channels through which we offer our value propositions to our customers and the types of relationships we entertain with our customers
- **Value Infrastructure**: the key activities, resources and suppliers/partners on which the value proposition is built
- **Value Monetization**: the revenue streams through which the company earns from its customers and the corresponding cost structure

The Value Proposition Canvas (Osterwalder, 2013) (1/2)

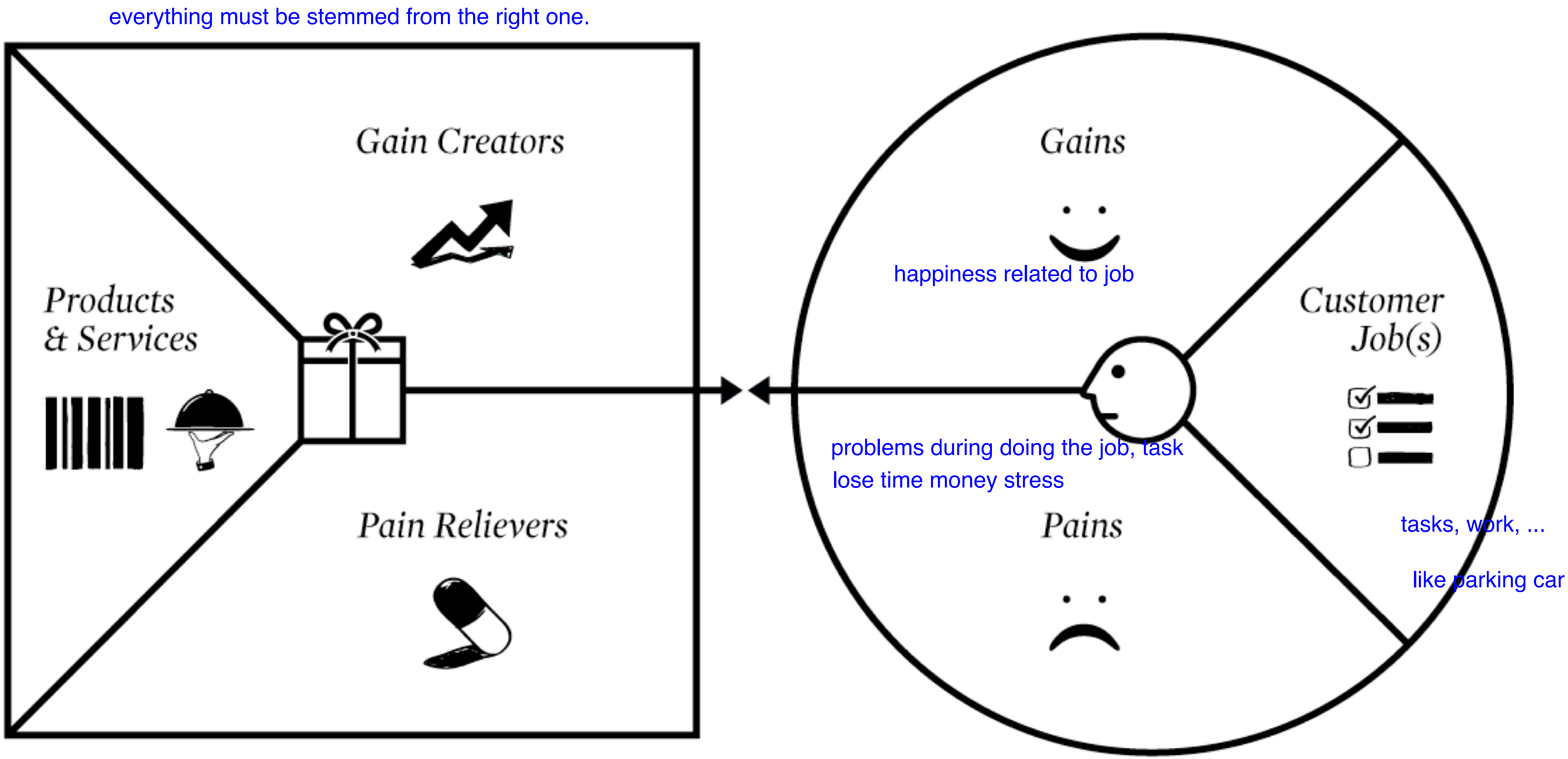
The **Value Proposition Canvas** makes explicit how you are creating value for your customers. It helps you to design products and services your customers want.

Value Proposition Map you can design

Customer Profile you can observe

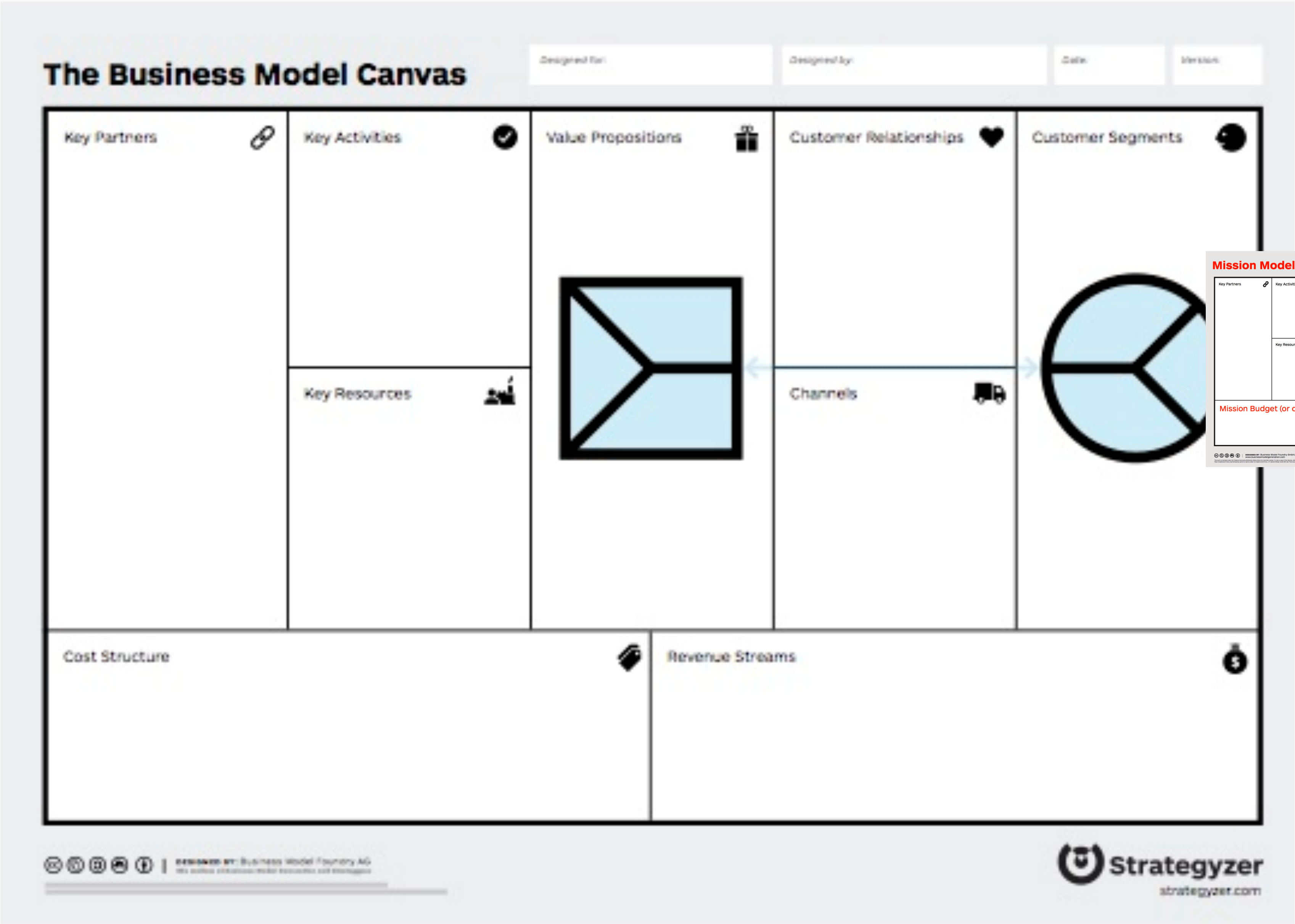


The Value Proposition Canvas (Osterwalder, 2013) (2/2)

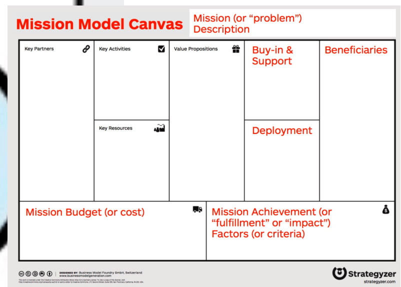


Feeding the BM Canvas with the VP Canvas

first VP canvas then the BM



The Mission Model Canvas is a tool that can help social impact firms and non-profits define their business model



The Business Model Canvas
The Building Blocks of a Business Model

A business model can be described by looking at a set of nine building blocks. To get a good picture of our business model we should describe our:

1. **Customer segments**: Our groups of customers with distinct characteristics.
2. **Value proposition**: The bundles of products and services that satisfy our *customer segments*' needs
3. **Distribution channels**: The channels through which we communicate with our customers and through which we offer our value propositions.
4. **Customer relationships**: The types of relationships we entertain with each *customer segment.*
5. **Revenue streams**: The streams through which we earn our revenues from our customers for value creating and customer facing activities.
6. **Key resources**: The key resources on which our business model is built.
7. **Key activities**: The most important activities performed to implement our business model.
8. **Partner network**: The partners and suppliers we work with.
9. **Cost structure**: The costs we incur to run our business model.

1. Customer Segments

- Customers are the heart of any business model. Successful companies know how to turn satisfied customers into revenue streams.

- A clear description and understanding of a company’s customers is an integral part of every business model.

- **Key Questions:**
  - Who do we create value for?
  - Do any of these customers merit to be grouped into a distinct category, because…
    - ·… we propose them a distinct offer?
    - ·… we reach them through different communication and distribution channels?
    - ·… we entertain different relationships with them (e.g. more personal)?
    - ·… they have a substantially different profitability?

2. Value Proposition

- The value proposition is the reason why customers turn to one company over another. It solves a customer problem or satisfies a customer need. Each value proposition consists of a selected bundle of products and/or services.

- Some value propositions may be innovative and represent a new or disruptive offer. Others may be similar to existing market offers, but with added features and attributes.

- **Key Questions:**
  1. What do we offer the market?
  2. What is the specific bundle of products and services you offer each of our customer segments?
  3. Which customer needs does each value proposition cover?
  4. Do we offer different service levels to different customer segments?

Factors enabling value creation

- Originality
- Performance
- Customization
- «Getting the job done»
- Design
- Brand/Status
- Price
- Cost reduction for the customer
- Risk reduction for the customer
- Accessibility
- Handiness

3. Channels

- A company reaches its customers through various communication and distribution channels. They represent the interface between a company, its value propositions and its customers.

- Communication and distribution channels have become increasingly important in business model design. For example, cost intensive channels should be used for very profitable clients, while unprofitable clients should be served through cost efficient channels.

- **Key Questions:**
  1. Through which communication and distribution channels do we reach our markets?
  2. How well does each channel work?
  3. How expensive or cost efficient is each of our channels?
  4. Through which communication and distribution channels do we promote and deliver each value proposition?
  5. Through which channels do we reach each customer segment?

Channels

- The direct (sales force, web) or indirect channels (owned dealers, dealer of partner, wholesalers) have different functions:
  - Create awareness of the proposal
  - Support the customer in the evaluation of the proposal
  - Allow the purchase of specific products/services
  - Get the value proposition to the customer
  - Support the customer in the post-sale phase

4. Customer Relationships

- Getting relationship management right in our business model is crucial today to satisfy customer's expectations. For instance, customers paying a high price for a product or service will expect a high touch relationship, while customers paying a cheap price do not expect more than automated, yet customized relationships.

- A sound business model has a clear strategy for customer relationship management for each customer segment.

- Key Questions:
  - Do we develop and maintain different types of client relationships in our business model (e.g. more or less intense, more or less personal)?
  - How resource intensive is each of these client relationship types in terms of time consumption and other costs?
  - For each client segment, which client relationship types and mechanisms do we develop and maintain?

Customer Relationship management

- Personal assistance
- Dedicated personal assistance
- Self-service
- Automated services
- Online community
- Co-creation

5. Revenue Streams

- If customers comprise the heart of a business model, revenue streams are its arteries.
- Revenue streams come from one or several segments of clients who are willing to pay for the value they get from our offer.
- These revenue streams come in the form of selling, lending, licensing, commissions, transaction fees or advertising fees.
- Key Questions:
  - What are our revenue streams?
  - What are the revenue streams from each customer segment and value proposition?
  - How much is each revenue stream's contribution to overall revenues in terms of percentages?

Examples of revenue streams

- Sell of products/services
- Usage fees
- Subscription fees
- Exclusive right of use for a limited time (renting)
- Licence
- Brokerage fees
- Advertising fees

6. Key Resources

- At the basis of every business model there is a set of key resources a company must dispose of to make its business model work.
- These key resources include classical ones such as human resources and tangible assets. Increasingly, business models are also built on intangible assets that are difficult to quantify, such as brand equity and expertise of a specific domain.
- Key Questions:
  - What are the key resources we rely on to run our business model?
  - How does each of these resources relate to our value propositions and their corresponding customer segments, channels and relationships?

7. Key Activities

- To implement a business model a company needs to perform a number of key activities. It may perform these activities itself or get them done through a network of partners.

- Key Questions:
  - What are the main activities we operate to run our business model?
  - On which key resources do they rely?
  - To which value propositions, channels or relationships do they contribute?

8. Partner Network

- Today's Business Models are more and more the result of a network of partnerships, joint ventures, cooperation and alliances between different companies.

- Every company must ask itself if and how it can leverage its own business model by partnering with other companies. This includes the question of what a company wants to do by itself and what it wants to do with partners. It also includes the question of levering one's own value proposition by combining it with the value proposition of strategic partners.

- Key Questions:
  - Which partners and suppliers do we work with?
  - Which key resources do they relate to?
  - To which value propositions, channels or relationships do they contribute?

9. Cost Structure

- The cost structure is a direct result of all the other building blocks of the business model. Ideally costs should be traceable back to each business model block.

- Key Questions:
  - What are the most important cost positions in our business model?
  - Can the cost positions be easily connected to a business model building block?
  - Can costs be calculated for each customer segment?

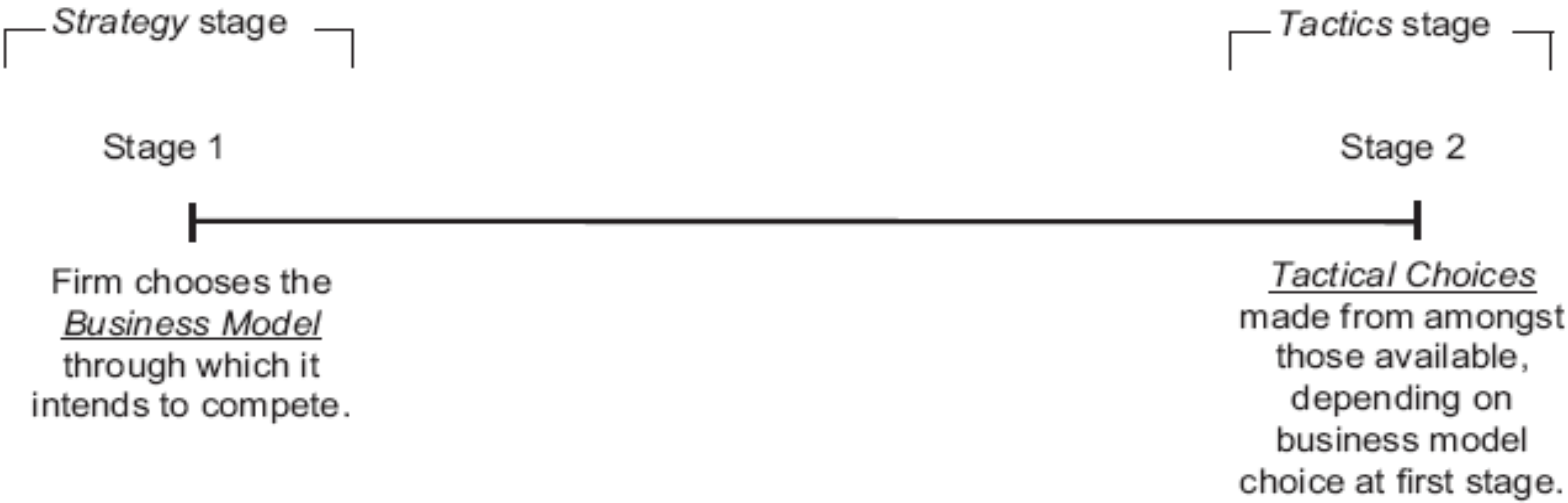
Task:

Design a Business Model Canvas for

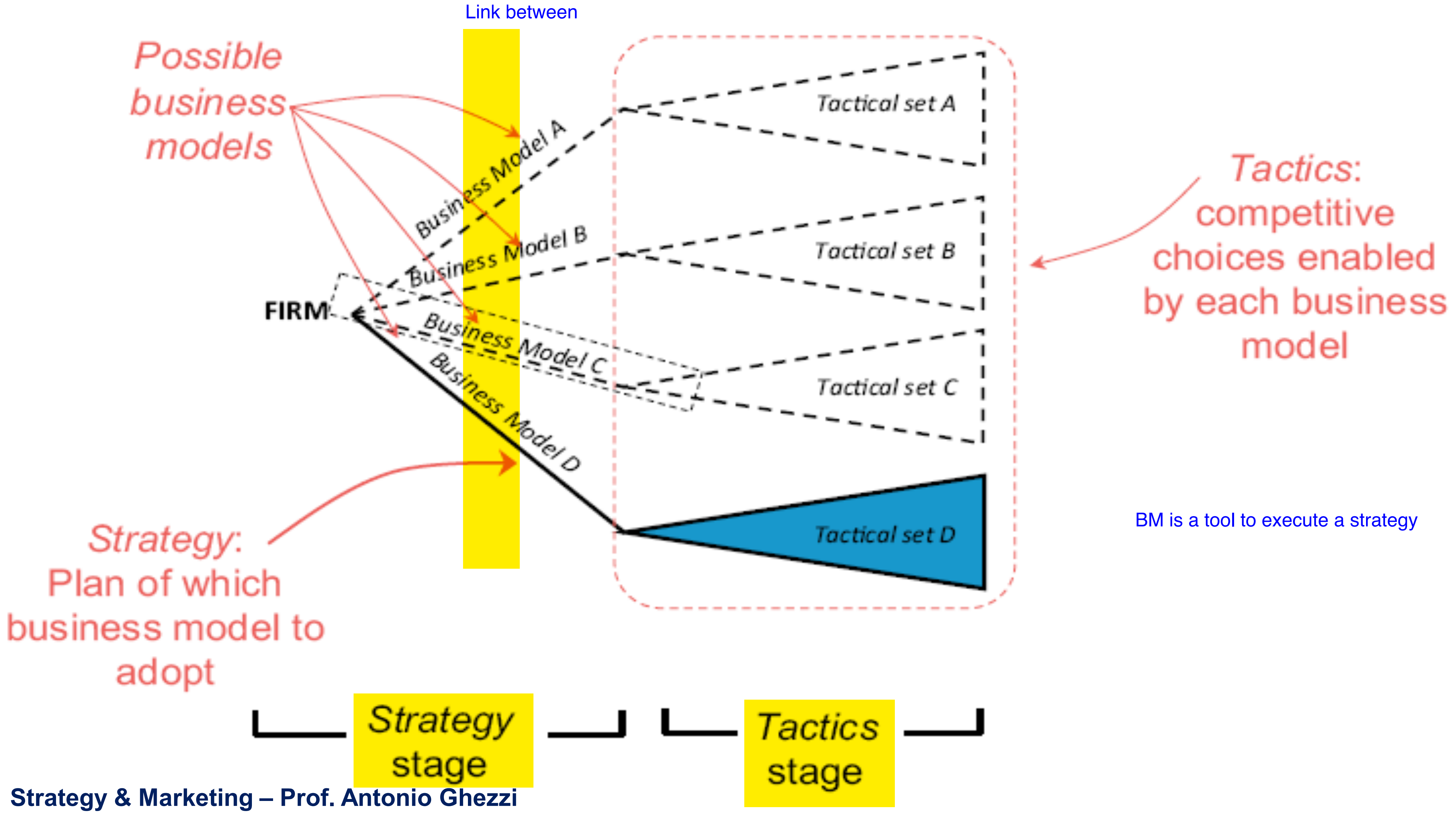
Whatsapp

Business Model, Strategy & Tactics relationship

Generic two-stage competitive process framework (Casadesus-Masanell and Ricart, 2010)



Strategy, Business Model and Tactics (Casadesus-Masanell and Ricart, 2010)

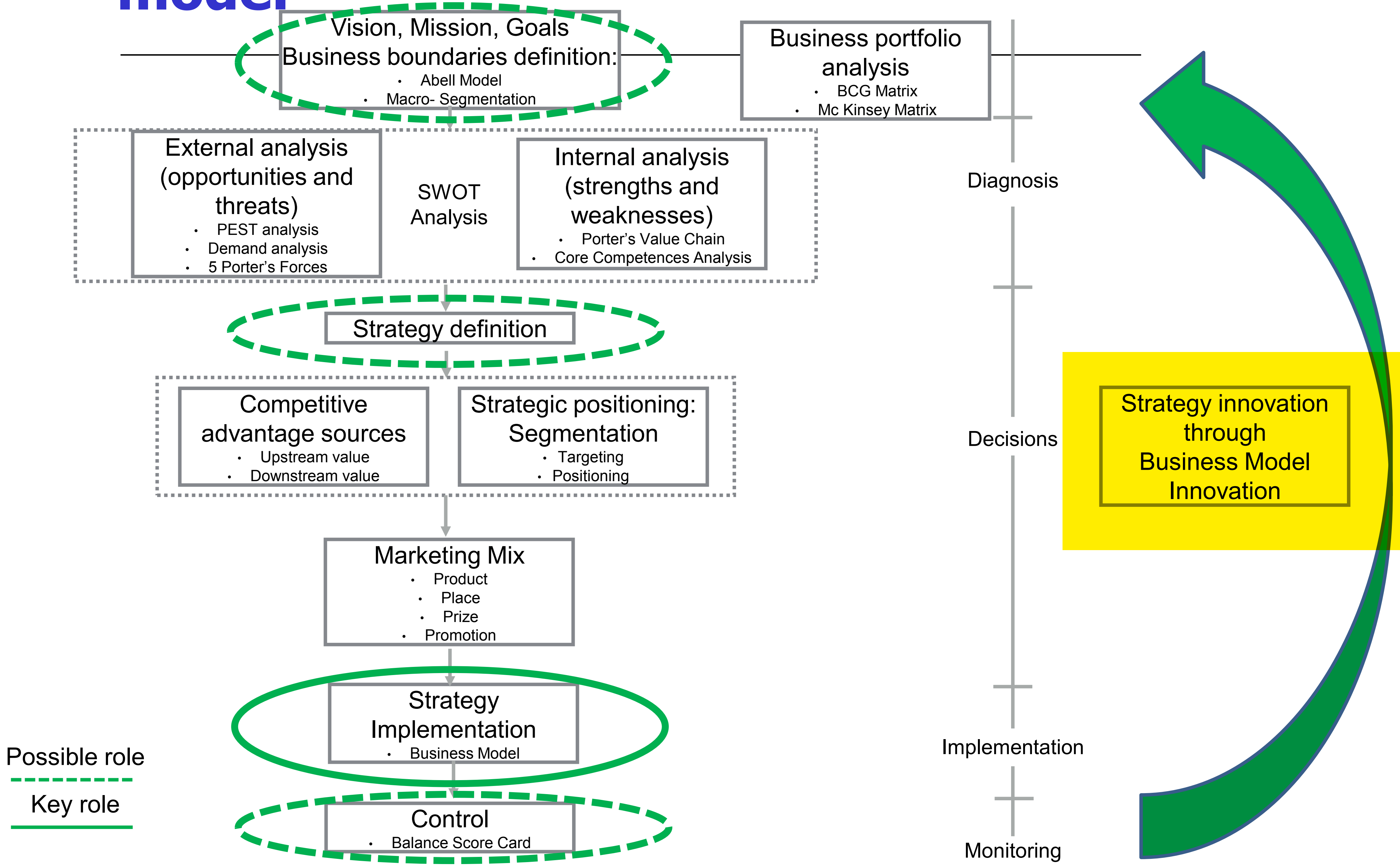


BM is a tool to execute a strategy

Business Model vs. Strategy
What a business model is and is not (Ghezzi, 2014)

Table I	What a business model is and is not
What a business model is	
Instrument to concretize a business idea, getting it down to earth, thus constraining entrepreneurial creativity in a usable model	
Checklist to address the "what did I forget about" and "what's next" in early entrepreneurial agendas	
Organized construct revolving around the concept of value proposition, to imprint the notion of value creation and value capture in a company's overall business strategy	
Model to support the execution and implementation of the business strategy	
Model to enable strategic innovation–either incremental or radical–through Business Model Innovation, i.e. applying changes to the business model's building blocks of value proposition, value infrastructure and value formula (revenue streams and cost structure)	
What a business model is not	
Instrument for business planning	
Instrument for external market attractiveness analysis	
Instrument for in-depth internal core resources, competencies and dynamic capabilities assessment	
Instrument for comprehensive and holistic strategy formulation	
Instrument for strategy monitoring and performance measurement	
Substitute for strategy	

Strategy formulation and business model



Strategy formulation and business model

- Steps of a strategy formulation process that integrates the business model (Ghezzi, 2014):

  1. sharpen your generic business idea through a **preliminary business model**;
  2. define your business' industry foresight, strategic intent and goals;
  3. perform a SWOT strategy analysis;
  4. assess alternative strategic decisions that lead to many **possible business models**
  5. formulate your strategy (differentiation/cost leadership/hybrid) through a set of consistent strategic decisions **embodied in a business model**;
  6. <u>Execute and implement your strategy through a **detailed business model**</u>;
  7. control your strategy by controlling and monitoring **business model performance**;
  8. innovate and experiment on your strategy through **business model innovation**.

Business Model Innovation

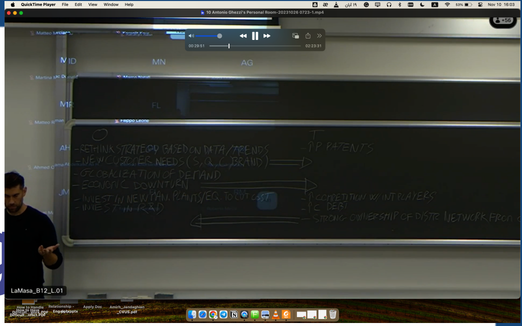
- Business models are enablers to achieve successful innovations, and hence business models themselves became **subject to innovation**.

- Companies started to realize that in response to **changes** in their environment, even a successful business model is never a permanent given (Chesbrough, 2007; Lindgardt et al., 2009). Rather, firms are required to **reconsider their established models** (Chesbrough, 2010) – either in response or pro-active anticipation of changes in their environment.

- **Business model innovation** thereby goes far beyond **isolated product, service or technology innovation** (Lindgardt et al., 2009). It captures the innovation of at least one of its constituting elements including its value proposition, its value infrastructure, or revenue model and thereby provides a firm with potentials like the activation of overlooked value sources within the company or the creation of novel systems that are difficult to imitate (Amit, Zott, 2010).

- **Business Models hence represent the new focus of strategic innovation**

O:
- rethink strategy based on data and trend
- raise of customer needs through customization, Y, Z
- globalization (international Market)
- Economic downturn is T for everybody
- cut cost and insource in company
- Brand image is growing important
-



Strategy & Marketing

T:
- Price of patent are increasing
- increasing competition with international
- cost of debt increasing

DEVICES CASE (Exam simulation)

we are missing perspective! External analysis is not about the Device! (Average market player). it is not our opportunity! it is right in the market

what devices can do is Strategic alternative

sometime we may have something in both side! like globalization! in this case
the O is globalization of demand and T is globalization of players

Prof. Antonio Ghezzi

you are focused on cost, now they want to go to differentiation.
So change the market, expand, reposition this current business model (money to invest to get patents)
invest to dedicated network

you start to take control of value chain with vertical integration (in this example we addressed downhill and uphill value)
but capital expenditure is high

they can update their business model with these new information:
Cutomers: today are italian with low cost =>> high cost, international, e-commerce
channel :
C R: enagamaent, b2b expenses, ... they sell to distributor (decrease margin but no risk, or selling through them)
VP=> high cost high sevice high personaliztion

now they are low capital intesitve, but in vertical integration they increase

«DEVICES» CASE (1/2)

- The company DEVICES operates in the Italian market for consumer electronics, where it has always been aiming at obtaining high profits thanks to the efficient management of distributors and the optimization of production processes.
- The company's core business lies in offering a selected range of products based on technology patents acquired from external suppliers. DEVICES then assembles components bought by Far East suppliers and creates a "no frills" design and packaging; its products are often similar to those of competitors, although positioned on the low-end market.
- The products sold are characterized by simple functionalities and a clear focus on reliability and easiness of use; product commercialization is performed by means of a network of multi-brand resellers, not directly controlled by DEVICES.

Cost leadership !!!

«DEVICES» CASE (2/2)

- Although DEVICES had been enjoying earnings and profits for years, its performance dramatically dropped in the last two quarters. Worried by this negative result, DEVICES' Management team gathered unstructured information and data relevant to the company and its business area.
- The information collected showed that because of the economic downturn Italian firms are forced to bear high costs to acquire external sources of capital; however, DEVICES possesses high liquidity, which grants it a certain degree of financial flexibility.
- The acquisition cost for technology patents is constantly growing, and several competitors decided to internally invest in research & development in order to reduce their dependence from suppliers. Competitors' expenditures in Marketing and promotion are also quite high, while DEVICES saves a lot on Marketing (considered a not significant activity).
- The average customer is growingly showing to appreciate products characteristics like personalization, quality and brand image, and thanks to the globalization of markets is often shifting its preferences toward international suppliers of consumer electronics whose brand is strong. The average customer also shows to appreciate pre/post-sales services and assistance (and because of this, some competitors are developing proprietary distribution networks).

«DEVICES» CASE: QUESTIONS

1. On the basis of the information gathered by the Management team, how would you analyze DEVICES' current situation? Which strategic considerations would you draw? internal analysis & External an. => running SWOT you should leverage models and tell why you chose that

2. How would you map DEVICES' current Business Model?

3. How could DEVICES formulate (or reformulate) its Business Strategy consistently with the emerging trends?

4. How could DEVICES redesign its Business Model and align it with its reformulated Business Strategy?

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DI MILANO

Strategy Advance

Blue Ocean Strategy

an approach to stimulate strategic innovation
how? through strategic innovation through redefining source of competitive advantage.
to exexcute strategic innovation you need to change the B.M.

Antonio Ghezzi

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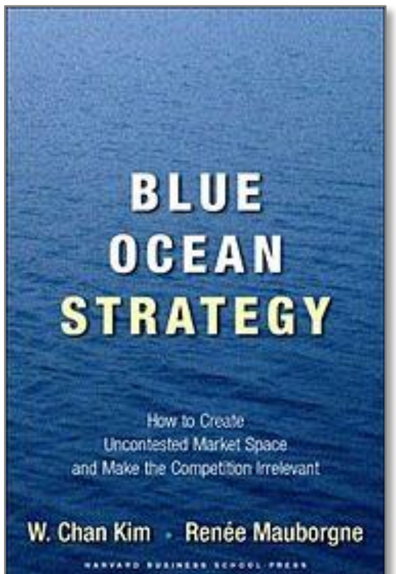
Blue Ocean, from INSEAD … to the Globe



Blue Ocean Strategy (BOS)

Look for new markets/industries; existing competitors not relevant

Aim at developing products/value propositions targeted to the largest possible audience

Mainly visual approach to stimulate creativity and alignment

Focus on some "simple" tools to support the identification of potential innovation

BOS is considered the alternative/complementary approach to Porter's

Red Oceans and Blue Oceans

- Red oceans represent all the industries in existence today - the known market space. In red ocean industry boundaries are defined and accepted, and the competitive rules of the game are well understood. Here, companies try to outperform their rivals in order to grab a greater share of existing demand

try to capture new demands

- Blue oceans denote all the industries not in existence today - the unknown market space, untainted by competition. In blue oceans, demand is created rather than fought over. There is ample opportunity for growth that is both profitable and rapid

The origins of a blue ocean

it's not about technology

in blue ocean reinvent the way customer perceive value

- In a few cases, companies can give rise to completely new industries (as eBay did with the online auction industry)

usually we have a existing market

- But in most cases, a blue ocean is created from within a red ocean when a company alters the boundaries of an existing industry (as Cirque du Soleil did with the circus industry)

- It is not about technology innovation. Blue oceans seldom result from technological innovation. Often, the underlying technology already exists - and blue ocean creators link it to what buyers value

A new way to make competition irrelevant

Blue Ocean Strategy, a fancy "concept" …
…not easily put into practice!

RED OCEAN STRATEGY (Competitive Strategy)	**BLUE OCEAN STRATEGY**
Compete in existing market space	Create an uncontested new market space
Beat the competition	Make the competition irrelevant
Exploit existing demand	Create and capture new demand (hidden or even not existing)
Make the value/cost trade-off	Break the value-cost trade-off (seek greater value to clients and lower cost simultaneously)
Align the whole system of company's activities with its strategic choice of differentiation ***or*** low cost	Align the whole system of company's activities in pursuit of differentiation ***and*** low cost

in exam

The standard implementation process: 4 steps

in exam

step 1 & 2 => like external analysis

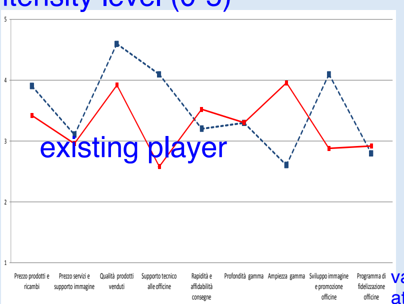
What do customer look for when the pay?
Car: price/performance/safety/design/...

you have to identify a given market which you want to analyzw, which is a red ocean and you want to turn it to blue ocean

1. Strategic Curves, As-Is

1.1 As-Is Value Curves (and tag-lines)

intensity level (0-5)



value attributes

- *So what?*
- *Strategic insights*

qualitative to addadi:
sentiment analysis
focus group
interview with manager

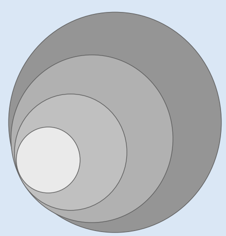
2. Brainstorming, through BOS

after listing value drivers

2.1 6 Innovation Paths

- Industry
- Strategic Groups
- Buyer Groups
- Look across time
- Scope of product/ service offering
- Functional-emotional orientation of the industry

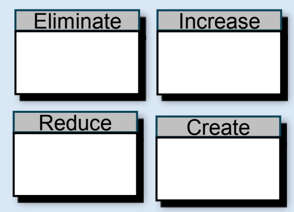
2.2 Non-Clients' Framework



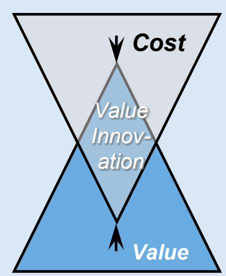
Clients / Non-Clients Frustration analysis

3. Re-creating the Value Curves

3.1 4 Actions framework

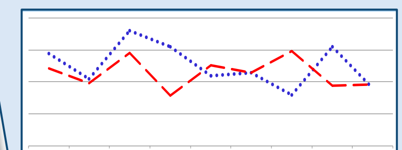


3.2 Profitable Growth Equation

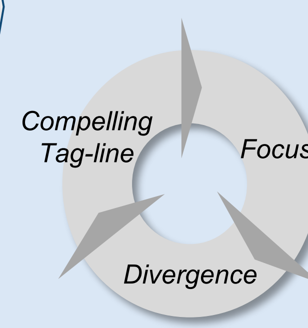


4. New, Blue Ocean, Strategy

4.1 To-Be Value Curves (and tag-lines)



4.2 "Robustness" test



On field analyses (interviews, workshops…)

perspective is customer!

How to map the AS-IS Value Curve

1 ***How to define the value curve?***

Definition of Industry **Clients**

Identification of the **value attributes** within the Industry

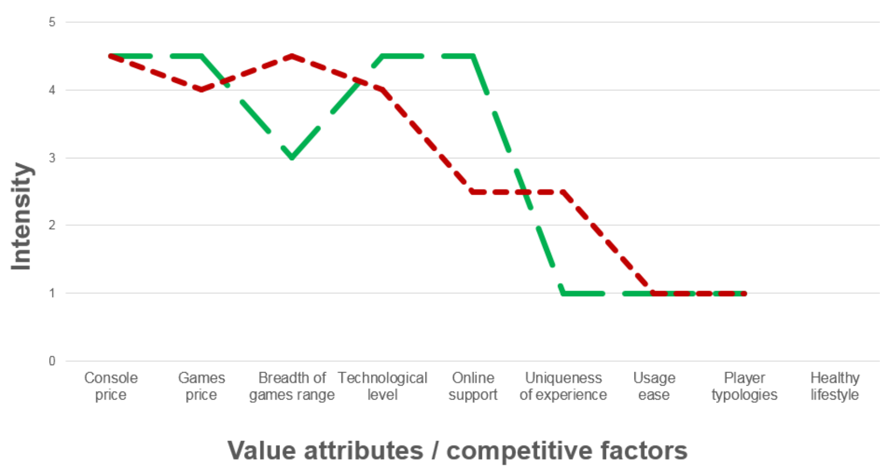
Integration and **elimination** of **attributes**

Identification and **positioning** of the **strategic groups**

AS-IS VALUE CURVE DESIGN

How to identify the Value Attributes?

2



How to properly identify the Value Attributes

Two important features:

Representing an investment / cost for the Industry / Co.

- They need to have a **financial** or **managerial impact** (e.g. dedicated time, focus, …) on the Company
  - E.g. not "*brand*" but "*marketing above the line*"

Recognized and valued by Clients

- **Clients** have to assign a **value** to the attribute
  - Not an internal factor, but a perceived benefit
  - E.g. not "*know-how*" but "*tailor made solutions*"

Furthermore …

- **Valid for the whole industry**
- **Limited** in number (e.g. not more than eight), to enable a proper focalization
- **Gullible** by the **actions** of a company

Clear, simple, but also sufficiently specific (e.g. not "quality" but "quality of the product related to the packaging")

6 “Innovation Paths”: think beyond competition

1. Industry	Look across alternative industries and evaluate opportunities *e.g. Cirque du Soleil, Nintendo WII*
2. Strategic groups [(1)]	Look across strategic groups (reasons for clients’ choices) *e.g. Retail outlets, H&M “mastige”* similar competitor
3. Buyer groups	Focus on direct clients and clients’ client. Look at all steps of the value chain. *e.g. Bloomberg, Pharma/MD firms* segmentation
4. Product / service offering	Look beyond your product, developing global solutions (product & service). *e.g. Pre-cooked food, office printers* compementro products coffee and sugar
5. Functional-emotional	Re-think the “functional-emotional” orientation *e.g. Swatch, Accor Formule 1*
6. Look across time	Participate in shaping external trends over time *e.g. Apple I-tunes, Cisco*

The 6 “Innovation paths” enhance strategic “lateral thinking”

1. This terminology refers to groups of companies, within the same industry, which follow the same market/product strategy. Strategic groups generally have different positioning on price/quality

The 6-paths framework

Innovation paths (1/2)		
Industry	• Which are the industries that satisfy the same needs? Or complementary needs? • On which features does the company need to focus, in order to get closer to these other sectors?	
Strategic groups	• Which are the drivers that bring the clients to the decision of buying our products / services or to "differently" satisfy the same need?	
Buyer groups	• On which buyer groups does the current market focus? Direct clients or clients' client? • Which type of values can be created, by a shift of the purchase decision?	

The 6-paths framework

Innovation paths (2/2)		
Scope of product / service offering	• How does the product / service fit in the adoption experience of the customer? What happens before and after the usage? • Is it possible to add complementary products / services? • Is it possible to shift the focus towards the service or towards the product?	
Functional / emotional orientation	• If the competition is concentrated on the functional (emotional) appeal, which emotional (functional) elements could be integrated?	
Look across time	• Which trend will most probably hit the sector? • What does the endless extrapolation of this trend imply? • How is it possible to exploit this trend?	

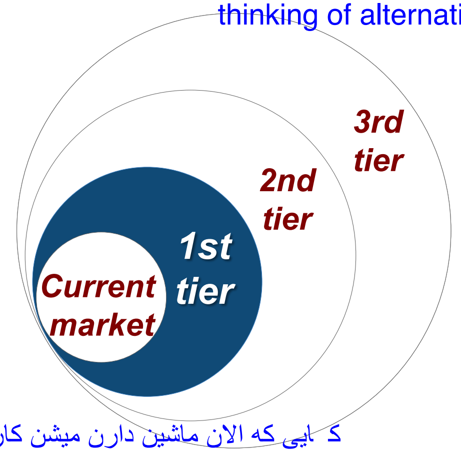
Leverage on non-clients' latent demand

not compeletly blue! orange-ish

"Soon-to-be" non-clients

(unsatisfied, occasional or unfaithful)

thinking of alternatives



ک ایی که الان ماشین دارن میشن کارنت مکارت

bloody competition ocean

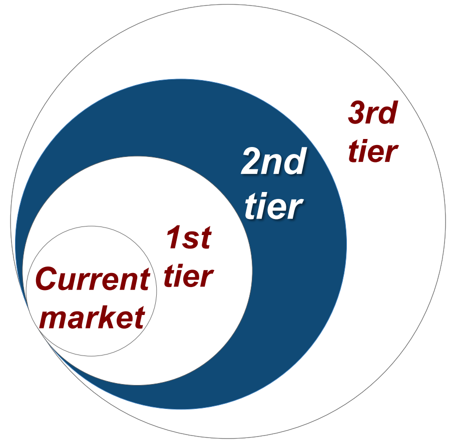
- Investigate **key clients´ frustrations**
- Spend **a day in the life** of the **clients** to "understand"
- Find key **commonalities** across **current market** and **first tier** and build on insights

not thinking of the product because of bariers of adoption

blocked!

"Hindered" non-clients

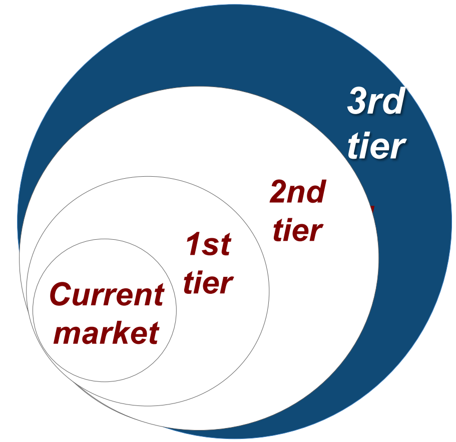
(potential clients who don´t buy for different reasons)



- Identify and **eliminate adoption barriers**:
  - Financial (e.g. spending, credit, etc.)
  - Functional (e.g. user-friendliness)
  - Educational (e.g. lack of training)
  - Perception / knowledge (e.g. clients don´t know the existence)
  - Geographical (e.g. distribution)

"Unexplored" non-clients

(other markets)



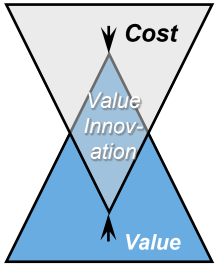
- **Remove long-held assumptions** on Clients behavior and on the fact that some markets only belong to certain specific industries

Reducing costs while boosting client value

The "4 actions" framework

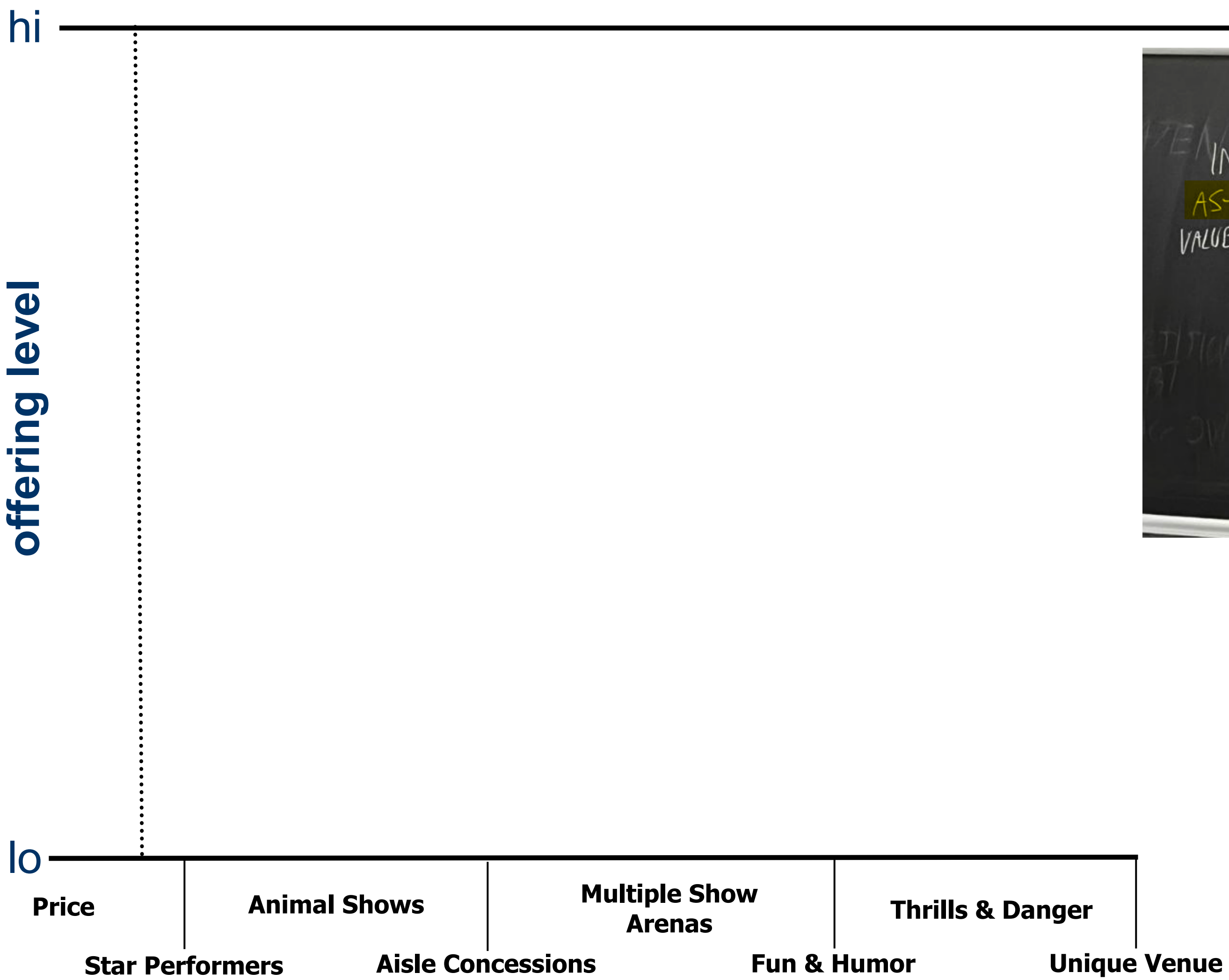
Eliminate	Increase
Which of the factors that the industry takes for granted should be eliminated?	**Which factors should be increased well above the industry standard?**
Reduce	**Create**
Which factors should be reduced well below the industry standard?	**Which factors should be created that the industry has never offered?**

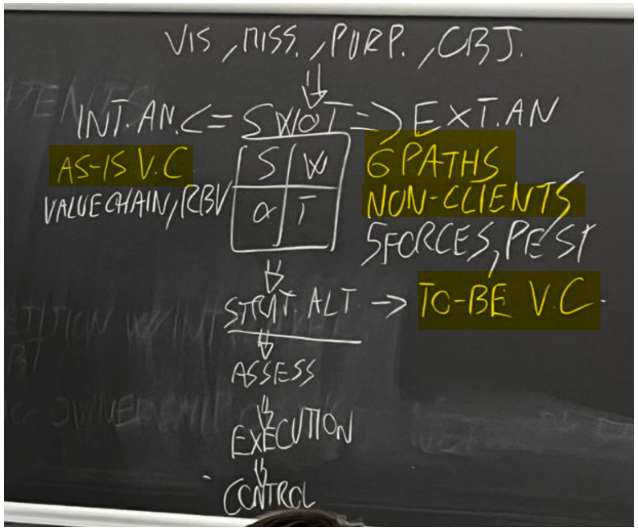
Value innovation: the cornerstone of BOS



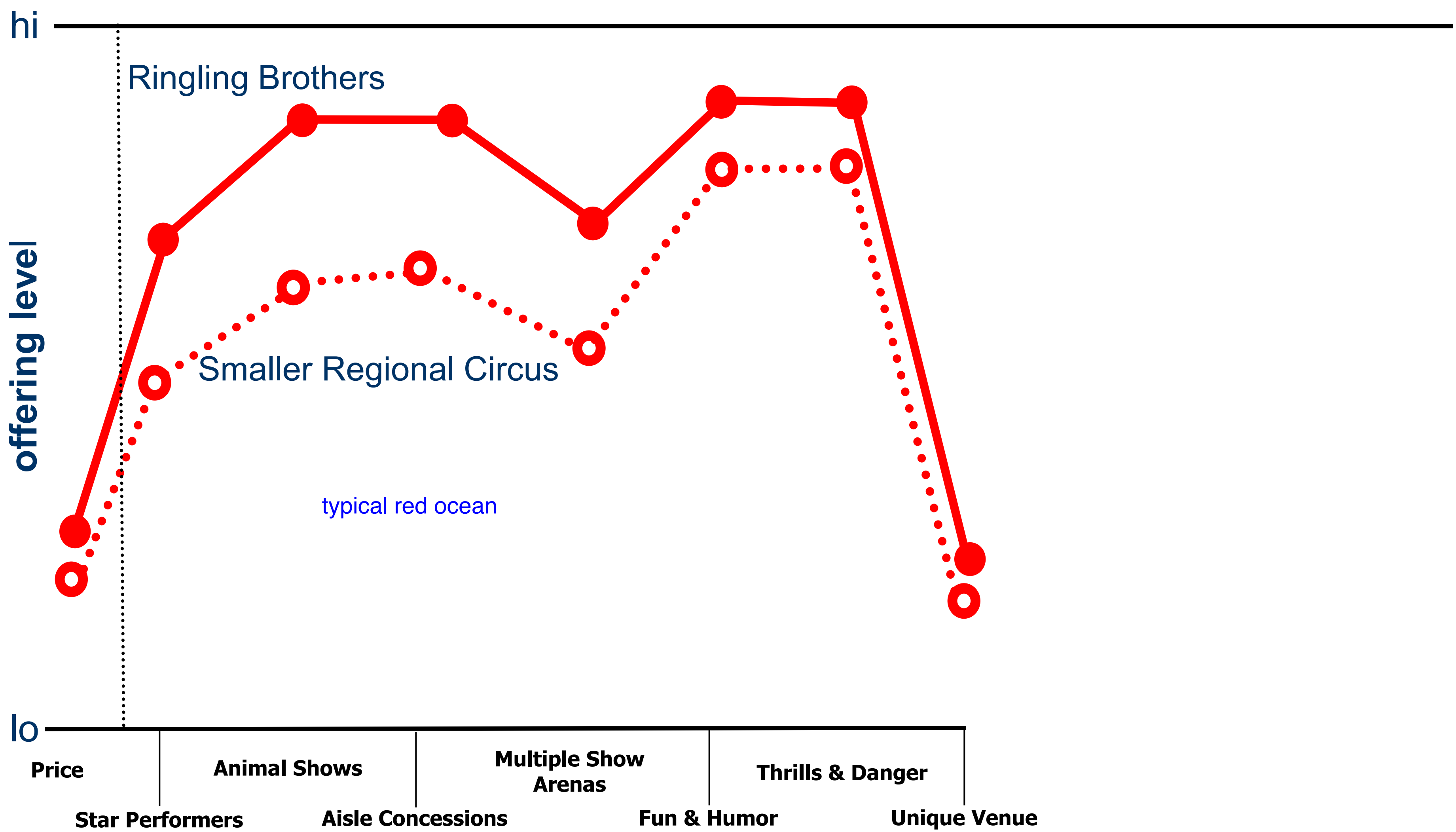
- **Value Innovation** is created in the region where a company's actions favorably affect both its **cost structure** and its **value proposition to buyers**
- Cost savings are made by **eliminating** and **reducing** the factors an industry competes on.
- Buyer value is lifted by **raising** and **creating** elements the industry has never offered.
- Over time, costs are reduced further as scale economies kick in due to the high sales volumes that superior value generates.

Drawing a to-be value curve with the Blue Ocean Strategy canvas





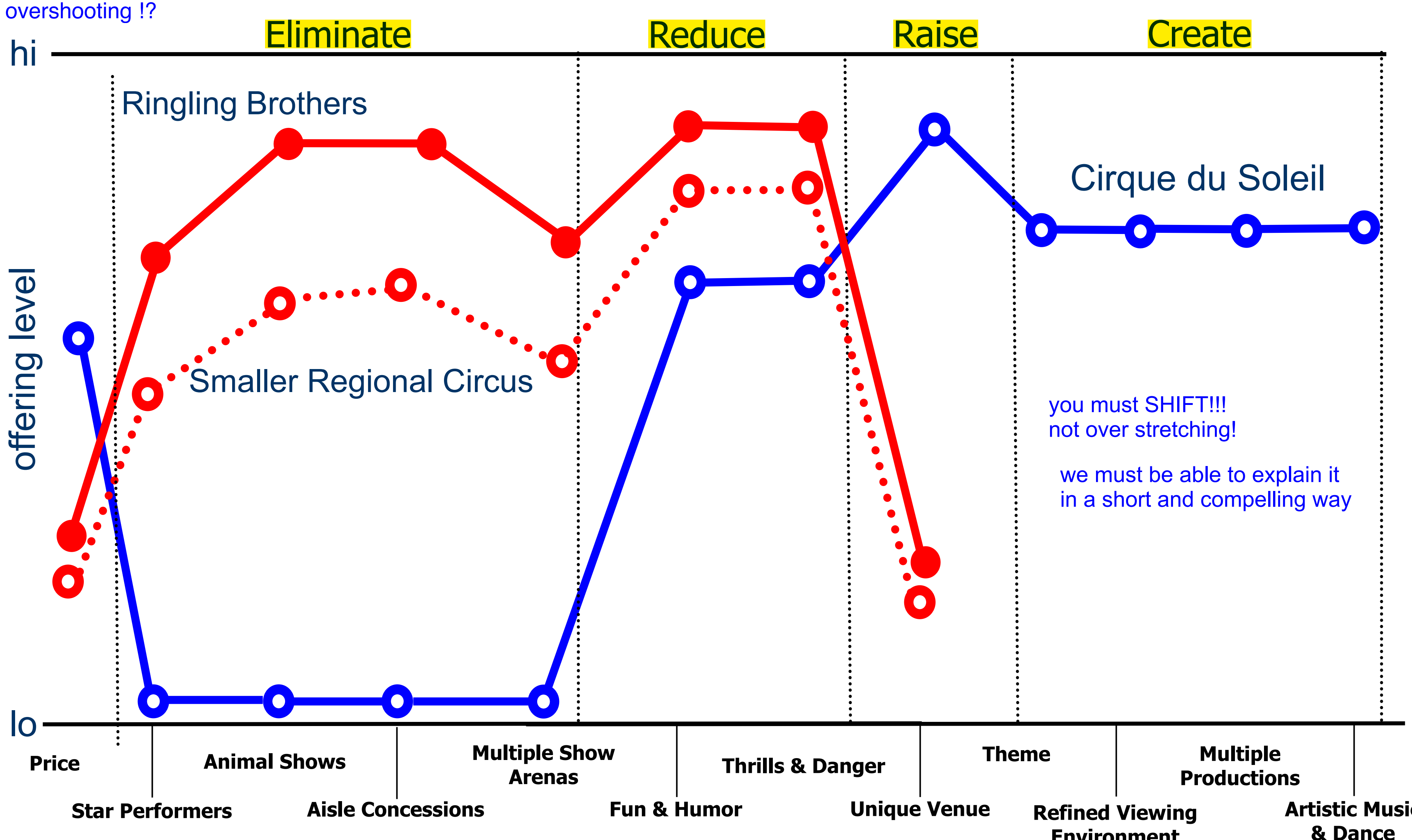
Drawing a to-be value curve with the Blue Ocean Strategy canvas



Drawing a to-be value curve with the Blue Ocean Strategy canvas

باید دوتای اول رو داشته باشیم تا بتونیم فضا برای دوتای اخر ایجاد کنیم
ری ورس اضافه میکنیم اگر چیزی اضافه نکنیم داریم یه مدل گرووووون دیفرنشین ایجاد میکنیم.
overshooting !?

four actions framework



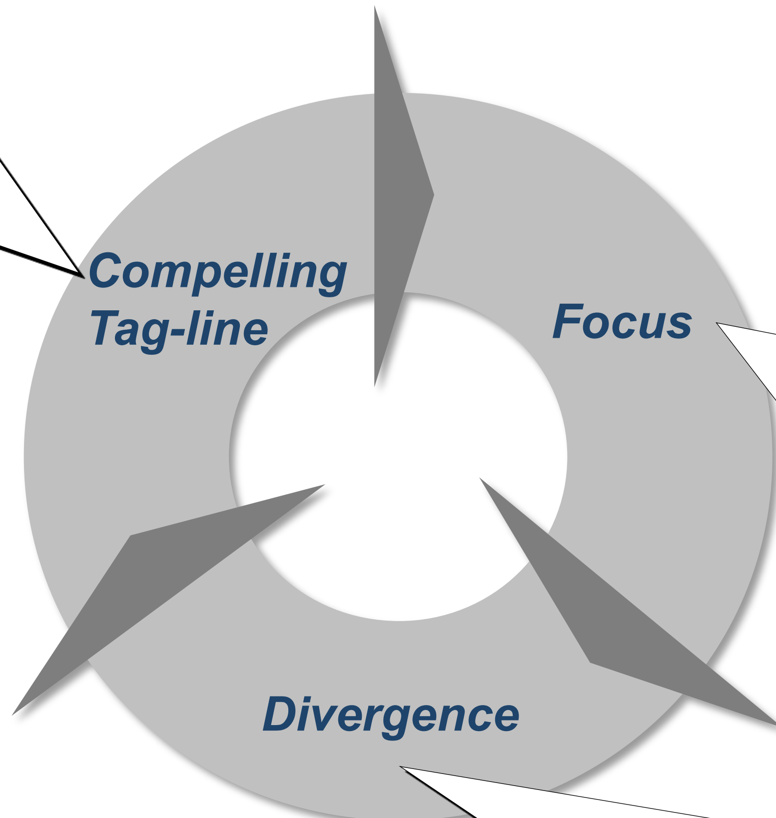
you must SHIFT!!!
not over stretching!

we must be able to explain it
in a short and compelling way

Three tests for a good Value Curve

new position, short tagline

- The tag-line is the ***motto*** that synthesizes the strategic profile
- A good strategy has a **clear-cut** tag-line (**as 20 words**)
- Can / should be effectively **communicated internally and externally**



- A winning strategy has to focus on a **narrow number of key value attributes**
- The firm should not follow other players on each competitive factor, thus avoiding a head-to-head competition

- A "Blue Ocean" Value Curve always **stands apart and diverges from competitors**
- A divergent Curve indicates an innovative strategic profile **beyond the competitive boundaries of the industry**

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Blue Ocean Strategy Institute

The Marvel Way:

Restoring a Blue Ocean

08/2016-6205

This case was written by Michael Olenick, Institute Executive Fellow at the INSEAD Blue Ocean Strategy Institute, under the supervision of W. Chan Kim and Renée Mauborgne, Professors at INSEAD. It is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

Additional material about INSEAD case studies (e.g., videos, spreadsheets, links) can be accessed at cases.insead.edu.

After *Iron Man* smashes his way to victory the credits roll. For those who linger the movie unexpectedly starts again and Tony Stark arrives home to find a stranger wearing a leather jacket and an eye patch in his living room.

"You think you're the only superhero in the world?" asks the man. "Mr. Stark, you've become part of a bigger universe. You just don't know it yet."

"Who the hell are you?" asks Iron Man Stark.

"Nick Fury," answers the man. "Director of S.H.I.E.L.D."

"Huh?" shrugs Stark.

"I'm here to talk to you about the Avenger initiative."

This roundabout announcement – that Marvel intended to recreate their epic *Avengers* storyline in a future series of Marvel-produced movies – was arguably more exciting to Marvel fans and investors than the blockbuster movie itself. "Seeing Sam Jackson with the eye patch telling [Iron Man actor Robert Downey Jr.] about the Avengers initiative made the hairs on my arms rise," wrote a Marvel fan on Reddit. Marvel investors should have been equally intrigued by the roundabout announcement of a major strategic pivot.

Marvel, which struggled to make payroll just a decade earlier, went on to unlock a blue ocean of moviemaking that has yielded more revenue and profit than any film franchise in history.

Marvel's Early Years

Founded in 1939 by Martin Goodman, Marvel[1] has seen a cast of heroes, villains, and events that rival anything found in their comic books. Goodman produced pulp fiction, magazines, and comic books and his strategy was straightforward: create many titles then, "If you get a title that catches on … add a few more; you're in for a nice profit."[2] Goodman's motive was purely financial, but over the next few decades, his company would go on to create over 8,000 characters in what became arguably an American version of Homer's *The Odyssey* and *The Iliad*.

During the 1940s, the comic book industry thrived, filling the entertainment space now saturated by children's television programming, games, websites, smartphones, and all other manner of media. Besides the iconic *Captain America* – created for WWII – most Marvel titles of this era were thin knockoffs of the more popular DC Comics, home to *Superman*, *Batman*, and *Wonder Woman*.

Except for a short time after the war,[3] business boomed until, in 1954, squirrel-faced psychiatrist Dr Frederic Wertham testified to the Senate Subcommittee on Juvenile

1 In the early years the business that would come to be named Marvel had many names and corporate shells. For clarity we refer to these collectively as Marvel.
2 Howe, Sean (2013-10-01). *Marvel Comics: The Untold Story* (p. 10). HarperCollins. Kindle Edition.
3 In 1949, during the post-WWII recession, economics forced Marvel editor Stan Lee to layoff virtually the entire comic book staff. Many were rehired when the business rebounded.

Delinquency that comic books were linked to teenage pregnancy and homosexuality. "I think Hitler was a beginner compared to the comic-book industry!" testified Wertham to the US Senate during a two-day hearing.[4] Comic book sales plummeted[5] and the industry created a self-censorship organization, the *Comics Code Authority*.

Marvel's First Blue Ocean

Before Wertham there were five major comic book publishers. By the time comic book hysteria subsided only two were left, Marvel and DC Comics.[6] Vying to compete by controlling retail shelf space, DC purchased Marvel's distribution arm and limited the number of books that Marvel could distribute each month. Marketing low-cost me-too knockoffs targeted towards children would not sustain the business in this environment: Marvel needed to attract *noncustomers*.

Marvel's as-is strategy – delivering little original work and me-too knockoffs – no longer worked. Faced with red ocean competition that threatened to shutter the comic book division Marvel adopted a new strategy: original content aimed at an older demographic, college students. From 1961 to 1965 Marvel Editor-in-Chief Stan Lee, along with comic book legends Jack Kirby, and Steve Ditko, delivered a multi-year burst of creativity creating a new blue ocean.[7] Rather than copying DC's traditional macho crime fighters many Marvel characters start as ordinary people and are transformed, oftentimes by accident, into reluctant superheroes.

In 1961 Marvel introduced four ordinary people mutated by cosmic rays into superheroes, the *Fantastic Four*. After the *Fantastic Four* came *The Incredible Hulk*, a quiet scientist who morphs into a ferocious green monster when angered. *Thor*, a God who visits earth as a superhero, was introduced soon after. *Ant-Man*, the reformed thief who changes size, came next. In June 1962, Steve Ditko introduced the world to a teenager, bitten by an irradiated spider, who develops spider-like abilities, *Spider Man.* Next came an alcoholic womanizing military contractor with a bad heart who builds a high-tech metal suit to fight bad guys, *Iron Man*.

Not long after this burst of creative output Lee and his team decided to bundle their superheroes into a group called *The Avengers*. At the same time they created another group of entirely different characters, ordinary people endowed with extraordinary powers and distrusted by the unenhanced they lived amongst, *The X-Men*.[8]

---

4 Wertham released his book, *Seduction of the Innocent* – which argued comic books were tied to juvenile delinquency – days before the Senate hearing.

5 In 1956 Lee again had to fire his entire staff.

6 EC Comics produced, depending upon one's vantage point, either the edgiest or most inappropriate comics and refused to submit their work to the censor. EC closed as a comic book publisher but went on to reinvent the business, publishing *Mad Magazine*, since magazines were not subject to censorship.

7 Lee served as editor-in-chief and lead storywriter.

8 Countless other characters would be introduced during this period, including *The Human Torch*, *Dr Strange*, *Thor* enemy/brother *Loki*: Lee's prolific team created literally thousands of different personalities. Eventually they would re-introduce the only 1930s Marvel superhero into the modern fold, *Captain*

"We were trying to reach a slightly older, more sophisticated group," Lee wrote.[9] Stan Lee also created a new writing method, *The Marvel Method*, where he outlined stories, sent them for drawing, then filled in the story bubbles later.

Lee's focus on noncustomer college students opened a blue ocean where Marvel thrived. "Marvel Comics are the first comic books in history in which a post-adolescent escapist can get involved, for Marvel Comics are the first comic books to evoke, even metaphorically, the Real World," wrote the *Village Voice* in April, 1965.[10]

By the end of 1965 Marvel circulated 35 million comic books per year and inspired 500 fan letters per day.[11] By 1967 Marvel sold six million comic books per month, just behind DC's seven million despite that Marvel's distribution channel, which was owned by DC, restricted the number of issues they could offer.

Into the Red

In a typical comic book plot all goes well until it doesn't, then mayhem erupts.

In June 1968, Goodman sold Marvel to conglomerate Cadence Industries[12] for $15 million ($102.1 million, inflation adjusted to 2015). Cadence owned a print distribution arm but knew nothing about publishing.[13] Not long after the acquisition, Cadence hired Sheldon Feinberg, the former CFO of Revlon, as CEO, the first of many awful managers. "Pit your executives against each other, make them fight each other, and then, somehow they should do better. And try to humiliate your subordinates," is how a Feinberg associate described his management style.[14] Legendary cartoonist Jack Kirby soon quit, signing a three-year contract with DC Comics. The *X-Men* and *Silver Surfer* series were cancelled.[15]

Blue Ocean Strategy requires the alignment of value, profit, and people. Marvel's comic books from this era were generally considered high quality but, internally, the lack of *fair process* damaged and demotivated the people, which led to potential profits being left unrealized. Untapped profits and poor management are like blood in the water, attracting sharks, and Marvel was soon swimming face to face with some of the bloodiest predators in the business world.

In November 1986, Cadence sold Marvel to New World Entertainment, an entertainment conglomerate whose executives did not know the difference between *Superman*, owned by DC Comics, and Marvel's *Spider-Man*. New World's fortunes quickly foundered – Marvel

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America, and also recreate *Daredevil*, the blind lawyer whose heightened other senses give him superpower-like abilities.

9 Howe, Sean (2013-10-01). *Marvel Comics: The Untold Story* (p. 38). HarperCollins. Kindle Edition.

10 Kempton, Sally. "Marvel Comics Are the First." *Village Voice* 1 Apr. 1965.

11 Howe, Sean (2013-10-01). *Marvel Comics: The Untold Story* (p. 63). HarperCollins. Kindle Edition.

12 Cadence was then called Perfect Film & Chemical Corporation but changed the name later. For clarity we use the name Cadence throughout.

13 Cadence also owned a vitamin division, which is where Spider-Man vitamins were developed, an early crossover product.

14 Howe, Sean (2013-10-01). *Marvel Comics: The Untold Story* (p. 104). HarperCollins. Kindle Edition.

15 Both were later revived and went on to perform well.

was their only profitable business – and they turned to Wall Street for help. Their investment bankers decided to sell Marvel.

"Trouble with the comic business," said then Marvel Editor-in-Chief Jim Shooter, "is that it seems that every time things look like they're going to look good, then the owners of the company end up selling it. And it falls into the hands of the philistines and you've got to start all over again."[16]

In November, 1988[17] investment bank Drexel Burnham Lambert auctioned Marvel to corporate raider, and long-time Drexel client, Ronald O. Perelman for $82.5 million ($165.3 million adjusted for inflation to 2015).[18] Perelman, a multi-billionaire, used $10 million of his own money to finance the acquisition and borrowed the rest.[19] Like most Drexel-connected raiders Perelman believed strongly in value extraction rather than value innovation. Raiders typically purchase companies using high-priced "junk" debt, build the businesses through high-yield[20] debt-fueled acquisitions, and finally flip the business, oftentimes carved up into pieces.

Perelman immediately and repeatedly raised comic book prices. During this time collectors were bidding the price of sports trading cards into a frothy bubble, where single sports cards could sell for hundreds of thousands of dollars. These collectors also fueled sales of new trading cards, as they sought to purchase the cards when released, betting they would increase in value over time. Perelman decided to copy the trading card strategy and build his own bubble in comic books. To fuel speculation Marvel introduced many versions of every comic book – each with a different cover – encouraging collectors to purchase more volumes.

Perelman's bubble strategy initially worked to raise revenues, and he sold 40 percent of Marvel to the public in July 1991, raising $70 million. Buoyed by strong sales – value extraction managers oftentimes produce short-term returns at long-term expense – the stock soared. Perelman used $30 million from the IPO to buy down a portion of the debt he used to acquire the business and paid another $40 million to himself as a "special dividend." Perelman then borrowed approximately $600 million to spend on acquisitions and sold another $700 million in junk bonds, eventually pocketing a total of about $300 million from the bond sales personally.[21]

Besides raising prices and encouraging speculators, Perelman also consolidated all distribution from twelve distributors to one, Hero's World Distribution, which Marvel owned. Perelman's goal was to effectively sell comic books directly to retailers, capturing revenue paid to distributors. This single-source distribution system wreaked havoc on comic bookstores, their primary retailer, and the number of comic bookstores quickly fell from 9,400

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16 Thomas, Michael. "Jim Shooter Interview: Part I." *Comic Book Resources*. CBR News, Oct. 6, 2000.
17 The sale closed January, 1989.
18 Perelman had a byzantine array of holding companies the most well-known being MacAndrews & Forbes. For clarity these businesses are collectively referred to as Perelman himself.
19 Inflation adjusted to 2015 Marvel was sold for $165.3 million with Perelman's investment amount to $20 million.
20 High-yield low-rated or unrated corporate debt is informally referred to as "junk bonds."
21 Perelman retained the proceeds from the bond sales. Judge Roderick McKelvie, presiding judge in Marvel's bankruptcy case, would eventually rule this was legal because it was disclosed.

to 4,500.[22] Perelman's Marvel also decided to branch into trading cards and purchased three companies, sports card makers Fleer and SkyBox, as well as Italian sticker company Panini.[23] Finally, Marvel acquired 46 percent of toymaker Toy Biz in exchange for an exclusive royalty-free license to produce and sell Marvel characters.

High prices, fewer distributors, lower quality, underperforming acquisitions, and a predictable burst in the comic book collecting bubble destroyed sales. In January, 1996, Marvel fired 275 people then followed-up in November by firing another 115, one third of its workforce. On December 27, 1996 Marvel filed for bankruptcy: Marvel's red ocean strategy had run its course.

For nineteen months, various groups fought for the business. Perelman, legendary corporate raider Carl Icahn[24], Marvel's banks, Marvel bondholders[25], Marvel subsidiary Toy Biz, and a few other parties wanted Marvel. Perelman offered creditors $365 million, leaving Perelman owning about 80 percent of Marvel, with the public, bondholders, and bankers owning the other 20 percent.[26] Icahn, who briefly took control of the business[27], offered creditors similar terms with a different management team. Toy Biz majority owners Isaac Perlmutter and Avi Arad offered $231.8 million cash, 40 percent of restructured Marvel, the Italian sticker company, and a strategy to return the company to profitability. Creditors voted to accept the Toy Biz offer even though the cash was $100 million less, due to Perlmutter and Arad's strategy and vision.[28] Even when battling billionaires a solid strategic vision can prevail over cash.[29]

Perlmutter and Arad – low on cash but high on chutzpah with their strategic vision – prevailed over the battling billionaires. Perelman told the *New York Times* if he had to rank his

22 Comic book stores receive discounts from distributors based on the total number of books they order from any publisher. Forcing comic book stores to split their orders between Hero's World and their regular distributors, lowered their volume, subsequently lowering their discount and their already slim profits.

23 Perelman's Marvel acquired trading card maker Fleer for $286 million in July 1992, Hero's World Distribution for $7 million in 1994, trading card maker SkyBox International for $150 million in March 1995 and later, also in 1995, Italian sticker company Panini for $158 million.

24 Icahn and Perelman are arguably the two most well-known corporate raiders of their time. They were both prominent attendees at Drexel's *Predators Ball*, an annual conference of junk bond luminaries.

25 Icahn purchased distressed Marvel bonds so fought for control both on his own and as the lead bondholder.

26 All parties also offered creditors the Italian stocker company Panini, which was performing reasonably well internationally.

27 Perelman pledged Marvel's stock as collateral for the bonds and, once he defaulted on bond payments, bondholders successfully acquired the stock and control of Marvel. However, in December, 1997 – one year into bankruptcy – the bankruptcy court ousted Icahn in favor of a court-appointed receiver.

28 Creditors were owed about $700 million. They were paid $230 million in cash, given the sticker company which sold for another $120 million, and received 40 percent of the new Marvel.

29 Perlmutter and Arad's vision was reinforced by a well-timed stroke of luck. On July 2, 1997, in the midst of the bankruptcy battle, Sony released *The Men in Black*, a movie based on a Marvel comic book that had been in production for years. Two prior Marvel character movies, *Howard the Duck* and *The Punisher*, both bombed. *The Men in Black* earned $589.4 million ($869.6 million adjusting for inflation to 2015), the second highest grossing film in 1997, suggesting the economic viability of movies based on Marvel's characters.

successes Marvel would not be included. Icahn said "I have framed articles of every deal I've ever done. In all honesty, this is one frame I'm considering taking down."[30]

On October 1, 1998, with approval of the court and creditors, Toy Biz, Inc. used $250 million in high-yield debt (junk bonds) to acquire the assets of the former Marvel and renamed itself Marvel Enterprises.[31] Perlmutter's Marvel now faced the daunting task of resuscitating the struggling business and executing their strategy.

Evaluating Post-Bankruptcy Marvel

After bankruptcy, in late 1998, Marvel had five high-level businesses:

1. Comic books. Marvel's flagship comic book business produced direct revenue and vast intangible assets: intellectual property, decades of characters, storylines, brand, customer goodwill, and an institutional knowledge about how to weave their IP into great stories. Marvel estimated the intangibles of their comic book business to be worth $127.7 million.
2. Trading Cards. Marvel had two trading card companies, SkyBox and Fleer, which had been combined under Perelman. A third business, Panini – an Italian company that made trading-card like stickers – was ceded to Marvel's bankers to end the bankruptcy. Trading cards required guaranteed steep royalties to sports leagues, lacked company-owned intellectual property, and sales were driven by collectors who tended to buy based more on speculation than any real interest in the cards. Marvel did not break out revenue or profitability for the trading card business separately from the toy business in 1998.
3. Toys. Toys were a low-margin business but Marvel did well; most 1990s-era Marvel revenue came from the toy group. Movies based on Marvel characters brought incremental toy revenue that was expected to increase as Marvel inked more movie deals. Marvel leveraged their unique character's intellectual property to build high quality toys.
4. Character Licensing. Marvel always licensed characters. Licensing deals were optimal: with an investment of little more than drafting a contract Marvel need do nothing but open envelopes and cash checks for high margin revenue. In 1998 Marvel received $4.9 million in licensing fees for $4.5 million in gross profit but estimated the licensing business to be worth $401.1 million.
5. Marvel Studios. Marvel had a handful of people in Hollywood licensing Marvel characters to motion picture studios for films. This team, referred to as Marvel Studios, was not a real movie studio: they did not independently make movies and had no intention of doing so. Their goal was to drive sales of licensed goods by increasing demand for Marvel characters through films.

30 Bryant, Adam. "Pow! The Punches That Left Marvel Reeling." *The New York Times* 24 May 1998.
31 The bonds carried interest of 12 percent and required monthly payments so the capital costs Marvel $30 million annually in interest alone.

Management Stabilizes the Business

The post-bankruptcy late 1990s was a dire time for Marvel. Comic book sales were slipping 20 percent year-over-year and licensing deals dried up because licensees were concerned about long-term contracts with a company that might cease to exist. Cash became so tight that Marvel almost failed to make payroll. One *Spider-Man* comic from this era describes a "criminal businessman" who advises the publisher of *Spider-Man's* employer, The Bugle newspaper, to take the paper public. "I'd never take the Bugle public ... because I know that its long-term integrity would suffer under corporate connivers like you, who dream up ridiculous little schemes which only produce short-term goals!" *Spider-Man's* alter ego, Peter Parker, along with 100 other comic book characters, are then laid off.[32]

Marvel was starved for cash and saddled with $30 million in annual junk-bond interest payments. In this context Perlmutter and his board of directors hired turnaround specialist Peter Cuneo, who had worked with Perlmutter turning around Remington, as CEO. Cuneo focused on Marvel's core businesses, selling comic books and toys, and licensed the exclusive movie rights to several of Marvel's most popular characters.[33] Cuneo and the board reasoned that successful movies would spur sales of licensed goods, driving toy revenue. Additionally, the early movie deals provided much-needed capital and helped prove the economic viability of Marvel-based comic book movies. Sony purchased the rights to *Spider-Man* for $10 million plus 5 percent first-dollar royalties.[34] Twentieth Century Fox acquired the rights to *X-Men*, the *Fantastic Four*, and several lesser-known characters on less expensive terms. Universal purchased the rights to make standalone *Hulk* movies. Marvel does not release actual figures but industry analysts estimate Sony paid Marvel no more than $62 million in royalties for *Spider-Man*, *Spider-Man 2*, and *Spider-Man 3*, which collectively grossed about $2.5 billion. Fox is estimated to have paid Marvel $26 million total for *X-Man* royalties; the films have collectively grossed approximately $2.3 billion. *Blade*, a deal struck during the Perelman years, grossed $131 million; Marvel was paid $25,000.

Although the deals may not appear favorable in hindsight they served a strategic and tactical purpose. Tactically they brought much-needed capital to Marvel in the form of up-front payments and increased licensing royalties giving the company a breathing space to eventually move in a more strategic direction. "The big kicker for us was the licensing around the movies. That was more important to us than the actual amount of money we got from the films. When we started Marvel Studios, with our own financing, we were then able to capture all the profits that came from the movies ourselves and that was a gigantic change," Cuneo said. Strategically the deals proved the popularity of Marvel characters at the box office and taught Marvel how to make movies so that, someday, Marvel could produce their own films. "Sony did a great job on *Spider-Man* and Fox with the *X-Men* did a great job," said Cuneo. "Those are big and they make a lot of money from those franchises."

32 Howe, Sean (2013-10-01). *Marvel Comics: The Untold Story* (p. 382). HarperCollins. Kindle Edition.

33 Some of these licenses have since reverted back to Marvel and some others, notably *The Incredible Hulk*, are licensed back in exchange for film distribution rights.

34 Under a system informally called "Hollywood Accounting" movies never earn a profit so the provision for royalties based on gross revenue to the studio is a victory.

In February, 1999, Marvel divested trading card businesses Skybox and Fleer for a combined total of $26 million, a $410 million (94 percent) loss that would offset future earnings from taxation.

The toy business accounted for the bulk of Marvel's revenues but these were relatively low-margin high risk revenues. In March 1999, Marvel exited the toy production and sales business, selling exclusive rights to market Marvel characters, for five years, to their toy manufacturer for a $5 million per year fee[35], a 15 percent royalty, plus an additional 24.5 percent fee for Marvel to continue designing the toys.[36] "When I came to the company we had a full toy business doing everything: designing toys, finding a manufacturer, taking working capital risk, selling to mass retailers, and so on," said Cuneo. "That's what I inherited. After two years I felt we shouldn't be in any business where we were taking capital risks: we had a lot of cash flow problems. The industry in 2001 had a terrible year because Hasbro oversold Star Wars toys into mass retailers around the world. Marvel lost $30 million that year on the toy business and we couldn't afford to lose anything. So the board agreed to license out the business to one of our primary vendors. We transferred the risk of working capital to this guy and we were just responsible for the selling. We were also able to sell off about $25 million in inventory so we got an influx of cash from that."

Besides stabilizing the business financially Cuneo moved to quickly heal the corporate culture, building an environment where creativity could thrive. "If you as an organization can't handle a culture which rewards people with crazy ideas, of people who are difficult to deal with, then you're not going to be successful in a creative business," said Cuneo. "You want to create an atmosphere where those people feel good about where they're at, and prosper, and you're able to cope with some of the idiosyncrasies that they might exhibit. But, in the end, that's where all the revenue growth is coming from. In a character-based business you can't discount the value of having great creative people work with you on a positive basis. Instill the proper atmosphere, the proper rewards system, let them know that you appreciate what they do."

Marvel Steers Towards a Blue Ocean

Once management stabilized the business there was a sense that a major strategic initiative was needed to boost the company beyond stability, towards a blue ocean. In 2004, Hollywood veteran David Maisel, who had worked at the highly influential talent firms Endeavour and Creative Artists Agency (CAA), approached Ike Perlmutter with a radical new strategy. Over lunch the relatively young Maisel – who had also worked with senior executives at Disney but had never made a movie himself – proposed a new strategy: create a real movie studio to fund and produce Marvel movies. Maisel, a lifelong comic book fan, reasoned that by licensing characters Marvel was unnecessarily forgoing large profits, needlessly ceding creative and scheduling control, and making it more difficult to bring characters together in one large

35 Four years of fees, $20 million, was paid in advance. The buyer had been purchasing Marvel debt at a discount and passed that discount on to Marvel so that they were able to cancel $39 million in high-interest debt. This relieved the business of $4.7 million in annual interest payments plus the principal.

36 In 2006, Hasbro would take over the sales and distribution of Marvel toys, which were still designed by Marvel.

Marvel character universe[37]. The current licensing strategy was literally ripping apart *The Avengers*.

Besides better upside, Maisel reasoned, downside risk could be mitigated with the right type of financing. By using Marvel characters as collateral[38] to secure funding for movies, bankers could never again threaten the core business that Perlmutter and Cuneo had restored. Additionally, even if a movie flopped and the banks took the characters the eventual moviemaker would still have to pay similar terms as if Marvel licensed the characters on their own.

Perlmutter agreed and hired Maisel as COO of Marvel Studios with the intention of sustainably extracting more long-term value from the business. With the decision to build a real movie studio, in 2006, Maisel was promoted to Chairman of Marvel Studios. The transformation was not without controversy because independent studios rarely made large-budget films. Some key Marvel executives, including Perlmutter's former partner Avi Arad, moved on. Additionally, even once green lighted, the studio they planned would be very different: being run the Marvel Way, with a culture of cost consciousness carried over from Toy Biz which was anathema to Hollywood.

Maisel convinced the Board of Directors to allow him to proceed and worked 18 months to eventually close the deal exactly as he described: $525 million in low-interest debt, secured against Marvel characters, with no financial risk to the business, to produce Marvel films. The former management consultant and talent agent then went on to build a real movie studio, Marvel Studios. Marvel premiered their first movie, *Iron Man*, in May 2008. The movie was a blockbuster, grossing $585 million worldwide.

"It is extremely rare for a company to find a new strategy that could add multiples to the valuation of the business. That was the fortunate situation where we found ourselves in 2004. After five years of hard work and careful execution it was extremely gratifying to see the success of the strategy with the well-received launch of Iron Man in 2008," said Maisel.

Movie studios spend lavishly to foster a glamorous image but Marvel decided this expensive tradition added cost without commensurate buyer value. Marvel located their California movie studio above a car dealership. Their office furniture was old and threadbare. There were no free lunches or even free coffee. [39] Marvel managers, steeped in the Toy Biz culture wary of wasteful spending, would even slash office supply orders. Marvel *eliminated* the Hollywood tradition of spending on glamour that was not helpful for moviemaking. "…with our own studio, we didn't have any studio overhead," said Cuneo. "The studios would charge us 30 percent indirect overhead for a film. If they were making a film for $100 million we knew right away, because we had no overhead, that we could make it for $70 million. Same talent, same quality film. But we weren't being dragged down by these latent, unproductive

37 Each character was licensed individually, usually to different studios, so bringing them together as *The Avengers* would be impossible. This is the same reason that *X-Men*, which are licensed to Fox, do not appear in Marvel movies.

38 The agreement initially used ten characters for collateral: *Ant-Man*, *Black Panther*, *Captain America*, *Cloak & Dagger*, *Doctor Strange*, *Hawkeye*, *Nick Fury*, *Power Pack*, *Shang-Chi*, and *The Avengers*. After rights were reacquired *Iron Man* and *The Incredible Hulk* were added to the agreement.

39 Marvel employees would sometimes walk downstairs to the car dealership for coffee where, ever anxious for the chance to sell cars, they were welcome.

assets that the studio system has. These can be empty sound stages, it can be backlots that are never used, it can be empty offices, and some studio executives driving around in Lamborghinis paid for by the company. We didn't have any of that. So right away we had a 30 percent cost advantage. So we were able to make the films for less with the same talent and that's one reason we made $200 million on Iron Man 1."

Blockbusters normally require movie stars but Marvel reasoned their own characters were the stars and they need talented, if lesser known, actors, directors, and screenwriters to bring their characters to life. Widely known actors were sometimes cast in small supporting roles, where they charged less, but Marvel relied primarily on lesser known actors. "Marvel distinguished themselves by going after good actors, writers, and directors who were unexpected choices," said Josh Whedon, director of *The Avengers*.[40] "One side to that is they don't have to pay them as much."[41] To lock in the savings actors were signed to long-term contracts, with many obligated to appear in six or even nine films at rates negotiated while the actors were still lesser known. Even after these lock-ups expire, Marvel is known to replace actors, in the same role but different movies, rather than offer significant raises. Marvel *reduced* the use of known talent, especially movie stars, and their high cost.

"We were not enveloped by the Hollywood way of doing things," Cuneo said. "Our strategy from the beginning was that our characters were the heroes of the films and we did not want to hire any highly paid actors or actresses… We thought the heroes, the stars, were the characters and there were many fine actors who could play these roles and we did not need expensive talent. Obviously we hired talented people. We had very talented directors and producers, which are very important. If you were a highly paid actor and wanted to be in our films then you had to take less than normal compensation."

Besides using lesser known actors Marvel also edited films to reduce shots that added cost without commensurate buyer value. Rather than a series of elaborate and expensive scenes to tell a backstory two men sat discussing it in a cave, which cost far less to produce and added a level of intimacy with the characters. Chase scenes that initially called for ten trucks were reduced to two, creating a less expensive and more realistic storyline.

Marvel also *reduced* middle management by failing to hire back the layers of managers lost during the lean years. "[T]he low headcount has meant minimal layers of management and bureaucracy, so that each individual had the power to focus on solving his or her problems and could have a visible hand in building the business," said Cuneo. "This atmosphere has attracted self-starters and creative thinkers all of whom have contributed greatly to Marvel's decade of growth and success."[42] Additionally, the leaner organization was able to move faster and assume more risk. For example, Robert Downey Jr. was an Academy Award winning actor suffering from drug addiction: he had been in and out of rehabilitation and jail. Marvel was able to hire him whereas traditional studios had more layers of executives able to exercise a veto. Gwyneth Paltrow was an Academy Award winning actress who had taken time off to raise her children. After several actresses turned down the lead female role for *Iron*

40 *The Avengers* was the third highest grossing movie of all time when released, with $1.5 billion in worldwide revenue.

41 Finke, Nikki. "Avengers' Cast and Stingy Marvel Ready to Rumble Over Sequel Cash & Strong-Arming." *Deadline Presents* 7 May 2013.

42 Reiss, Robert. "How Marvel Became A Business Superhero." *Forbes* 1 Feb. 2010.

Man, due to compensation issues, she agreed to take the role as part of a comeback. She expressed interest one Wednesday and was hired the next Monday; Marvel was able to move quickly due to the lack of bureaucracy.

While Marvel may be cheap with capital, they are rich with narrative and storytelling. Leveraging decades of intricate comic book storylines, and a deep commitment to the integrity of that narrative, Marvel builds characters that are people first and superheroes second. *Superman* and *Batman*, owned by DC Comics, may get beat up physically or emotionally but Marvel characters show angst even absent the bad guys. Marvel arguably doesn't make superhero movies: they craft high-quality dramas that contain superheroes. These character-first storylines also appeal to *noncustomers*. "Marvel was one of the deciding factors in how nerd culture began to spill over and eclipse pop culture," said comedian Chris Hardwick. Marvel *raised* storytelling.

Said Cuneo: "Marvel's great claim to fame, and the great leap that was made by Stan Lee and his co-creators, such as Jack Kirby, Steve Ditko and other talented artists, was from 1961 to 1965 they created the best known Marvel characters. The big leap was that they spawned characters that readers could identify with and therefore be emotionally connected to. The *X-Men* are mutants and, as mutants, they have special abilities but they're also alienated. At some time in life we all think we are mutants. For example, every kid in high school, unless you're incredibly confident for that age group, thinks they're a mutant. Marvel's success is because people who read the comics or see the movies get so connected to these characters.

"Think about *The Hulk*. We all get mad sometimes; we all blow our top. Hopefully not too often, but this is the emotional connection of *The Hulk*.

"*Spider-Man*, a young guy, a nerd, Peter Parker, has great powers and cannot handle them. His uncle is killed because he becomes arrogant about his strengths. With great power comes great responsibility; that's really a great phrase if you think about it. It's very simple but it's very true. A lot of people in their lives are trying to handle a new job, a new power ... whatever it is, but they're asking 'How do I handle responsibility?' He had all this wonderful ability but he couldn't get a date with the girl he liked.

"*Iron Man* has a life threatening heart condition. He also has a huge ego and develops a drinking problem. People just relate to this. Suddenly you had believable characters that people can really get excited about. That was the great leap that Marvel made and that was the leap that we wanted to make in film."

Besides the characters themselves, the storylines appealed to *noncustomers*. *Iron Man 1* is more love story than superhero movie. Love stories between a middle-aged arms dealer who flies around in a metal suit and a 30-something woman are not standard Hollywood fare. Yet, with its appeal to *noncustomers*, the movie went on to gross $585 million in box office receipts worldwide.

In Stan Lee's original *Marvel Universe* characters are interwoven between stories, allowing old characters to introduce and support newer characters. Marvel initially diversified revenue by "layering" characters upon one another, building the success of each new character with the success of preceding characters to ensure they were not too dependent on any single character. With the creation of the movie studio this evolved into a new creation, the *Marvel*

Cinematic Universe, where characters support one another until they become strong enough for their own movie line, and also appear together in movies.

Finally, Marvel *created* a Creative Committee to craft the films consisting of lead comic book editors and company executives to ensure the integrity of their characters and storylines. Rather than grant a *carte blanche* creative license for directors to bring comic books to life, Marvel executives retained this role for themselves, going so far as to replace traditional storyboards with cut-up comic books. Marvel is vested in the well-being of their characters, almost as a parent is to a child. In line with the husbandry of their characters Marvel producers are substantially more involved in the movie-making process, actively managing actors and directors to bring the Marvel vision to life, rather than relying upon the vision of an individual actor or director.[43] Via the Creative Committee Marvel *created* a cohesive storyline not dependent on any single actor or director.

As discussed above, a vital key factor of competition was Marvel's decision to control their own destiny in the movie business. That decision, and the mechanism to do that – the $525 million non-recourse credit line[44] – enabled Marvel to unlock many other key factors and sail to their new blue ocean.

Marvel Morphs into a Blue Ocean … Again

When Marvel character Bruce Banner becomes angry he transforms into *The Hulk*, a giant green monster that smashes anything in his way. Similarly, Marvel's misfortunes inspired a strategic pivot that quickly opened a blue ocean.

One hundred and twenty-nine live-action feature-length movies, based on comic books, have been released in theaters since the first modern comic-book movie, *Superman*, in 1978.[45] These films grossed $38.6 billion[46] total; $23 billion (59 percent) from movies based on Marvel characters, $8.8 billion (23 percent) from DC characters[47], and the remainder from other comic book characters. The median comic book movie earned $176.2 million worldwide revenue. Movies based on Marvel characters, but not produced by Marvel, earn a median $373.6 million. The median for Marvel-produced movies is $660.2 million.[48] One Marvel-produced movie, *The Avengers*, grossed over $1.5 billion, the then third highest

43 This tradition dates back to Marvel's early years where even their most famous and talented cartoonists were treated more like typical employees than stars.

44 Marvel created two tranches of debt. Mezzanine debt, of $60 million, carried interest at LIBOR plus 7.0% while senior debt carried interest of LIBOR plus 1.635 percent (rising to 2.935 percent after the financial crisis eroded the guarantor's credit slightly). After the success of *Iron Man*, Marvel used the profits to repay the $60 million of higher-interest mezzanine debt.

45 Through October, 2015, many more movies were released directly to video or turned into television films but, for analysis, these are not considered. Additionally, there were 14 live-action comic book movies and serials before *Superman*, most released in the 1940's.

46 All figures are adjusted for inflation from their release date to October, 2015.

47 Notable DC characters include *Superman*, *Batman*, and *Wonder Women*.

48 The average comic book movie produces $299.5 million worldwide revenue. Movies based on Marvel characters, but not produced by Marvel, averaged $417.6 million. Marvel produced movies average $713.2 million.

earning movie of all time. Marvel's characters clearly thrive best in Marvel's blue ocean of moviemaking.

Besides the movies, Marvel's other businesses prospered as the films gained popularity. "Even people in senior positions in entertainment did not understand what we call The Wagon Wheel," said Cuneo. "The hub of the wheel is your intellectual property: your characters, your brands. The spokes on the wheel are how you monetize the IP and the spokes can be media forms or consumer product categories. The rim of the wheel is the synergy between all of those spokes. When we started at Marvel we really only had two spokes. We had the comic book business, called print media, and we had the toy business. That's a very wobbly wheel; two spokes don't support a wheel very well and that reflects the bankruptcy that Marvel had gone through. When we did *X-Men 1*, that added a third spoke on the wheel, motion pictures. And of course motion pictures then led directly to licensing and then you added videogames, which is a very big category. When the motion picture came out we went from two spokes to probably ten spokes and that's the essence of what happened. Then we could move into television. We firmly believed that if people saw our films they would buy our toys for their kids, they would play our videogames, they would go to the amusement parks where our characters were, and all these experiences played into other experiences. The holy grail of entertainment is owning and controlling your own IP to maximize spokes on the wheel."

Hollywood could not help but notice the creative and financial success of Marvel's new strategy, especially the movie studio. Sensing that Marvel's shareholder value as an independent studio might be more limited than what could be achieved with the right larger studio, Maisel approached his former boss, Disney CEO Bob Iger, about an acquisition. Besides the financial strength, Disney is arguably the world's best company at protecting and building fictional brands and characters. Marvel investors and employees would do well under Disney: *The Avengers* would be expertly cared for indefinitely. In addition, Marvel shareholders obtained a substantial amount of Disney stock that went on to appreciate significantly.[49] Iger expressed interest and Maisel arranged a meeting with Perlmutter. After some due diligence on working conditions, negotiations on price, and a phone call from Steve Jobs to Perlmutter (Jobs had recently sold his movie studio, Pixar, to Disney) they reached an agreement.

On December 31, 2009, Disney acquired Marvel for $4.2 billion[50], barely a year after the release of the first *Iron Man* movie and a decade after the company almost folded.[51] "It's

49 Maisel realized that the financial crisis, which had just stabilized at the time of the acquisition, devalued Disney stock well below where a more stable economic environment would suggest and negotiated 40 percent of the purchase price in stock. Between August, 2009 and October, 2015, Disney stock increased by 453 percent. Taking this into account the adjusted purchase price, as of October, 2015, would be $10.1 billion, $2.5 billion in cash and $7.6 billion in stock.

50 The acquisition was announced in August, 2009 at which point the mix of Disney stock valued at $4.2 billion. By the time the acquisition was complete, on December 31, Disney stock increased leading to a total valuation of $4.5 at closure.

51 Marvel's stock price at the beginning of 2001 was $1.43. The final split-adjusted price of the stock in 2009, when the acquisition closed, was $54.03.

almost like they have a built-in GPS system for the storytelling," said Bob Iger about Marvel.[52]

Further reinforcing the notion that Marvel is the best at creating movies based on Marvel characters, Marvel and Sony came to a unique agreement in 2015 to cross-license *Spider-Man*. Sony will license the *Spider-Man* character back to Marvel for use in Marvel-produced films with other superheroes. In exchange, Marvel will produce future stand-alone *Spider-Man* movies, hiring the director, reviewing the script, and shooting them the Marvel Way. There is no money involved: Sony would not pay royalties on their use of *Spider-Man* from the stand-alone movies and Marvel would not pay royalties on future films that include *Spider-Man*. Since royalties for even the most successful *Spider-Man* movies were marginal compared to overall movie revenue, this deal represents an acknowledgment that Marvel characters are best managed by Marvel.

Conversely, Marvel made clear their displeasure about the ongoing use of the popular Marvel characters *X-Men* and the *Fantastic Four* by 20th Century Fox. While there is nothing Marvel could do legally they protested by suspending production of new comic books featuring the characters and went so far as to digitally remove the characters from some old comics. Even though they still profit from licensing royalties, which increase with the release of a feature film, Marvel strongly prefers that Marvel characters are produced by Marvel Studios. "Once you license something to a studio, you have to watch them like a hawk," Perlmutter's former partner Avi Arad told the *Hollywood Reporter* in 2006. "These are our children, not theirs."

As with other blue ocean offerings, Marvel effectively has no competition. "*Iron Man* was the number one movie of 2008 until *The Dark Knight* came along, and I loved it, frankly," said current Marvel studio head Kevin Feige. "I love that the number one and the number two movies of that year – and it has happened a number of times since then – [were] comic-book movies, even if it wasn't one we made… Here we are now, 14 years since the first Marvel movie I worked on. At that point it had been eight years and for those eight years people had been asking 'How much longer [is enthusiasm for comic book movies] gonna last?' 'When are people gonna get tired of these movies? And my answer always was 'People only get tired if a whole slew of terrible ones come out'. And it's our job to make sure that doesn't happen. If there are other people out there interested in that not happening as well, I'm all for it!"[53]

Marvel, DC and other comic book businesses were unusually close to one another. Before moving offices Marvel and DC were nearby and would routinely share lunches, company picnics, and employees would switch back and forth between the businesses. Smaller comic book companies were oftentimes started by former employees of Marvel or DC so the businesses have a tradition of being unusually close. Given the limited number of high quality comic book characters, Marvel's primary competitor is bad comic book movies, not other movie studios. That is, if audiences watch a bad comic-book movie – or if too many are released – audiences might sour on the whole genre. Conversely, if they watch an entertaining comic book movie they are likely to want to see another, no matter which studio produces the film.

52 Leonard, David. "The Pow! Bang! Bam! Plan to Save Marvel, Starring B-List Heroes." Bloomberg Business 3 Apr. 2014.

53 Jagernauth, Kevin. "Kevin Feige Talks DC Films." The Playlist 18 July 2014.

"If, at the end of the year, ten comic book movies come out, and they're all bad then attendance will be bad," said Cuneo. "If they're all great then attendance will be great. I don't think that people sit around saying 'I'm only going to see two comic book movies this year.' That isn't how it works. It's not a zero-sum game. If the creative is great on a lot of movies the box office will expand right along with that. Whether it's Marvel or Time-Warner or anyone dealing with fantasy films they're really competing with themselves meaning they've got to make a good film. If they make a good film they'll be successful."

Would-be competitors agree competition is irrelevant. "We're all in this big business together, and we hope people are interested in the adventures that we put up on screen," said Zach Snyder, director of the upcoming DC film *Batman Vs. Superman*. "And I do believe it's infectious, and the next weekend you're like, 'You know what? Let's go do that again, that was awesome. We saw a cool movie, maybe we'll get another cool movie.'"[54]

Just as Marvel layered characters upon one another to rebuild the company, they are now layering different types of media, expanding aggressively into television. In June 2010, Marvel announced an initiative to produce their own television programs and, in 2013, launched the critically acclaimed *Agents of S.H.I.E.L.D.* Marvel/Disney sees their shows as strategically important – bringing Marvel characters from the big to the small screen – and has committed to spending $200 million to produce entirely new shows. Other Marvel television shows include *Agent Carter*, *Powers*, *Daredevil*, *Jessica Jones*, and *Luke Cage*.

Marvel at Present

On July 14, 2015, Marvel sent actor Michael Douglas and thief-turned-superhero *Ant-Man* to ring the closing bell of the New York Stock Exchange and celebrate the movie's premier. *Ant-Man* is the last of the second stage of the *Marvel Cinematic Universe* movies: each phase lasting six movies like each comic book story lasts six books. But there was a double-entendre: Douglas also portrayed Gordon "Greed Is Good" Gekko in the movie *Wall Street*, a character widely believed to be based on a composite, based in part on some of the corporate raiders Marvel once struggled under. So Gekko works for Marvel now (in a supporting role of course: Douglas is already a movie star who would be too expensive as a lead). It's not hard to imagine that Marvel was implicitly sending Wall Street a message about their final thoughts on value extracting raiders.

Marvel is doing well. Maisel and Cuneo, who had resigned as CEO after the business stabilized but remained on the board of directors, left after the Disney acquisition in 2009. Perlmutter remains as CEO of the Marvel division.

However, in Marvel's Universe – both in the comic books and also the business – calm always foreshadows a fight. Currently, Marvel is filming *Captain America: Civil War*. As work progressed, studio head Feige became frustrated by Perlmutter's frugal ways; Feige reportedly wanted more budget and Perlmutter more cuts. Finally, Feige waged his own civil war and successfully lobbied that the movie studio be reassigned from Perlmutter to Disney studio head Alan Horn. Additionally, Feige all but dissolved the Creative Committee, the

54 Hughes, Mark. "Exclusive Interview with Zack Snyder, Director Of 'Batman Vs. Superman'" Forbes 17 April 2014.

Marvel group that carefully managed continuity and adherence to the comic books. Not long before that, Marvel Studios moved from the car dealership to the Disney Studio's lot where they surely noticed the nicer furniture and free lunches at *Pixar* and *Lucasfilm*, two other studios Disney acquired.

There is no question that Marvel's current as-is blue ocean strategy is a resounding success. From 1999 (after the bankruptcy) until October 2015 there have been 93 live action movies released in theatres based on comic books; 41 are based on Marvel characters, 16 are based on DC characters, and the rest are based on comic books from various smaller companies. Movies based on Marvel's characters grossed $21.7 billion, whereas DC-based movies earned $5 billion over the same time period. Marvel produced movies earned $9.3 billion[55], an average of $713.2 million, well above the non-Marvel average of $338.7 million. In contrast, the six Star Wars films grossed $4.8 billion and the eight Harry Potter films grossed $2.95 billion.[56] With 8,000 characters, Marvel is just getting started: the Marvel Cinematic Universe has plans for movies stretching far into the future.

By using value innovation – eliminating and reducing factors of competition and raising and creating other factors – Marvel unleashed a blue ocean in moviemaking larger than anything the world has ever seen.

"There was a long-term focus (on the part of the board of directors, including Perlmutter)," said Cuneo. "I think some people mistook some of the drivers to be short-term. We were willing to be patient and nurture the business. I don't ever remember having a discussion that was short-term in nature at the expense of the long term."

Marvel's current blue ocean is about ten years old, and continues to endure, but eventually all blue oceans turn red if companies either start to compromise the strategy to their success or when competitors aggressively imitate and companies fail to value innovate again. Marvel knows the history of their characters and of their company: this is a business that does not forget. Marvel swam in an early blue ocean, was almost destroyed in a subsequent red ocean pivot, and was revived – almost like a superhero from their books – in a subsequent blue ocean strategic move. Only time will tell if these recent changes signal the unravelling of Marvel's blue ocean or represent small changes to refine and update the strategy as the business blossoms. Quoting Stan Lee, at the close of every Marvel comic book, "Excelsior!"

55 All figures in this case are inflation adjusted to 2015.

56 Since then Disney released *Star Wars: The Force Awakens* that looks likely to earn over $2 billion in worldwide box office.

Questions

1. There have been several attempts to explain Marvel's success via competitive strategy but they fall flat: competitive strategy, with this specific case, neither predicts nor explains the outcome. Why?
2. If Marvel had spent more to hire top-tier movie stars, well-known directors, and moved forward the Hollywood Way, would the movies have performed better?
3. Why do or don't you think Marvel broke the value/cost trade-off?
4. Explain the difference between value extraction and value innovation as well as the long-term financial impact of each.
5. Who were the noncustomers Marvel targeted?

POLITECNICO DI MILANO

Disruptive Innovation and Big-Bang Disruption

Silvia Sanasi

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Department of Management, Economics and Industrial Engineering

What is a disruption?

- A disruption happens when an estalished company, well respected and well positioned on the market (**incumbent**), is beaten (from a competitive standpoint) by a **newcomer**, usually a new venture, which takes the market leadership.

What is a disruption?

- How is it possible that a large, established (and normally financially strong) company is beaten by a smaller, unknown company new to the market? Shouldn't have the top management and the line management of the organizational functions (marketing, R&D,…) foreseen what was going on, anticipated the newcomer and prevented this change from happening?

Let’s start with some case histories

Case histories

RCA

S.S.I.H.

(Société Suisse puor l'Industrie Horologé - SA)

oticon
PEOPLE FIRST

Case history: the hearing aid industry

oticon

PEOPLE FIRST

neglecting the innovation when company grows
and new product development only

The early successes of Oticon

From 1958 to 1985 Oticon, a Danish hearing-aid company, **dominated its market** in the USA and Europe

The firm had a tradition of great technical and manufacturing excellence. Its **behind-the-ear (BTE) hearing aid** was both technologically sophisticated and reasonably priced

Over time, Oticon had acquired specific characteristics:

- Emphasis on New Product Development (NPD) focused on technical superiority (under the belief that a technically superior product would sell itself)
- Technologists spent more time talking with each other than interacting with their diverse and increasingly global customers
- Managers were good at improving their products incrementally, but their cultural arrogance and insularity blinded them to radical technologies

Case history: the hearing aid industry

Starkey
Hearing Alliance

A radical innovation by Starkey

In 1985 Starkey, a small US-based player, reconfigured BTE components to produce an **in-the-ear (ITE) hearing aid**.

This new product sacrificed sound quality a bit, but it was **smaller and less intrusive**.

The market for the ITE aid was **fashion-oriented**, rather than hospital- or physician-oriented.

Oticon reacted defensively and actively **resisted ITE products**. They felt that the new products were technically inferior and could not be mass produced.

The established processes, structures and culture prevented Oticon from taking seriously an innovation that **<u>violated their assumptions</u> about the hearing-aid market**.

The outcome of Oticon's decision

The market for ITE hearing aids boomed. By 1986, 80% of the American market shifted to ITE products.

Oticon historical prosperity evaporated. In the face of dramatic loss in market share (from 15 % to 9 % between 1985 and 1986) and profits, a new management team was brought in.

This team initiated a revolutionary change in the structure and culture of the company, that brought fruit:

By 1995, Oticon's profits were up to 10 times from their 1990 level
The firm had developed a breakthrough product (digital hearing aids), that would become over the years a dominant solution in the market

Case history: what happened to Oticon?

Case history:
RCA and the vacuum tube technology

The transistor business in RCA

The transistors were invented at Bell Labs (AT&T) in 1947.

The first transistors had not enough power to be used in radios, TVs, telecommunication equipment, etc.

RCA got the license to use transistors and started to invest heavily to empower them and made them usable for its own products.

Sony commercialised the first transistor-based pocket radios in 1955. Their sound quality was much lower than common radios. Customers were teenagers.

Case history:
Sony and the transistor technology

SONY

Disputes about the transistor business in RCA

Within RCA, there were disputes about **whether the company should enter the transistor business** and cannibalize their profitable tube business …

The transistor business was new and the **profits uncertain**… but it was too risky not to pursue the new technology

How to organise the transistor business within the company? Should the solid state division report to the head of the electronics group, a person stepped in vacuum tube expertise?

The transistor business in RCA

Afterwards, Sony started to commercialise black-and-white portable TVs, sold to people who do not have room available for floor-standing TVs (product segment where RCA was largely the dominant company)

Sony was not seen as a threat

When transistor achieved power enough to be used in higher quality appliances...

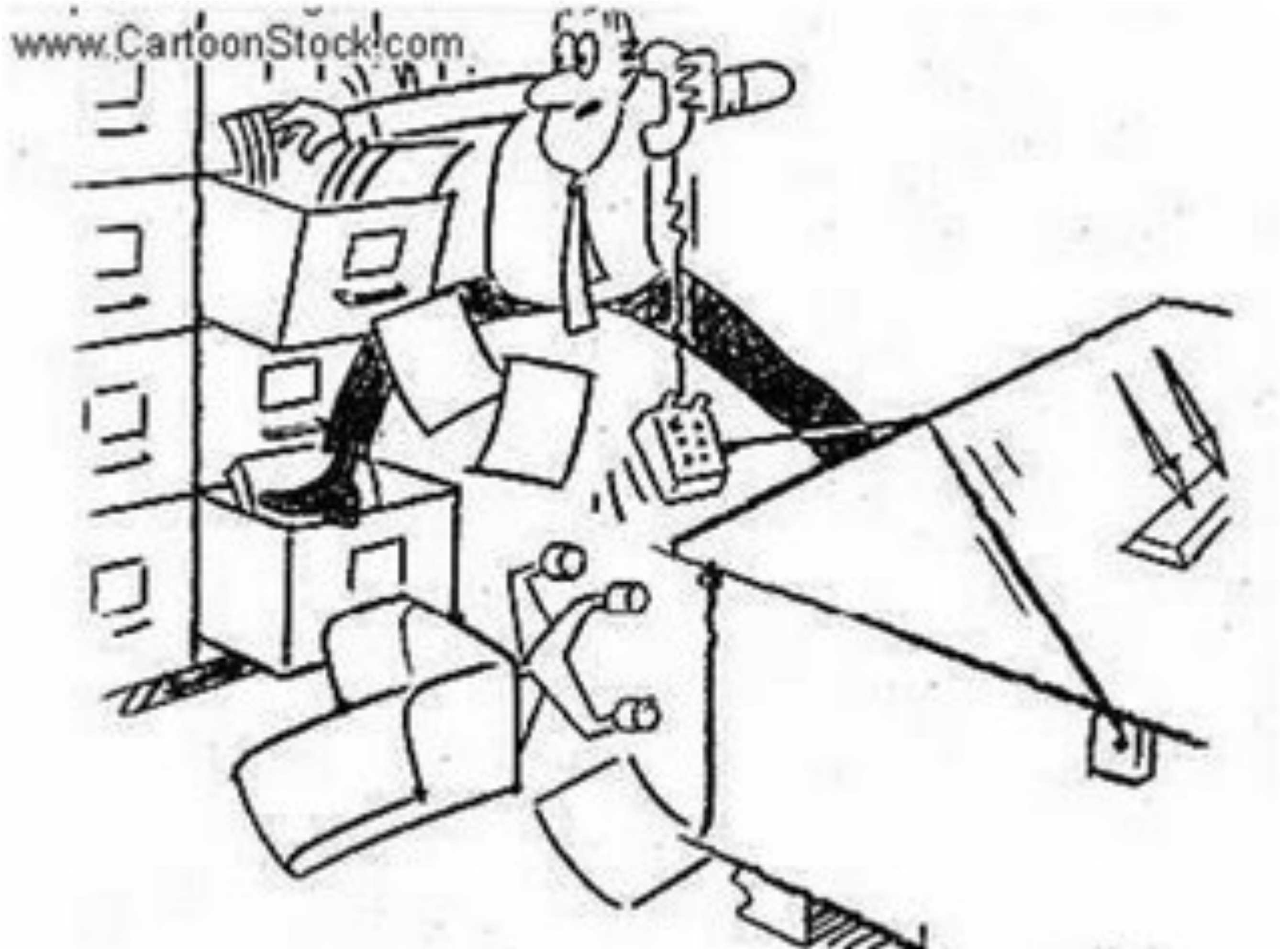
The ultimate decision of RCA

With its great wealth of marketing, financial, and technological resources, **RCA decided to enter the business** …

RCA management recognized the **problems of trying to play two different technological games**, but was unable to solve them.

Without a clear strategy and the cultural differences required to compete in both markets, **RCA failed**.

Case history: what happened to RCA?



Seiko enters the quartz watch business

Hattori-Seiko was the dominant Japanese watch producer in the 1960s, although a small player in global markets, dominated by Swiss firms (e.g., S.S.H.I. and Ausag)

Driven by the aspiration of becoming a global leader in the watch business, Seiko transformed itself from being merely a mechanical watch firm into **both a quartz and a mechanical watch company**

This move into low-cost, high-quality watches required a **deep and well-managed wholesale change within Seiko**

The failure of Swiss watch firms

At the beginning of the 1970s, quartz movement watches replaced mechanical watches

Even though Swiss firms had invented both the quartz and tuning fork movements, at that point in time they moved to reinvest in mechanical watches

As Seiko and other Japanese firms prospered, **the Swiss watch industry drastically suffered**

- By 1980, SSIH, the largest Swiss watch firm, was **less than half the size of Seiko**
- Eventually, **SSIH and Ausag**, the two largest Swiss firms, **went bankrupt**

The Swiss watch industry

Year	No. Of Firms	No. Of Employees
1955	2,300	70,000
1965	1,900	84,000
1970	1,600	89,000
1975	1,200	63,000
1980	900	47,000
1985	600	32,000

Lessons learnt

- Technology matters …
- **It is not just "innovation"** (incumbent firms are innovative as well) **… it is an innovation that disrupts mainstream technologies**

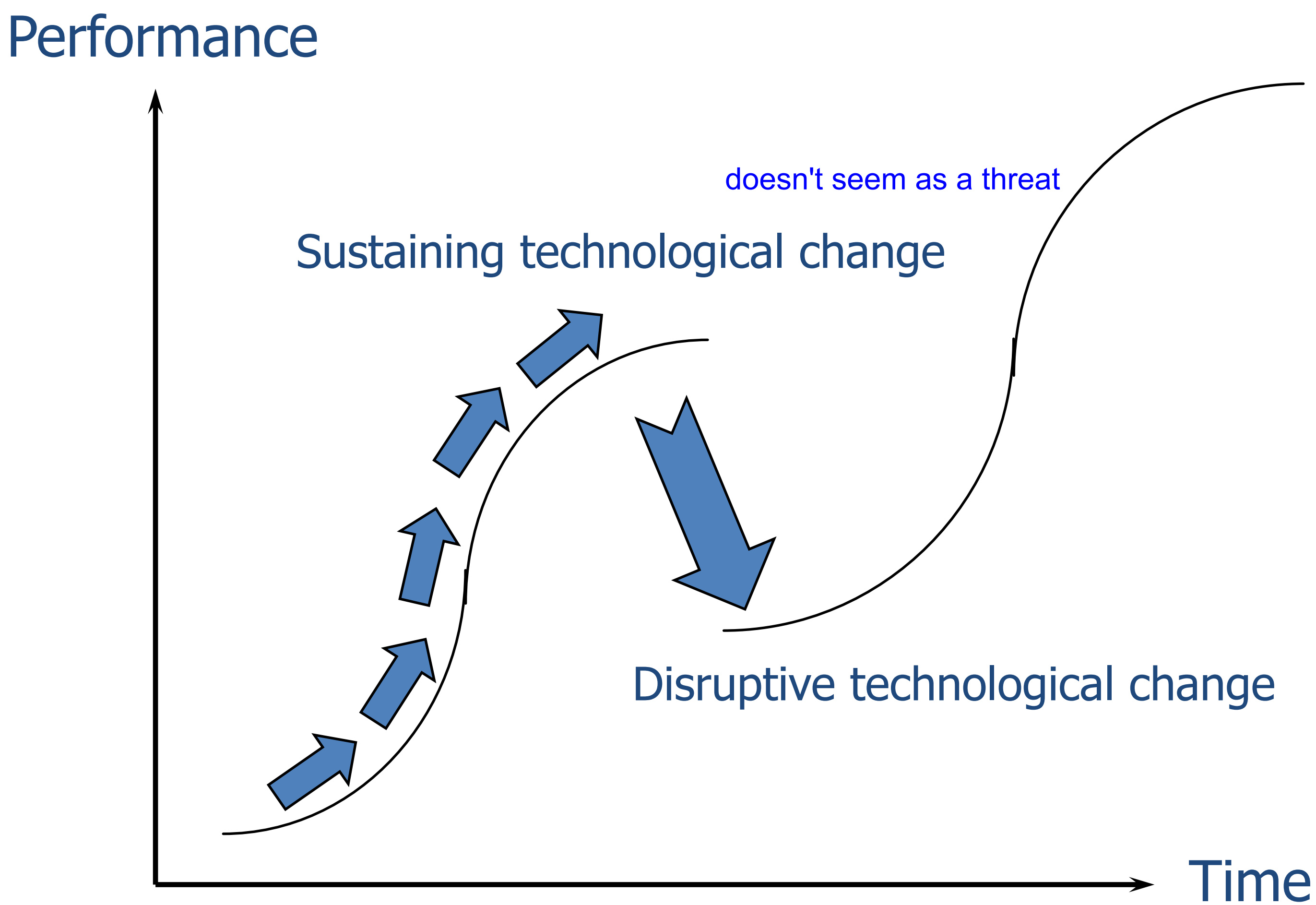
core business is beated.

- **Disruptive technologies are hard to intercept as they appear as significantly weaker than the established one at the very beginning (they usually start "cheap and simple")**

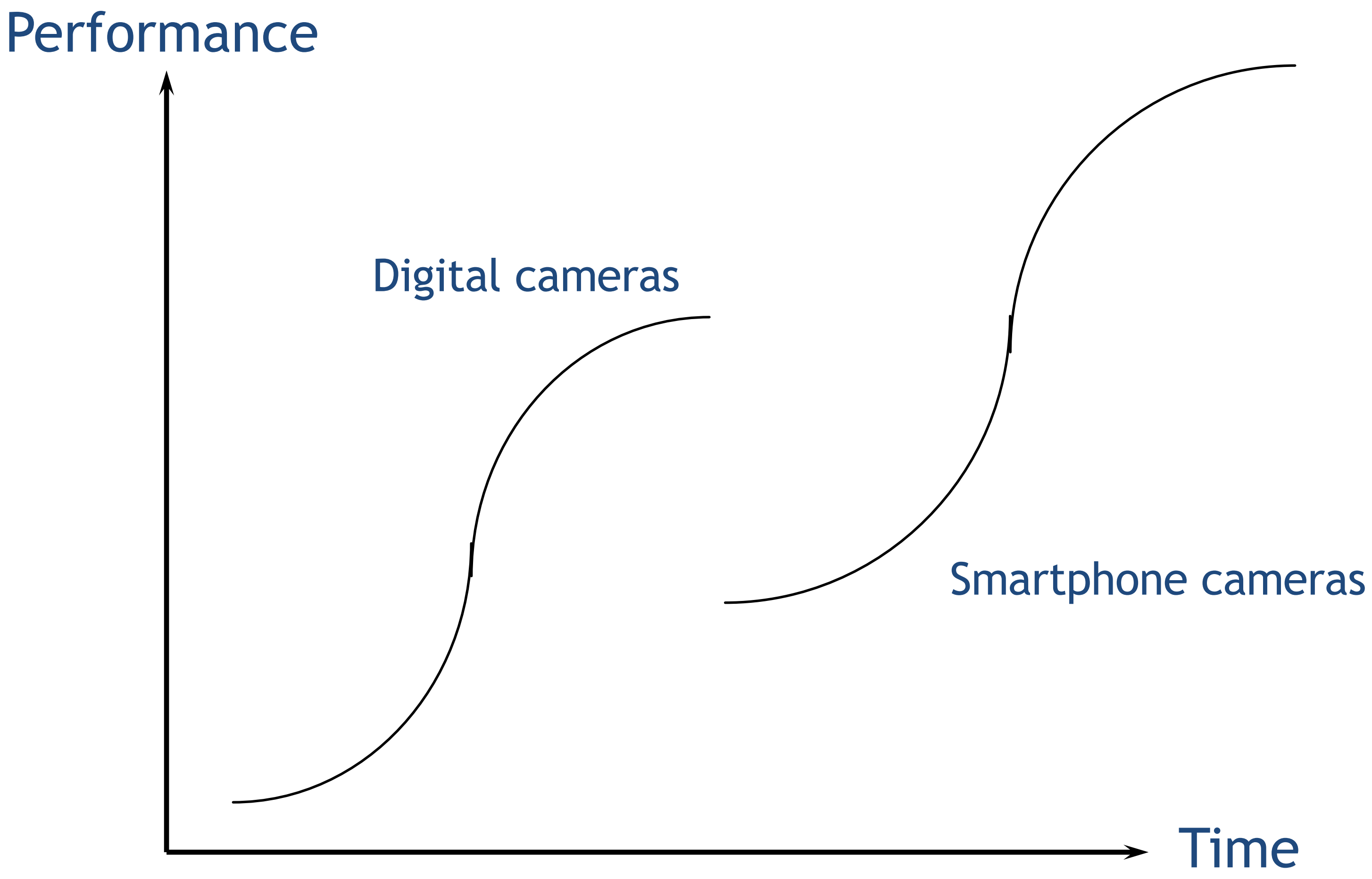
start in niche market with weaker product !!! (lower performance)
so new product seems unattractive to stablished company ... so they don't see it as a threat.
and new product become improved as users give feedbacks

Understanding disruption coming from technological discontinuities

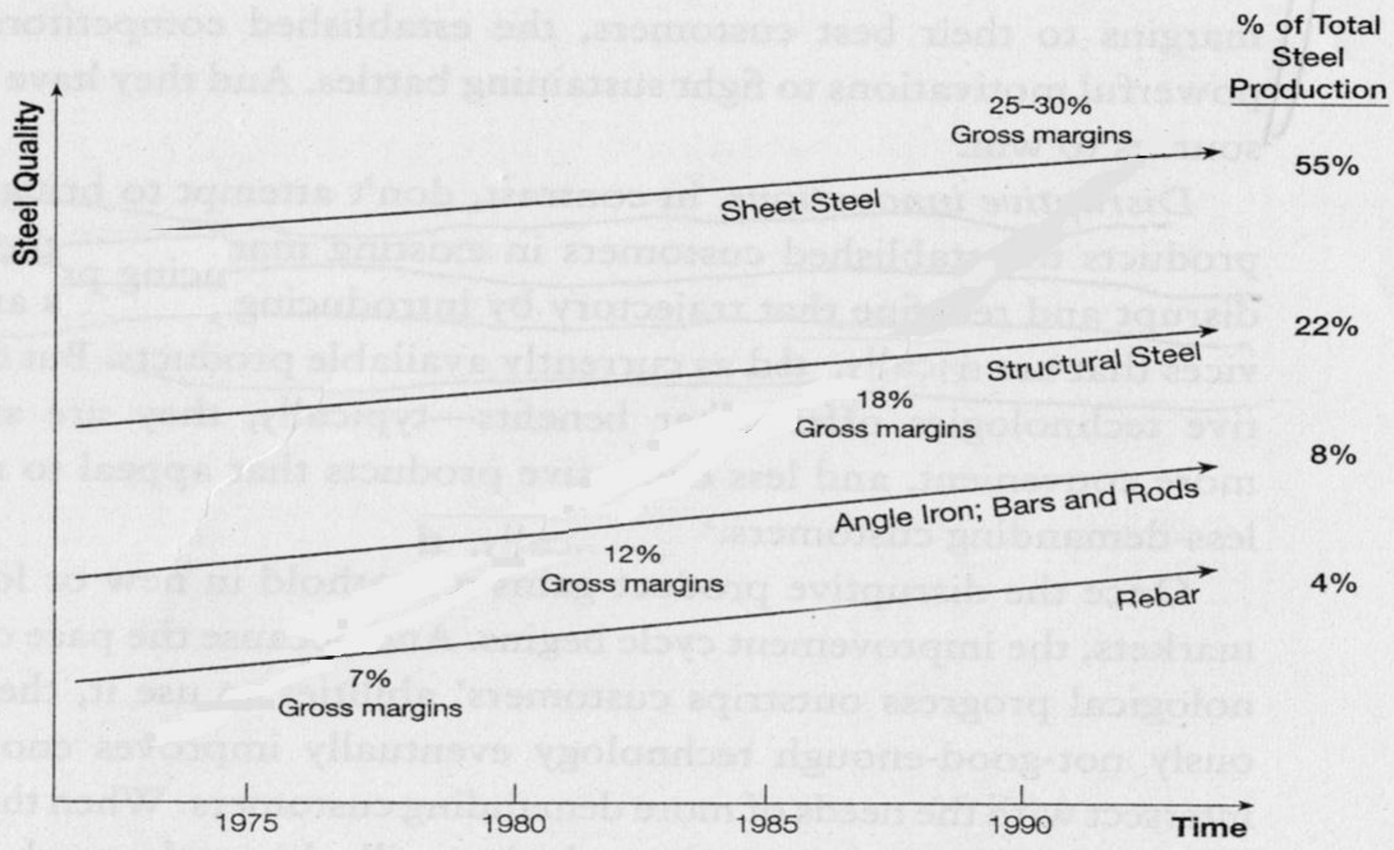
Sustaining vs. disruptive technological change



Case history: the photovoltaic industry

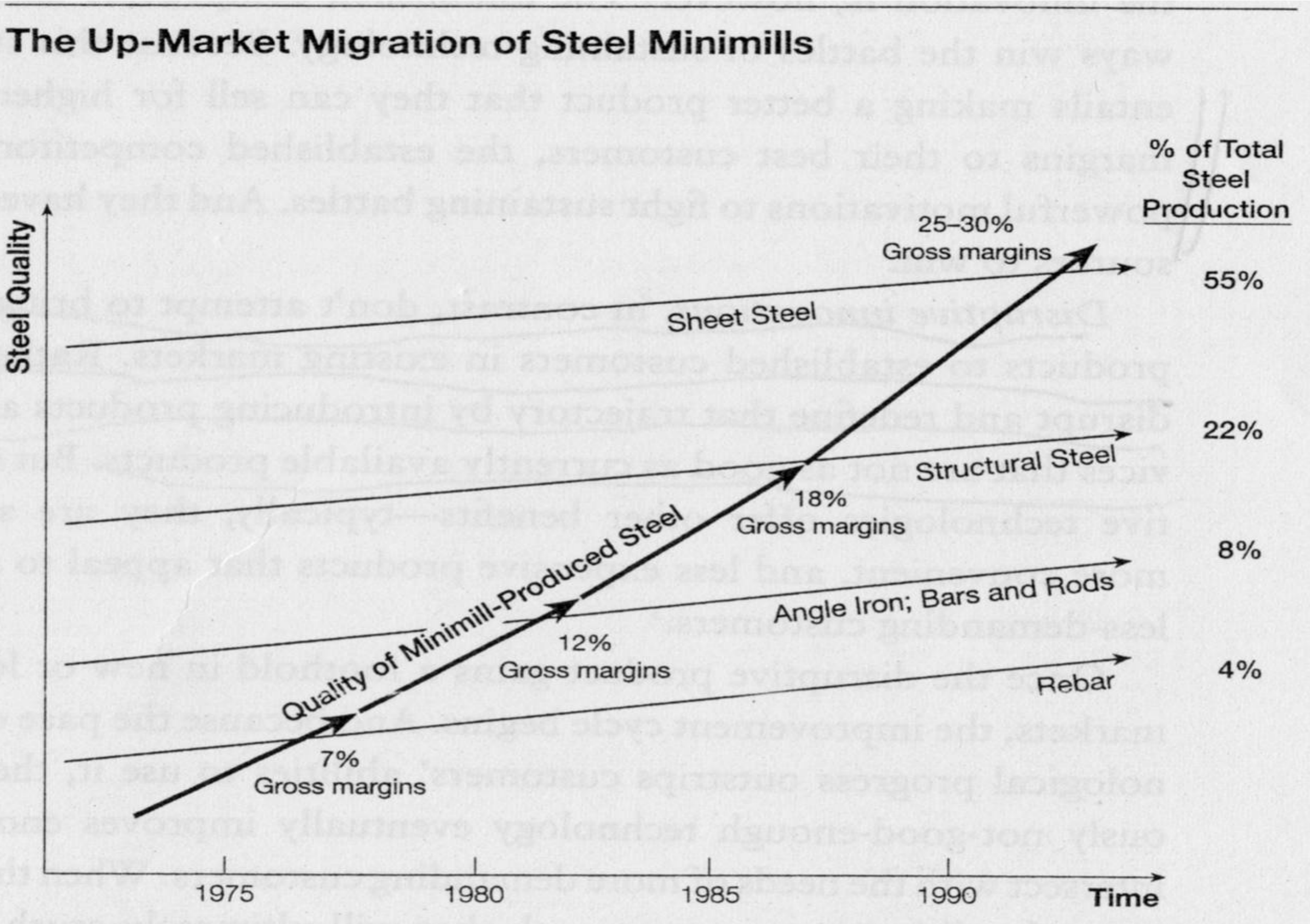


Case history: disruptive technologies in the US steel industry



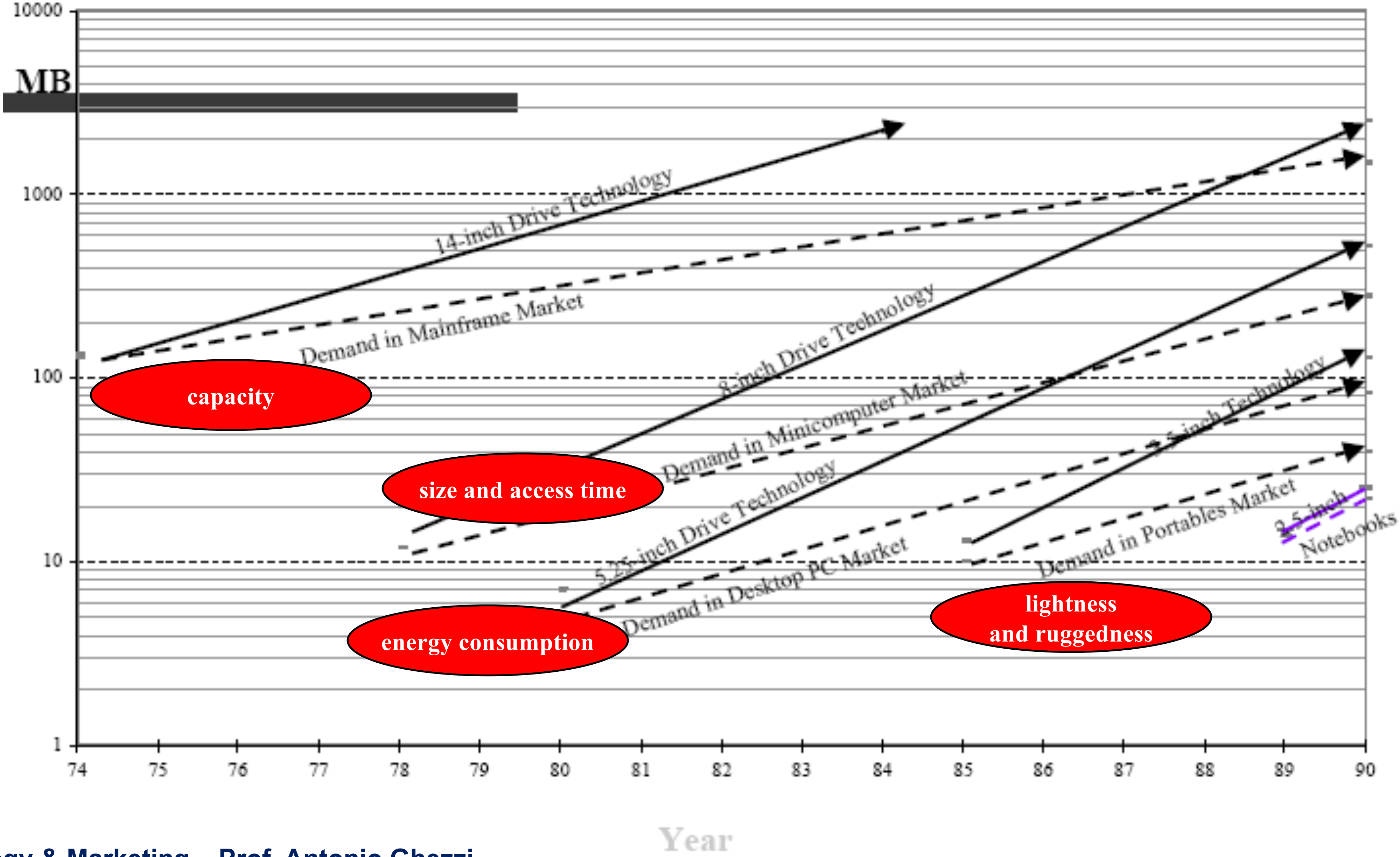
Source: American Iron and Steel Institute; interviews with company executives. Note that the tonnage percentages do not sum to 100 percent because there are other specialty categories of steel.

Case history: disruptive technologies in the US steel industry



Source: American Iron and Steel Institute; interviews with company executives. Note that the tonnage percentages do not sum to 100 percent because there are other specialty categories of steel.

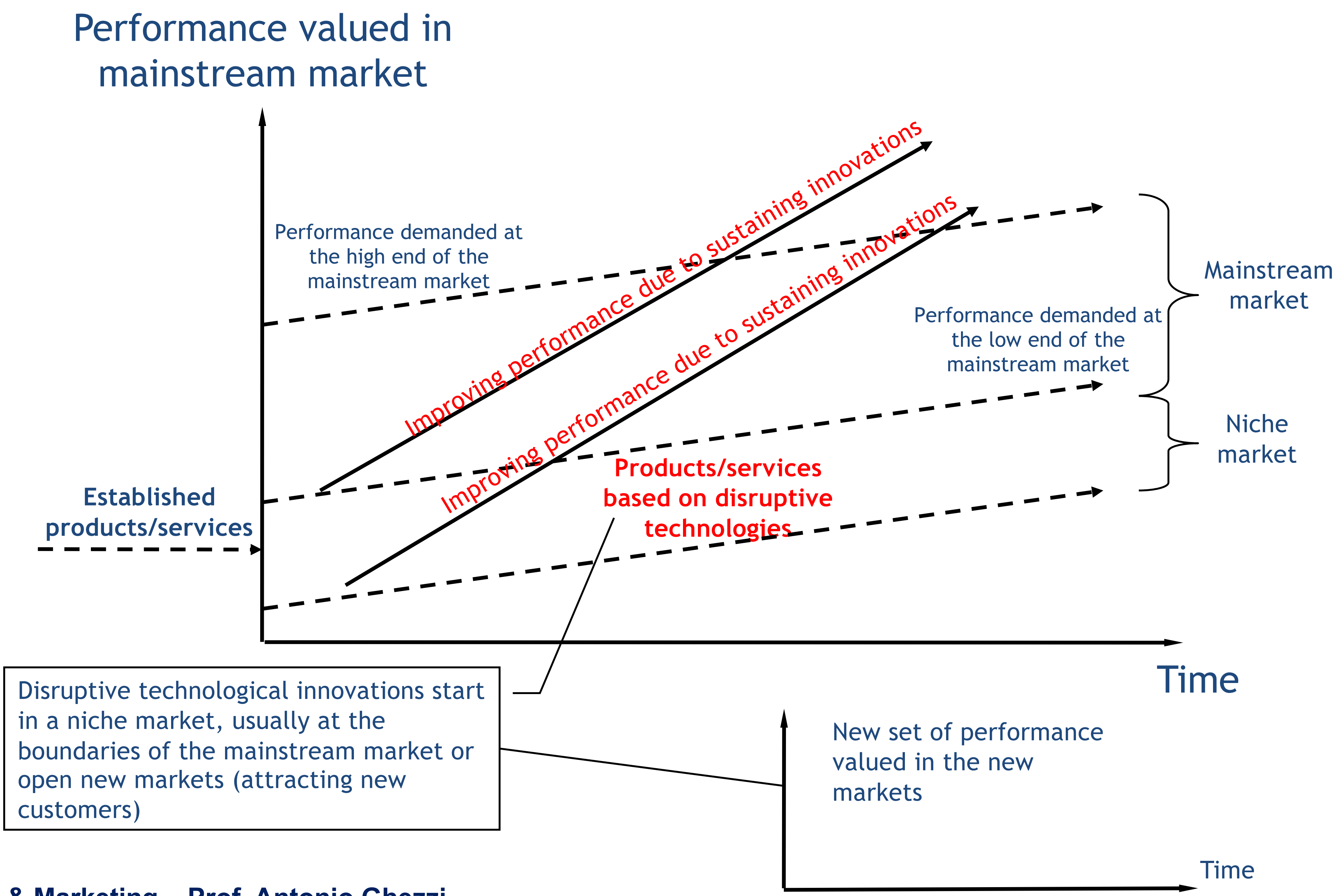
Case history: disruptive technologies in the disk drive industry



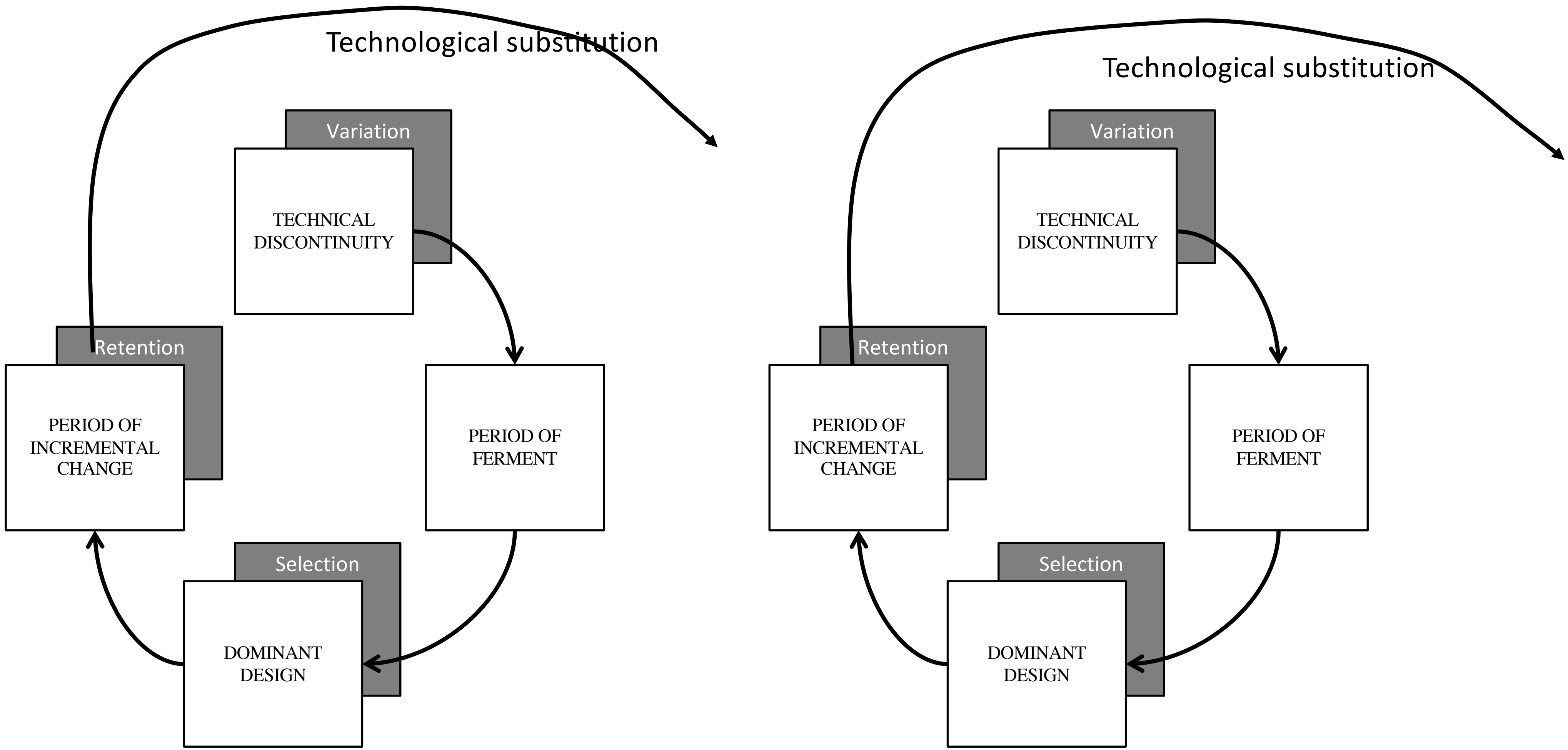
The disk drive industry

Product Generation:	Leading Firm:
14-inch (1973)	Control Data
8-inch (1978)	Priam, Shugart
5.25-inch (1981)	Seagate, Miniscribe
3.5-inch (1986)	Conner, Quantum
2.5-inch (1990)	Conner, Quantum
1.8-inch (1994)	Integral

The threat of disruptive technologies



Technology cycles



As a result, technological change in a product class is characterised by **long periods of incremental change punctuated by discontinuities** (radical innovations)

Lessons learnt from the cases: strategic warnings

Established companies believe that **investing aggressively in disruptive technologies is not a rational financial decision**:

1. Disruptive products are often simpler and cheaper, they generally promise lower margins, not greater profits

2. Disruptive products are first commercialized in emerging and insignificant markets

3. Established firms' most profitable customers generally don't want products based on disruptive technologies

4. The start-ups or new-comers that aggressively promote disruptive products do not appear as a real challenge to their market position

Is it possible to “manage” disruptions?

Ingredients for success

1. **Spot** the disruptive technology
2. **Develop your market insight and conduct directed research**
3. **Adapt** your organization and business model to the disruptive technology
4. **Invest** in disruptive technologies

Spot the disruptive technology

- Build **networking** and **scouting** capabilities
- Develop an appropriate **culture** in your organization

Build networking and scouting capabilities

*"For each of the 7,500 P&G's researchers, there are elsewhere in the world about 200 scientists or technicians equally talented" (*A.G. Lafley)

"99.999996% of world population live outside DSM! Networks needed!" (R. Kirschbaum)

"Ninety-nine percent of everything exciting that happens will happen outside your own research labs" (T. McKillop)

"Not all the smart people work for you!" (H. Chesbrough)

Not invented here is a cultural problem
not accepting things from out side of the company

Case history: Procter & Gamble

From Harvard Business Review (2006):

Much of the operation and momentum of connect and develop depends on our network of ***70 technology entrepreneurs based around the world****. These senior P&G people lead the development of our needs lists, create adjacency maps and technology game boards, and write the technology briefs that define the problems we are trying to solve.* ***They create external connections*** *by, for example, meeting with university and industry researchers and forming supplier networks, and they actively promote these connections to decision makers in P&G's business units.*

Case history: Google

From FT (29 September 2010):

The internet leaders clearly see the risk and are working frantically not to miss a trick. ***Google has taken to hoovering up small internet start-ups in its search for talent and fresh ideas, pulling off 23 deals already this year compared with only six in 2009****. Apple bought a streaming music company, although it has yet to launch a service. There's no guarantee, though, that they can identify all the challenges.*

Case history: Intel

- Intel started an **independent business unit** named **Intel Capital**, acting as a **venture capital company** with more than 100 **investment professionals** around the world
- Up to now, over **$ 10 billion** have been invested into more than 1000 companies
- Intel Capital provide venture funds to **three types of investments**:
  - **Ecosystem development investment** (about 60% of the total invested), companies building technologies related with core products of Intel
  - **Gap-filling investments** (about 30% of the total invested), focused on technologies complementary to those of Intel and not sold directly
  - **'Eyes and ears' investments** (about 10% of the total invested), centered on monitoring opportunities looking extremely useful, promising and profitable but also very challenging and risky

Develop an appropriate culture in your organization

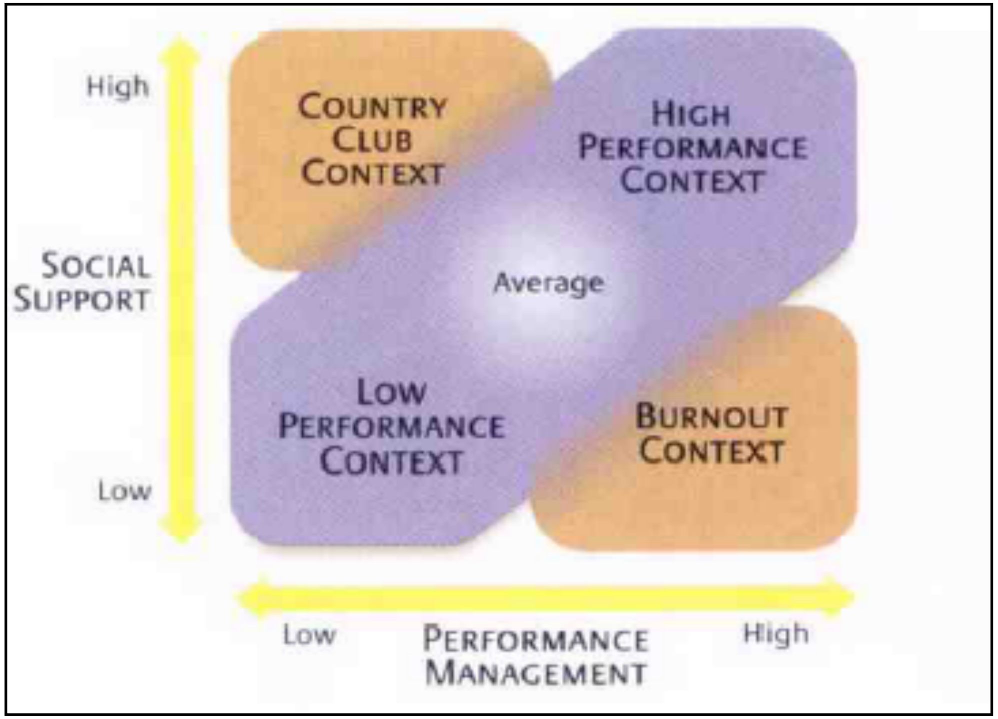
- Create an **organisational context** in which **individual employees** are encouraged to think and speak **out-of-the-box**

- This requires acting on **the human side of the organisation**

- The context should stimulate these types of **behaviour in individuals**:
  - Initiative
  - Risk-taking
  - Entrepreneurship
  - Brokering
  - Multitasking

Develop an appropriate culture in your organization

- A firm should encourage these behaviours through acting on two levers:
  - **Social support**, which is concerned with providing people with the security and latitude they need to perform
  - **Performance management**, which is concerned with stimulating people to deliver high-quality results and making them accountable for their actions



Ingredients for success

1. **Spot** the disruptive technology
2. **Develop your market insight and conduct directed research**
3. **Adapt** your organization and business model to the disruptive technology
4. **Investing** in disruptive technologies

talk directly to people in the market

What is a market insight

- The key aim of market insight research is **to discover a fact about that market that has not previously been made use of, but when leveraged will generate increased profits.**

- Alternatively, market insight can be defined as **the attempt to discover a penetrating truth about consumers, their aspirations and motivations which can in turn be used to generate growth.**

- Develop the «customer insight» means to identify the latent needs of the customers and discover new unexplored market segments

- Adopting the customer perspective is a guiding principle for the entire business model design process. Successful innovation requires a deep understanding of customers, including their environment, their daily routine, their concerns and their aspirations.

Case histories

- GE and diagnostic devices for emerging countries
- Toyota Prius
- P&G and the disposable diapers
- Samsung and the LCD technology for flat panel TVs

Case history: the Toyota Prius

- In mid-1990s, the company launched a project called G21 (Global 21° Century) with the goal of building a car with a **fuel efficiency** of 47.5 miles per gallon, 50% more than that of a basic Corolla

- The first approach was improving transmission and engine of existing cars. Engineers felt that they could potentially improve fuel efficiency of as much as 50%

- So they decided to reject conventional technologies and began looking at **hybrid technology**. The problem was that this model could deliver dramatic fuel cost savings but was prohibitively expensive.

Case history: the Toyota Prius

- Engineers were ordered to create a concept hybrid car that would boost fuel efficiency by at least 100% and cost effective, by one year time (in time for Tokyo Motor Show)
- A thousand engineers were assigned to work on the initiative and investigated 80 alternative power trains then shortlisted to 4
- The battery was a major problem to solve: the technology was very sensitive to temperature

Case history: the Toyota Prius

- The president asked for full production in twenty four months (two thirds the usual time)

- In December 1997 the car was on the market, perfectly on time and was a great success from the beginning, appealing to the growing number of consumers environmentally conscious

- The development cost was more than 1b$, at that time Toyota had half the annual sales of GM

Case history: P&G and the disposable diapers

- When P&G introduced the product it had already been on the market for decades
- But P&G saw two major trends: the desire for consumers for greater convenience and the increasing presence of women in the workforce
- To tap into the mass market it had to dramatically lower costs and after five years of research the price went down to 10 cents per diaper
- It was not enough because diaper services were at about 3.5 cents per diaper and home washing was about 1.5 cents

Case history: P&G and the disposable diapers

- The breakthrough came when P&G developed a machine able to mass-produce diapers at 5.5 c$ a piece.
- It was more expensive than diaper service but affordable to increasingly affluent consumers
- The market grew from $10 million to 370 in seven years
- Today it is a 10 billion industry, rapidly increasing thanks to emerging market consumers

The concept of directed research

- Once a market insight is identified, the problem is how to best serve that market
- Technology is seen as a means to do this, therefore companies are flexible about the technology to use
- Companies usually explore different alternatives
- They combine internal development with technology acquisition from outside

Ingredients for success

1. **Spot** the disruptive technology
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Case study: Polaroid and the digital photography

Apparently, Polaroid was **well positioned to succeed in the digital photography business**:

- It was leader in instant photography for decades
- It had a great brand, brilliant engineers and scientists and a large global marketing and distribution network

Polaroid identified digital imaging as a potential threat to its market position: it was **one of the first companies** to start investing **in digital photography**, in the 1980s

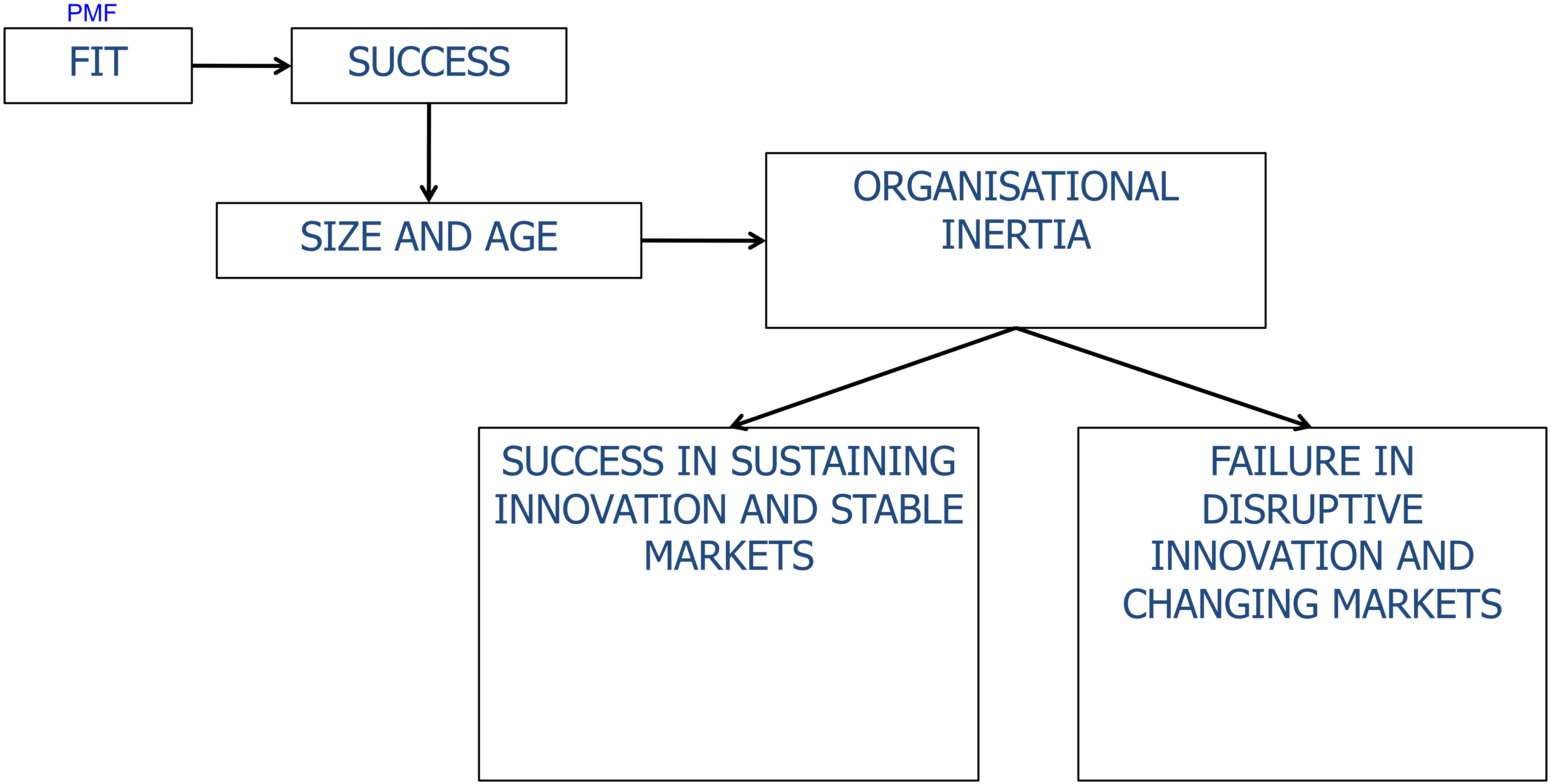
This research has led to **several major technological breakthroughs**, but few of the products that resulted from this effort had been successful

At the end, it was beaten by old, well established firms like Kodak and Sony…

Why?

Polaroid

Organisational inertia theory



both hands

Build an ambidextrous organisation

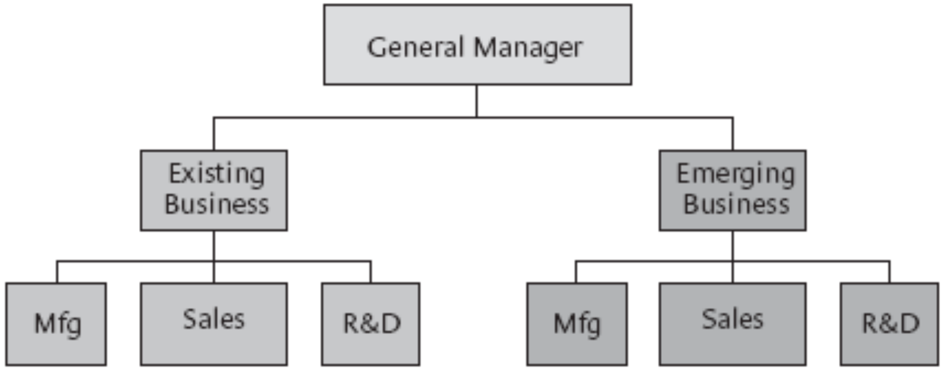
Ambidexterity has two ingredients:

1. **Structural separation** between organisational units devoted to:

   Exploitation of current technologies and businesses
   Exploration of new, disruptive technological trajectories and businesses

   each having its own processes, structures and cultures

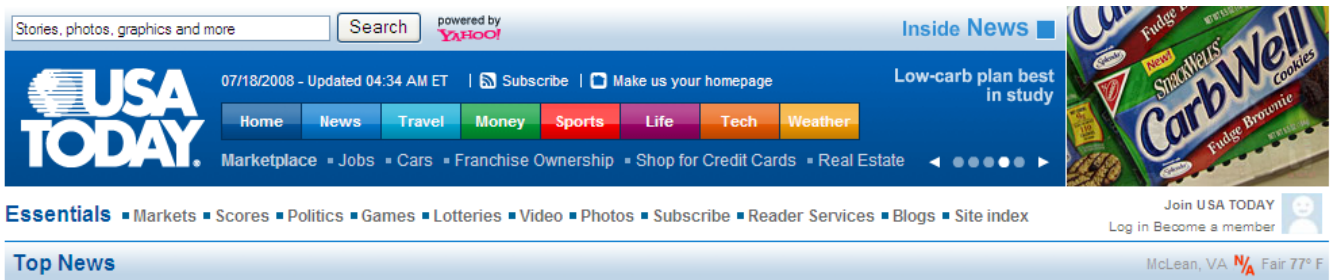
2. **Tight integration** between the exploitation and exploration units **at the senior executive level**



keep them sync in c-level layer

Case history: USA Today

- **Founded in 1982**, USA Today lost more than half a billion dollars during its first decade
- **It turned to profit in 1992**, and continued to expand rapidly, becoming the most widely read daily newspaper in the USA
- But, in the second half of the 1990s, **clouds appeared on the horizon**: readership was falling steadily, competition was heating up, newsprint costs were raising
- Tom Curley (president and publisher) recognised the firm would have to **expand beyond its boundaries** to maintain steady growth and profits
- The company would need **dramatic innovation** to find new ways to apply its capabilities to **new media**



Case history: USA Today

Curley choose Lorraine Cichowski (USA Today's general manager of media projects) to **launch an online news service** called USAToday.com

He gave her free rein to operate independently from the print business. She built **a fundamentally different kind of organisation**, with roles and incentives suited to the instantaneous delivery of new content and to an entrepreneurial and highly collaborative culture

But results were disappointing … its growth was sluggish and had little impact on the broader business's results

The problem, Curley saw, was that **the new unit was so isolated** from the print operation that it was failing to capitalise on the newspaper's vast resources

Case history: USA Today

- In 1999, Curley launched a "**network strategy**", according to which the company would share news content across three platforms: the newspaper, USAToday.com and USAToday Direct (TV operation)

- In 2000 he replaced Cichowski with an internal executive who **was a supporter of the "network strategy" vision**

- Both the online and the television operations remained separate from the newspaper, with their distinct processes, structures, cultures, but Curley required that **senior leadership of the three business was tightly integrated:**

  - He introduced daily editorial meetings between the heads of the three units
  - He let go off a number of senior executive who did not share his commitment to the network strategy
  - He changed incentives programs for executives, replacing unit-specific goals with a bonus program tied to growth target across all areas
  - A "Friends of the Network" recognition program was established to explicitly reward cross-units accomplishments

Ciba Vision

Ciba Vision, created in the early 1980s as a business unit of Ciba-Geigy (now Novartis), develops and sells contact lenses and eye-care products to optometrists.

In the second half of the 1980s it was dramatically suffering from the competition of Johnson & Johnson. Ciba Vision's president, Glenn Bradley, understood that, without **radically innovative products**, his company risked a steady decline and failure.

In 1991, Bradley launched **6 innovation projects**, each focusing on a radical innovation (e.g. daily disposable and extended-wear lenses).

Bradley faced the problem to decide **how to manage and organise these new projects**; he decided not to integrate them within the company's traditional organisation, fearing that **conflicts in resource allocation** and **conventional procedures** and **conservative cultural principles** could have hampered the creativeness and the focus each project needed to succeed.

Building ambidexterity into Ciba Vision's organisation

- Bradley created an **independent unit for each project**, with its own R&D, finance and marketing functions, and located it in **dedicated facilities**
- Each unit hired its staff, established its **own rewarding systems**, designed its **business processes** and, ultimately, came out with unique **organisational structure** and climate
- Bradley faced the problem of **integrating** the independent units with the traditional businesses:
  - the leaders of the breakthrough projects should report to a single senior executive, i.e. Adrian Hunter, vice president for R&D
  - Ciba Vision's incentive system was enhanced so that managers were rewarded on the basis of the overall company performance, rather than their own business unit's
  - a new vision statement for the whole company was elaborated ("Healthy Eyes for Life"), that served the purpose of enlightening the relationships and complementarities between new and traditional business units

The role of the senior executive team

- Senior executives have the key role of **ensuring integration in structurally ambidextrous organisations**
- This can be achieved through:
  - Articulating a clear, emotionally engaging and consistent **vision**
  - Building a senior team with **diverse and heterogeneous competencies**
  - Introducing specific **processes and integration mechanisms**
- **Ciba Vision** provides insightful examples of how to build a structural ambidextrous organisation

Ingredients for success

1. **Spot** the disruptive technology

2. **Develop your market insight and conduct directed research**

3. **Adapt** your business model to the disruptive technology

4. **Invest** in disruptive technologies

Justify investments in the disruptive technology

- Good managers are driven to **keep their organizations growing**
- Unfortunately, companies that become large and successful find that **maintaining growth becomes progressively more difficult**
- Disruptive technologies are **initially sold in small, emerging markets**
- This is why **it is difficult to justify investments in their development**

Justify investments in the disruptive technology

- Company's freedom of action **is limited to satisfying the needs of those entities outside the firm** (customers) that give it the resources it needs to survive

- **It is customers**, rather than the managers, **who really determine what a firm will do**

- Good resource allocation processes are designed to **weed out innovation proposals that customers don't want**

- Resource allocation depends not only on executives' decisions, but also on non-executive participants, whose **career trajectories can soar when they sponsor highly profitable innovation programs**

How to overcome these barriers?

- One approach is to embed the project into **an organization that is small enough** to be motivated by the opportunity offered by a disruptive technology in its early years
- This can be done by:
  - **Spinning out (or spinning off)** an independent organization
  - **Acquiring** an appropriately small company

Case history: Cisco Systems

When the firm identifies a technological opportunity which is promising but with a potential disruptive impact, it **encourages some valuable researchers to leave the company** through a spin-out process and finances the research activities of the newly founded firm.

Besides, it maintains the possibility to **acquire the spin-out back** in case it produces relevant research results.

This strategy was adopted in 1999 with **Andiamo**, a spin-out firm operating in the field of big disk hardware and software for web server applications, that was re-incorporated in 2003

… but some times disruptions are "big bang"

BIG-BANG DISRUPTION

A new kind of innovator can wipe out incumbents in a flash. *by Larry Downes and Paul F. Nunes*

Smartphones scrap portable navigation devices


CORRIERE DELLA SERA - 4 novembre 2013

Tecnologia Tutte le novità, gratis e a pagamento, delle mappe vocali satellitari

Addio vecchio navigatore Ora ci guida lo smartphone

Dal TomTom alle App, cambia il modo di viaggiare

NOKIA HERE

TOMTOM APP

APPLE MAPPE

GARMIN STREETPILOT

GOOGLE MAPS

WAZE

COPILOT

Le App per telefonini e tablet fanno sempre più concorrenza ai navigatori portatili: sono precise, piene di servizi e, spesso, gratuite

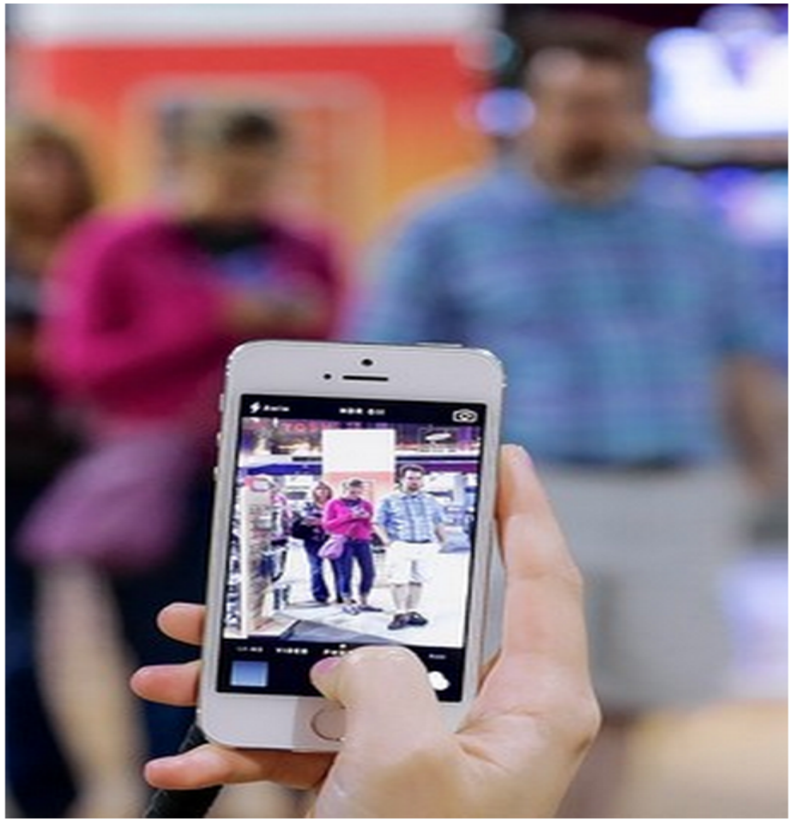
We buy fewer compact digital cameras

VS

THE WALL STREET JOURNAL.

NOV. 10, 2013

Cameras Succumb to Smartphone Juggernaut



There was a time when it would have been crazy to suggest that a phone camera would ever approach the speed and quality of a stand-alone camera. Now, that day is over.

Sales of point-and-shoot cameras have been declining for years .. Taking a picture with a phone simply isn't a subpar experience. For most people, most of the time, a phone is all you need.

What the phone did to the camera isn't an isolated incident. The story behind the death of the stand-alone camera is a history of the future of almost everything.

ft.com/frontpage Europe All times are London time

FINANCIAL TIMES

SEP. 29, 2014

Cameras: out of focus

The popularity of smartphones has allowed to displace one consumer product, the digital camera, especially low cost fixed lens cameras. Unit sales of digital cameras, by makers such as Nikon and Canon, have fallen 60 per cent in the past two years.

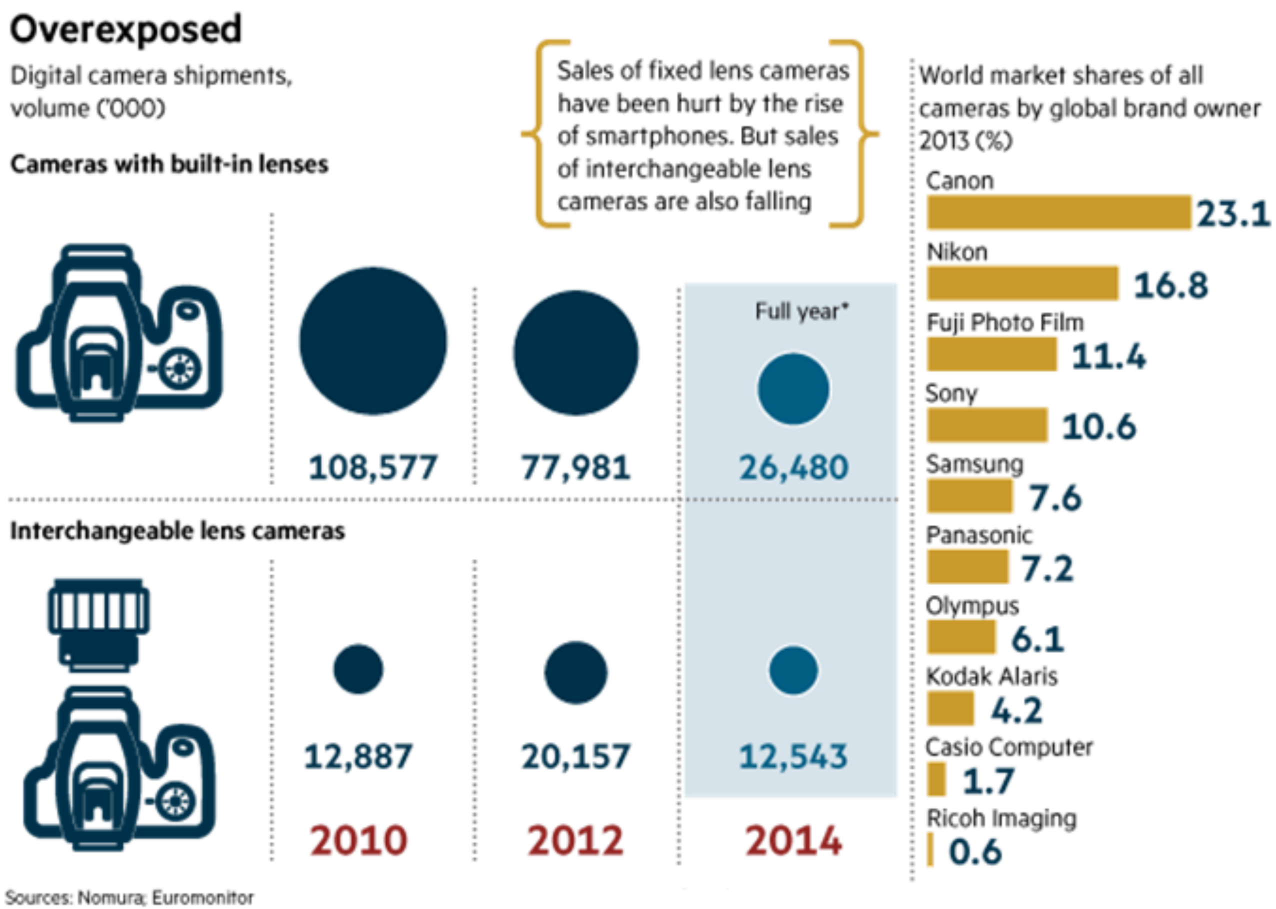
Digital camera makers have not reacted well to the onslaught from smartphones. They have already lost the casual snapper. As phones start to incorporate higher quality lenses, they risk losing the camera enthusiasts too.

ft.com/frontpage Europe All times are London time

FINANCIAL TIMES

SEPT. 29th, 2014

Cameras: out of focus



The lack of innovation in digital cameras has meant that consumers are happy with their current cameras and less motivated to buy newer models

Smartphone and tablets steal room for gaming consoles

ft.com/frontpage Europe All times are London time

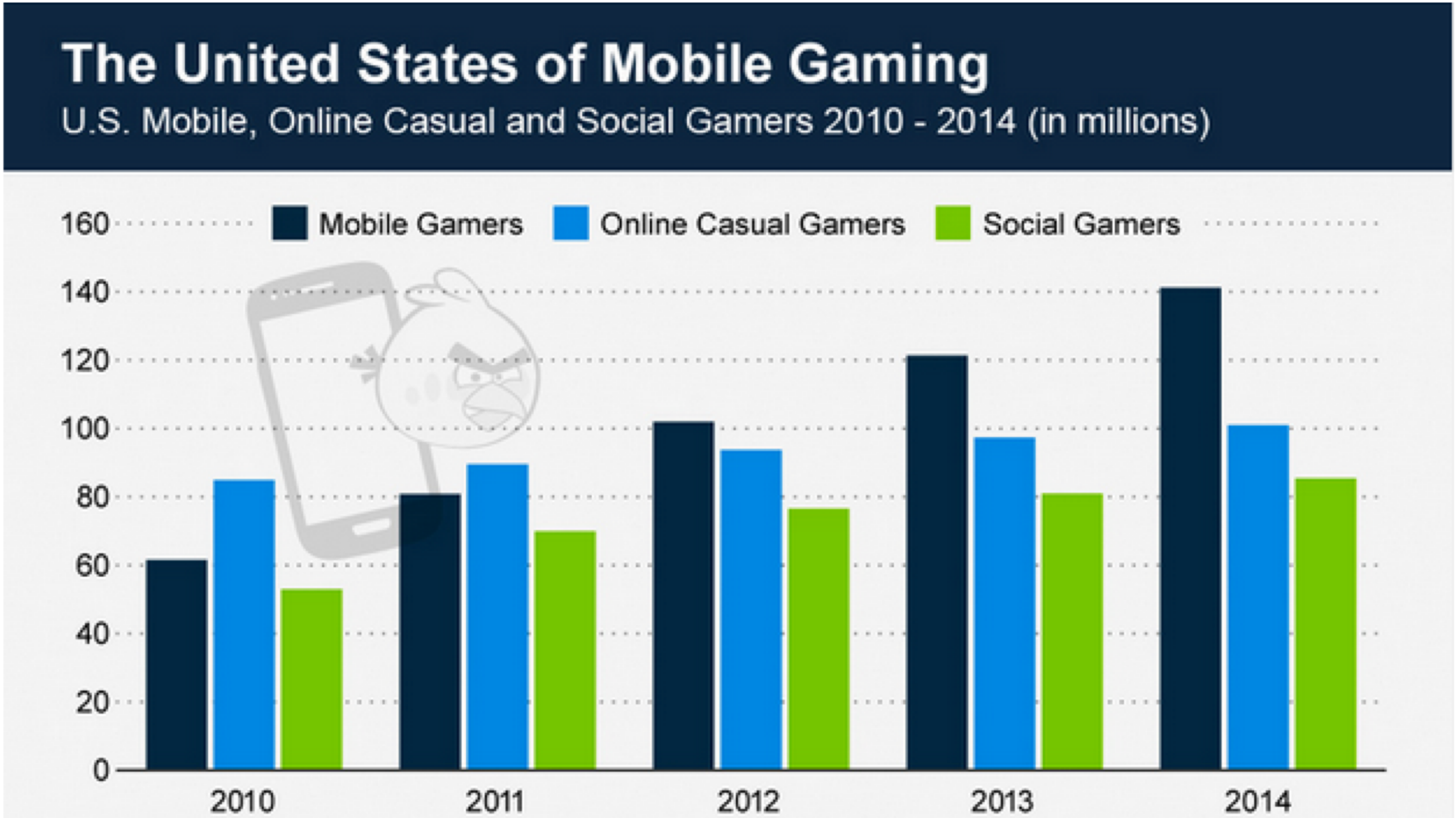
FINANCIAL TIMES

JAN 20, 2014

Nintendo's declining sales put change of game plan on cards

Nintendo announced that it had cut its net profit forecast of Y55bn ($527m) in the year to March to a net loss of Y25bn, as sales of its Wii U games console and 3DS handheld unit fell well short of global targets ..

*The core problem is that the world's largest games machine maker has been **hurt by the big shift to mobile devices.** Casual gamers are abandoning specialised hardware in favour of playing on phones and tablet computers, on which titles can be downloaded at a fraction of the cost …*

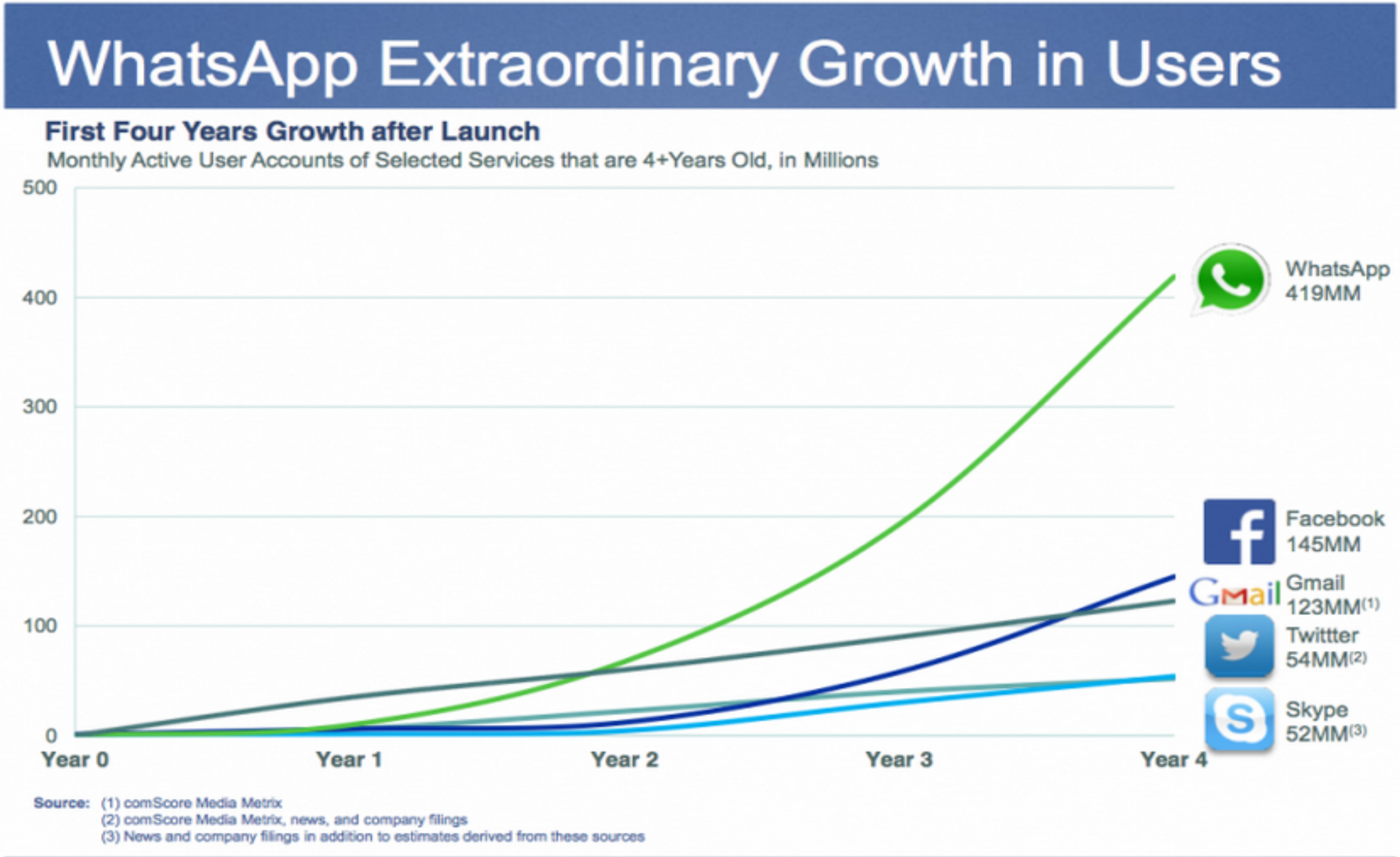


Source: Statista

Only businesses «disrupted» by other businesses … without «real» gains for the destroyers?

Of course not!

Creating value by disrupting established industries: the case of WhatsApp



The case of WhatsApp (1/4)

«WhatsApp has succeeded to destroy the market of SMS in only four years: an operation that would required in other times between 20 and 30 years»,

it claimed one of the world's leading operators of venture capital, at the recent acquisition of WhatsApp by Facebook for **$ 19 billion**.

Nineteen billion for a startup founded in 2009, which succeeded in 4 years – investing few money **($ 60 million**), and with very few people (**55 in all**), but giving up almost entirely (given its business model) to revenues – to overcome the threshold of **450 million users** and **50 billion of messages** processed per day: the highest rate of growth in the history of the world economy.

The case of WhatsApp (2/4)

Apart from the entity of the amount paid, it is the speed rate at which WhatsApp and other startups are disrupting a market as rich as that of SMS, with heavy damage to the telecom operators who controlled it, that deserves a reflection.

Short Message Service is a market of relatively recent birth, developed (until the advent of smartphones) with the spread of phones, and also because their customers are mainly large enterprises.
An equally worthy reflection is addressed to the fact that new entrants – WhatsApp and other startups – increasingly steal market shares from the incumbent firms (Mobile Network Operators), but do not take over them (if not in small part) in revenues and profits, because they offer alternative services (almost) for free.

The case of WhatsApp (3/4)

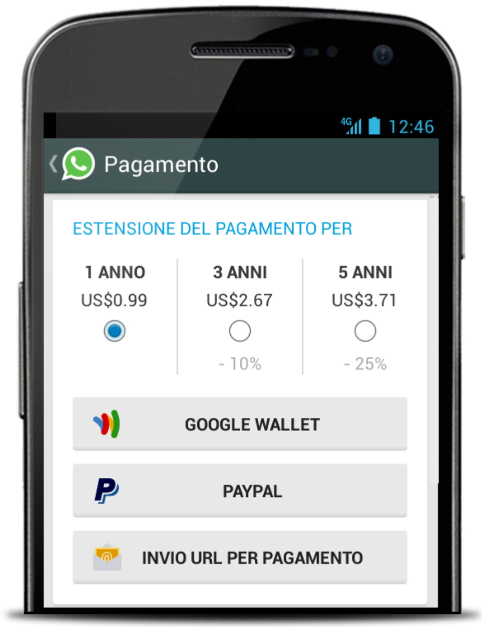
What were the main features of the WhatsApp phenomenon?

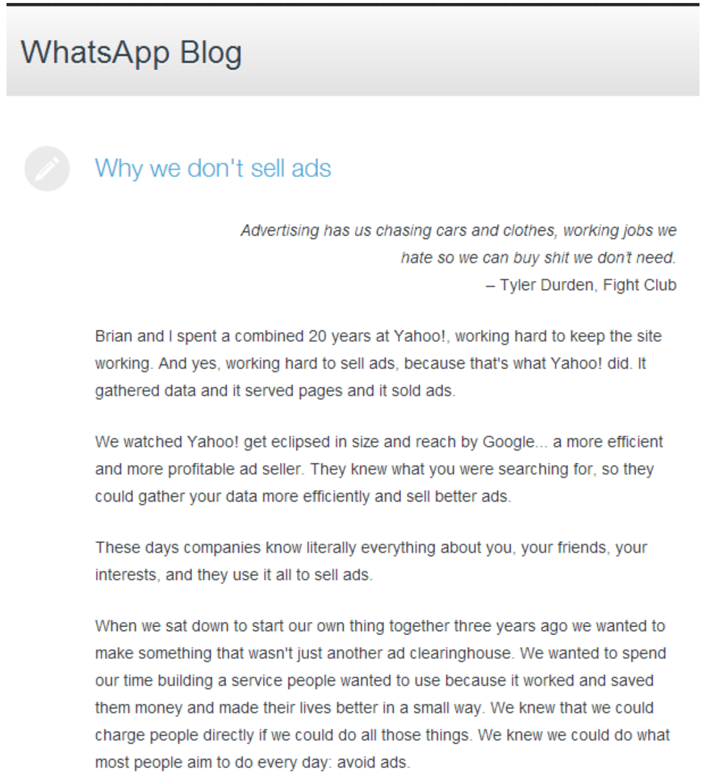
1. the possibility born with smartphones of a mobile access to the Internet and therefore an alternative media for the messages;
2. the possibility of passing through the Internet to circumvent the policy of price discrimination, on the basis of uses, applied by telecom operators: such as the inclusion of photos in the messages themselves;
3. the growing availability of broadband, for its impacts on the quality of services moved through the Internet;
4. the availability of an infrastructure even more consistent of cloud computing;
5. the very low cost for the creation and dissemination of an app.

The case of WhatsApp (4/4)

The growth of WhatsApp through the disruption of an industry segment as rich as that of SMS is a case of big-bang disruption!

But is the growth of WhatsApp sustainable?





WhatsApp Blog

Why we don't sell ads

Advertising has us chasing cars and clothes, working jobs we hate so we can buy shit we don't need.
– Tyler Durden, Fight Club

Brian and I spent a combined 20 years at Yahoo!, working hard to keep the site working. And yes, working hard to sell ads, because that's what Yahoo! did. It gathered data and it served pages and it sold ads.

We watched Yahoo! get eclipsed in size and reach by Google... a more efficient and more profitable ad seller. They knew what you were searching for, so they could gather your data more efficiently and sell better ads.

These days companies know literally everything about you, your friends, your interests, and they use it all to sell ads.

When we sat down to start our own thing together three years ago we wanted to make something that wasn't just another ad clearinghouse. We wanted to spend our time building a service people wanted to use because it worked and saved them money and made their lives better in a small way. We knew that we could charge people directly if we could do all those things. We knew we could do what most people aim to do every day: avoid ads.

ft.com/frontpage Europe All times are London time
FINANCIAL TIMES

NOV. 12, 2013

Airbnb rallies users amid regulation threat

...Brian Chesky, Airbnb's co-founder and chief executive, showed off a redesigned mobile app and networking site for hosts - for **Apple**'s iPhone and **Google**'s Android - to make it easier for them to rent out their spare rooms and get support from other users of the service.

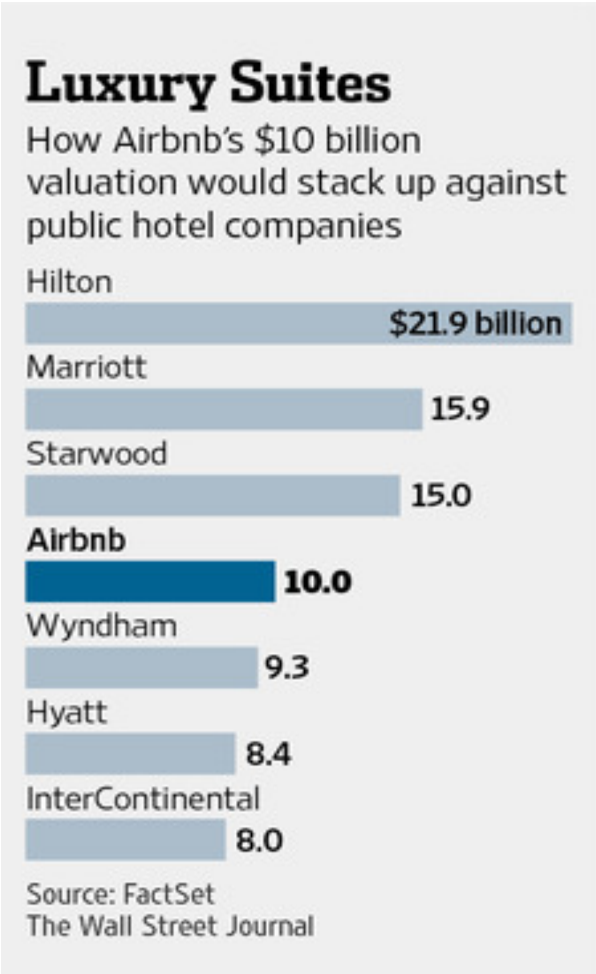
The company, **a "sharing economy" pioneer** , which launched in 2008 and now operates in **34,000 cities**, is also overhauling its reviews systems to provide more detailed ratings, such as cleanliness, accuracy, availability and a host's "commitment".

"We are confident that in the future the majority of guests staying with you will be booking their trips on a phone" ...

THE WALL STREET JOURNAL.

March 20, 2014

Airbnb Is in Advanced Talks to Raise Funds at a $10 Billion Valuation

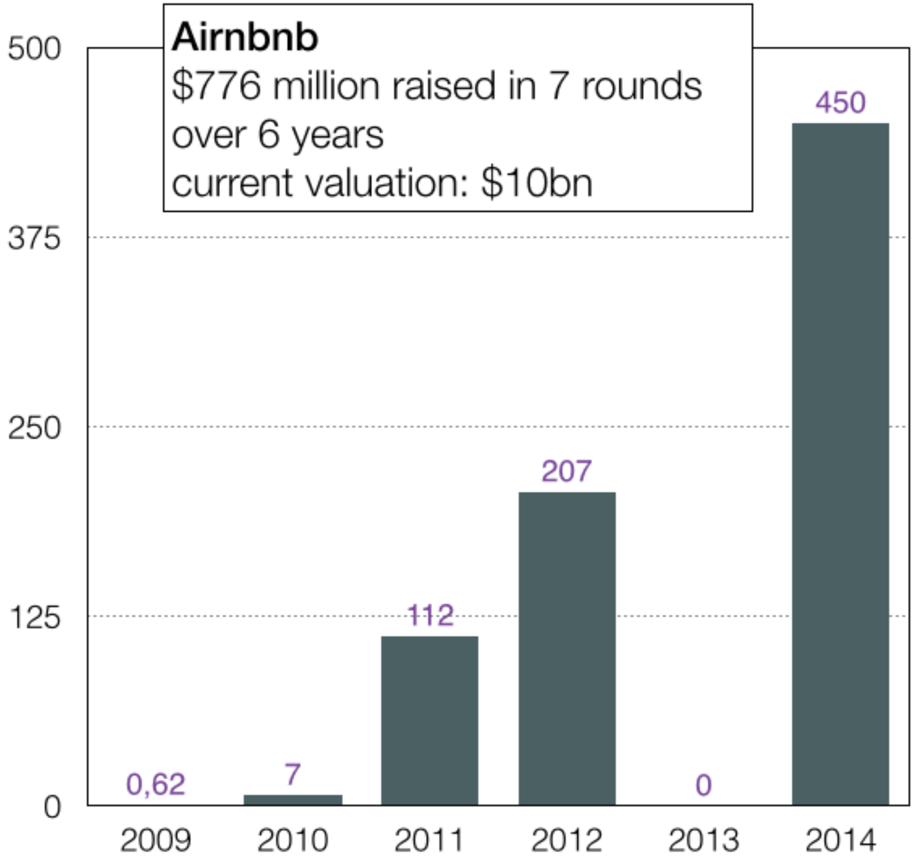


*The rich price tag reflects Airbnb's potential to **disrupt** the hotel industry. In six years, the company has become a required destination for millions of tourists looking for cheap rooms, while giving homeowners a new source of income.*

*The company could be worth **more than** Wyndham Worldwide, which manages 7,500 hotels under the Wyndham, **Ramada** and other brands, and is valued at $9.3 billion. **Hyatt** Hotels has a market value of $8.4 billion.*

The effects of disruptive models

Source: http://www.mondaynote.com/



In 2015, Airbnb Inc. is raising money from investors in a financing round that would value the room-sharing service at $20 billion or more (Source: http://www.bloomberg.com/).

Finance loves «dirupters»:
Alibaba collected from the stock market the highest amount in the history of listings

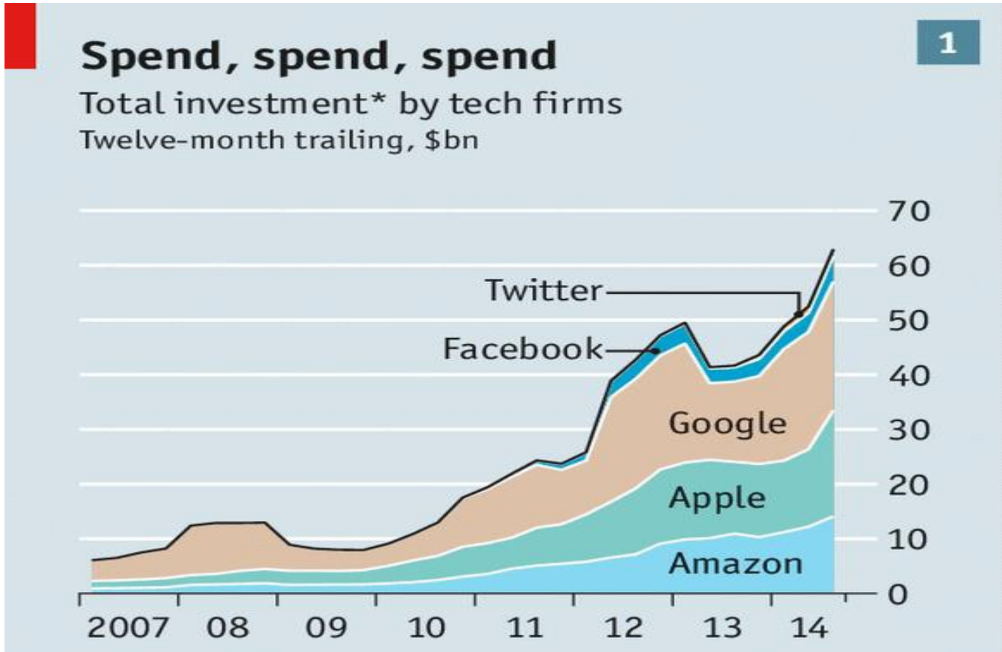
The Chinese Alibaba, a leader company in China in the e-commerce field and also operating in the finance sector, was listed on the NYSE in September 2014 by collecting the highest amount in the history of quotations – **$ 25 billion** – with a market capitalization over $ 200 billion.

Finance loves «disruptors»:
9 companies not yet listed are evaluated at least $ 10 billion and 78 those who are avaluted at least 1

The Chinese Xiaomi is the first, leader in the Chinese market of smartphones and with only four years of life, which has an **implied market capitalization** (calculated on the basis of the last received private funding) of $ 46 billion and has collected $ 1.4. It is followed by Uber, which is «evaluated» at least $ 40 billion, but it has collected twice that number.

Finance loves «disruptors»

Together, Apple, Amazon, Facebook, Google and Twitter invested $66 billion in the past 12 months. That is ***eight times*** what they invested in 2009.



*Capex, R&D, cash acquisitions and leasing of fixed assets
Sources: Bloomberg; *The Economist*

The Economist

Dec 20th, 2014

Together these five tech firms now ***invest more than*** any single company in the world: more than ***Gazprom***, ***PetroChina*** and ***Exxon***, which each invest about $40 billion-50 billion a year.

The five firms ***together own $60 billion of property and equipment***, almost as much as ***General Electric.*** They employ just over ***300,000 people***.

But it is not the same for stakeholders…

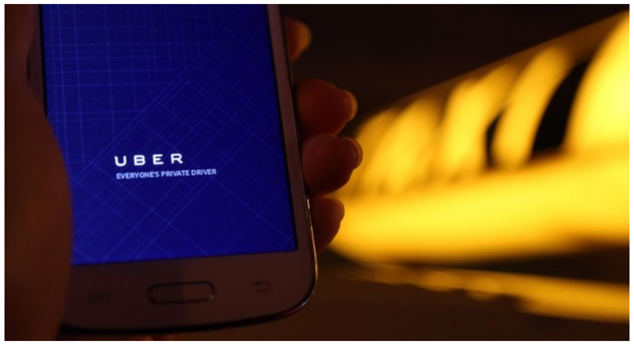
#UberPop: two years in prison and a €300,000 fine. France blocks #Uber 'ride-sharing' service http://on.wsj.com/12SKkUN

FT - December 8, 2014

Uber banned in New Delhi after sexual assault allegations

FT - December 24

Uber chief indicted in South Korea



But it is not the same for stakeholders…

WSJ March 15, 2015

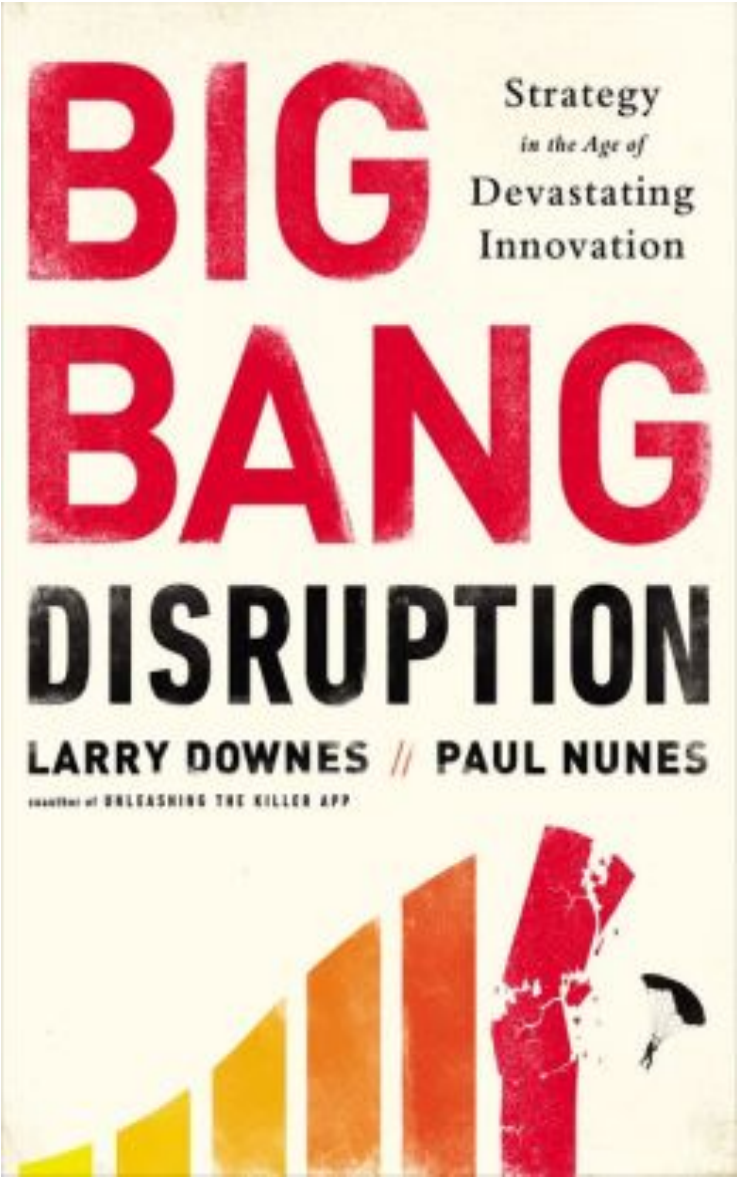
Uber, Lyft Cases Focus on Drivers' Legal Status

Ride-sharing firms' business models could be affected by verdicts

*Two San Francisco judges separately ruled last week that suits filed by **drivers of the ride-sharing services Lyft and Uber*** should go before juries.

At issue in both cases is ***whether drivers, who are employed as independent contractors, should be considered employees*** of those firms, and thus entitled to the protections afforded most full-time workers.

Three questions on Big-Bang Disruption



1. Is it «really» a phenomenon so qualitatively different to the entry of new business models in the last 30-40 years, up to assume it is a new paradigm?

2. Is it likely to continue, and if so is it likely to amplify or shrink gradually?

3. Is it so spread even in cases where there is no «big bang»?

THE BIG IDEA

Big-Bang Disruption

A new kind of innovator can wipe out incumbents in a flash. *by Larry Downes and Paul F. Nunes*

(1/2)

*The speed and the dramatic impact of Big Bang Disruption are the result of **disruptive technologies** that continue to enter the market **better and cheaper** than their predecessors.*
*In this brave new world, **new products and services start out life competing simultaneously on price, performance, and customization**.*

The disruptors have already redefined the rules of engagement in highly competitive, technology intensive industries, including consumer electronics, computing, and communications.
*But as the computing revolution continues to insinuate itself into every corner of our lives, **Big Bang Disruptors are starting to appear in every industry**.*


THE BIG IDEA

Big-Bang Disruption

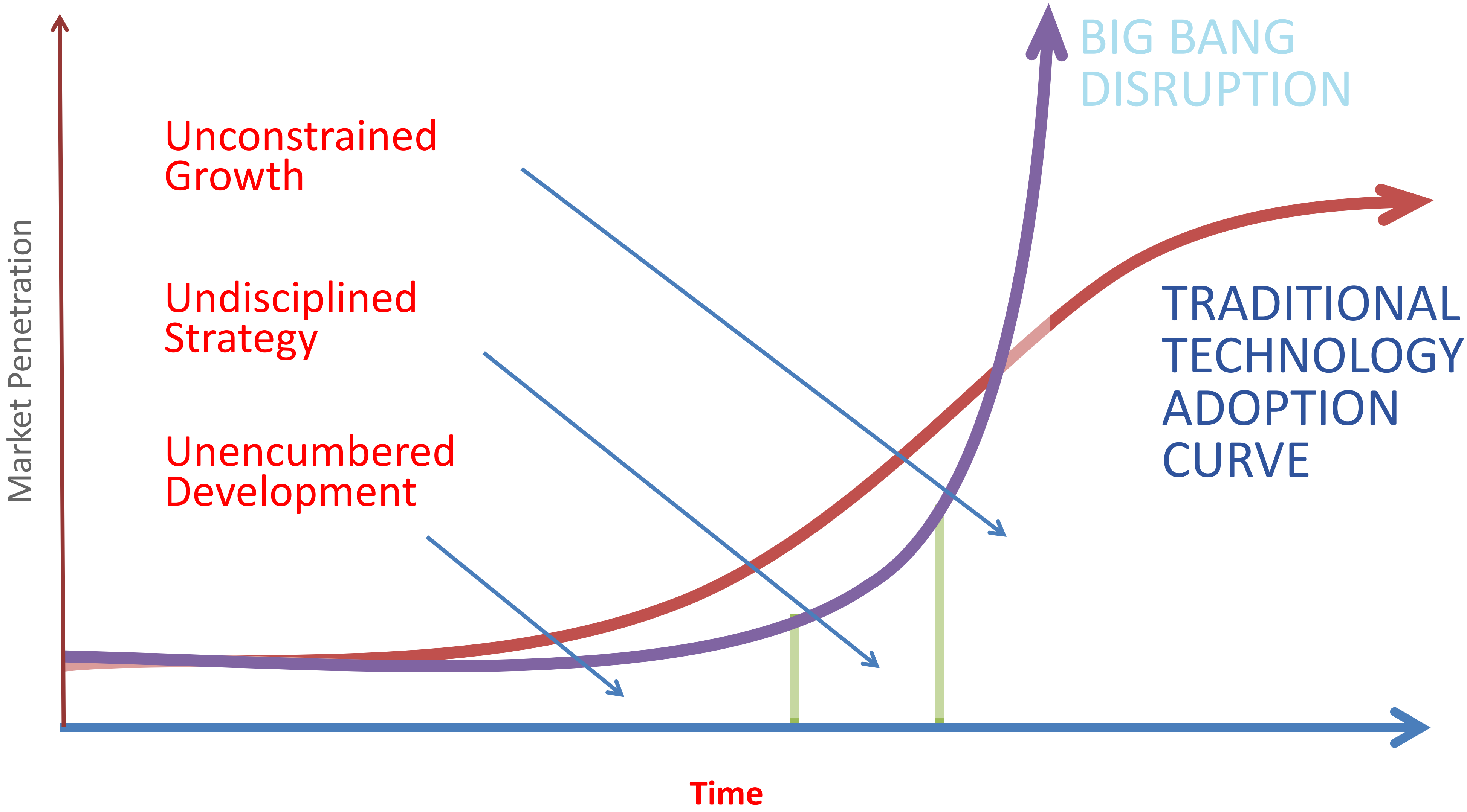
A new kind of innovator can wipe out incumbents in a flash. *by Larry Downes and Paul F. Nunes*

(2/2)

For each of the items listed above ***the source of disruption is the same*** *- the* ***programmable smart phone****, a hybrid computing and communications device with an endless number of small software apps.* ***Apps*** *can be small because most of their data processing takes place elsewhere, in what is known as* ***cloud*** *computing.*

This ***combination of hardware, software, and distributed computing*** *have quickly replaced a wide range of devices, products, and services; some very old and others relatively recent innovations themselves.*

Three key characteristics («devastating features») of Big-Bang Disruption



Three key characteristics («devastating features») of Big-Bang Disruption

1. Unencumbered development

- Big-bang innovations are often born of rapid-fire, low-cost experiments on fast-maturing, ubiquitous technology platforms
- They don't need budget approval and aren't vetted before development begins
- These innovations are often built out of readily available components that cost little or are free
- Innovators and entrepreneurs can experiment with new applications at little risk to investors, abandoning prototypes that do not quickly prove popular

Three key characteristics («devastating features») of Big-Bang Disruption

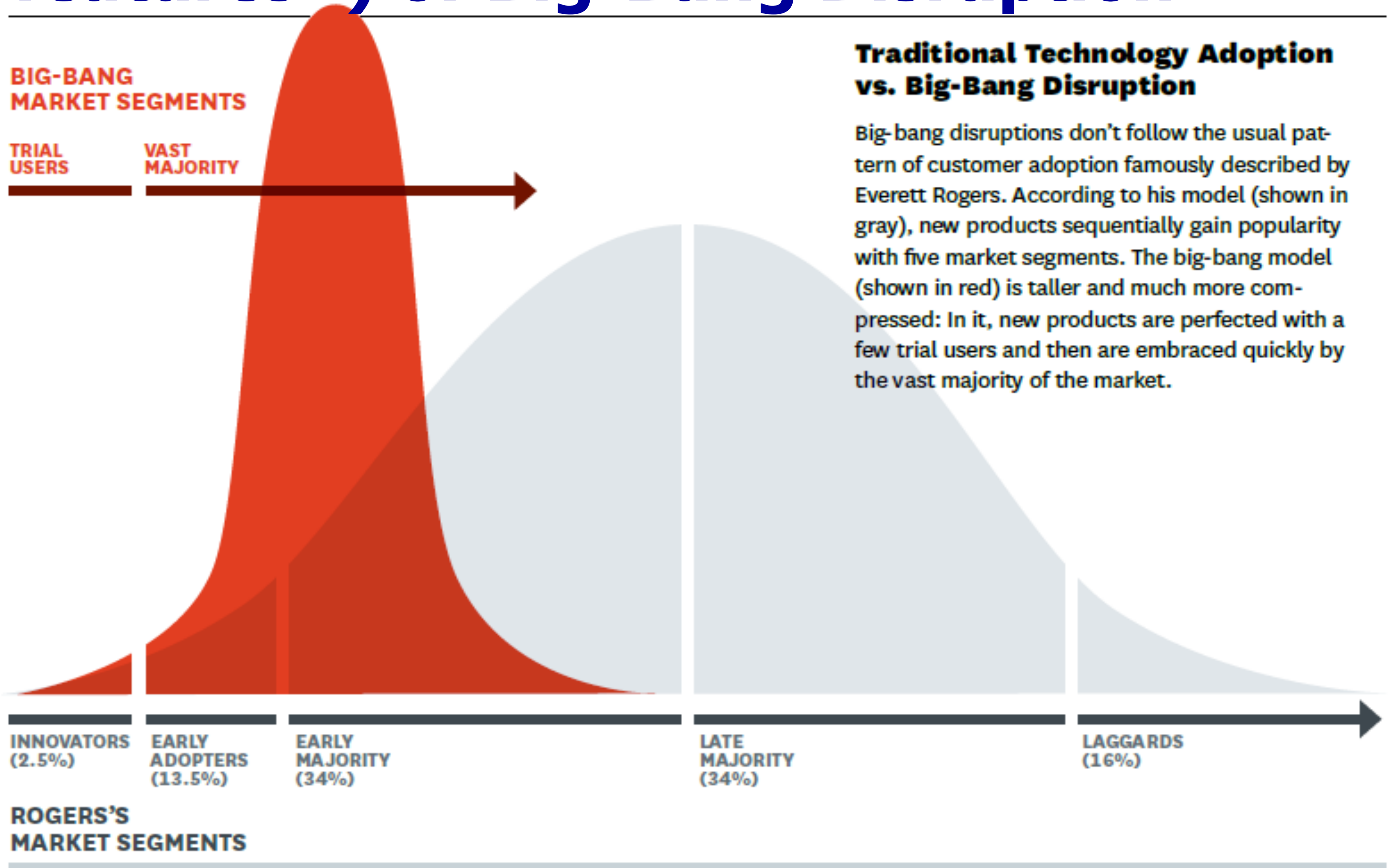
2. Unconstrained growth

- Big-bang disruptions collapse the product life cycle
- Now there are only two segments: **trial users**, who often participate in product development, and **everyone else**
- The new product cycle can be simplified into three basic stages:
  1. development
  2. deployment
  3. replacement
- The innovators collectively get it wrong, wrong, wrong—and then unbelievably right.
- In today's hyperinformed world, each epic failure feeds consumer expectations for the potential of something dramatically better

Three key characteristics («devastating features») of Big-Bang Disruption

Traditional Technology Adoption vs. Big-Bang Disruption

Big-bang disruptions don't follow the usual pattern of customer adoption famously described by Everett Rogers. According to his model (shown in gray), new products sequentially gain popularity with five market segments. The big-bang model (shown in red) is taller and much more compressed: In it, new products are perfected with a few trial users and then are embraced quickly by the vast majority of the market.



Three key characteristics («devastating features») of Big-Bang Disruption

3. Undisciplined strategy

- Big-bang disrupters contradict much that you know about competitive strategy

- Big-bang disrupters are thoroughly undisciplined:
  - They start life with better performance at a lower price and greater customization. They compete with mainstream products on all three value disciplines (low cost; constant innovation; product customization) right from the start.

- How can better also be less costly?
  - The faster, cheaper, and smaller computing power (Moore's law) is now deployable on a **global scale** and delivered through the **cloud** to inexpensive **mobile devices**
  - **Today's technology continually and dramatically reduces costs** (parts and manufacturing, embedded technologies and intellectual property, and development costs), thus making it possible to sell new products and services more cheaply than the inferior alternatives they displace

Three questions on Big-Bang Disruption

It is not «a phenomenon», but the result of some **MEGATRENDS**:

- Growth of the **«sharing economy»** model
- Growth of the **«product servitization»** model (use vs. ownership)

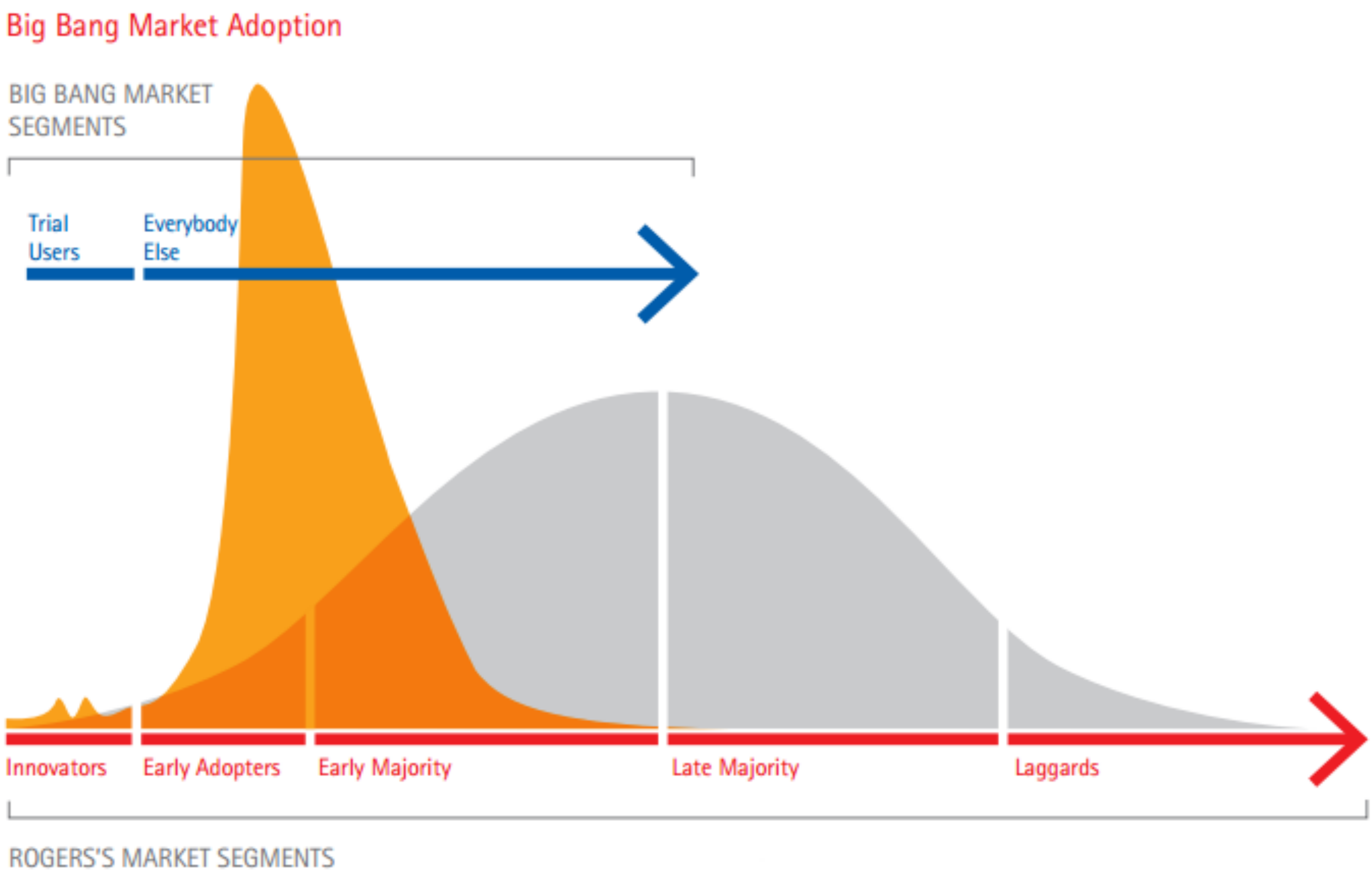
And…

- The **momentum growth of the «entrepreneurial» dynamic**

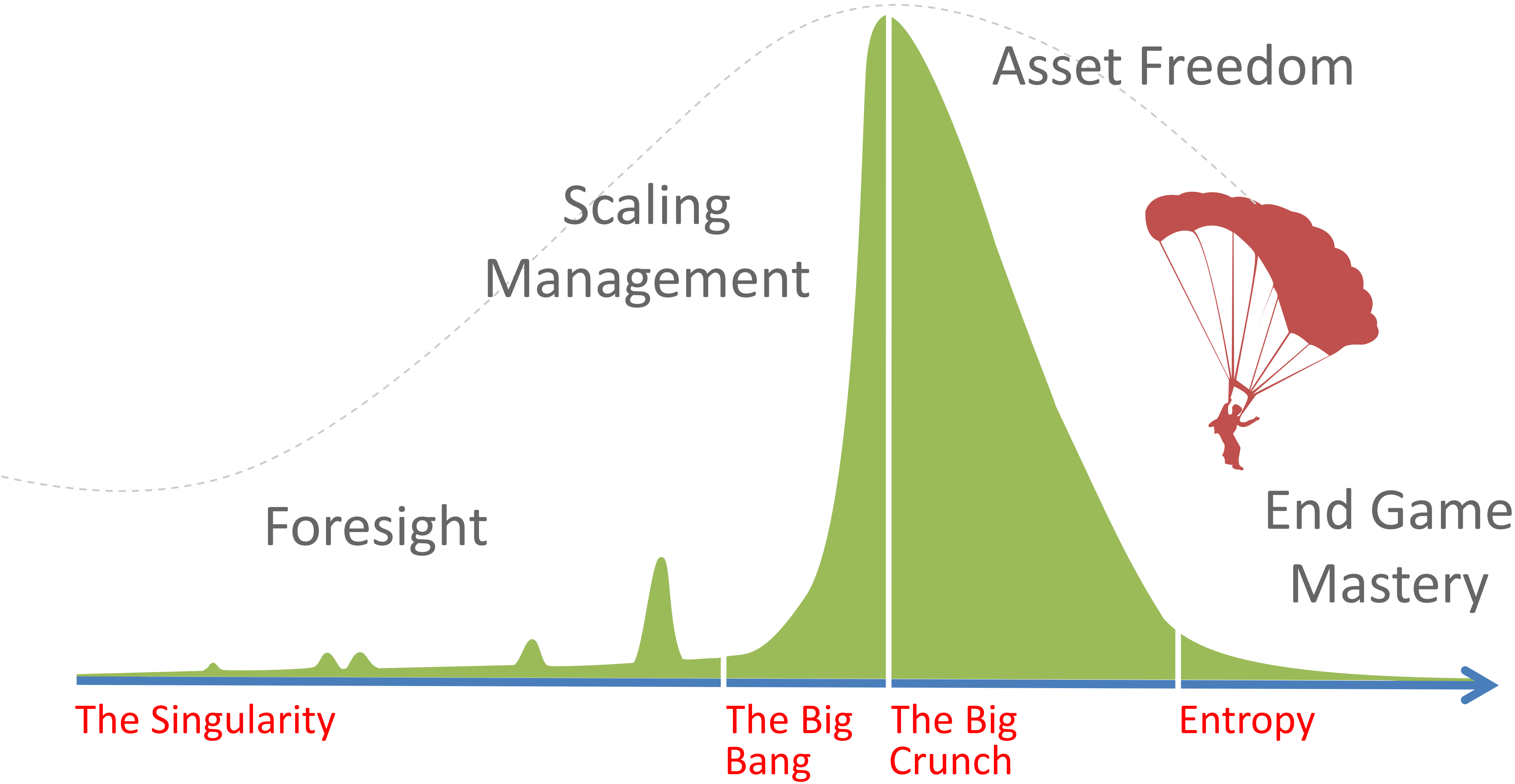
And…

- The **reduction** of creation cost
- The **reduction** of marketing cost
- The **reduction** of experimentation cost

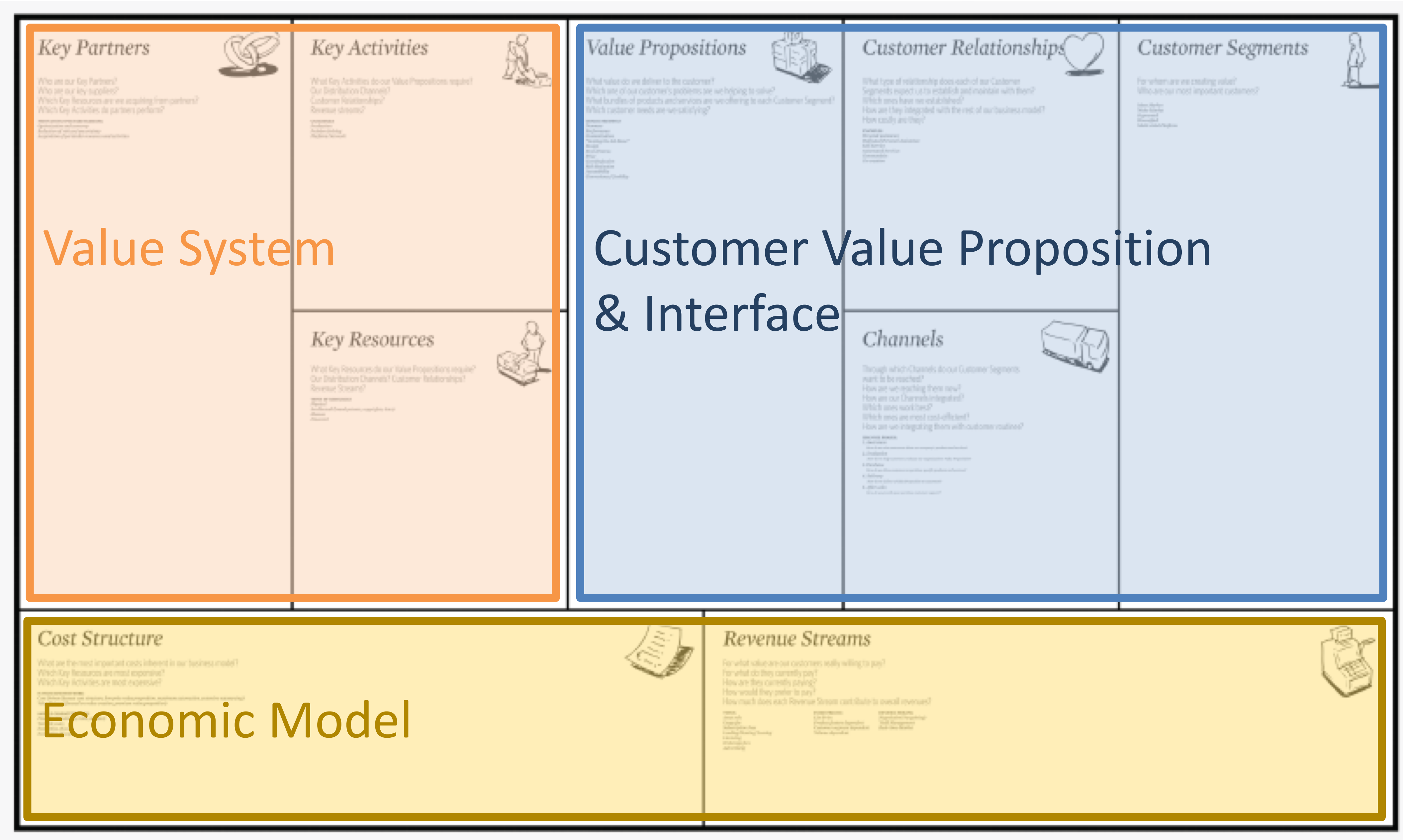
… not without risks



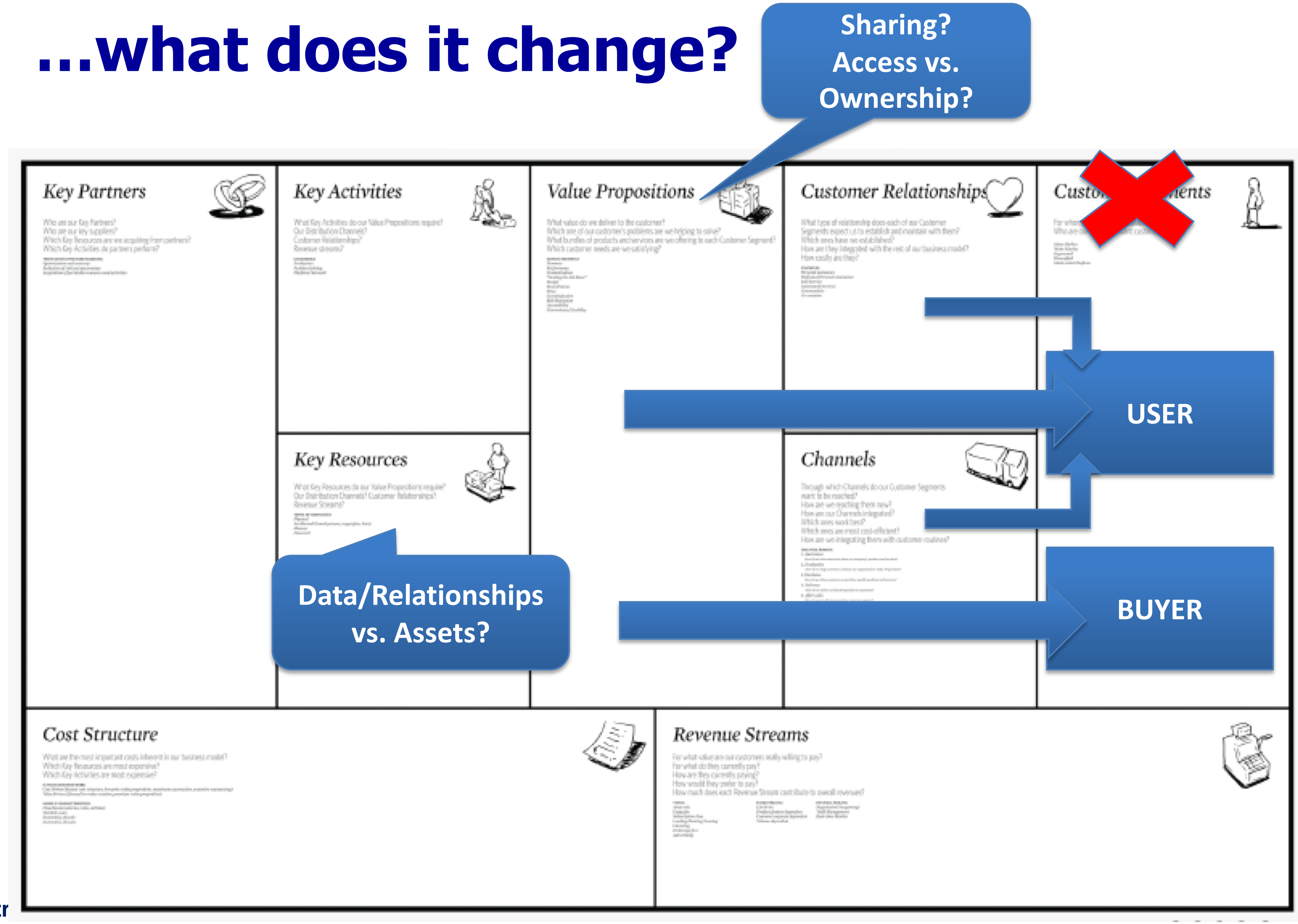
Four stages of Big-Bang Disruption: Four strategic Imperatives



...what does it change?



...what does it change?



POLITECNICO
DI MILANO

Disruptive Innovation and Big-Bang Disruption

Silvia Sanasi

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Department of Management, Economics and Industrial Engineering

POLITECNICO DI MILANO

Multisided platforms Strategies and Business Models

Prof. Antonio Ghezzi, PhD

Politecnico di Milano

Department of Management, Economics and Industrial Engineering

rapid strategy

Agenda

1. *Definitions*
2. *Examples*
3. *Network effects*
4. *Subsidy-side and Money-side*
5. *Critical issues*
6. *Ignition strategies and tactics*

1. Definitions

In the last 15 years, multi-sided platforms have:

- Become some of the largest and fastest-growing businesses
- Reduced several market frictions
- Challenged many industries
- Overran the incumbents in many cases

1. Definitions

"A platform provides the ***infrastructure and rules*** *for a* ***marketplace*** *that brings together* ***producers and consumers****"* (Van Alstyne et al., 2016).

offer and demand

*"****Multisided platforms*** *are* ***technologies, products and services*** *that create value primarily by* ***enabling direct interactions between two or more customer or participant groups****"* (Hagiu, 2013).

"They [Multi-sided platforms] *enable direct interactions between two or more distinct sides. Each side is* ***affiliated to the platform****"* (Hagiu and Wright, 2015).

"Platforms are ***matchmakers*** *of sorts, although the matchers are often not one-to-one. But like matchmakers, they* ***discover a need for****, and then* ***facilitate****,* ***consumer coordination****"* (Wu, 2013).

"They are called platforms because they usually ***operate a physical or virtual place*** *that helps the* ***different customers get together****. Their efforts are aimed at* ***reducing a market friction****. Such a reduction is a* ***necessary but not sufficient condition*** *for a multi-sided platform to succeed"* (Evans & Schmalensee, 2016).

1. Definitions

sides: customer segments
more than 1!
market friction (Search Cost, Transaction cost, development cost, ...)

Multi-sided platforms create huge value by:

- **Reducing search costs**

  Airbnb provides advanced search functionalities based on the desirable characteristics;

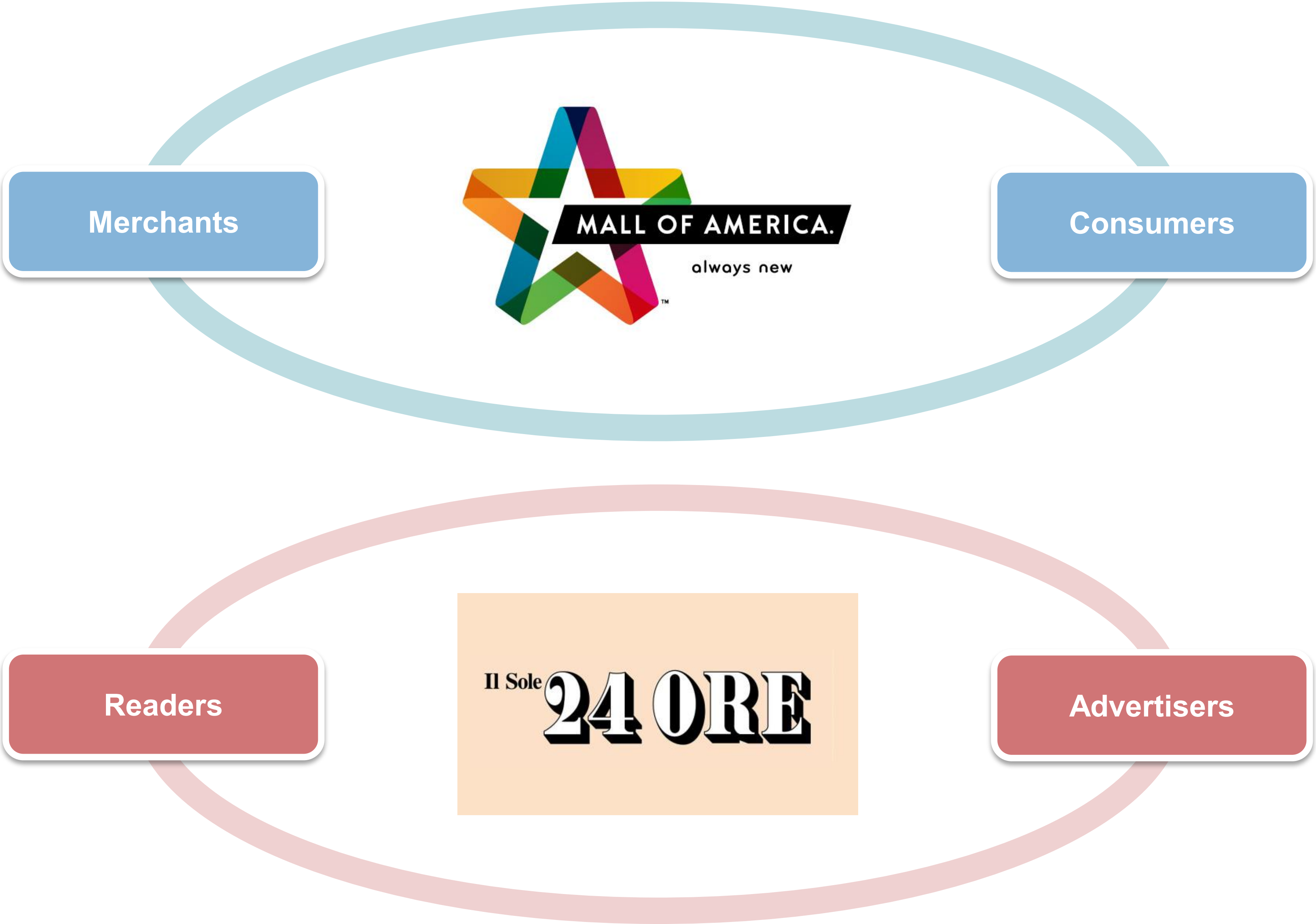
- **Reducing transaction costs**

  eBay allows payments performed by Paypal;

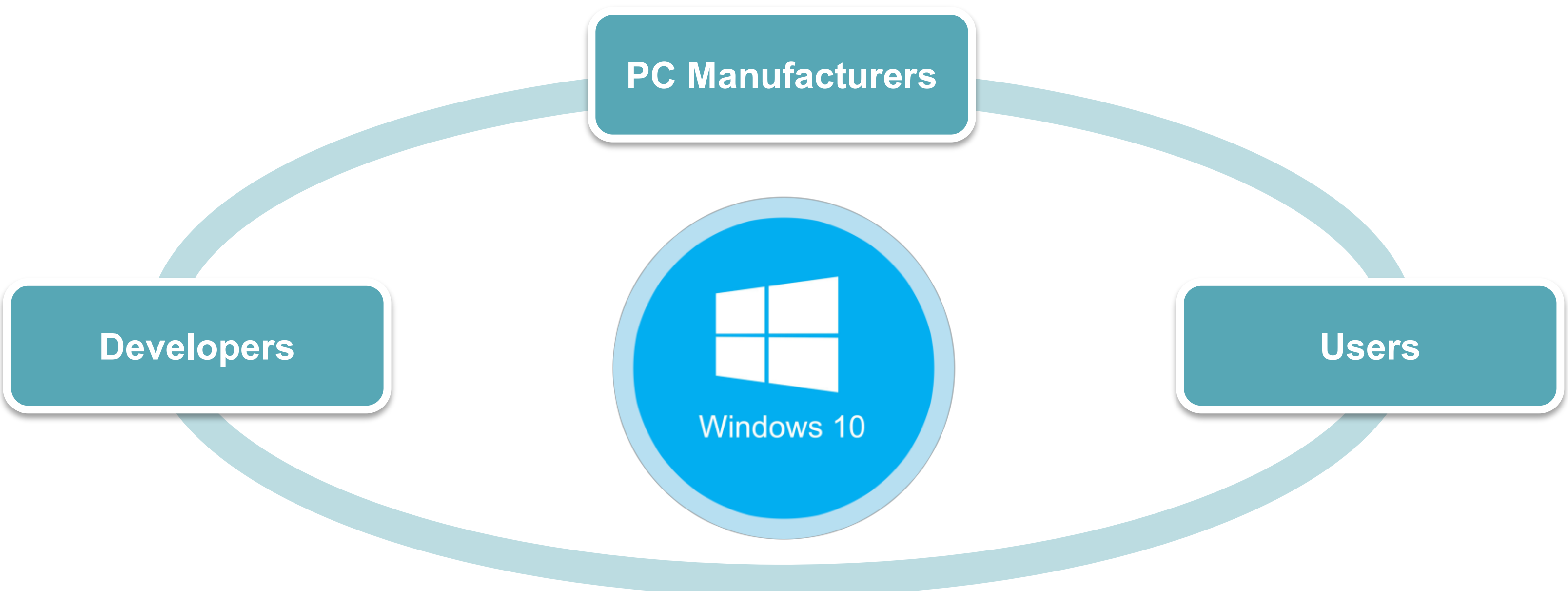
- **Reducing product development costs**

  Wikipedia provides editors with tools for collaboration; Sony provides game developers with development kits and application programming interfaces.

2. Examples: traditional businesses



2. Examples: more than two sides



2. Examples: new businesses

Passengers

UBER

Drivers

House Owners

airbnb

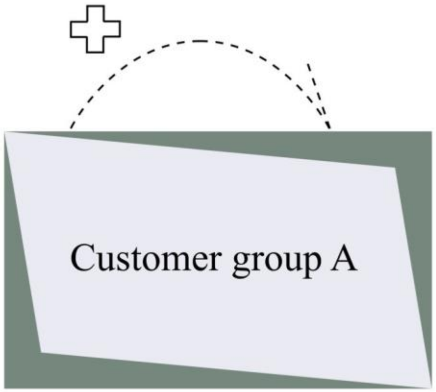
Travellers

Network effects

value of being in a group

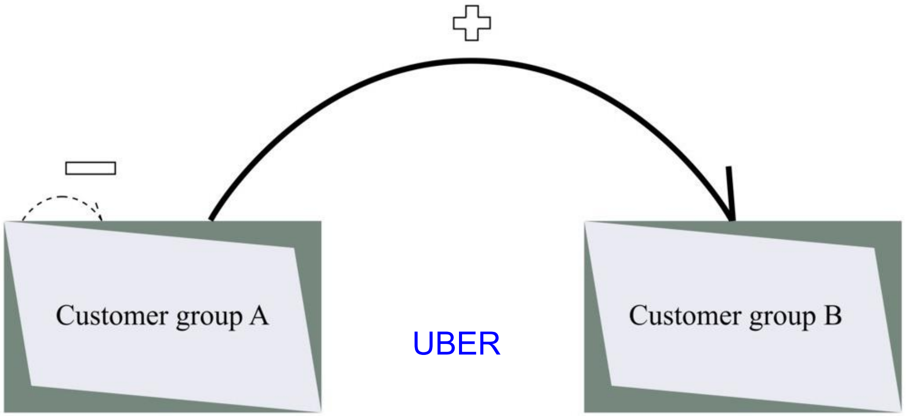
I. Same-side network effects

Network effects affect the same customer group they originate from.

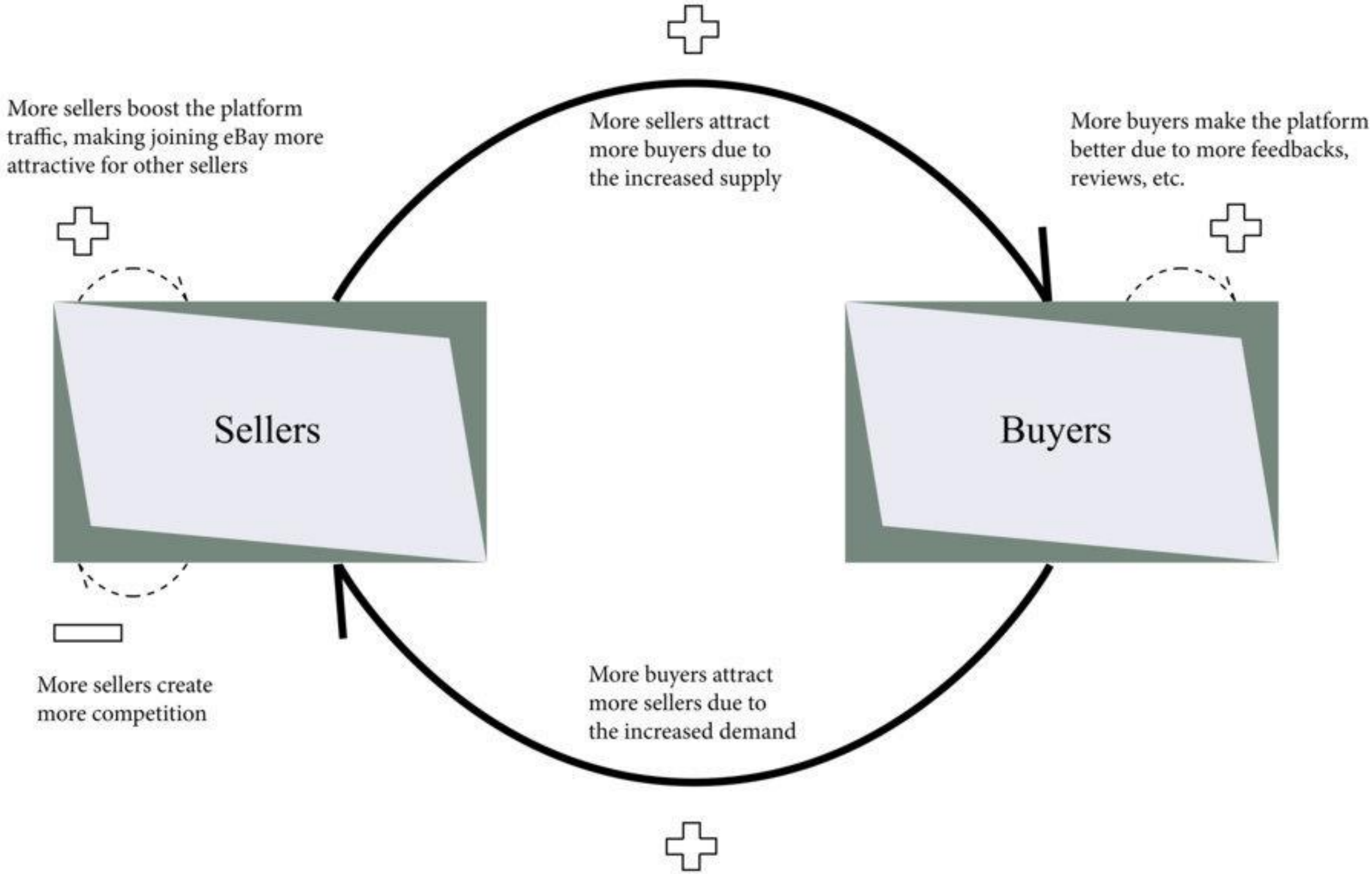


II. Cross-side network effects

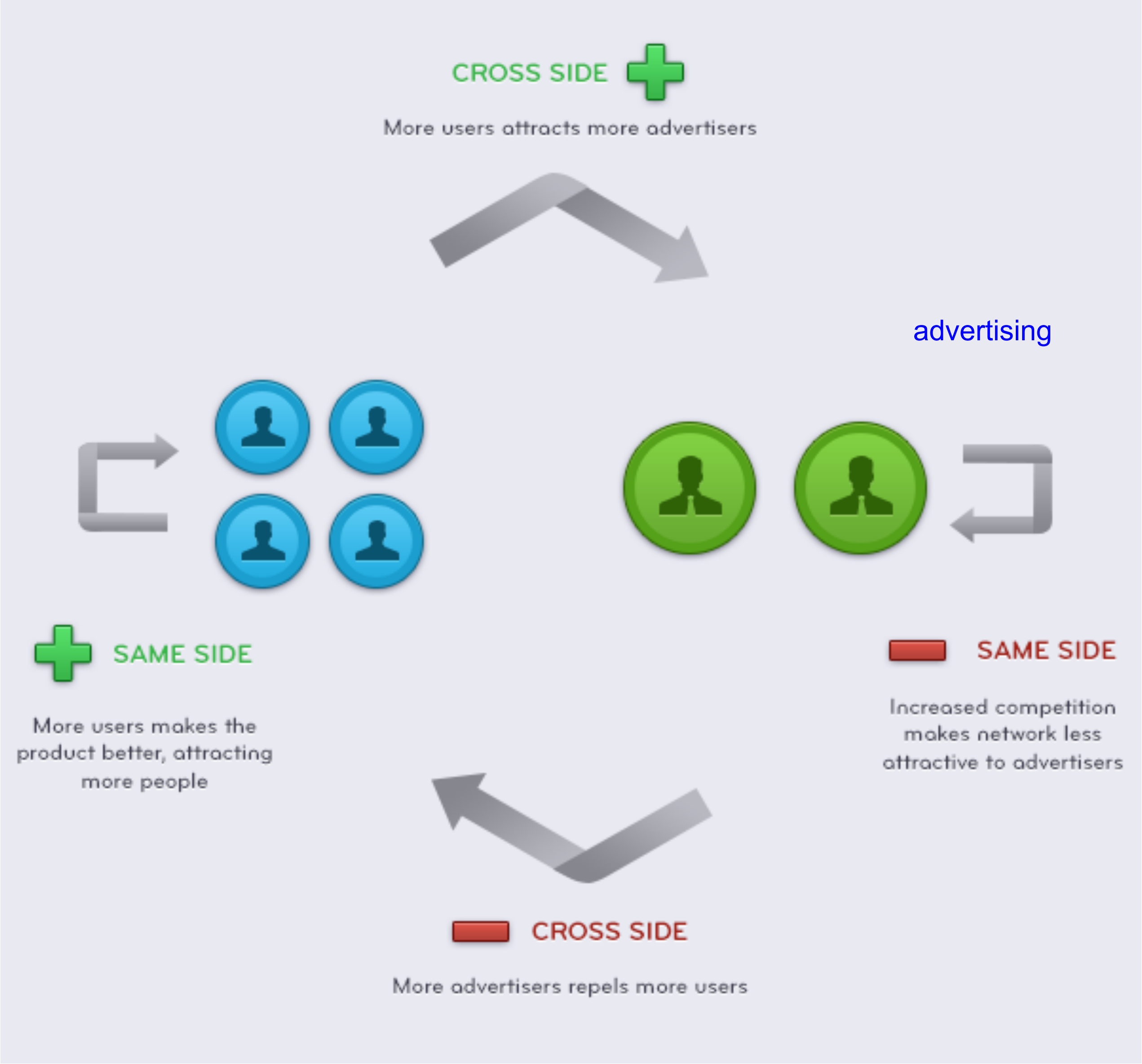
Network effects affect a different customer group from the one they originate from.



Network effects: the eBay case



Network effects: social networks



3. Network effects: possible causes 1/2

Cause	Description	Example	Nature
Information provision	Each user or customer can provide information that could be useful for other users or customers.	Reviews on TripAdvisor or Amazon, which are provided by users and buyers, drive the future choices of other users and buyers.	The network effects so generated may be either positive or negative, due to the quality of the information provided. When it is truthful, the network effects created are positive; when it is misleading, negative effects originate.
Competition	When transactions are performed between two customer groups, each additional customer in one group represents an additional competitor for customers of that group.	More sellers on eBay mean more competition on that side.	Negative for the customer group that exhibits the effect, while it may be positive for the customer group which perform the transactions with that group and that can benefit from price battles and so on.
Volume/traffic	In some cases, the traffic and volumes generated by more customers can affect the company's offering in ways that do not involve higher probabilities of matching and so on. Instead, fashion and trends of the moment can be the reasons.	Social networks are good examples: when snapchat faced its disruptive growth in terms of user, it became the trend of the moment. Each new user enforced this attractive power related to the trend.	As trends and fashions, this kind of network effects are positive when the trend of the moment is favorable, negative when it changes.
Higher probability of finding a counterpart for a transaction	When customer groups perform transactions between them, the wider the other customer base is, the higher the probability of finding a counterpart to perform the transaction with. It can be exhibited also inside the same customer group in case transactions are performed within it.	More Amazon buyers mean more demand to satisfy for independent sellers that use the Amazon marketplace to sell their products.	Network effects are positive, but they usually come along with network effects related to good behavior, misbehavior and content quality, due to the "social" component of dealing with another customer.

3. Network effects: possible causes 2/2

Cause	Description	Example	Nature
Higher probability of finding a counterpart for enjoying the company's offering	When the company's offering has to, or it may, be experienced and enjoyed with other customers, an increased customer base enhances the probability of matching.	More online FIFA players mean a higher probability of finding another player online to play with.	Network effects so generated are usually positive, but they come along with network effects related to good behavior and misbehavior of customers, due to the social experience.
Good behavior and misbehavior	When transactions and interactions exist between customers, positive behaviors and misbehaviors can improve or undermine the company's offering.	In case of frequent misbehaviors by Uber drivers, potential passengers are likely to prefer a taxi rather than Uber.	Positive in case of good behaviors, negative in case of misbehaviors.
Content provision	When transactions exist between customers or in case each user or customer can provide content that could be useful for other users or customers, the company's offering can be affected by this content.	The apps available on the App Store are an example of content provided by a customer group (developers, who are a customer group of Apple).	The network effects so generated may be either positive or negative, due to the quality of the content provided. High quality implies positive effects, while poor quality implies negative ones. The precision of firm controls on the content added by third parties is determinant.
Passion/sense of community	Each customer hopes for the diffusion of it, trying to convince other people to become customers or to join the platform. It is a typical effect when the company's offering concerns an hobby.	Close-knit Xbox players try to persuade other people to buy the console produced by Microsoft, instead of Playstation, for example. Each acquired player is an additional source of customer attraction due to her/his tries of conviction.	It usually generates positive network effects. However, in case the customers feel betrayed by the firm as concerns their passion, the consequent negative network effects would be strong.

Pricing structure

The existence of network effects strongly affects the decision about pricing: serving multiply types of customers, multi-sided platforms have potentially **multiple revenues sources**.

For a multi-sided platform, **subsidizing** certain users can be essential. **The choice of which side subsidize and for how long represents an important strategic issue**.

In a two-sided market, a common situation implies a subsidy-side and a money-side:

- The **subsidy-side** is charged less than it would be in an independent market, charged nothing or is given rewards to participate in order to reach high volumes and make more valuable the platform for the other side;
- The **money-side** is charged more than it would be in an independent market.

Pricing structure

Sometimes a side is subsidized only in the start-up phase in order to build critical mass, sometimes it is charged free, or “negative” prices are permanently applied, in order to maximize profits thanks to the monetization of the other side influenced by network effects.

Generally, the more price sensitive side is subsidized, while the side that increases mores strongly its demand as the other side volume grows is charged. The objective is to attract enough participants on the money-side in order to get huge revenues on the money side, which will be inclined to pay handsomely to access to the high volumes on the subsidy-side.

Ignition strategies and tactics

خمه شب بازی

Marquee customers

Customer relationships should not focus only the most profitable customers or most important ones, but a particular attention should be paid to the ones who enable the **strongest cross-side positive network effects**, too.
To do so, it is essential to understand who these customers are and if some **marquee customers** exist and who they are.

An example is provided by shopping malls, which sign up the stores that are likely to attract lots of people early on. Doing so, smaller retailers are persuaded to rent space at the mall, knowing that they will be able to exploit the traffic generated by the marquee shops.

Ignition strategies and tactics

Ecosystem seeding

Due to the chicken and egg dilemma, it might be convenient for a platform to start from a **market niche**. It allows to concentrate on defined customers, with delimited requests and needs.
How narrow should the niche be? The more the platform decides to keep it narrow, the smaller its market becomes. However, there are some advantages coming from a narrower target: the platform has the capability to address better and more specifically the customer preferences, and a smaller market niche makes easier the achievement of a critical mass.
Consequently, the platform may decide to enlarge the target, enabled also by the strength of the user volumes already attached to the platform. The approach is called "**ecosystem seeding**": starting with a subset of the target customers sufficient to get the platform going. That subset is called "seed", and it is chosen wisely, with the objective of making revenues soon, limiting the risk for investors. Clearly, **the choice of the seed is crucial**; nevertheless, the final aim is the growth of the platform's value, in terms of customers and functions or applications.

Ignition strategies and tactics

Zig-zag strategy

In case of positive cross-side network effects, a “**zig-zag strategy**” could be a good option for the platform. It continuously shifts its focus from one side to the other, trying to attract critical mass in all of them.

An example of “zig-zag strategy” is provided by YouTube. The American video-sharing website pushed participation on both sides, fostering with several strategies views and videos upload in an alternating way. When sides provide themselves a content that enriched the platform’s offering, or they perform interactions and/or transactions, it may be fundamental to build critical mass in more than one of them simultaneously. YouTube needed to get on board viewers and video content providers at the same time, as both groups need each other to enjoy the company’s offering.

Ignition strategies and tactics

Two-step strategy

don't over stretch

When the platform concentrates its efforts on attracting customers on one side, generating the positive cross-side network effects and, then, the efforts are focused on the side supported by those network effects, a so called “**two-step strategy**” is carried out.

An example is represented by social networks. The first step is a total focus on user attraction and registrations; consequently, advertising space is sold high prices in case a large user base is reached.

Ignition strategies and tactics

Commitment strategy

Sometimes customers of one firm's business model have to make a significant investment to receive the company's offering and to take advantage of positive cross-side network effects. In these cases, the firm should prove to these customers that there will be a large customer base on the business model from which the network effects originate. This **commitment strategy** is totally based on the capability of the firm to assure that promised customer base, for instance by specific partnerships or a favorable pricing structure in that business model.

An example is provided by Sony Computer Entertainment: it designed PlayStation 4 few years ago. When the console was launched, the firm persuade customers to invest several hundreds of dollars buying the PlayStation 4 thanks to a strong marketing campaign about future videogames, that Sony would directly developed, and an exclusive partnership with Spotify.

one side first to grow => two step strategy

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POLITECNICO DI MILANO

Strategic Entrepreneurship and Startups

constant search for business opportunity

Antonio Ghezzi

Politecnico di Milano

Department of Management, Economics and Industrial Engineering

Entrepreneurship: a possible definition

It is impossible to operationalize a concept that cannot be defined

… and

"the concept is synonymous with the corresponding set of operations"

(*Bridgman, 1927; Dewey, 1929*)

… so …

… What's entrepreneurship?

- "The discovery and exploitation of profitable (business) opportunities" (*Shane and Venkataraman, 2000 - AMR*)

Working definitions:

- "An *Entrepreneurial Event* involves the creation of a new organization to pursue an opportunity" (*Bygrave, 1989 - ET&P*)
- "The *Entrepreneurial Process* involves all the functions, activities, and actions associated with the perceiving of opportunities and the creation of organizations to pursue them." (*Bygrave and Hofer, 1991 - ET&P*)
- "An *Entrepreneur* is someone who perceives an opportunity and creates an organization to pursue it." (*Bygrave and Hofer, 1991 - ET&P*)

Entrepreneurship «reloaded»

What's a startup

?

constantly searching for business model capturing value

His definition of a startup is a great place to start: A startup is a temporary organization formed to search for a repeatable and scalable business model. Steve Blank

ways after spotting the opportunity

New ventures and Startups

What's a (new) venture?

rules of the game is clear like new restaurant

- a commercial undertaking characterized by risk of loss as well as opportunity for profit; and the merchandise, money, or other property placed at risk in such an undertaking (*Collins English Dictionary*)
- a new activity, usually in business, that involves risk or uncertainty (*British Dictionary*)

What's a Startup?

- A business or undertaking that has recently begun operation (*American Heritage Dictionary*)
- "A startup is a company working to solve a problem where the solution is not obvious and success is not guaranteed" (*Neil Blumenthal, cofounder and co-CEO - Warby Parker*).

… but also

- "Startup is a state of mind. It's when people join your company and are still making the explicit decision to forgo stability in exchange for the promise of tremendous growth and the excitement of making immediate impact" (*Adora Cheung, cofounder and CEO - Homejoy*)

New ventures and Startups

A possible list of common traits for a startup (*Forbes, 2014*) :

- up to 3-5 years old not make sense
- no acquisition by a larger company yet
- far from IPO (Initial Public Offering)
- a single office
- revenues lower than 20 mln. $ not make sense
- less than 80 employees and less than 5 people in the Board
- founders who haven't personally sold shares yet
- high ability to achieve unconstrained grow

… still, there are no hard and fast rules on defining a startup since revenues, profits, and employment numbers shift drastically between companies and Industries

Strategic Entrepreneurship: actions and opportunities

Strategic actions

- Those actions through which companies develop and exploit current competitive advantages while supporting entrepreneurial actions that discover and exploit opportunities that will help create competitive advantages for the firm in the future (*Porter, 2001; Kuratko et al., 2001*)

Entrepreneurial actions

- Actions through which companies identify and then seek to exploit entrepreneurial opportunities rivals have not noticed or fully exploited (*Ireland et al., 2001*)

Entrepreneurial opportunities

- External environment conditions suggesting the viability of introducing and selling new value propositions (products, services, raw materials and organizing methods) at prices exceeding their production costs (*Shane and Venkataraman, 2000*)
- They surface when actors have insights about the value of resources or a combination of resources that are unknown to others (*Alvarez and Barney, 2001*)

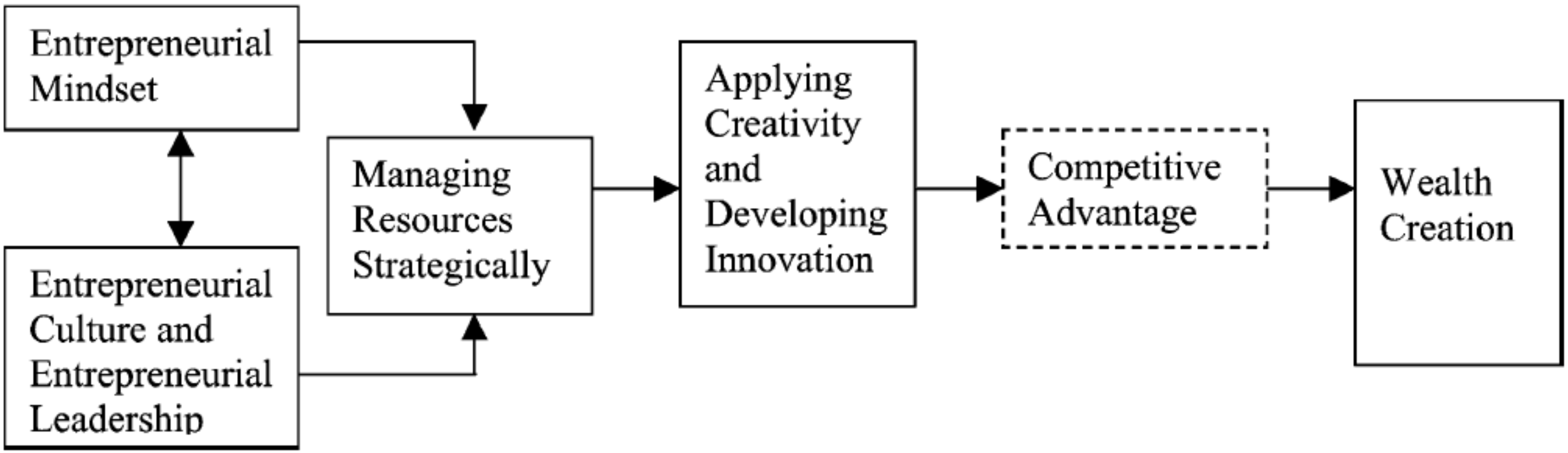
Strategic Entrepreneurship: integrating Entrepreneurial and Strategic perspectives

AS IS is more powerful
although we have to protect To be.

Strategic Entrepreneurhsip

- The integration of entrepreneurial (i.e. opportunity seeking actions) and strategic (i.e. advantage-seeking actions) perspectives to design and implement entrepreneurial strategies that create wealth (*Hitt et al., 2001*)
- Strategic Entrepreneurship is entrepreneurial action that is taken with a strategic perspective. “Romeo (entrepreneur) on the balcony (strategy)” (*Venkataraman and Sarasvathy, 2001*)
- Integrating entrepreneurial and strategic actions is necessary for firm to create maximum wealth
- Entrepreneurial and strategic actions are complementary, not interchangeable
- Entrepreneurial action is designed to identify and pursue entrepreneurial opportunities which arise from dynamic and uncertain environments
- Entrepreneurial action using a strategic perspective is useful to identify the most appropriate opportunities to exploit and then facilitate the exploitation to establish (hopefully sustainable) competitive advantages

Strategy – Entrepreneurship: a model (Ireland et al., 2003)



Strategy - Entrepreneurship: a model (Ireland et al., 2003)

- Small, entrepreneurial ventures are effective in identifying opportunities but are less successful in developing competitive advantages needed to appropriate value from those opportunities.

- In contrast, large, established firms often are relatively more effective in establishing competitive advantages but are less able to identify new opportunities.

- SE is a unique, distinctive construct through which firms are able to create wealth, and is made of the following dimensions:
    1. Entrepreneurial mindset
    2. Entrepreneurial culture and entrepreneurial leadership
    3. the strategic management of resources
    4. applying creativity to develop innovations

Strategy - Entrepreneurship: a model (Ireland et al., 2003)

Entrepreneurial mindset

- An entrepreneurial mindset is a way of thinking about business that focuses on and captures the benefits of uncertainty.
- The entrepreneurial mindset can be defined as a growth-oriented perspective through which individuals promote flexibility, creativity, continuous innovation, and renewal. Even under the cloak of uncertainty, the entrepreneurially minded can identify and exploit new opportunities because they have cognitive abilities that allow them to impart meaning to ambiguous and fragmented situations
- Components of entrepreneurial mindset:
  1. *Recognizing entrepreneurial opportunities*
  2. *Entrepreneurial alertness* ("flashes of superior insight"), ability to identify when new goods or services become feasible or when existing goods or services become unexpectedly valuable to consumers
  3. *Real options logic*
  4. *Entrepreneurial framework*, which includes actions such as setting goals, establishing an *opportunity register* (i.e. where firms record entrepreneurial opportunities), and determining the *timing* associated with launching the strategy required to exploit an entrepreneurial opportunity

Strategy - Entrepreneurship: a model (Ireland et al., 2003)

Entrepreneurial culture and entrepreneurial leadership

- Organizational culture is a system of shared values (i.e., what is important) and beliefs (i.e., how things work) that shape the firm's structural arrangements and its members' actions to produce behavioral norms (i.e., the way work is completed in the organization).
- An effective entrepreneurial culture is characterized by multiple expectations and facilitates firms' efforts to manage resources strategically. Committed to the simultaneous importance of opportunity-seeking and advantage-seeking behaviors, an effective entrepreneurial culture is one in which new ideas and creativity are expected, risk taking is encouraged, failure is tolerated, learning is promoted, product, process and administrative innovations are championed, and continuous change is viewed as a conveyor of opportunities.
- Thus, an entrepreneurial culture fosters and supports the continuous search for entrepreneurial opportunities that can be exploited with sustainable competitive advantages
- An entrepreneurial culture develops in an organization where the leaders employ an entrepreneurial mindset. Leaders are responsible for developing and nurturing an entrepreneurial culture.

Strategy – Entrepreneurship: a model (Ireland et al., 2003)

Entrepreneurial culture and entrepreneurial leadership

- Entrepreneurial leadership is the ability to influence others to manage resources strategically in order to emphasize both opportunity-seeking and advantage-seeking behaviors
- Imperatives of entrepreneurial leadership:
  1. *Nourish an entrepreneurial capability*. Human capital is the source of SE behaviors. A vision emphasizing the importance of SE as well as a commitment to develop human capital facilitates individuals' efforts to develop entrepreneurial capabilities such as agility, creativity, and skills to manage resources strategically
  2. *Protect innovations threatening the current business model*. Individuals sometimes see disruptive innovation as threatening—to them personally as well as to their organizations. Effective entrepreneurial leaders openly share information with organizational members to describe disruptive innovations' potential benefits (e.g., stimulating development of new competitive advantages).
  3. *Make sense of opportunities*. The probability that individuals will accept the need to pursue entrepreneurial opportunities and to develop unique competitive advantages needed to exploit them increases when those opportunities are a part of the firm's opportunity register. Entrepreneurial leaders are able to communicate the value of opportunities and how exploiting them contributes to the firm's overall goals as well as to individuals' goals.

Strategy – Entrepreneurship: a model (Ireland et al., 2003)

Entrepreneurial culture and entrepreneurial leadership

- Imperatives of entrepreneurial leadership:
  4. *Question the dominant logic*. Dominant logic describes how leaders conceptualize their business and evaluate resource allocation decisions. Key assumptions about industries and markets that influence the firm's opportunity- and advantage seeking behaviors should be periodically questioned to ascertain their validity (i.e., challenging the dominant logic). Entrepreneurial leaders evaluate the assumptions underlying the dominant logic to make certain that the firm is successfully positioned to identify value-creating entrepreneurial opportunities.
  5. *Revisit the "deceptively simple questions"*. Entrepreneurial leaders examine questions about the viability of the markets in which the firm competes, the company's purpose, how success is defined and the firm's relationships with different stakeholders. Revisiting these questions over time is vital in that the answers influence what the firm identifies as opportunities and how it manages its resources to exploit those opportunities.
  6. *Link entrepreneurship and strategic management*. Effective entrepreneurial leaders believe that to create the most value, firms must be "strategically entrepreneurial". This desired end state is achieved when leaders' entrepreneurial mindsets help them develop a culture in which resources are managed strategically (i.e., advantage-seeking behavior), yet entrepreneurially (i.e., opportunity-seeking behavior).

Strategy - Entrepreneurship: a model (Ireland et al., 2003)

Managing resources strategically

- The firm's idiosyncratic resources are likely to produce sustainable competitive advantages only when they are managed strategically.
- Resources are managed strategically when their deployment facilitates the simultaneous and integrated use of opportunity- and advantage-seeking behaviors.
- When firms structure a resource portfolio, bundle resources to form capabilities and leverage those capabilities flowing from their financial, human and social capital (resources) to simultaneously enact opportunity- and advantage-seeking behaviors and create wealth, they are managing their resources strategically
- Managing resources strategically affects the value to be derived from the intangible and tangible assets that organizations use to develop and implement their strategies, suggesting that, "the creation, maintenance, and sustainability of techniques for accumulating and deploying resources may become a focal point of research"

Strategy - Entrepreneurship: a model (Ireland et al., 2003)

Managing resources strategically

- Resources to be managed strategically are:
  1. Financial Capital (tangible)
  2. Human Capital (intangible)
  3. Social Capital (intangible).
     - Set of relationships between individuals – internal social capital – and between individuals and organizations – external social capital – that facilitate actions.
     - Collectively, social capital is the total set of value-creating resources that accrues to the firm because of its durable network of intra- and inter-firm relationships.
     - Resulting from relationships inside the firm and with external entities, social capital helps the firm to gain access to and control of resources and to absorb knowledge

Strategy - Entrepreneurship: a model (Ireland et al., 2003)

Managing resources strategically

- Three stages to manage resources strategically:
  1. **Structuring the resource portfolio**
     - Acquiring, accumulating and divesting resources
  2. **Bundling resources**
     - Bundling tangible and intangible resources to organize them in an original way that contributes to recognizing and exploiting entrepreneurial opportunities, to create competitive advantage.
     - Bundled resources give rise to **capabilities**
     - Usually these capabilities are needed to select and implement the firm's strategies. The unique capabilities created help companies differentiate themselves from competitors.
  3. **Leveraging capabilities**
     - Choosing how the capabilities will be leveraged within and across SBUs and organizational functions

Strategy - Entrepreneurship: a model (Ireland et al., 2003)

Applying Creativity and Developing Innovation

- Creativity and innovation result when resources are managed strategically
- Innovation is a force of “creative destruction” (Schumpeter)
- New combinations of production factors are the essence of innovation.
- Firms must be creative to develop innovation.
- Creativity stems from “**bisociation**”
  - Bisociation occurs when a person combines two or more previously unrelated matrices of skills or information
  - Bisociation takes place when individuals combine information to identify an opportunity or to help shape competitive advantages.
  - Commonly a function of entrepreneurial alertness, bisociation leads to the recognition of entrepreneurial opportunities often after periods of mental incubation.
- Innovation (both disruptive and sustaining) is used to exploit entrepreneurial opportunities; thus, it is highly important to SE.

The startups' quest

What's a startup #1 priority (and concern)

?

Make or find Money

equity or debt

- friends family and fools
- informal investors (don't need a business plan, due diligences)
- Crowd funding
- Formal: VC (evaluating business plans formally)
--- ivc -- cvc --- gvc

- accelerator (when there is a business plan for scale up)
- independent funds
CVC, GVC, ...
(NOTES)

3T = Team / Tech / Traction (small number but growth)

Startups and financing

What’s a Business Angel?

- Business angels are individual investors, usually with business experience, who provide capital for start-up firms. They are an important source of equity for small firms with growth potential in their early stages of development, long before they become attractive for venture capital funds (*European Union*).

…and what’s FFF?

- Family, Friends, Fools (love money vs. smart money) (*Business Angels Institute*)

What’s Venture Capital (VC)?

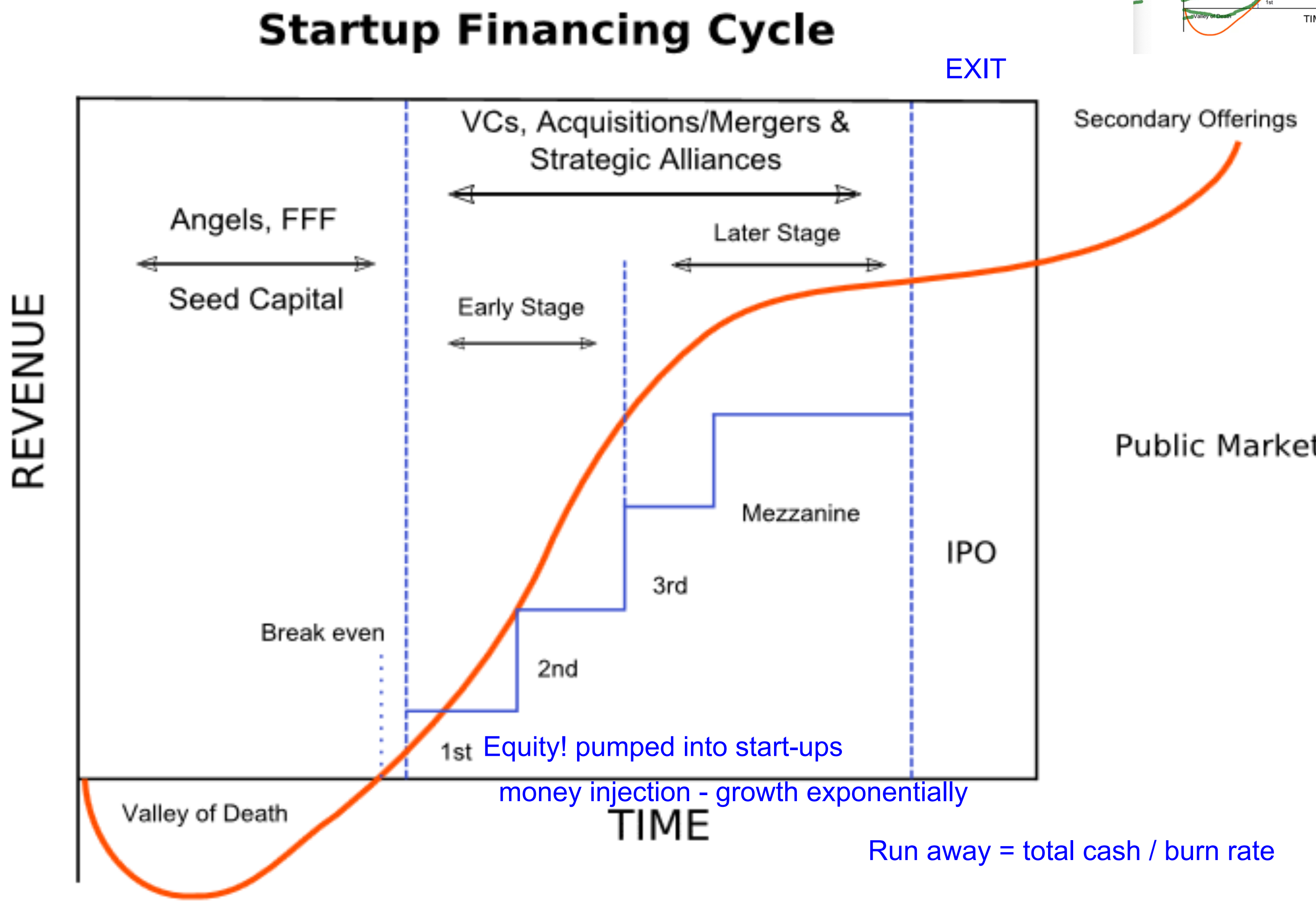
- a subset of private equity, it refers to equity investments made to support the pre-launch, launch and early stage development phases of a business (*European Venture Capital Association – EVCA*).
- a segment of the private equity industry which focuses on investing in new companies with high growth potential and accompanying high risk (*National Venture Capital Association – NVCA*)

Startups and financing

Financing rounds stages (*EVCA*)

1. **Seed:** Financing provided to research, assess and develop an initial concept before a business has reached the start-up phase.
2. **Start-up or early-stage venture**: Financing for product development and initial marketing. Companies have not sold their product commercially and are in the process of being set up.
3. **Later-stage venture**: Financing for the expansion of an operating company. Later-stage venture tends to finance companies already backed by venture capital firms.
4. **Growth**: A type of private equity investment – most often a minority investment – in relatively mature companies that are looking for capital to expand into new markets or restructure operations.
5. **Buyout**: Financing to acquire a company. It may use a significant amount of borrowed money to meet the cost of acquisition.
6. **Rescue/Turnaround**: Financing made available to an existing business in difficulty, with a view to re-establishing prosperity.
7. **Replacement capital:** The purchase of a minority stake of existing shares in a company from another private equity firm or from another shareholder or shareholders.

Startups and financing



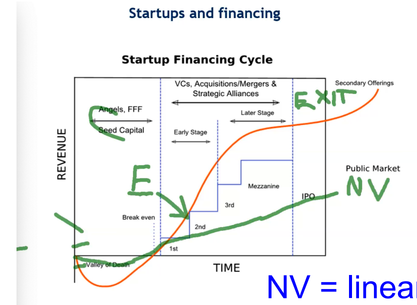
EXIT

NV = linear growth less cash burn

Equity! pumped into start-ups

money injection - growth exponentially

Run away = total cash / burn rate



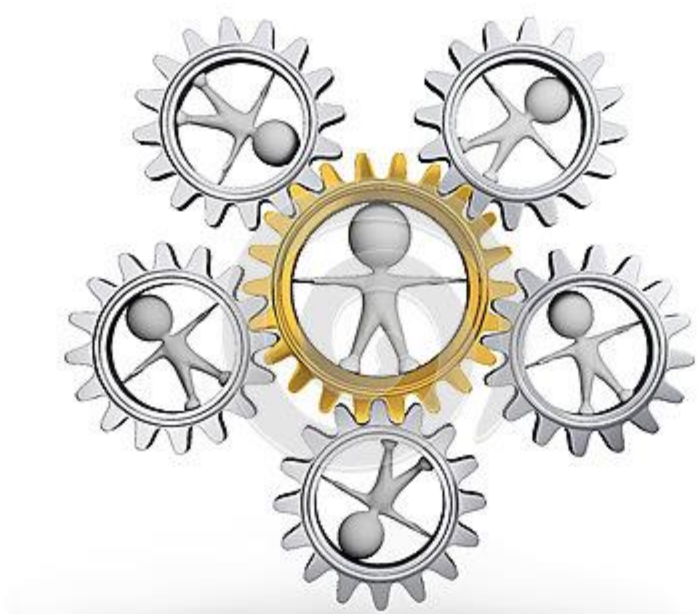
POLITECNICO DI MILANO

Italian hi-tech startups ecosystem

(see the related presentation)

What's the ecosystem of players a startup arises and operates in

?



Startups and their surrounding ecosystem

The players	2013	2014
"Innovative Startups"	1227	2716
Funded Startups	113	197
"Institutional" investors	32	36
Incubators & Accelerators	97	100
Science & Technology parks	40	38
Coworking spaces	65	62
Startup Competitions	33	52
Associations, Online resources & communities	20	27
Hackathons	-	21
Empowerment programs	-	38
Call for tenders	-	46
Crowdfunding platforms	-	48
Fablabs	-	46

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Italian hi-tech startups research 2016

(see the related presentation)

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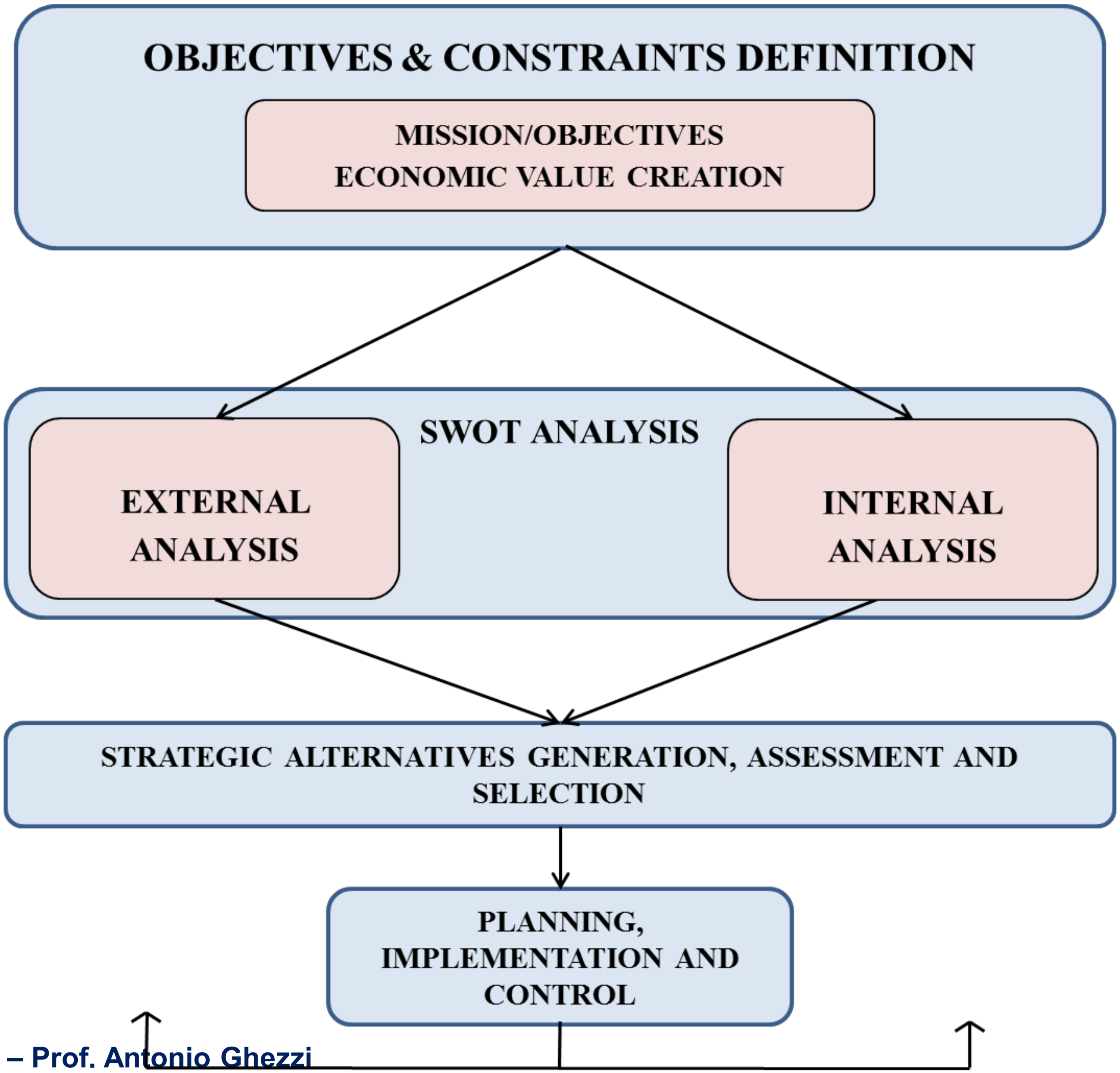
Startups and the strategy formulation process

Startups and strategy: a missing link?

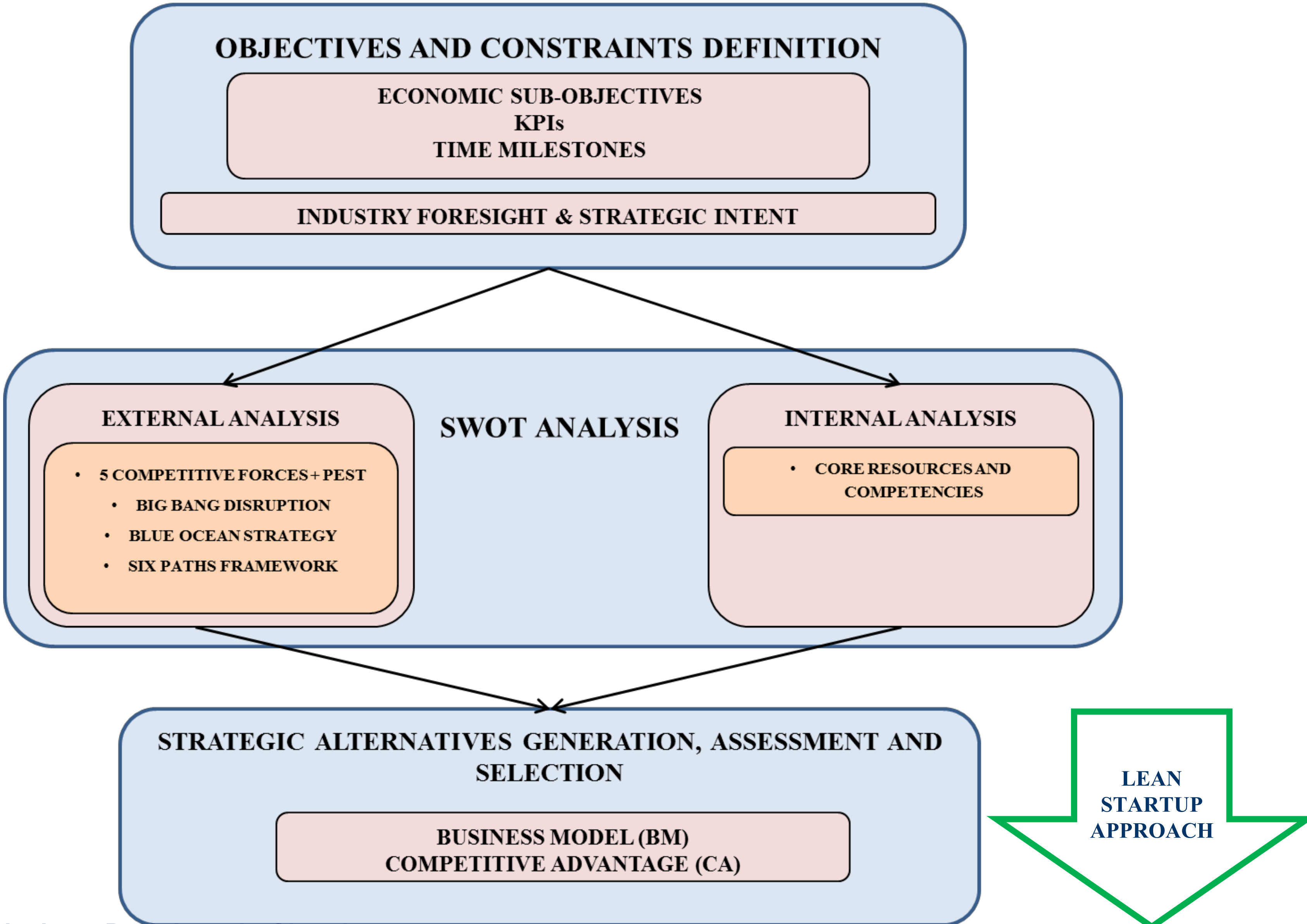
- **Entrepreneurs and "startuppers" are mostly focused on pragmatic problems, like operationalizing their business idea, promoting it and receiving funding…**
  - they often believe that sketching a business model is enough to get their startup up and running and to endow it with some sort of "strategic direction" (*Ghezzi, 2014 - SD*)
  - however, they also need to formulate an overall business strategy to set objectives, assess the external/internal context and implement their business model in a way that catalyzes the startup's innovation potential towards the achievement of an original competitive advantage
  - failing to get this would likely jeopardize the chances of success and very survival of their endeavor

- **Nonetheless, the strategy formulation process for a startup significantly differs from the traditional process undertaken by large or consolidated companies**
  - Focus on strategic innovation (with a "bootstrapping" approach)

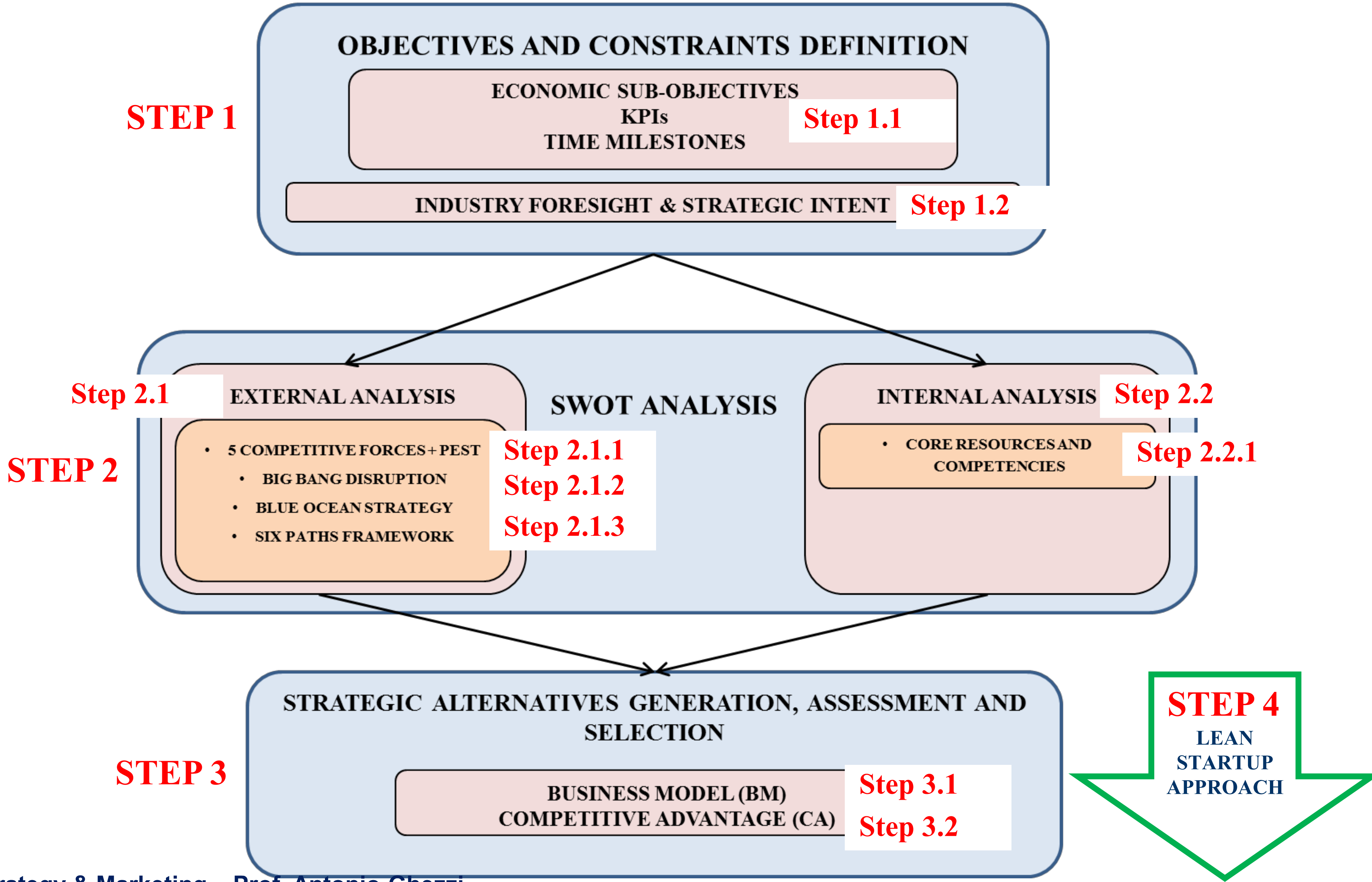
The traditional strategy formulation process



The Startup strategy formulation process



The Startup strategy formulation process



The Startup strategy formulation process

STEP 1: OBJECTIVES AND CONSTRAINTS DEFINITION

- STEP 1.1: Economic Sub-objectives, KPIs, Time Milestones
- STEP 1.2: Industry Foresight and Strategic Intent

STEP 2: SWOT ANALYSIS

- STEP 2.1: External Analysis
  - STEP 2.1.1: 5 Competitive Forces + PEST
  - STEP 2.1.2: Big Bang Disruption
  - STEP 2.1.3: Blue Ocean Strategy (6 Paths Framework)
- STEP 2.2: Internal Analysis
  - STEP 2.2.1: Core resources and competencies

STEP 3: STRATEGIC ALTERNATIVES GENERATION, ASSESSMENT AND SELECTION

- STEP 3.1: Business Model Design
- STEP 3.2: Competitive Advantage

STEP 4: LEAN STARTUP APPROACH

POLITECNICO DI MILANO

Strategic role of IT and Digital Strategy

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Harvard Business Review Debate

Does IT (ICT) matter?

Carr's article: IT doesn't matter
Harvard Business Review (May 2003)

- **IT (ICT) cannot be a source of sustainable, long term, competitive advantage, since it is becoming more and more**
  - **standard**
  - **cheap**
  - **available to all**
  - **outsourceable**

  …in one word a <u>commodity</u>

- **IT (ICT) is more and more essential to operations but it is insignificant to strategy**

"What makes a resource truly strategic is not ubiquity but scarcity." (Carr, 2003)

Reply from other HBR authors

- **Technological perspective**
  ICT Competence is seen as a bundle of software & hardware assets and technical skills that are fully available on the market

- **Infrastructural perspective**
  The focus is mainly on Infrastructure (hardware and network) that is becoming more and more a commodity

- **Single ICT Project perspective**
  The focus is on the single ICT Project, that may or may not be the driver of competitive advantage

VS

- **Organizational & Business Perspective**
  ICT Competence is the <u>ability</u> of a company to exploit/leverage ICT to pursue business innovations, to change business practices, to improve business performance …. <u>this is in short supply</u>!

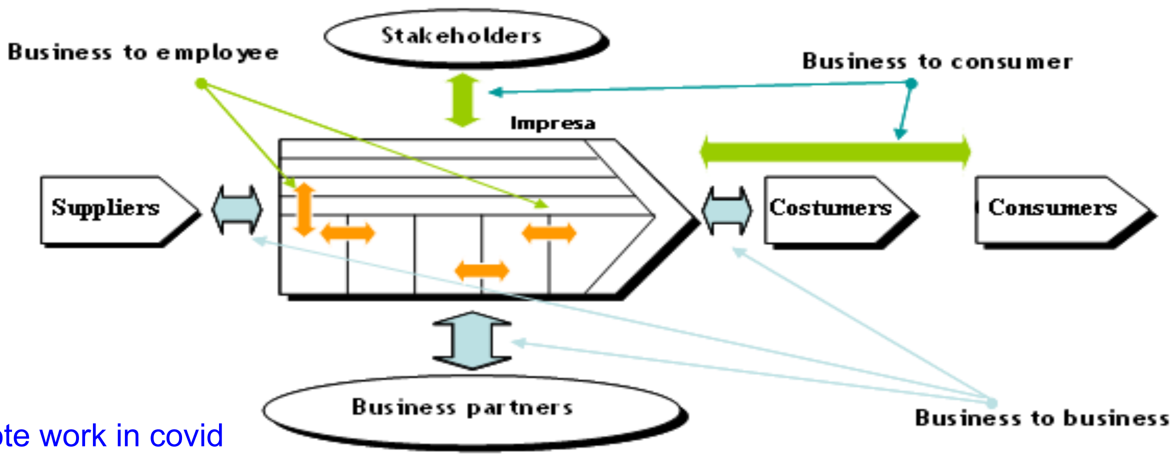
- **Application perspective**
  Business Applications are extremely customized … built on the specific business logic of the company … embedded in the organizational routine of the company. They can create <u>strategic differentiation</u>

- **Learning Process perspective**
  This capability is the result of a complex and long cumulative (path dependent) and collective (organizational) learning process. This can lead to <u>durable and defendable competitive advantage</u>

The “strategic” role of ICT according to the “strategic” models

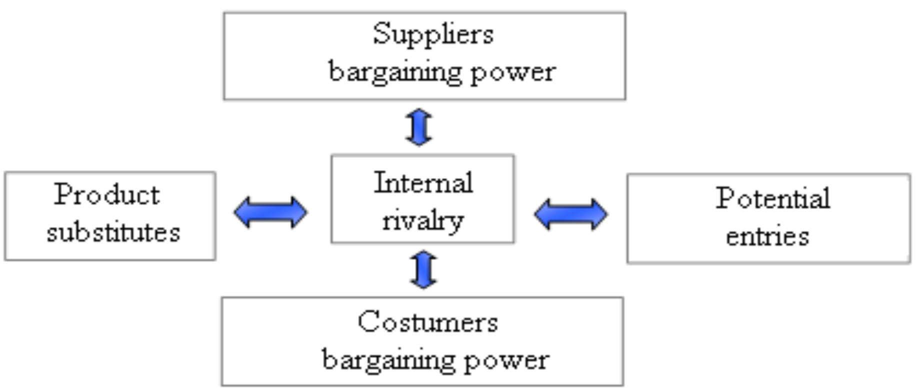
where can it be a source of company advantage!?

- **Internal Perspective**
  ICT can create new sources of competitive advantage both in terms of cost and differentiation by impacting on the company’s Value Chain



like communication or remote work in covid

- **External Perspective**
  ICT can drive transformations in the competitive landscape, changing the role and the intensity of each competitive force (internal rivalry, potential entries, substitute products, suppliers’ and customers’ bargaining power)



… but the real business role of ICT depends on the <u>specific business context</u> …

The business role of ICT: depending on the specific business context (Nolan & McFarlan's Approach)

internal

LOW TO HIGH NEED FOR RELIABLE INFORMATION TECHNOLOGY

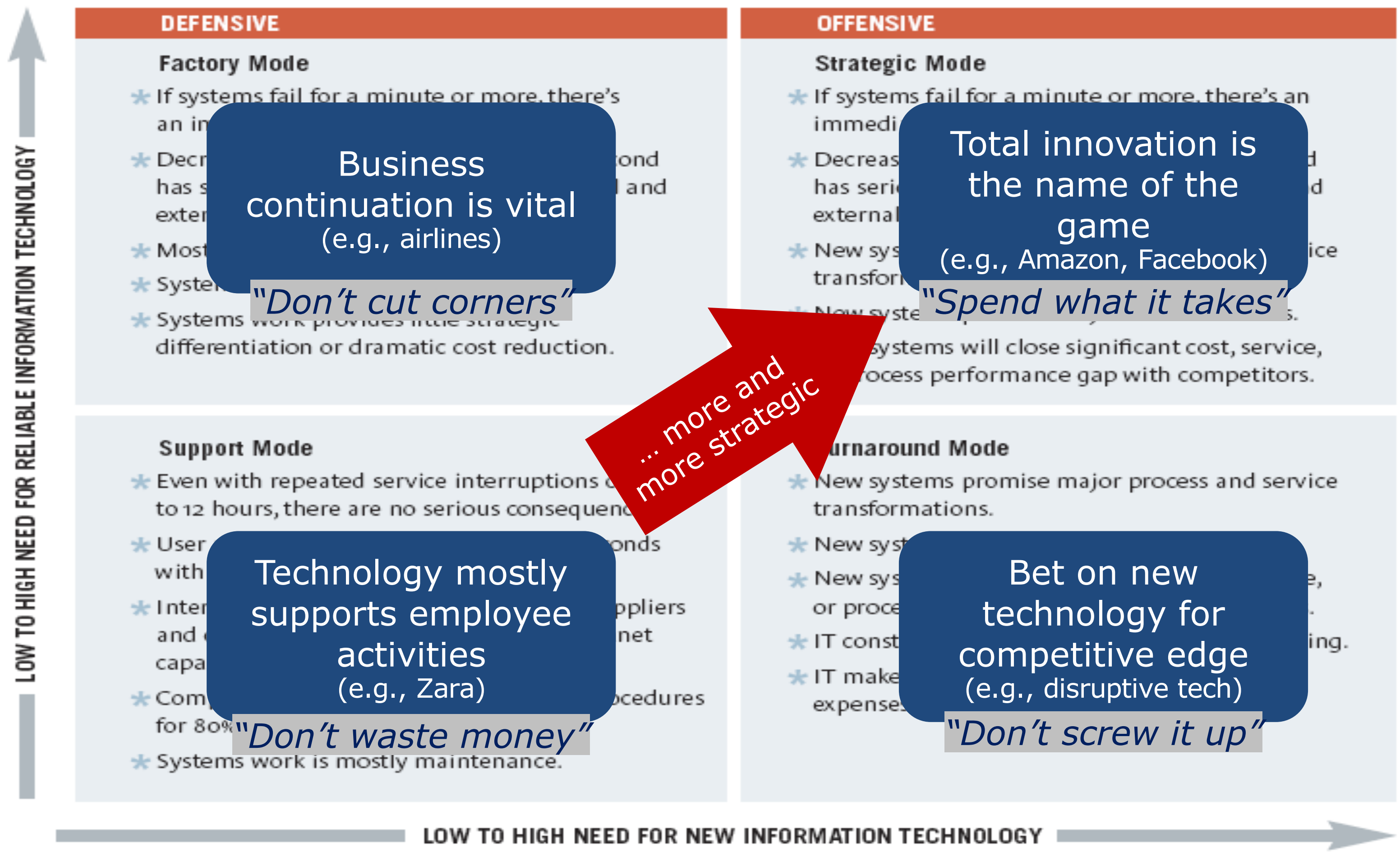
DEFENSIVE	OFFENSIVE
Factory Mode manufacturing * If systems fail for a minute or more, there's an immediate loss of business. * Decrease in response time beyond one second has serious consequences for both internal and external users. * Most core business activities are online. * Systems work is mostly maintenance. * Systems work provides little strategic differentiation or dramatic cost reduction.	**Strategic Mode** strong depend on IT. amazon! * If systems fail for a minute or more, there's an immediate loss of business. * Decrease in response time beyond one second has serious consequences for both internal and external users. * New systems promise major process and service transformations. * New systems promise major cost reductions. * New systems will close significant cost, service, or process performance gap with competitors.
Support Mode * Even with repeated service interruptions of up to 12 hours, there are no serious consequences. * User response time can take up to five seconds with online transactions. * Internal systems are almost invisible to suppliers and customers. There's little need for extranet capability. * Company can quickly revert to manual procedures for 80% of value transactions. * Systems work is mostly maintenance.	**Turnaround Mode** * New systems promise major process and service transformations. * New systems promise major cost reductions. * New systems will close significant cost, service, or process performance gap with competitors. * IT constitutes more than 50% of capital spending. * IT makes up more than 15% of total corporate expenses. it not for practical use! they show that they use it for reputation

LOW TO HIGH NEED FOR NEW INFORMATION TECHNOLOGY

external
industry perspective

The position of a company on this grid depends on both exogenous (industry characteristics) and endogenous (company characteristics) variables

The business role of ICT is becoming...



The cultural barriers

1. Top Management's real commitment and sensitivity to ICT - the CEO above all

2. The characteristics of the CIO and his/her key people (in terms of leadership, business acumen, organizational competence, communicational skills, etc.)

3. Business Managers' open-mindedness and sensitivity to ICT

The cultural barriers

- Top Management's real commitment and sensitivity to ICT - the CEO above all

- *"Top management's ability to really worry about ICT? It is a cultural problem. ICT is like mathematics : either someone was able to teach it well, help you to understand and appreciate, or you are put off for life" (Massimo Capuano, CEO, Milan Stock Exchange)*
- *"You can learn finance and marketing, but not technology. ICT is not sexy enough for a top manager to take the time to understand and learn" (Luca Majocchi, CEO, Seat Pagine Gialle)*

- Business Managers' open-mindedness and sensitivity to ICT

The cultural barriers

- Top Management's real commitment and sensitivity to ICT - the CEO above all

- The characteristics of the CIO and his/her key people (in terms of leadership, business acumen, organizational competence, communicational skills, …)

- *"… ICT people must be able to play their game: to speak the language of business, to demonstrate concrete results, earning credibility… "*
- *"ICT people speak a language different from ours: I don't want technical terms or acronyms, I want logical reasoning!"*
- *"The CIO must have a good mix of technical, organizational, communication and relationship skills"*
- *"Too often CIOs focus only on their projects, paying no attention to their actual impact on the business"*
- *"… It would be useful for the key people in the IT Department to have an MBA …"*

The cultural barriers

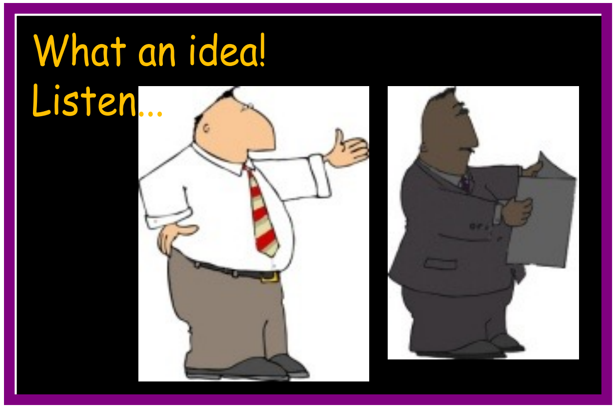
- Top Management's real commitment and sensitivity to ICT - the CEO above all

- The characteristics of the CIO and his/her key people (in terms of leadership, business acumen, organizational competence, communicational skills, etc.)

- Business Managers' open-mindedness and sensitivity to ICT

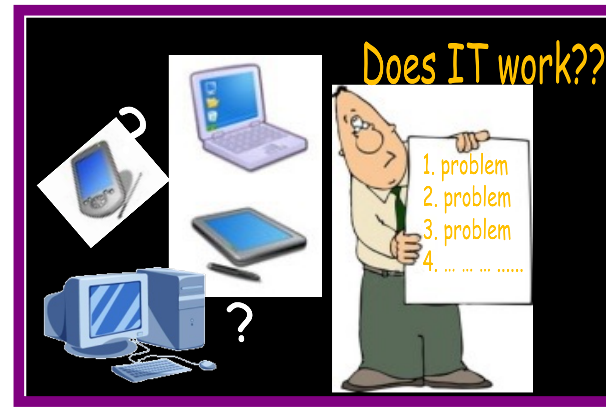
Business Managers: the different approaches to ICT

✔ **Pro-active**

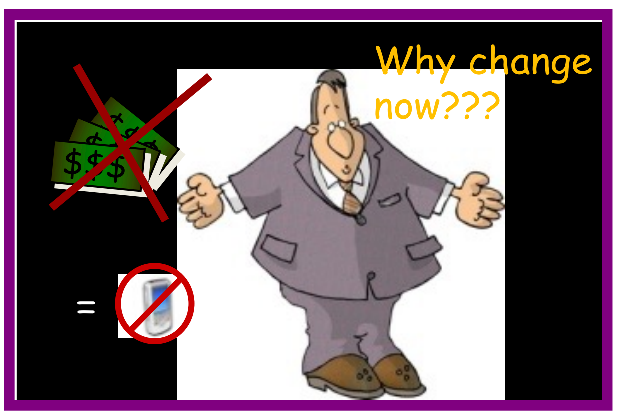


✔ **Re-active**

✔ **Eternal skeptic**



✔ **Procrastinator**



✔ **Unwitting**

Business Strategy, IT Strategy and Digital Strategy

Business Strategy vs. IT Strategy vs. Digital Strategy

- **Business Strategy**, **IT Strategy** and **Digital Strategy**
  - shall be related and aim at common goals (i.e., higher performance in terms of value creation and value capture)
  - have different meanings.

- A **Business Strategy** is an integrated, comprehensive and long-term plan that includes a consistent set of strategic decisions and is aimed at creating and sustaining competitive advantage in a business area, compared to competitors

Business Strategy vs. IT Strategy vs. Digital Strategy

- Concerning **IT Strategy** and **Digital Strategy**, boundaries become fuzzy and blurred.
- Although often used as synonyms and overlapping terms, IT Strategy and Digital Strategy are growingly **diverging** in the **meaning** associated to them and the **approach** they evoke and advocate for.
- "Everyone thinks they have a digital strategy these days. But while your company may have a business or IT strategy that incorporates digital technology, an IT strategy does not equal a digital strategy." (McDonald, 2012)

Business Strategy vs. IT Strategy vs. Digital Strategy

IT Strategy:

- **Functional-level strategy** aiming at The use of information technologies adopted by organizations as tools to **boost productivity** or **lower operational costs**.
- The broad strategic view was that **IT strategy had to be aligned with the firm's business strategy** (Henderson and Venkatraman, 1993).
- "IT Strategy is a **technical answer to a business question**: "How will IT help the business win?". It assumes the business strategy is set, then considers how to use IT to make that strategy successful. IT Strategy is **usually conducted downstream of/ after business strategy**" (Aron, 2013)
- "Most IT strategies treat technology in isolation. Your company may be working on a cloud strategy, social strategy, or mobile strategy." (McDonald, 2012)

Business Strategy vs. IT Strategy vs. Digital Strategy

From IT to "Digital Technology": a pragmatic definition

- Digital technologies can be viewed as the combination of:
  - Information
  - Computing (Hardware and Software)
  - Communication
  - Connectivity (protocols such as Internet and Mobile web)

  technologies which are fundamentally reshaping traditional business strategy as modular, distributed, cross functional, and global business processes that enable work to be carried out across boundaries of time, distance, and function (Bharadwaj et al., 2013)

Business Strategy vs. IT Strategy vs. Digital Strategy

From IT to “Digital Technology”: what’s new about digital?

- **Pervasive**. Digital technologies are so pervasive that they create a different everyday experience
- **Multi-purpose**. Digital technologies can be employed in a plethora of alternative environments with a vast range of applications
- **Customer-centric**. Digital technologies affect customers’ touchpoints and journey to such an extent that they enable and call for a true customer centricity in a company’s strategy
- **Value-relevant and transformational**. Digital technologies, if properly leveraged, can have a transformational and innovative impact on value propositions

Business Strategy vs. IT Strategy vs. Digital Strategy

- Due to Digital’s characteristics, today it is easier for managers and strategists to grasp and be aware of the **strategic implications of such technologies at all level**.

- Digital Strategy cannot be confined to the IT Function anymore (as it happened to IT Strategy), but shall be **formulated alongside Business Strategy, as it impacts all of its key steps.**

- As a result, rather than calling it Digital Strategy, we should refer to it as “**Digital Business Strategy**” (i.e. **a Business Strategy which is inherently Digital in nature, aim and scope**)

Business Strategy vs. IT Strategy vs. Digital Strategy

Digital Business Strategy:

- “Digital Business Strategy is a business answer to a digital question: “**How should our business evolve to survive and thrive in an increasingly digital world**?” It is not a separate strategy, but instead **a lens on business strategy**. All aspects of the business strategy should be **informed by digital considerations**.” (Aron, 2013)

- “Digital Business Strategy is **more than IT strategy** since it is the extent to which a firm engages in **any category of IT activity to create value**.” (Mithas et al., 2013)

Business Strategy vs. IT Strategy vs. Digital Strategy

- "Digital Business Strategy is a **pattern of deliberate competitive actions** undertaken by a firm as it **competes by offering digitally enabled products or services**." (Woodard et al., 2013)

- "Digital Business Strategy is an organizational **strategy formulated and executed by leveraging digital resources to create differential value**." (Bharadwaj et al., 2013)

- "Digital is the application of information and technology to **raise human performance**. Human performance is the **essence of digital transformation**. Human performance **creates the type of value that leads to revenue**. Alternative goals for digital create efficiencies that largely drive down the cost of creating short-term benefits but drain the economy and growth." (McDonlad, 2015)

Business Strategy vs. IT Strategy vs. Digital Strategy
The essence of a Digital Strategy

- "Today's hottest customer-facing solutions rely on pervasive digital connections in which the individual technologies (cloud, near field communications, mobile, big data, etc.) **merge to deliver an experience that looks and feels an awful lot like our natural behavior**.
- In other words, the more connections between people, places, information, and things (aka **digital density**), the more **customers can interact with companies** and each other in a **seamless** and satisfying way.
- Digital strategies are not only about **digital substitution** (i.e. automating and substituting physical resources with digital transactions, thus only creating virtual copies of the real world which are commoditized and duplicable), but call for creating a **digital edge**, where digital information and physical resources combine in new ways to create value and revenue" (McDonald, 2012)

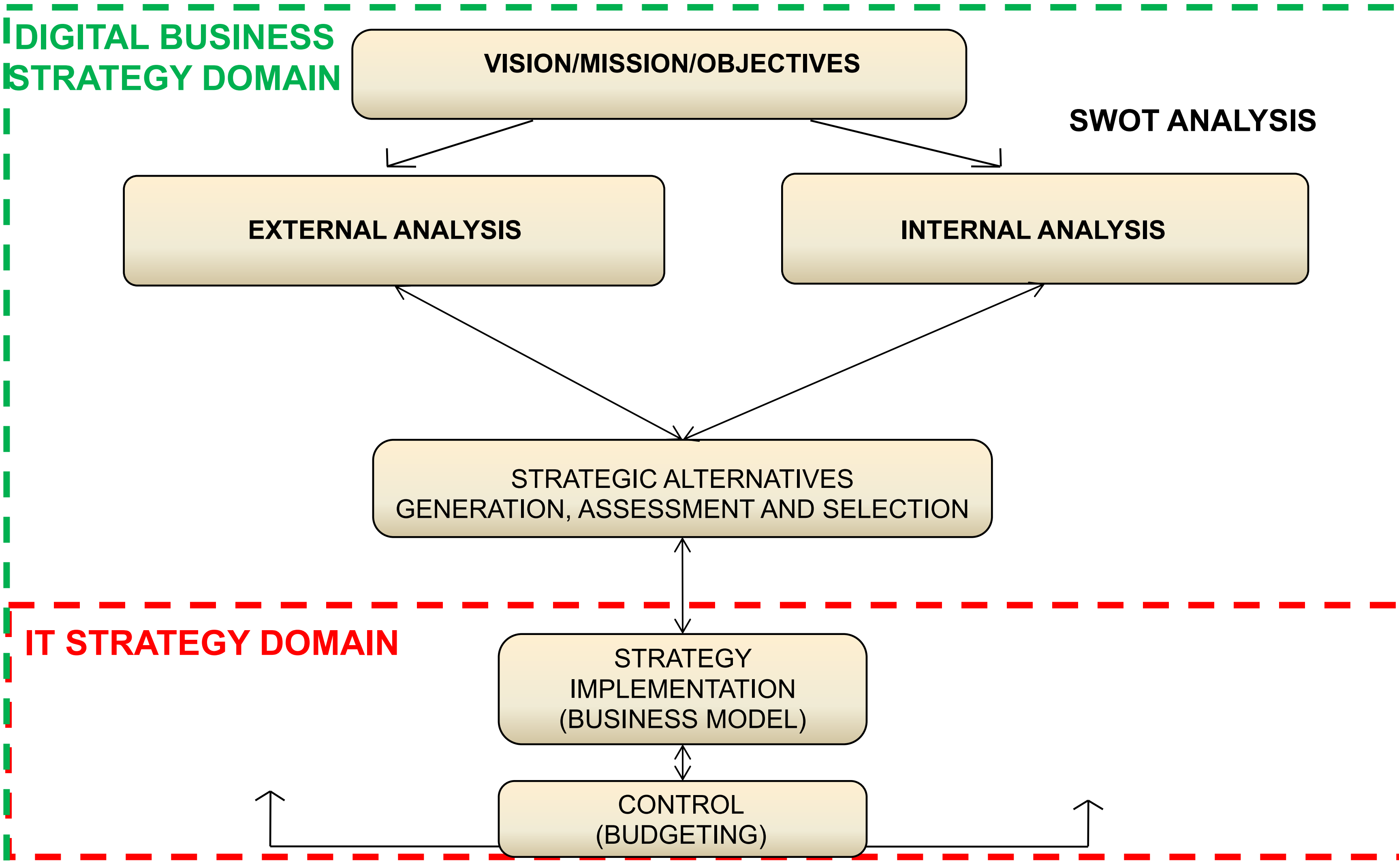
Business Strategy vs. IT Strategy vs. Digital Strategy
The essence of a Digital Strategy

- Enterprises seeking a digital edge **transform** processes, business models, and the customer experience by exploiting the pervasive digital connections between systems, people, places, and things.

- **A digital edge is a performance edge**, as it exploits a Digital Strategy merged with a Business Strategy **to create competitive advantage** (**Digital Business Strategy**).

- The **essence of digital strategy** is to **deliver more because leaders think broadly about how digital technology creates value and revenue;** and to think about **how digital will combine to create new capability rather than replace old operations.**

Digital Business Strategy: a new domain



Business Strategy vs. IT Strategy vs. Digital Strategy Conclusions

- To wrap it all up (with my take on the recent debate, keeping in mind the older “quarrel” about the strategic role of IT):
  - A Digital Strategy is a **revamping** of the IT Strategy in a world with **a new context, new tools, new management and consumer awareness and a greater digital density.**
  - Digital Business Strategy is what IT Strategy should have been if virtuously applied, but what it seldom delivered.
  - **Alignment** is not enough: Business Strategy and Digital Strategy **co-creation** and **co-formulation** and **digital strategic renewal** around the idea of the **original combination of digital assets and capabilities as the new sources of competitive advantage** are and will be key for companies’ innovation and transformation (Ghezzi, 2016)

POLITECNICO DI MILANO

Lean Startup Approaches

the way to check whether the market wants your idea

Antonio Ghezzi

Politecnico di Milano

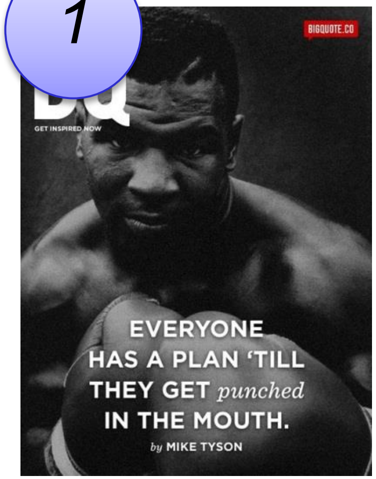
Department of Management, Economics and Industrial Engineering

Agenda

- Fallacy of the «perfect business plan»
- Models for startup development
- Focus on Lean Startup Approaches
- Key principles of the Lean method

Lessons Learnt from startups failures&successes

1



«Business Plans rarely survive first contact with customers»

2

«No one besides VC and the late Soviet Union requires 5 years plans to forecast complete unknowns»

3

«Start-ups are not smaller versions of large companies»

Models for Start ups development

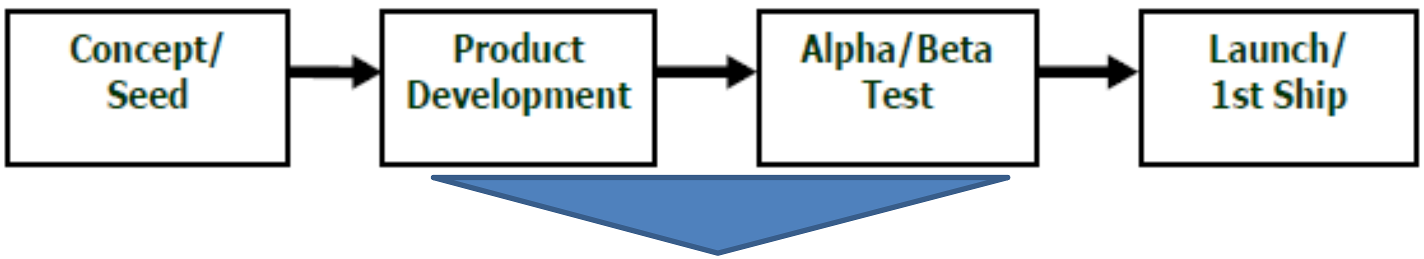
- Product development

"Too many startups begin with an idea for a product that they think people want. They then spend months, sometimes years, perfecting that product without ever showing the product, even in a very rudimentary form, to the prospective customer. When they fail to reach broad uptake from customers, it is often because they never spoke to prospective customers and determined whether or not the product was interesting" (Ries, 2012).

- Waterfall development
- Agile Development
- Customer development
- Lean Startup

Product Development (‘50)

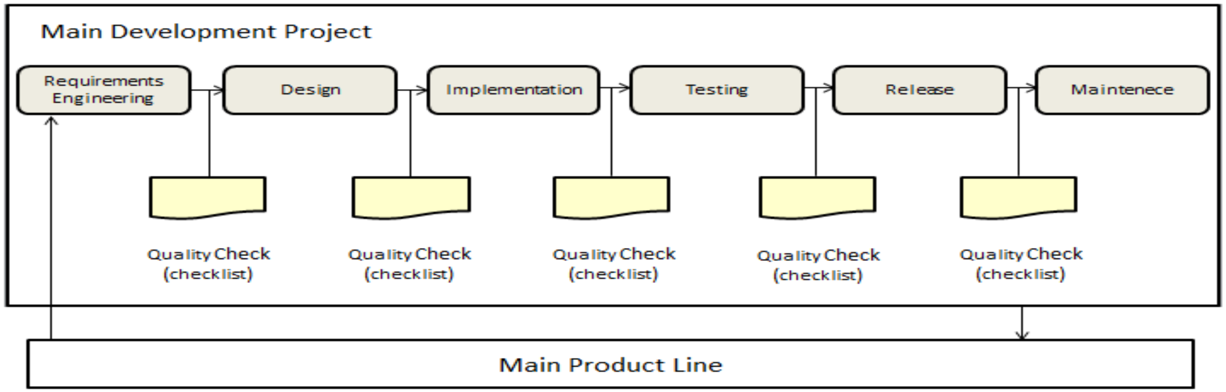
- Methodology for new products development, focused on the product itself, divided in 4 phases:



PROS	CONS
Effective & efficient in KNOWN markets	1. Customers are NOT considered 2. Focus on the go to market DATE 3. Emphasis on EXECUTION, not on learning and discovering processes 4. Lack in significance of the milestones 5. Ramping up too rapidly

Waterfall Development ('70) *(Stage-Gate Model)*

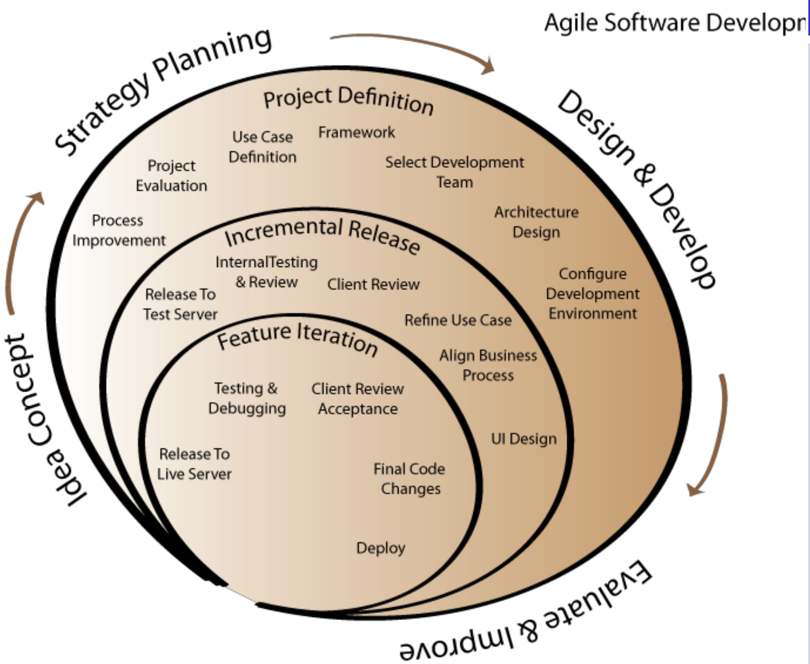
- In a waterfall model, each phase must be completed fully before the next phase can begin.
- At the end of each phase, a review takes place to determine if the project is on the right path and whether or not to continue or discard the project.
- In waterfall model, phases do not overlap



PROS	CONS
1. Simple and easy to understand and use 2. Easy to manage due to the rigidity of the model – each phase has specific deliverables and a review process 3. Phases are processed and completed one at a time. 4. Works well for smaller projects where requirements are very well understood	1. Once an application is in the test stage, it is very difficult to go back and change something that was not well-thought out in the concept stage 2. No working software is produced until late during the life cycle 3. High amounts of risk and uncertainty 4. Not a good model for complex and object-oriented projects 5. Poor model for long and ongoing projects 6. Not suitable for the projects where requirements are at a moderate to high risk of changing

Agile Development ('90)

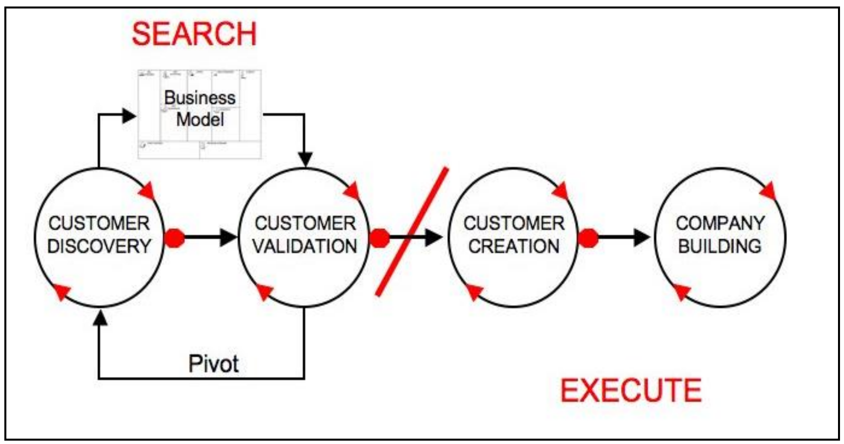
- Agile software development is a group of software development methods based on iterative and incremental development.
- It promotes adaptive planning, evolutionary development and delivery, a time-boxed iterative approach, and encourages rapid and flexible response to change.



PROS	CONS
1. Customer satisfaction	1. Customer engagement
2. Early feedbacks/integrated tests	2. Lack in documents
3. Interaction, collaboration face to face communication	3. Impossibility to plan resources/budget needed
4. Flexibility	4. Difficulty in evaluating each developer
5. Working before knowing all the requirements	5. Highly skilled members required
6. Saving Money and time	
7. Improvement in productivity	

Customer Development

- Customer Development focuses on customers and it is divided in 4 phases
- The first product is not designed to satisfy a mainstream customer but it's tested on a very small group of early and «visionary» customers (evangelists)



EVANGELIST

PROS	CONS
1. Iterative 2. Efficient & Effective 3. Improved learning 4. Time saving 5. Avoiding early scaling	1. Specific on business areas 2. Eary evangelist are difficult to be found 3. Evangelist are easily influenced by others or by the company's view 4. Vicious circle («bugs» detection never ends)

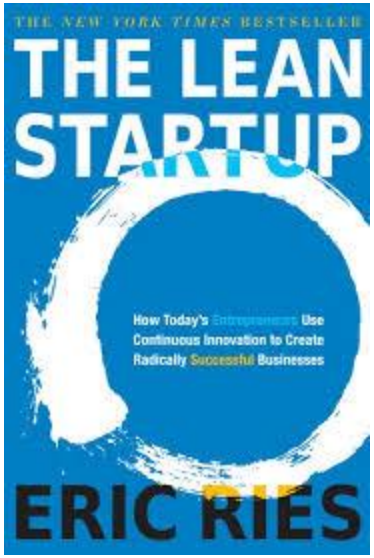
Lean Startup Definition

no waste = not creating value directly

waste = building things that no one uses!

worst enemy = the customer!

Lean Startup (2008) is an approach for launching businesses and products, that relies on **validated learning, scientific experimentation, and iterative product releases** to *shorten* product development cycles, *measure* progress, and *gain* valuable customer feedback. In this way, companies, especially startups, can design their products or services to *meet the demands of their customer* base without requiring large amounts of initial funding or expensive product launches



*"Lean Startup isn't about being cheap [but is about] being **less wasteful** and still doing things that are big."*

*"Startup success can be **engineered** by following the process, which means it can be **learned**, which means it can be **taught**. The Lean Startup method teaches you how to drive a startup-how **to steer**, when **to turn**, and when to **persevere-and grow** a business with maximum acceleration."*

Who is «an entrerpreneur»?

There are three starting points for entrepreneurship: ***a technology, idea, or passion****. If you have a passion but no specific idea or technology, do some introspection to figure out the best use of your knowledge, skills, connections, financial assets, and work experience.*

Lean Startup
Key principles

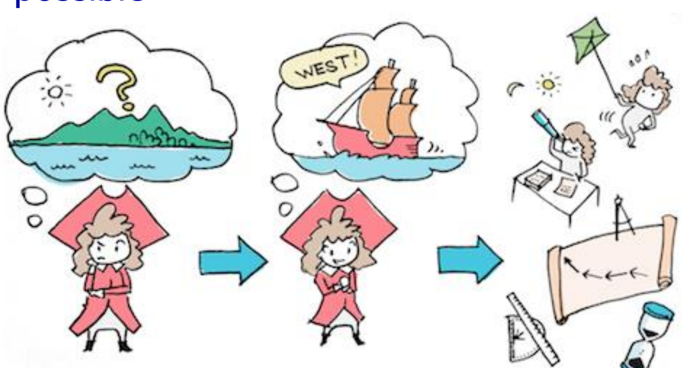
ELIMINATE UNCERTAINTY: Using the Lean Startup approach, companies can create **order** not chaos by providing **tools to test** a vision continuously

WORK SMARTER NOT HARDER: By the time that product is ready to be distributed widely, it will already have established customers

DEVELOP A MVP: A core component of Lean Startup methodology is the build-measure-learn feedback loop. The first step is figuring out the problem that needs to be solved and then developing a minimum viable product (MVP) to begin the process of learning as quickly as possible

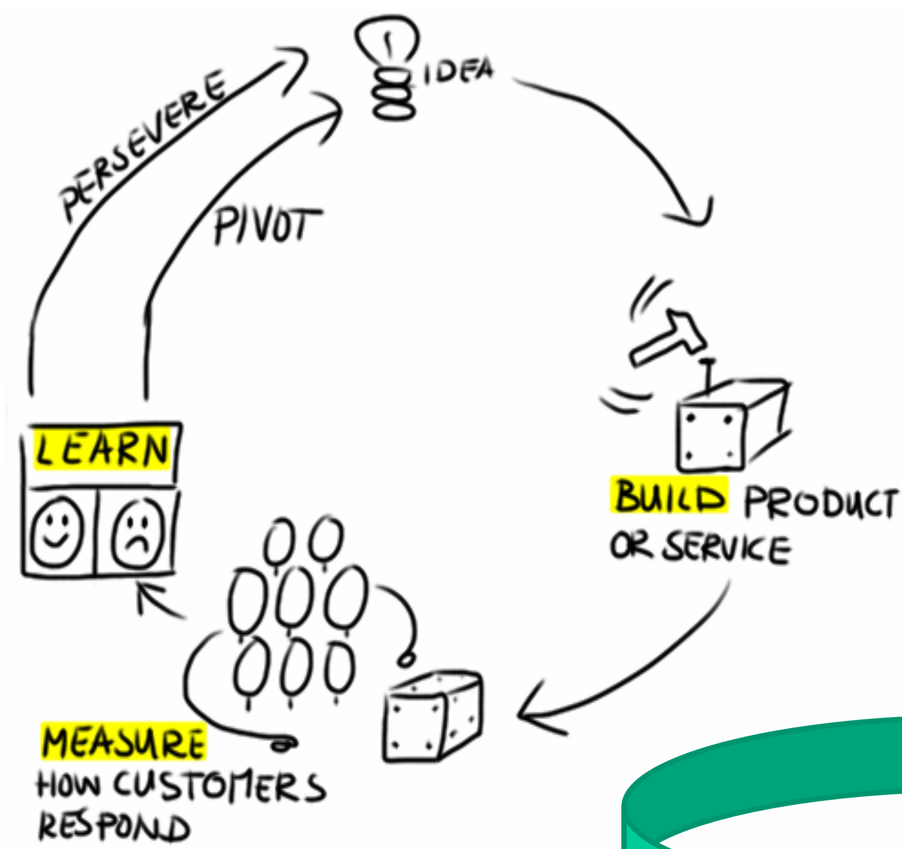
(minimum viable product) (product)

Presented by Braintree

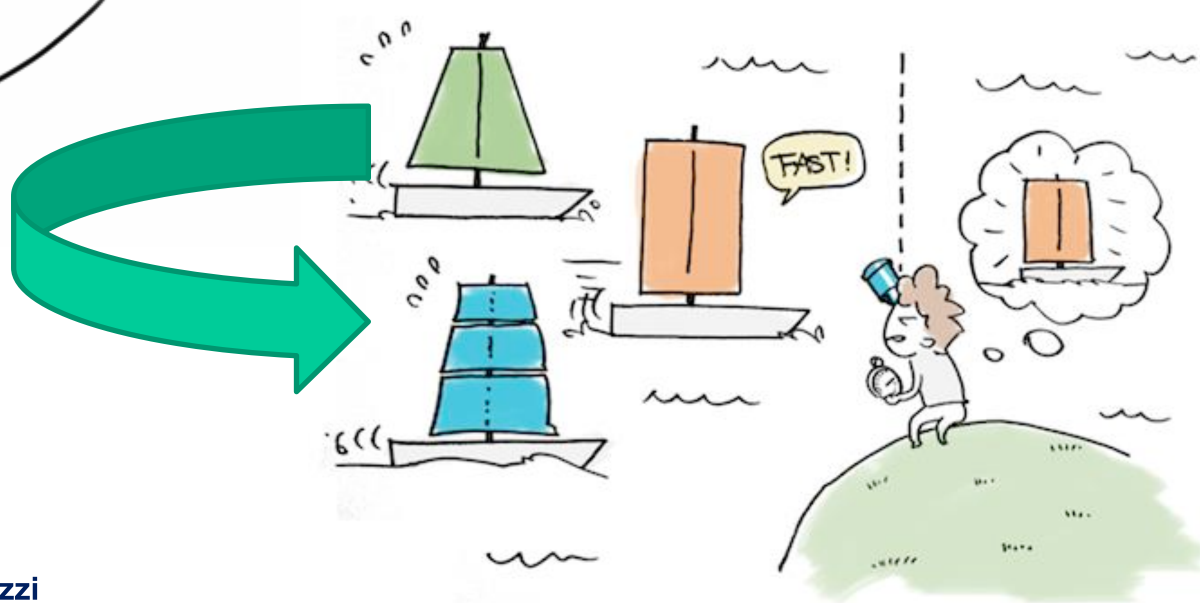


VALIDATED LEARNING: Progress in manufacturing is measured by the production of high quality goods. The unit of progress for Lean Startups is **validated learning** - a rigorous method for demonstrating progress when one is embedded in the soil of extreme uncertainty

Lean Startup
Build-Measure-Learn Loop

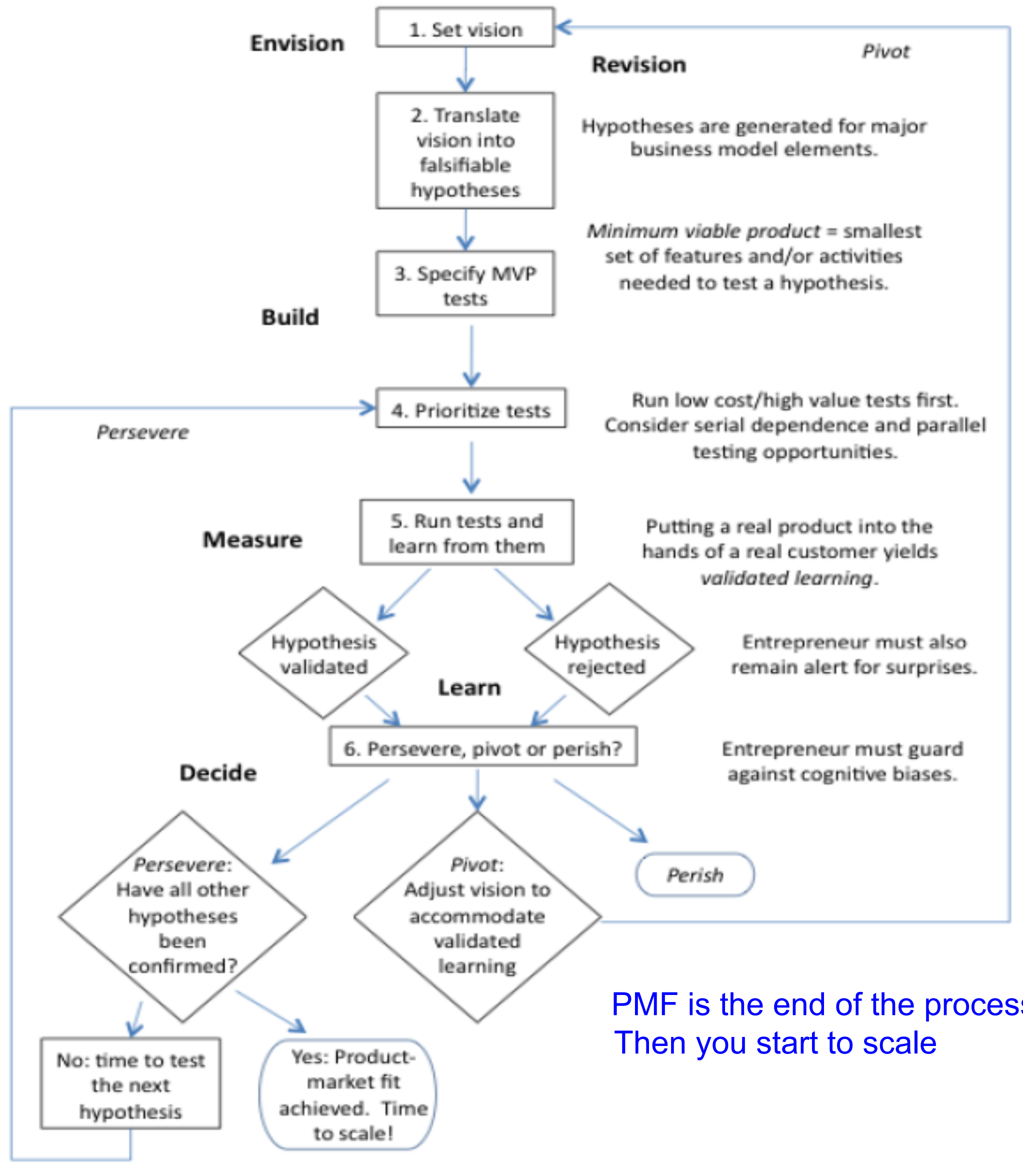


Build-Measure-Learn: How do you build the fastest ship? You try to build and test your hypothesis; you measure the result; and then you learn new knowledge that you can bring to your next ship design.



Process Flow Lean Startup
(Eisenman et al. 2012)

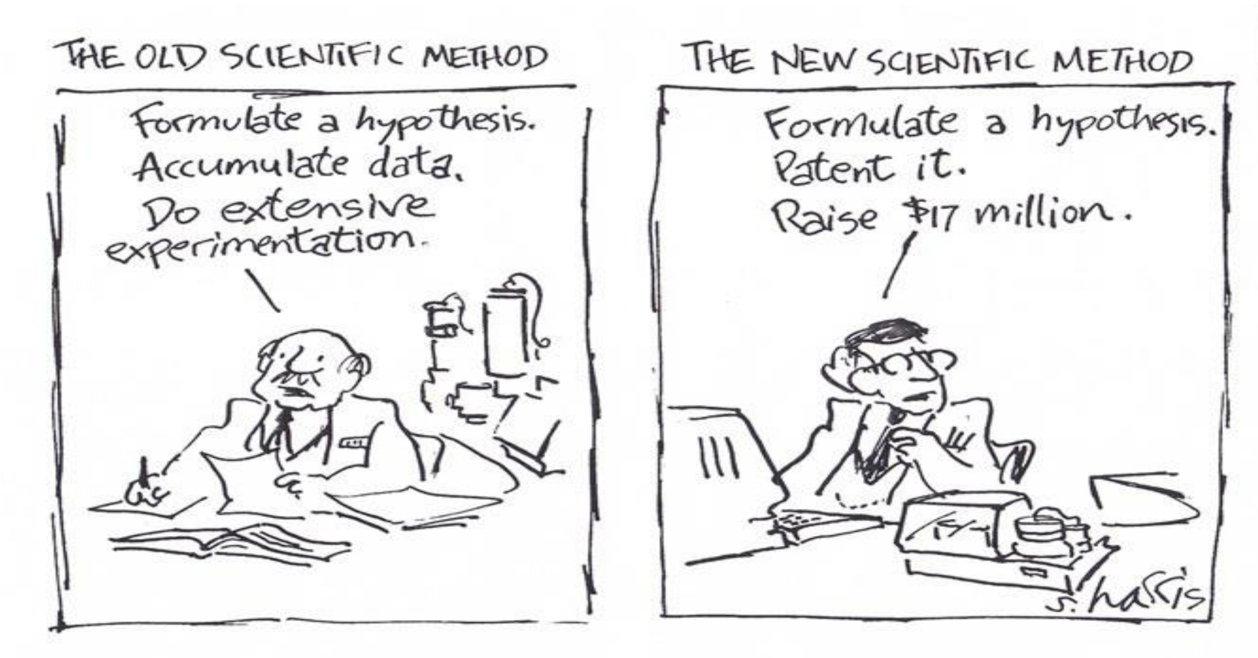
vision = IDEA

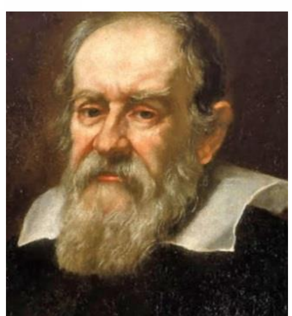


PMF is the end of the process
Then you start to scale

Focus on Lean Start up
FALSIFIABLE HYPOTHESIS

The high level of uncertainty means that startups need to make the best possible **guesses** as to what kind of product and market to target, thus minimizing the chances of producing waste**.**

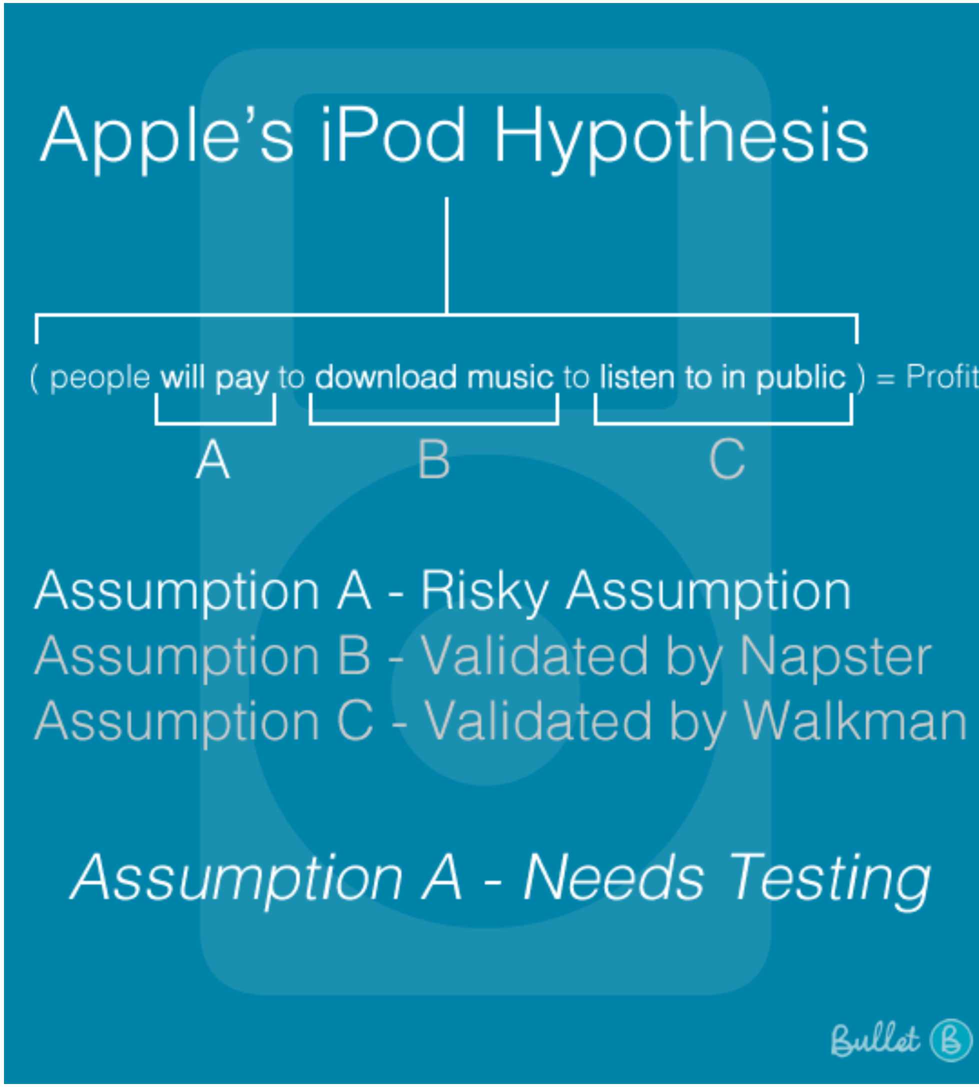




vs.

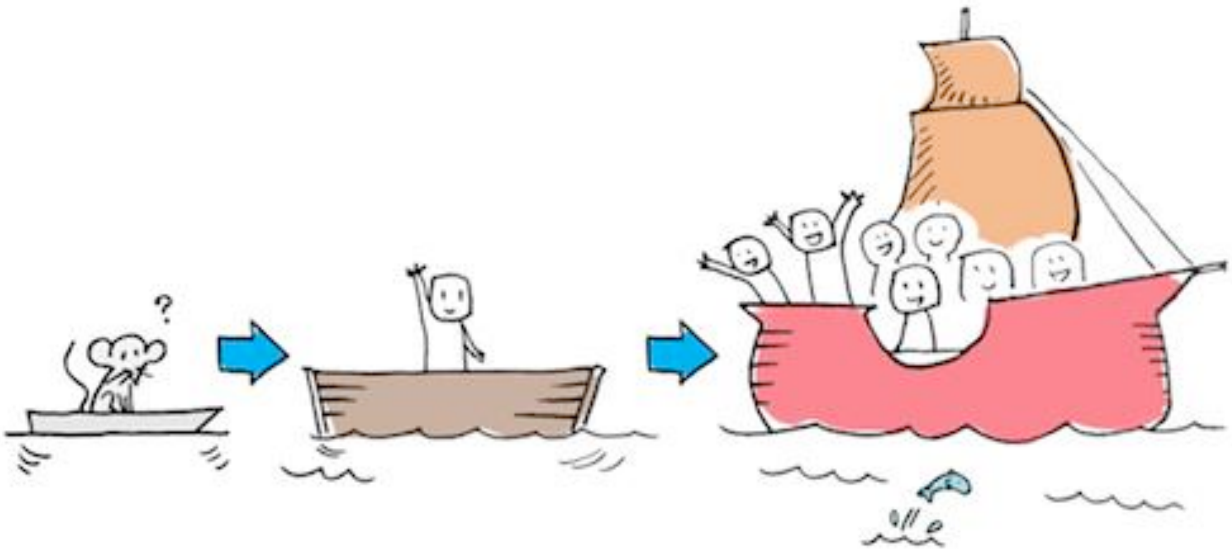
Example
FALSIFIABLE HYPOTHESIS

A lean startup will approach these assumptions with two things in mind:
1. Make these **assumptions testable and tangible**, not abstract.
2. Know **which of your assumptions are the most uncertain, and test these risky assumptions first**



Focus on Lean Start up
MVP

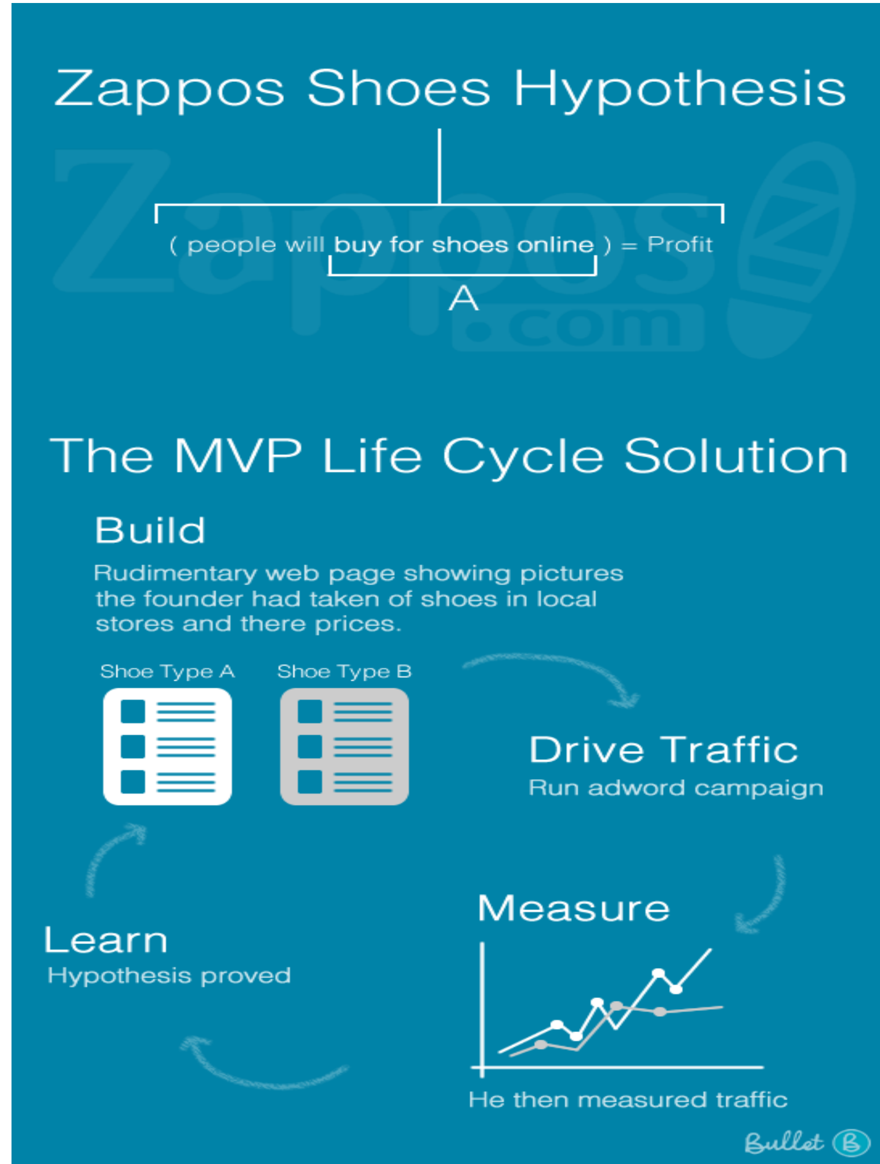
- **MVP**: Contrary to traditional product development, which usually involves a long, thoughtful incubation period and strives for product perfection, the goal of the MVP is to begin the process of learning, not end it. Unlike a prototype or concept test, an MVP is designed not just to answer product design or technical questions. Its goal is to test fundamental business hypotheses.



MVP: You want to build a huge ship, but instead of building the ship right from the beginning, you start by testing your idea with minimal design to see if it floats.

Example
MVP

"There's a huge difference between what people say and what they do" (Dan Ariely,2008).



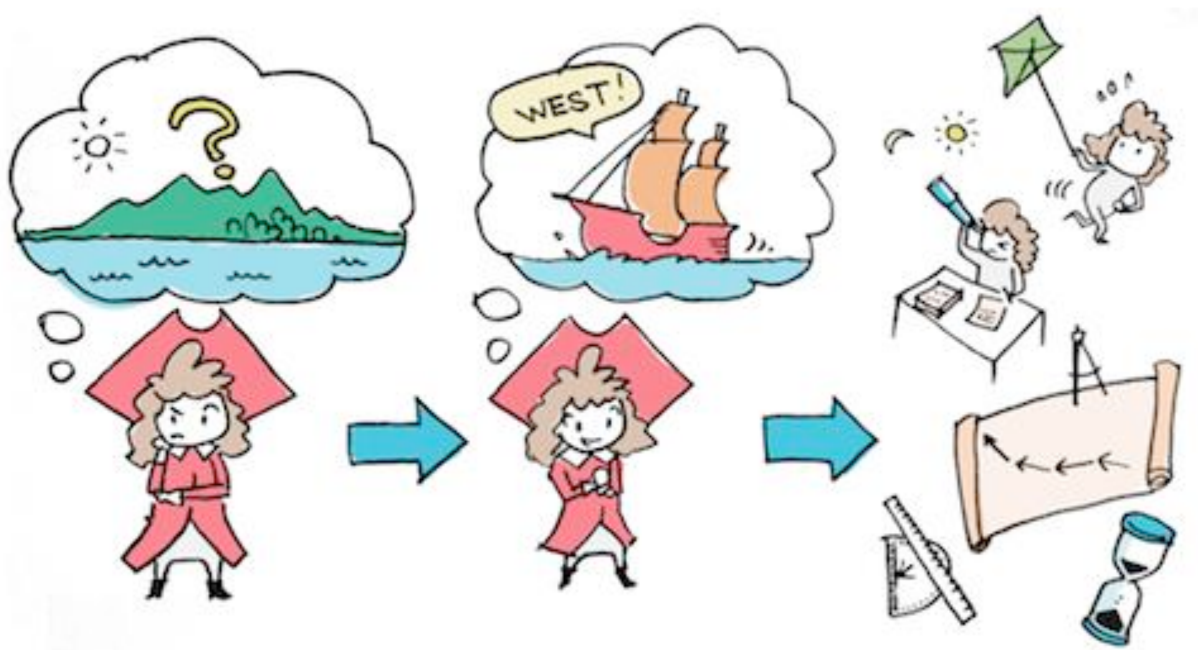
Dropbox MVP

I LIKE HOW WE'VE HAD THE INTERNET FOR DECADES, YET "SENDING FILES" IS SOMETHING EARLY ADOPTERS ARE STILL FIGURING OUT HOW TO DO.

- The founding team was made up of engineers, as the product demanded significant technical expertise to build
- Investors would explain that this "market space" was crowded with existing products, none of them had made very much money, and the problem wasn't a very important one. Drew would ask: "Have you personally tried those other products?" When they would say yes, he'd ask: "Did they work seamlessly for you?" The answer was almost always no.
- *The challenge was that it was impossible to demonstrate the working software in a prototype form.*
- In parallel with their product development efforts, the founders wanted **feedback from customers** about what really mattered to them. In particular, Dropbox needed **to test its leap- of- faith question: if we can provide a superior customer experience, will people give our product a try?**
- They **uploaded a demonstration video** on Hacker news on April 2007
- The **video drove hundreds of thousands of people to the website**. **The beta waiting list went from 5,000 people to 75,000 people literally overnight**.
- Using Lean Startup principles, in just 15 months, Dropbox went form 100,000 registered users to over 4,000,000

Dropbox
Lessons learnt

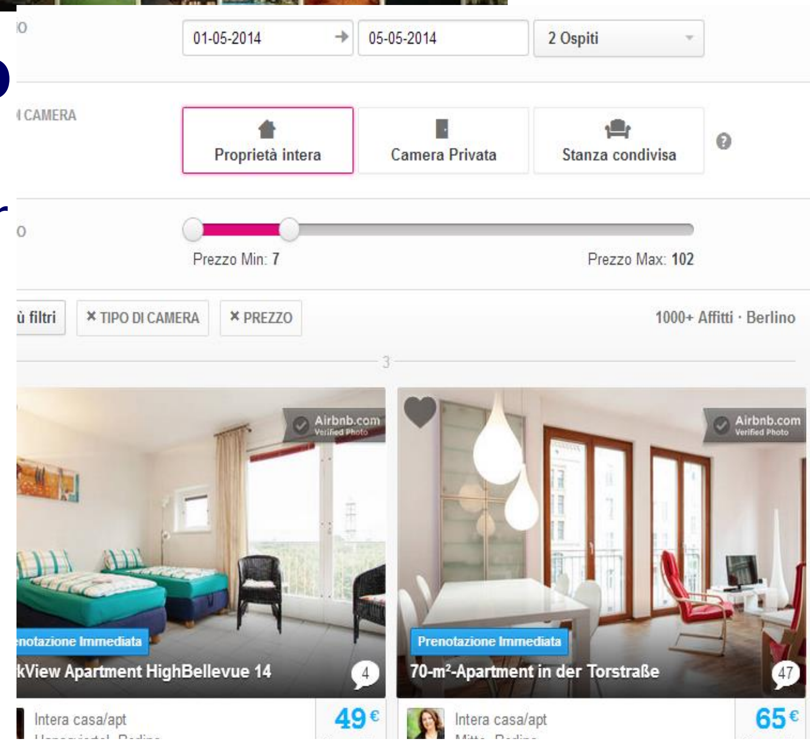
Focus on Lean Start up
VALIDATED LEARNING



Validated learning: You believe you'll find a new continent if you keep sailing west. So, you test your idea and verify the route using scientific methods and measurements.

Lean Analytics
Airbnb case

STEP 1: FIGURE OUT WHAT METRIC TO IMPROVE



The metric they wanted to improve was the number of nights that a property was rented. Notice that this is more central to their business than simply measuring revenue: Airbnb does well if its homeowners do well, and for it to succeed, it needs listed properties to be rented often so the homeowners will stick around.

The company knew that to succeed, they needed a significant improvement in rental rates per property.

- One Metric That Matters: "Number of nights rented."
- KPI: Property bookings
- Target: (not publicly known)
- Current level: (not publicly known)

Lean Analytics
Airbnb case

STEP 2: FORM A HYPOTHESIS

Properties with better pictures rent more often.

- Perhaps they had noticed that the pictures of those properties looked, to them, more professional.
- Maybe they realized that one common complaint from renters was that the property didn't actually look like the pictures on the site.
- Maybe they found that people would most often abandon a listing right after seeing photographs.
- Maybe they analyzed the metadata from pictures and found that there was a strong correlation between properties that rented often and expensive camera models.

Lean Analytics
Airbnb case

STEP 3: CREATE THE EXPERIMENT

- *Who is the campaign for?* Travelers looking at listings on Airbnb.
- *What do you want them to do?* Decide to rent a property more frequently.
- *Why do they do it?* Because the photographs look professional and make the property look beautiful

Find out if travelers will book more properties because of professionally photographed listings enough to improve the property bookings by X%.

Airbnb's experiment consisted of something that looked like a real feature, but under the covers was really just humans and contracted photographers. During the experiment they took pictures of properties, and then measured the KPI, comparing properties that had been photographed to those that hadn't.

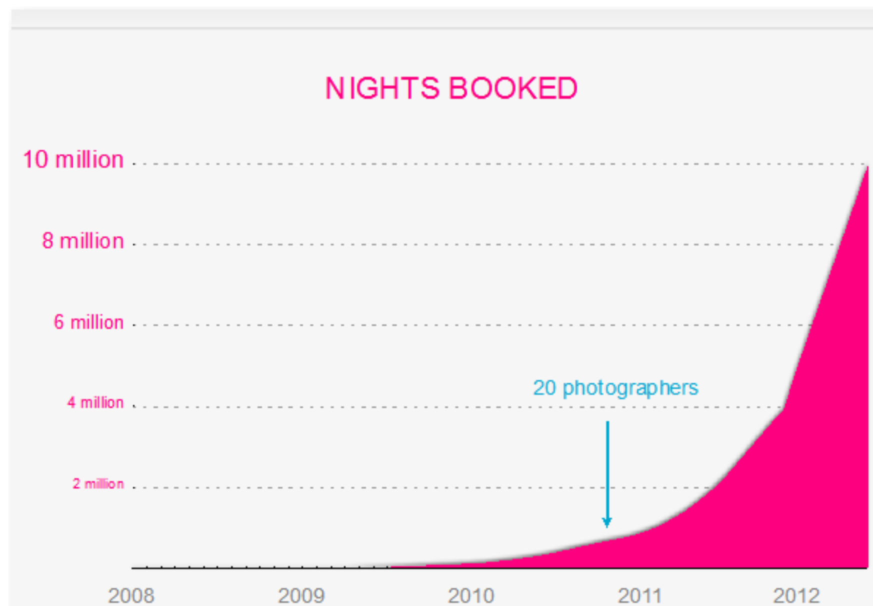
Lean Analytics
Airbnb case

STEP 4: MEASURE PERFORMANCE

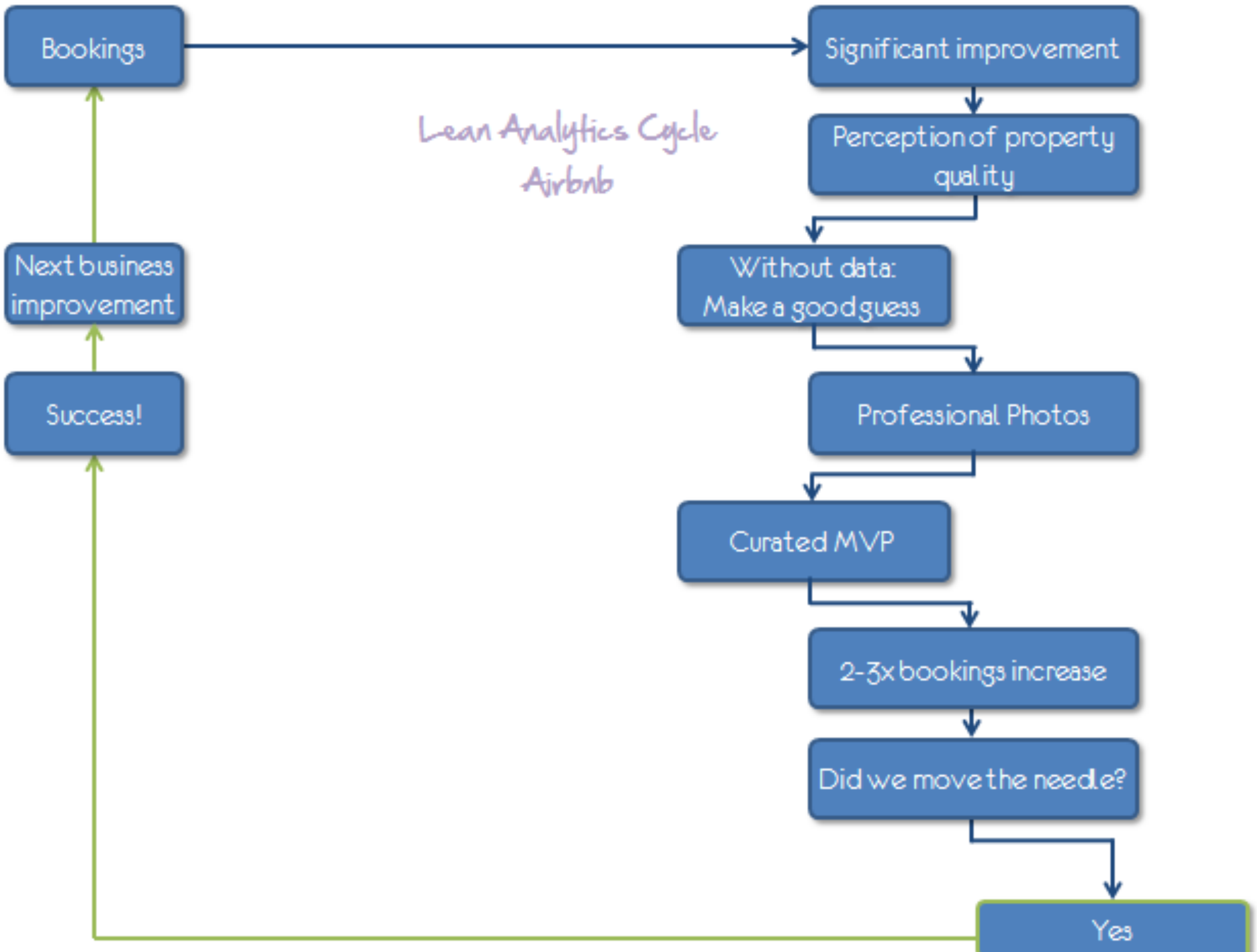
Airbnb measured the bookings from the few properties that had professional photos and compared the rate of bookings with properties that only had photos taken by property owners

The properties with professional photography had 2-3 times the number of bookings!

By 2011, the company had 20 full-time photographers on staff



Lean Analytics
Airbnb case



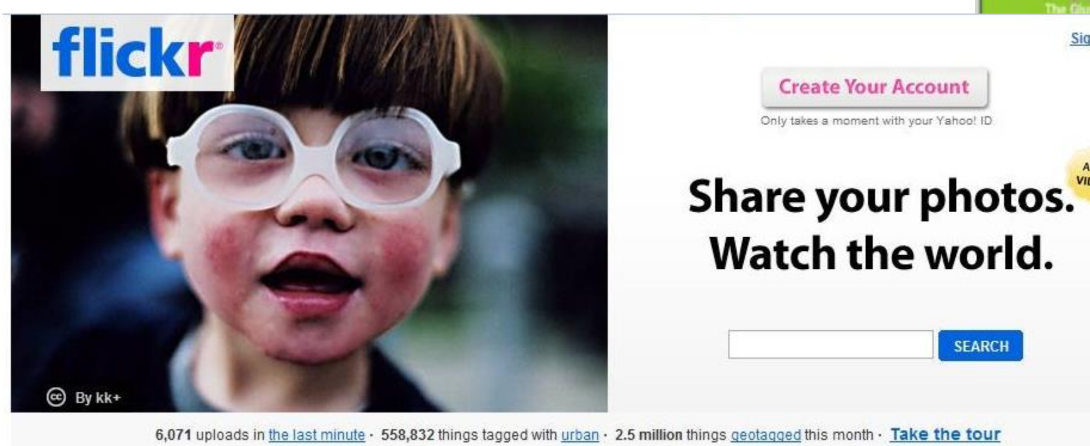
Focus on Lean Start up
PIVOT

<u>*Pivot (Basketball):*</u>
to keep one foot in place while
holding the ball and moving the other foot
one step in any direction.

Famous Pivot
Youtube: YouTube began life as a video dating site
Instagram: it was a location based social network
Groupon: formerly, "The Point", site for online collective action and fundraising of collective actions (social media platform designed to get groups of people together to solve problems)

PIVOTING
Flickr

From a “massively multiplayer online role playing game” called Game Neverending….

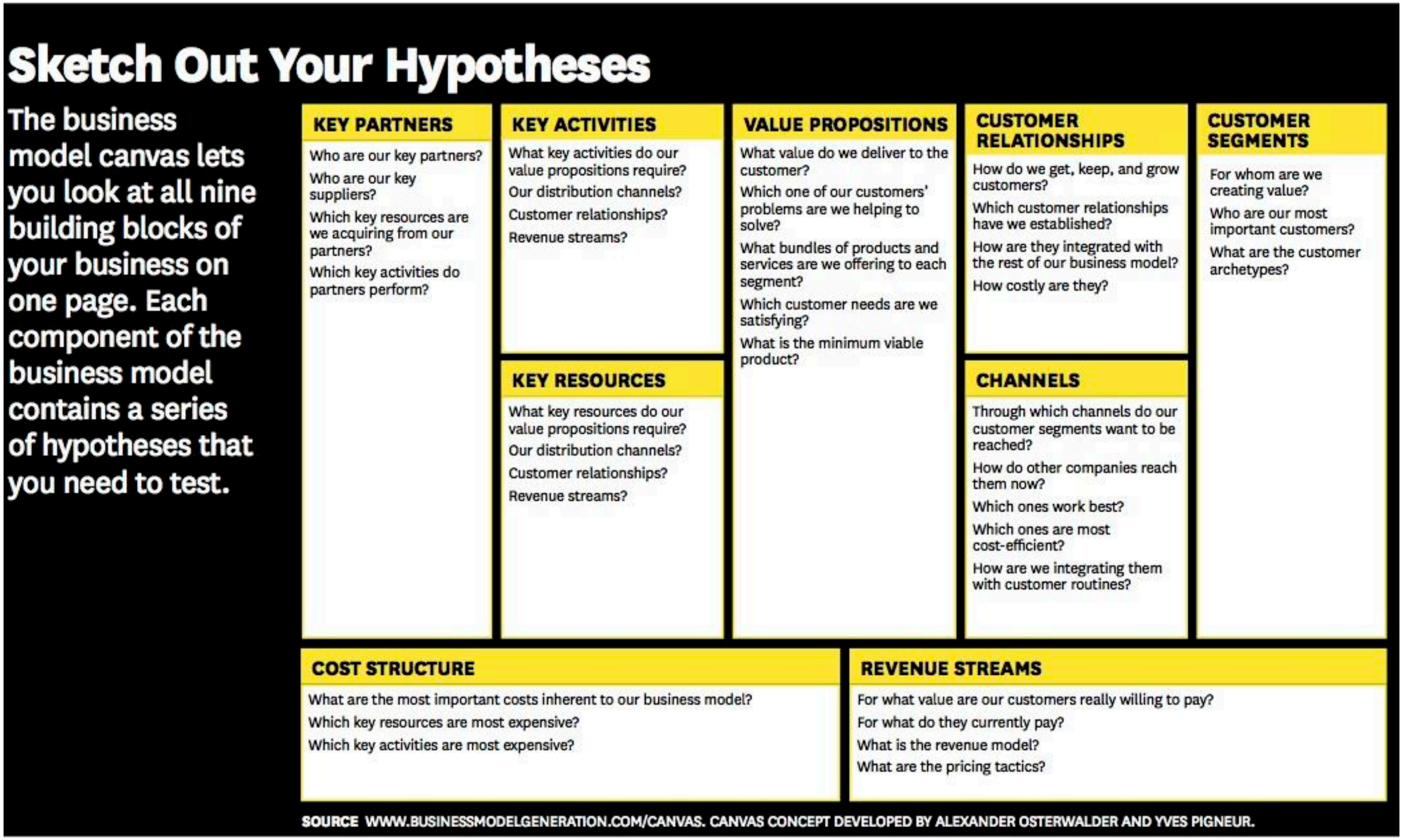


… to the larger potential of simplifying photo sharing on the web

Key principles of lean method
(*Steve Blank, 2013 – HBR)*

1. Instead of writing an intricate business plan, summarize their hypotheses in a framework called Business Model Canvas
2. Use a «get out of the building» approach called Customer Development
3. Practice Agile Development

Business Model Canvas

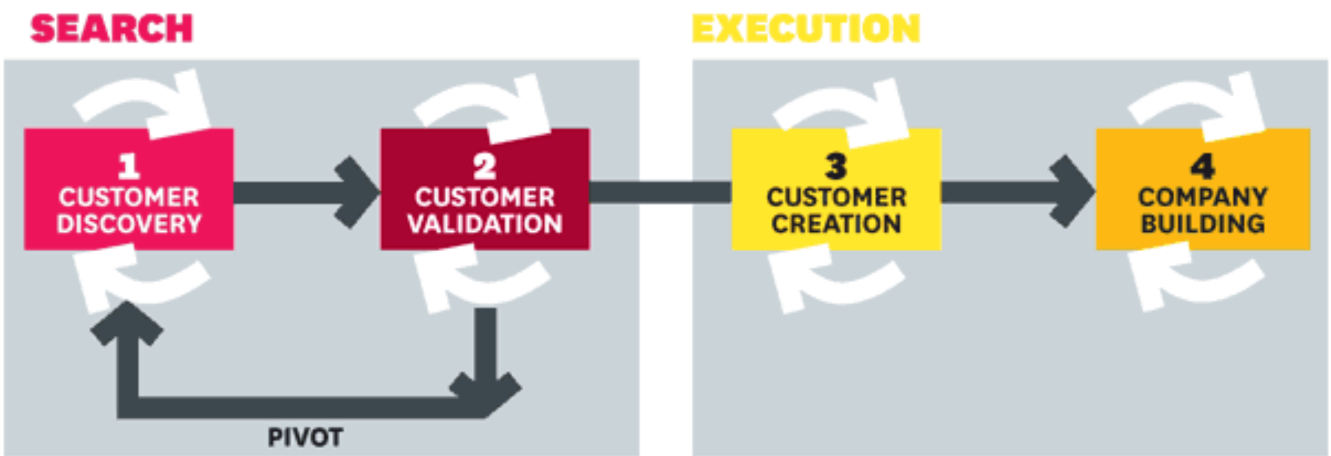


Key principles of the lean method

1. Instead of writing an intricate business plan, summarize their hypotheses in a framework called Business Model Canvas
2. Use a «get out of the building» approach called Customer Development
3. Practice Agile Development

Listen to customers (1/3)

- SEARCH: Looking for a business model that works
  - If customer feedbacks are negative = wrong hyotheses
    PIVOTING
  - If customer feedbacks are positive = proven model
- EXECUTION: Building a formal organization



Listen to customers (2/3): *SEARCH*

1. CUSTOMER DISCOVERY –

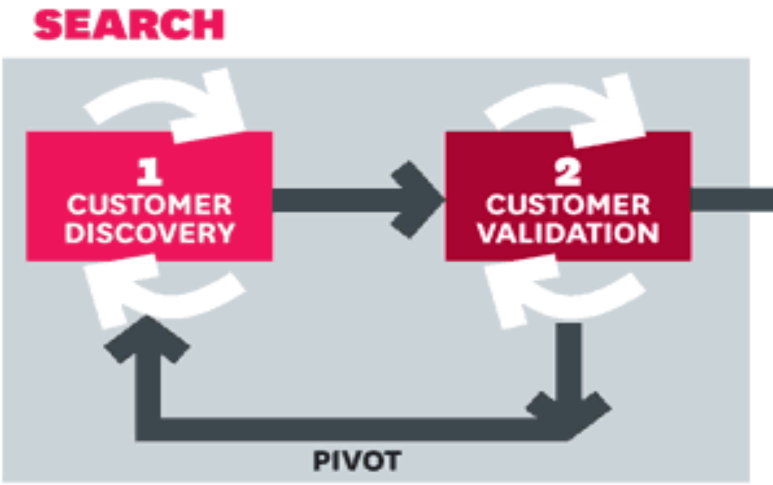
   Company ideas are translated into:

   a. *BM Hypothesis*
   b. *Test assumptions on customer needs*
   c. *Creation of a MVP*

2. CUSTOMER VALIDATION –

   Iterative process:

   a. *Test all hypotheses*
   b. *Validate customers' interest through early usage/orders*
   c. *Pivot (change in hypotheses)*



Listen to customers (3/3): *SEARCH*

3. CUSTOMER CREATION –

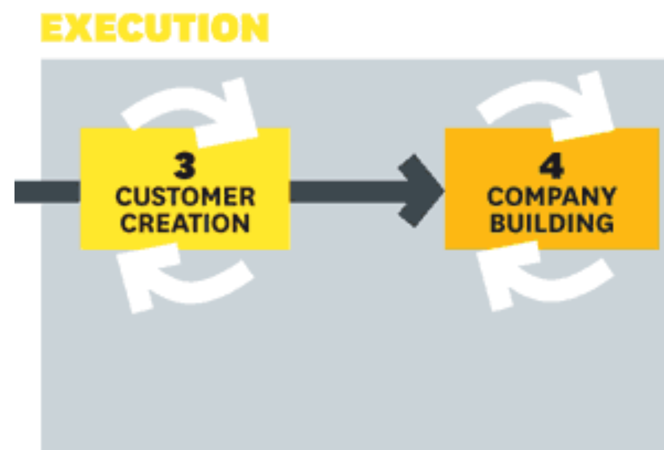
   The product is refined:

   a. *Demand building*
   b. *Marketing & sales spending*
   c. *Scaling up the business*

4. COMPANY BUILDING –

   Business transition from startup mode:

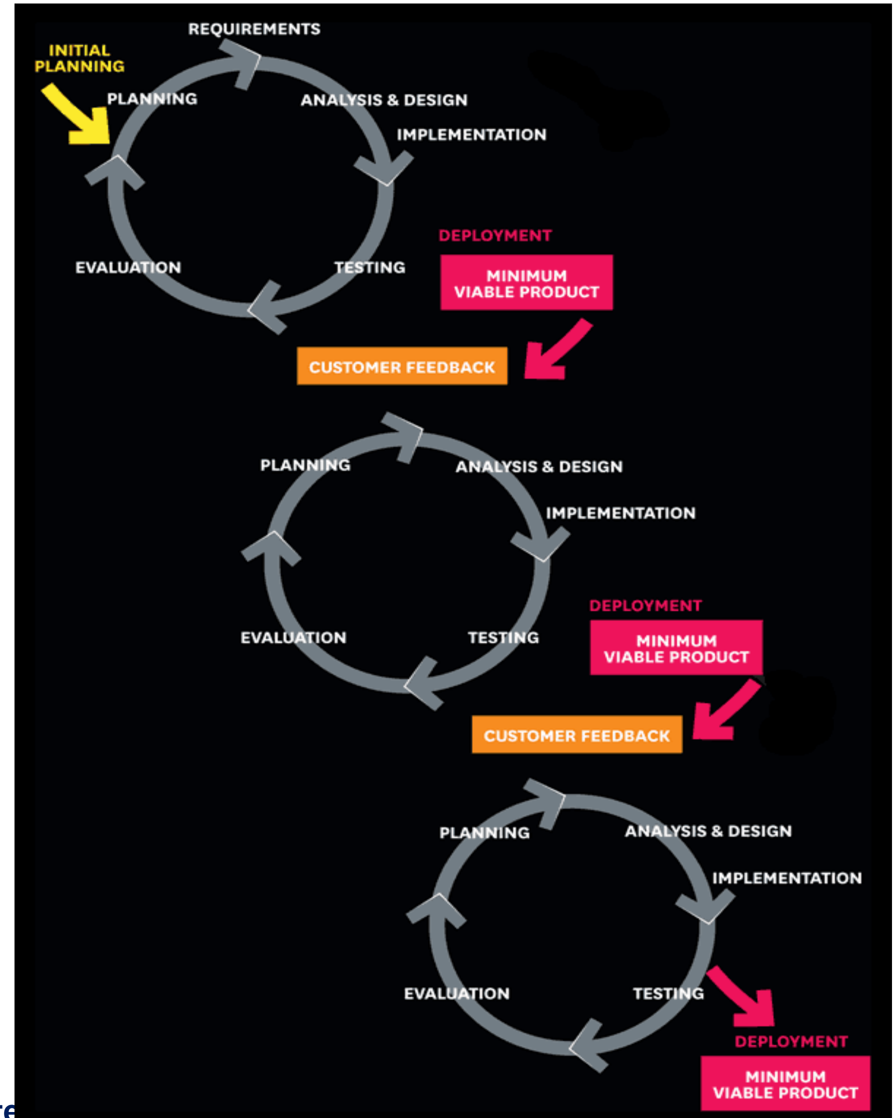
   a. *Customer development team*
   b. *Functional department*



Key principles of lean method

1. Instead of writing an intricate business plan, summarize their hypotheses in a framework called Business Model Canvas
2. Use a «get out of the building» approach called Customer Development
3. Practice Agile Development

Quick responsive development



«In contrast to traditional product development in which each stage occurs in linear order and lasts for months, agile development builds product in short, repeated cycles. A start-up produces a ***Minimum Viable Product (MVP) –*** *containing only critical features – gathers feedback on it from customers, and then starts over with a revised MVP»*

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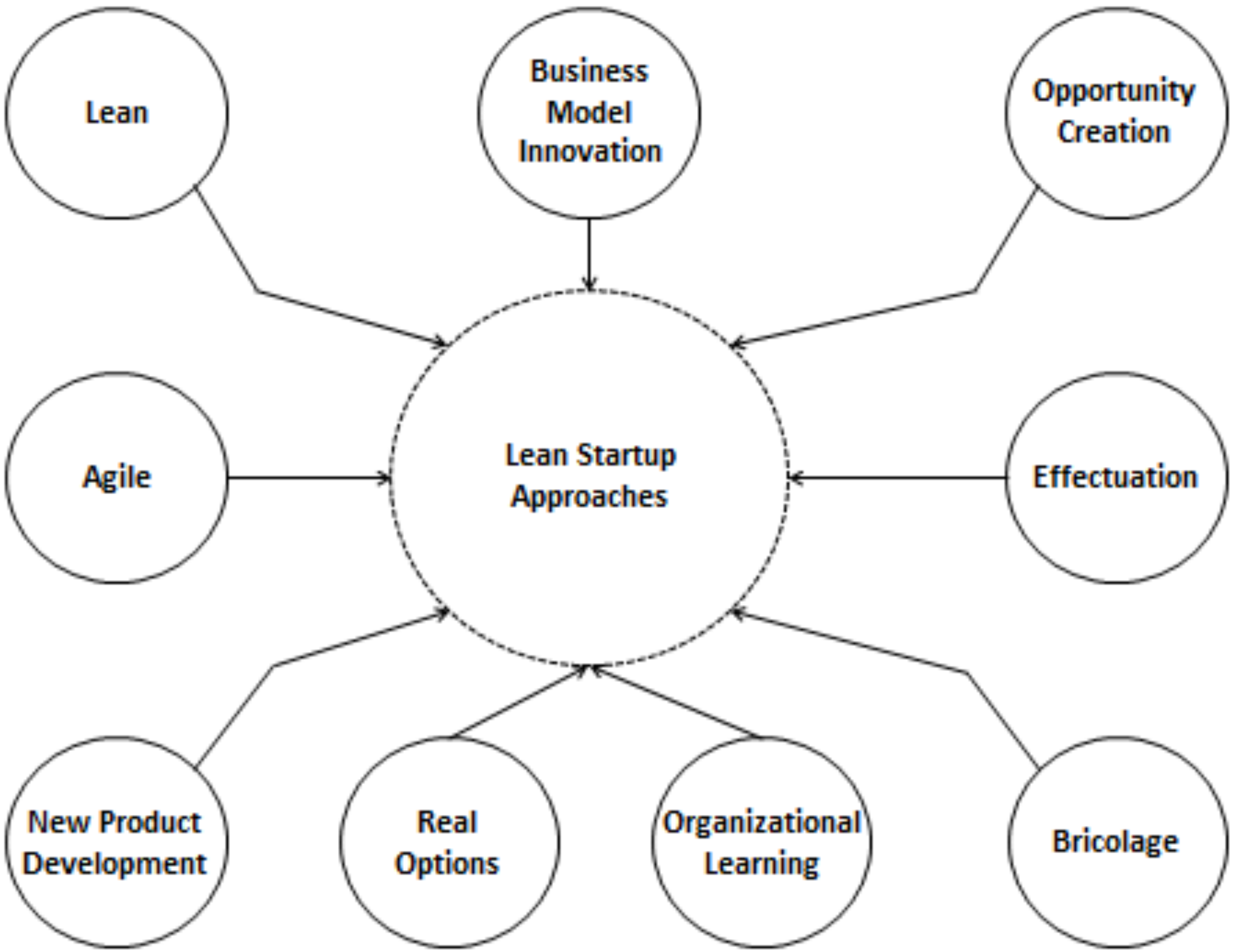
Lean Startup Approaches: theoretical roots and empirical findings

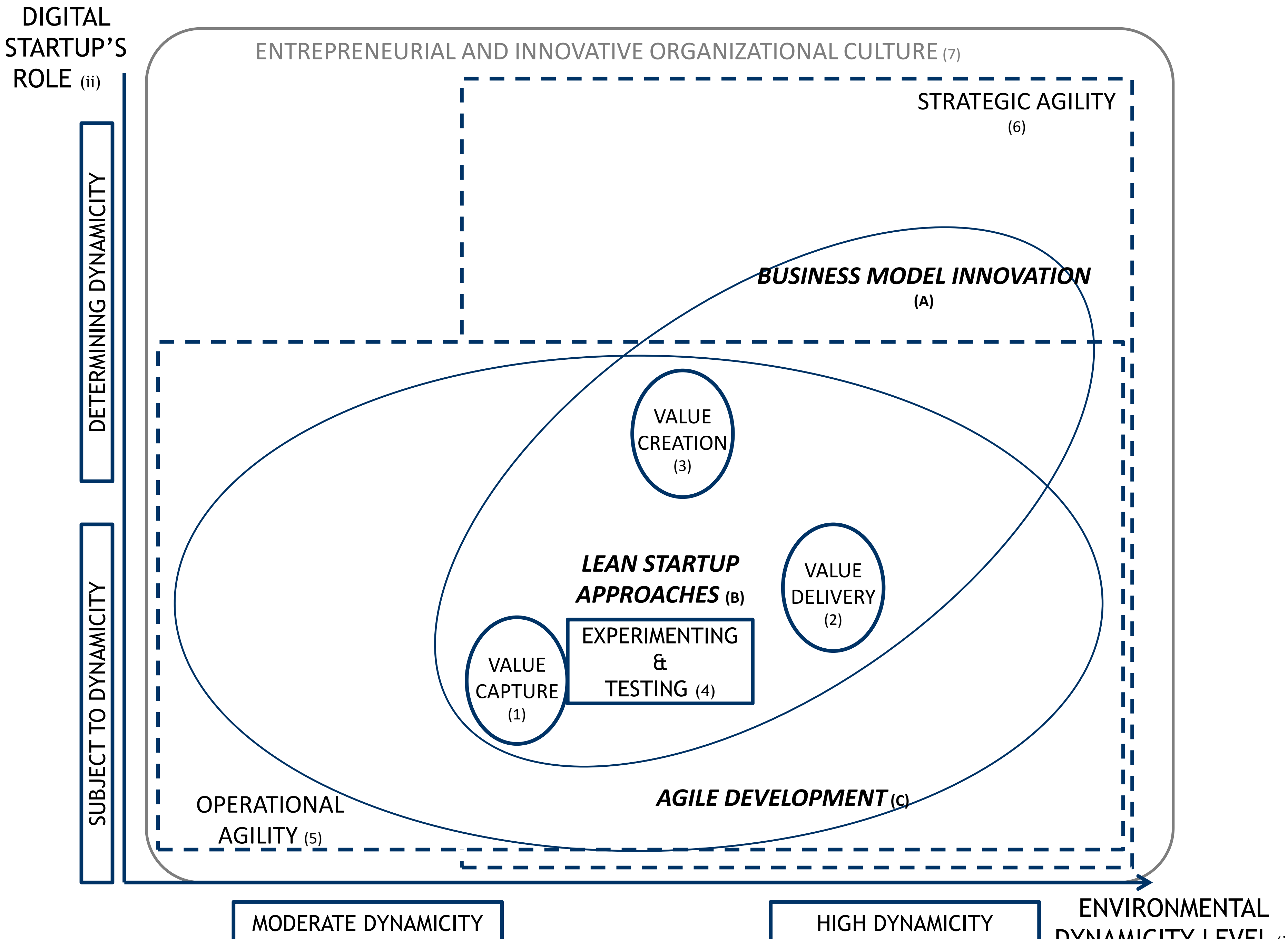
Antonio Ghezzi

Politecnico di Milano

Department of Management, Economics and Industrial Engineering

Lean Startup Approaches: theoretical roots (Ghezzi, 2018)





Unified Framework for LSAs, BMI and Agile Development *(Ghezzi and Cavallo, 2018)*

Empirical findings: practical guidelines for LSAs adoption (Ghezzi, 2018)

Issue	Practical Guidelines
Type of digital startup	• All startups, including those that are CVC-backed, benefit from adopting and implementing LSAs.
Stage of startup development	• Startups are to adopt LSAs in their early stages of development, while continuously implementing them following Agile principles whenever the context turns out to be uncertain.
Bad choices concerning the provision of LSA-related knowledge	• Startups are to carefully assess and select suppliers for LSAs courses and training sessions. • Startups are to rely on certified and experienced actors – e.g. universities, colleges and research institutions, top-ranked incubators and accelerators.

Empirical findings: practical guidelines for LSAs adoption (Ghezzi, 2018)

Issue	Practical Guidelines
Formulation of falsifiable hypotheses	• Entrepreneurs must think carefully on how they can accurately formulate falsifiable hypotheses about their startup's business model (a step they often neglect). • Falsifiable hypotheses constitute the operational trigger for the scientific methods embedded in LSAs.
Identification of earlyvangelists	• Entrepreneurs are to properly evaluate who their earlyvangelists and trial users are and where they "hang out", in order to target the right prospects and receive informed feedback. • In B2B settings, evangelists are found among existing business customers by carefully assessing the customers' purchasing processes and identifying the key decision-makers.

Empirical findings: practical guidelines for LSAs adoption (Ghezzi, 2018)

Issue	Practical Guidelines
MVP design	• MVPs are artefacts with these key characteristics: they (i) resemble and embody the business idea; (ii) are actionable; (iii) are measurable through the MVP testing outcomes; and (iv) are less wasteful than prototypes. • MVPs as paid-for products increase the amount of information they carry when tested upon. • MVP design can leverage Feature Development Design (FDD) to provide guidelines on how to identify and design minimum features and run iterations. • In B2B settings, an MVP cannot be too "minimum", as it should incorporate a sufficient number of features at a satisfactory level to compete with existing offers.

Empirical findings: practical guidelines for LSAs adoption (Ghezzi, 2018)

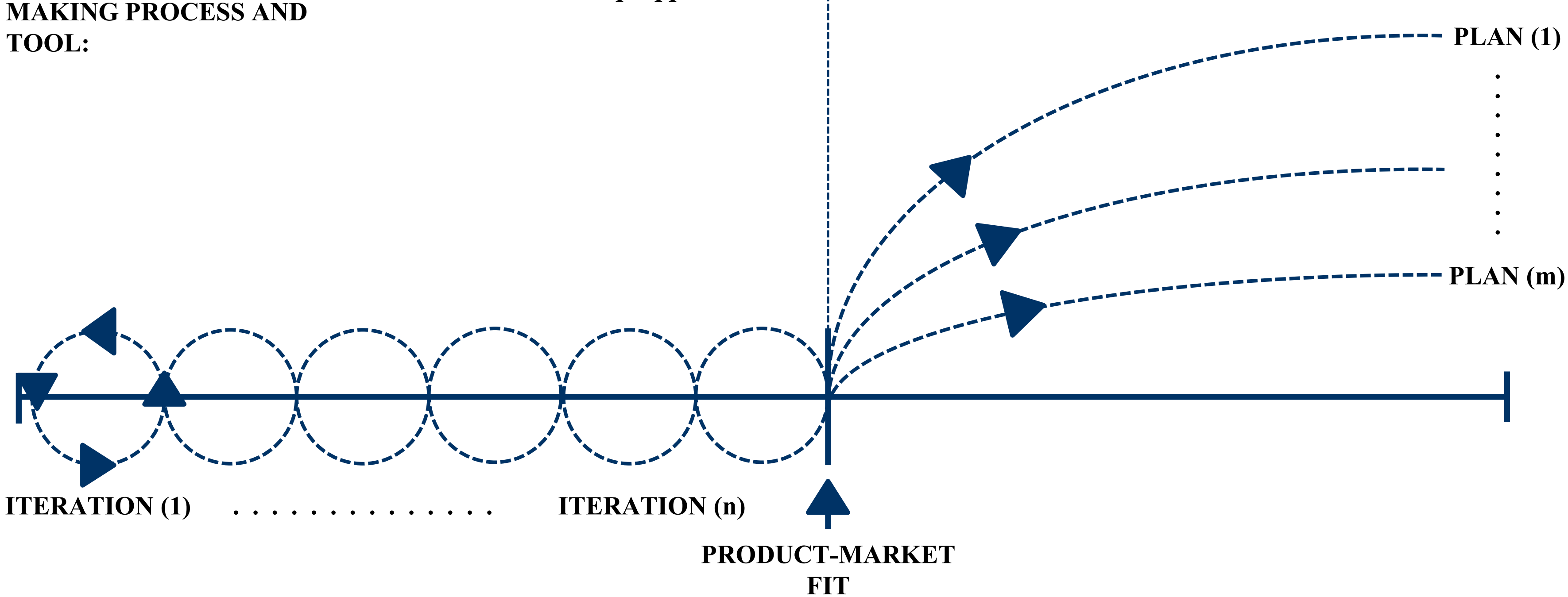
Issue	Practical Guidelines
Experimenting and testing	• Experiments are to be MVP-based, which in turn means they are BM-based. • Digital products and services can be run through Scrum sprint cycles, to control for time and budget. • Entrepreneurs are to radically rethink their views on IP protection, embracing openness and collaboration through fast experimenting and learning.
Business Model validation and pivoting	• Startups are to experiment and test on all elements of their business models, not just their value proposition (product, service, solution, bundle). • Executing a go-to-market strategy often requires more testing than the value proposition itself.

Empirical findings: practical guidelines for LSAs adoption (Ghezzi, 2018)

Issue	Practical Guidelines
LSA broad adoption and implementation process	• Entrepreneurs are to adopt LSAs comprehensively, rather than cherry-picking the steps and elements they perceive as most useful. • Entrepreneurs are to go beyond heuristics and apply a scientific method by means of the LSAs. • **Entrepreneurs are to integrate LSAs with business planning, thus altering Blank's motto to: "*before* writing a business plan, design a business model and apply LSAs"**. • Entrepreneurs are not to overlook the process of strategy formulation and strategy analysis which can inform the formulation of falsifiable hypotheses and design of a preliminary business model.

Bridging LSAs and Business Planning (Ghezzi, 2018)

ENTREPRENEURIAL OPPORTUNITY SETTING:	***Creation theory***	***Discovery theory***
UNDERLYING COGNITIVE LOGIC:	***Effectuation and Bricolage***	***Causation***
DECISION MAKING CONTEXT:	***Uncertain***	***Risky***
OPERATIONAL DECISION MAKING PROCESS AND TOOL:	***Lean Startup Approaches***	***Business Plan***



The entrepreneurial opportunity space

(Ghezzi, 2018. Digital startups and the adoption and implementation of Lean Startup Approaches: Effectuation, Bricolage and Opportunity Creation in practice. Technological Forecasting and Social Change. https://doi.org/10.1016/j.techfore.2018.09.017)

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POLITECNICO
DI MILANO

Business Plan

Politecnico di Milano

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Business Plan: what

A written document that describes in detail how a new business is going to achieve its goals.

A business plan will lay out a written plan from a marketing, financial and operational viewpoint.

The business plan is a tool to understand the present, make hypothesis about the future, plan the activities, coordinate people, and control costs and cash flows.

Business Plan: when

Established Company	Startup
Launching a new project, new product, opening a new market, a new branch	At launch
Re-Think	Think

Business plan is not just to plan new activities, but to control the ongoing business.

It is not done once for all, but must be kept updated, to verify how things have gone, and how far from forecast.

It is a difficult exercise, because it is both a program of future activities, and a forecast of the future itself, about variables that no one can control (the market, the customer' preferences, future technology developments, etc.)

Business Plan: how

There are more established tools to guide the activities of a company, and the business plan it this type of tools.

These are surely the best in very stable environments, with consolidated business, and stable conditions, with known clients, products, and processes.

For startups, new tools have been developed, which consider the startup as a temporary organization still in search of a viable and stable business model, and that don't have a clear idea of what are the products, the clients, and the processes for the future.

For them, Steven Blank and Eric Ries have conceived a method, known as Lean Startup or Lean LaunchPad, that has the mission to guide the decisions, the approach, and the activities of a startup during this first phase.

It is questionable, whether even established companies for new projects in unstable markets could gain an advantage in adopting LLP methodology.

Business Plan: tools to plan activities

Tools

Type of company	Classic	New
Established company	BP	LLP?
Startup	BP?	LLP

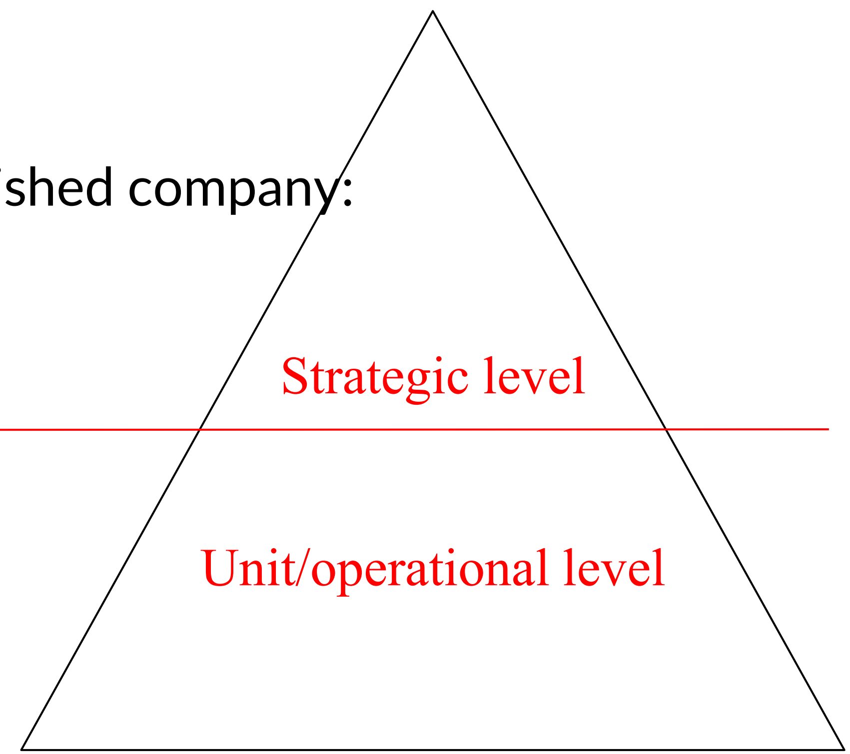
Business Plan: Who (targets)

Everyone who is responsible of an organization should know the structure, the function and how to create/evaluate a business plan.

Specifically:

- (most of) The Stakeholders of a new or established company:
    - Shareholders (Investors, Founder)
    - Executive Board

    - Management team
    - Workers?
- And …. yourself



Business Plan: why (objectives)

Planning
- Evaluate an investment opportunity
- Evaluate feasibility / profitability
- Find resources and funds
- Assess Risks and Opportunities
- Control

Communication
- Internal: executives, management team, workforce.
- External: shareholders and other stakeholders (e.g. government, institutions) etc.

12 Steps for a Successful Business Plan

1. Define your value proposition and the core business activity
2. Define the current status of the business
3. Identify your competitors, and define your market positioning
4. Define your objectives for the period of the plan
5. Develop a strategy to achieve the objectives
6. Identify risks and opportunities
7. Develop a strategy to reduce risks and exploit opportunities
8. Refine the strategies into working plans
9. Project costs and revenues and develop a financial plan
10. Document it concisely
11. Get it approved
12. Use it

Practical Tips

1. Tell a story!
2. Be concise (no more than 20-40 pages)
3. Document and support with references your affirmation
4. People (team) is as important as numbers!
5. Use a nice and ordered layout (nr. of pages, formatting, etc.)
6. Use a solid structure, e.g.: premises, body, conclusion
7. …add your own!

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Types and Sources of Data

When you add data, be sure to indicate what is the source of information. Basically, you have three types of data:

1. Your **historical** data → if you have historical data, that's the best!
2. **Market** data → cite the source
3. Your **assumptions** → if you don't have data, make and motivate your assumptions (don't be shy, it is reasonable)
4. Results of Lean Startup test (validated learning) → the business plan follows and leverages the lean startup approaches

If you are not sure, use journalistic ways of saying, like: "Commentators say that, …" ; "Industry sources indicates …", etc.

2. Business Plan Sections

Business Plan – Main Sections

Main sections of a business plan

1. Executive Summary
2. Product / Service
3. Strategic Plan
4. Marketing Plan
5. Operating Plan
6. Economic and Financial Plan
7. Risk Analysis

All the sections are connected!

All the sections are linked together and the choices done in one have consequences in the others.

Every section has an impact on other sections. A choice in strategy impact production, organization, etc.

E.g.: if you establish that your strategy to enter a new market is to offer a niche product, this choice impacts production, positioning, communication, distribution, pricing, etc.

Business objectives and local goals

The business objectives are introduced and explained in the strategy section (i.e. Strategic Plan). They form the red line keeping together the whole plan.

On the other hand, every section has a local objective/goals, consistent with the overall ones, while answering to specific questions or choices, regarding, for examples decisions about manufacturing, organization, communication, funding, etc.

The process is not linear: iteration!

Business Planning is an iterative process rather than linear: every section can impact the following ones and the previous ones.

E.g.: while building the financial plan, you realize that your business can’t be sustainable. Thus, you might have to reconsider the product itself, the strategic plan, or marketing plan, manufacturing and operational plan, etc.

A comprehensive vision

Creating a business plan is complex activity, as it has the objective to offer a comprehensive vision of an entire business, project, or even an entire company.

The business planner has understand peculiarities and problems at different levels of a business: from strategy to operation, from marketing to organization, from financial projections to risk analysis.

Business planner should be also able to engage/attract the audience.

A wide set of managerial tools

Every section has its own characteristics and also a set of managerial tools that may support the business planner.

These tools are basically frameworks to organize data and information and to clarify - first to our self then for the reader - the plan in each section.

The relations among sections

1. Executive Summary: Synopsis of the whole plan;
2. Products & Services (Value Proposition): presentation of main features and characteristics;
3. Strategic Plan: set strategic objectives; design of the competitive environment;
4. Marketing Plan: translate strategic Objectives into Marketing Objectives and Plan;
5. Operating Plan: translate strategic objectives into a series of actions and activities;
6. Financial Plan: measure sales, costs, cash flow related with the activities performed;
7. Risk Analysis: assess the risk of the venture.

Iterative Process!

Cover

Before analyzing the sections, consider to add some basic information on the cover, to add reference and to keep track of your copies. Here below an example.

Name of the company →	**Wardroba Srl**
Website (if relevant) →	http://wardroba.com
Title: business plan →	**Business Plan**
Date & Place →	Milano, March 2015
Confidential →	01 Personal and Confidential
Nr. version & nr. of copy →	Version nr. EN-01

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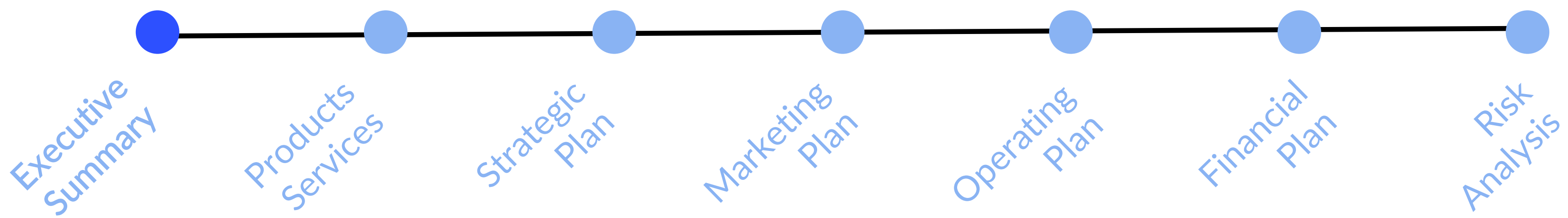
2. Business Plan Sections

Chapter 1: Executive Summary



Executive Summary

The Executive Summary is a synopsis of the whole business plan: it contains fundamental information discussed deeper in each section.
It's a way to give in few pages (2-3 maximum) an overview of the venture.
Interested readers will go deeper reading following sections.

Main topics are:

- **Company Introduction**: present the company, date of foundation, state of art, stage in the history of the company, seats, plants, type of ownership, governance, etc.

- **Business idea**: shortly, describe the value proposition, how you intend to deliver this value, why and to whom.

- **Market Opportunity**: describe what are the opportunities and the characteristics of the market in term of attractiveness

Executive Summary

- **Expected Results**: describe what are the main objectives / results and relative timing.

- **Resources, competences**: describe main resources, competences, skills the company can rely on.

- **Main activities**: describe the core activities to reach the objectives.

- **Economics**: introduce main economic and financial data

- **Objective of the business plan**: introduce the following sections of the business plan, clarifying what is the objective of the whole document

Executive Summary

- **Goals**

Introducing the reader to the business, offering first elements to assess whether the venture is interesting or not.

- **Premises**

All the other sections of the business plan. This is the last section developed (but the first read by the target)

- **Following**

None (it is the opening section in the business plan)

- **Tools**

None (it is just a synopsis of all the other sections)

Executive Summary

The Executive Summary is a plan in miniature, it is not an introduction. It should capture in no more than one or two pages most important points of the whole plan.

You have to encourage your audience to go ahead and read the whole document. At the same time, it has to present honestly the business.

Information to include

- Start with the objective
- Management Team (key people to make the business to succeed)
- Products or services (why are they special?)
- Market (what's your niche? What are your unique factors?)
- Assets, strengths, advantages, and competences
- Strategy to succeed
- Key Financial Data
- Funding required and its use

Executive Summary: some tips

State clearly and concisely (pieces of a business model)

- Your Value Proposition
- What's the Business Opportunity and the KSF of the Market
- What's your solution and why it's different from others
- What's your target and your positioning
- What's your price
- What are your revenue streams
- Key Activities
- Key Partners
- Channels
- Customer Relationships
- Structure of costs

Topics to Include

- Company stage of life, past results, and perspectives
- Value Proposition
- Customer Problem
- The solution
- Business Model
- Target Market
- Competition and competitive advantage
- Strategy
- Marketing activities
- Management Team and Organization
- Economics

Business Model Canvas

Very relevant if your business model is not immediate.

What's a business model?

"A business model describes the rationale of how an organization creates, delivers, and captures value"

Alex Osterwalder, Yves Pigneur "Business Model Generation"

2. Business Plan Sections

Chapter 2: Products & Services

Products & Services: description

In this section, the reader is introduced to the products and/or services offered by the company. The description not only from a physical or technical point of view, but in term of the value for the client.

- Physical / Technical Description (Features, Values for clients)
- Types of usage
- Product Positioning Map
  - Cost
  - Quality
  - Features
  - Values
  - Service
  - Image
- Product lifecycle stage

Products & Services

- **Goals**

Presenting products/services main features, characteristics, physical and technical description, advantages for users, plus, etc.

- **Premises**

Market & Product Fit; market opportunity, business opportunity, disruptive technology, untapped need, etc.

- **Following**

Go-to-market strategy; operating marketing; operation (production, localization, channels, delivery, etc.)

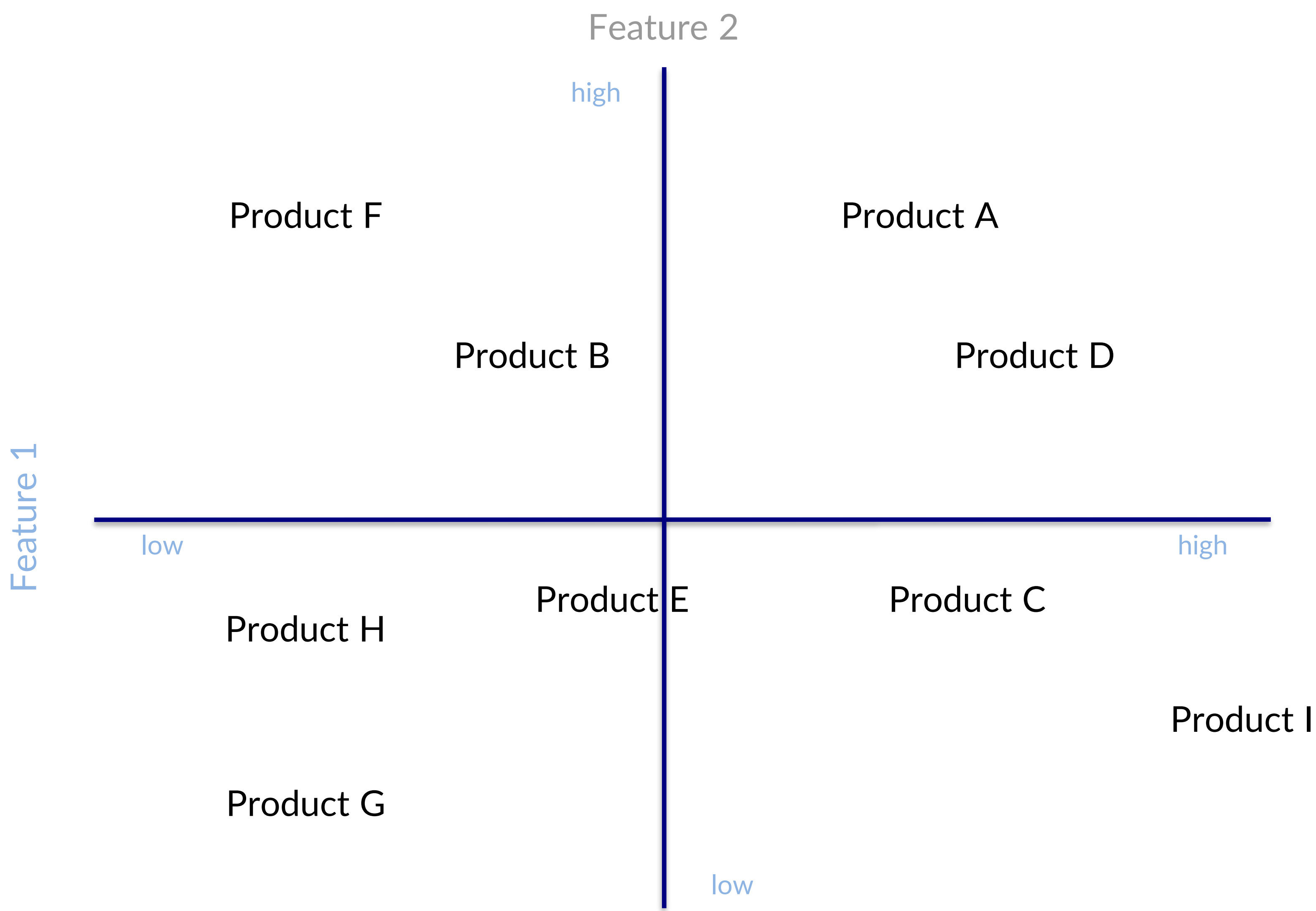
- **Tools**

Photos, drawings, models, technical description, product lifecycle and product positioning maps, etc.

Products & Services: practical tips

- Be very detailed if you are a startup or if your product is totally new, or it is a complex portfolio of products
- Start with one-paragraph summary, then repeat in more detail
- List all your products and services
- Highlight the importance of each of them
- Add pictures, sketches, diagrams, and any type of documents that can substitute the physical contact
- If it is something that people must use, describe how does it work (without getting too technical)

Product Positioning Map



Example: digital platform

- Describe the platform: its purpose and its main functionalities
- Describe the technological infrastructure (database, systems in use, style of the implementation, etc.)
- Define main components
- State clearly what you have already implemented and is online, what is going to be published, what you are developing, and what are future functionalities and improvements
- Include screenshot, sketches, etc.

2. Business Plan Sections

Chapter 3: Strategic Plan

Strategic Plan – the core of the plan

The strategic plan is the core of the whole business plan. It is the starting point to assess the competitive environment and to weight opportunities and risk. Through this analysis, a company define the value proposition and the unique positioning, with the objective to set a competitive advantage. In order to reach this competitive advantage, a strategy is defined, or the unique interconnection of choices and activities (what to do and what not to do) that make a company different from the other.
The strategy has a direct consequences on the activities and organization, and thus on the operating plan, and on the financial plan.

The strategy is not defined once for all. It is common that something in the operating or financial plans is considered as not feasible, and thus there is the need to refine and update the strategy, then operations, etc.

Strategic Plan – main sections

The strategic plan is divided into 3 main sections

- Values, Vision, Mission, Objectives
- Strategic Analysis (Internal vs External)
- Strategy

Values, Vision, Mission, Objectives

Values: in what you believe
Vision: where your target market or industry will evolve long term
Mission: how to reach the ideal stated in the vision
Objectives: results aligned with Values-Vision-Mission; S.M.A.R.T. objectives: Specific – Measurable – Attainable – Realistic – Time-related

This part of the business plan represent the culture and the belief of the company, where it sees itself in the future and how to arrive there; in order to measure progress, it defines corporate objectives.

Values, Vision, Mission, Objectives

- **Goals**

Presenting the culture and the long term goals of the company

- **Premises**

None

- **Following**

Strategy, Organization, Role of innovation & R&D, HRM, Recruiting Style, Markets, Products, etc.

- **Tools**

Corporate culture

10 Common Central Objectives

The business objectives are different for every company and they reflect the culture and the history of the founders, and the people working there.

Here below, a list of the most common categories of central objectives:

1. Maximizing shareholders value
2. Maximizing profitability
3. Maximizing dividends pay-out
4. Maximizing market share
5. Maximizing total assets
6. Minimizing risks
7. Positioning the company as a takeover target
8. Building an empire (nr. of employees, seats, markets, etc.)
9. Stability and growth
10. Maximizing some altruistic vision (CSR)

The objective of Strategic Analysis

As stated earlier, the strategy is the core of the whole plan, and the role in the business plan is to keep together all the pieces. Every activity should be a consequence of the strategy chosen, and the objectives set.

The following list contains a series of questions the strategic analysis should answer.

- Identify opportunities in the market and in the society
- Identify threats in the market and in the society
- Identify the type of competition in the industry
- Assess company’s competences, skills, resources
- Assess Key Success Factor (KSF) in the market
- Verify whether KSF matches company’s competences, skills, resources
- Identify the possible sources of competitive advantage

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Strategic Analysis

External Analysis	Internal Analysis
The Social and Economic Context	Values, Vision, Mission
The Industry	Competences and Resources
The Competition	Competitive Advantage

S.W.O.T. Analysis

The strategic analysis describes the environment and the characteristics of the company that can influence the establishment of a long lasting competitive advantages

Sources of competitive advantage

The strategic analysis must identify the sources of possible competitive advantages in the scope market, like (for a cost-based advantage):

- Economies of Scale → reduce average cost introducing a new unit of output
- Economies of Scope → reduce average cost introducing a new product
- Economies of Learning → becoming a true specialist
- Production Capacity Saturation
- Localization
- Distribution Channel Access
- Other Factors (regulations: depressed area incentives, etc.

12 Sources of Competitive Advantage

In your plan, it is fundamental to identify the real source of lasting and defendable competitive advantage, like the following 12:

1. Strong research and development capabilities
2. Access to intellectual property – trade names, trade secrets, patents,
3. Exclusive re-selling or distribution rights
4. Ownership of capital equipment
5. Superior product and or customer support
6. Low –cost production
7. Other economies of scale
8. Marketing skills related to specific customer types, market segments, channels, etc.
9. Access to working capital
10. Other excellence in management
11. Barriers to entry

Strategic Plan: Strategic Analysis

- **Goals**

Identify threats and opportunities in the market; identify Strengths and Weaknesses; define the structure of the industry and market in terms of intensity of rivalry and presence of extra profits; the type of competition; the Key Success Factor in the market; the core competences of the company; the sources of competitive advantage;

- **Premises**

Corporate Culture, Vision, Mission, etc.

- **Following**

Strategy

- **Tools**

P.E.S.T. Analysis; Porter 5 Forces; KSF; Porter's Value Chain, Competitive Analysis Maps, SWOT Analysis

Strategic Analysis: examples of insights

Through strategic analysis you should be able to identify the main reasons why some industries show average ROE than others

Industry	ROE (average)	Main competitors
Pharma	21%	Pfizer, J&J, Merck
Oil&Gas	20%	ExxonMobil, Chevron,ConocoPhillips
Software	14%	Microsoft, Oracle
Entertainment	2,7%	Time Warner, Walt Disney, News Corps

Strategic Analysis: examples of insights

Through strategic analysis you should be able to understand why some industries tend to be monopolies while some others tend to have perfect competition.

	Perfect Competition	Oligopoly	Duopoly	Monopoly
Concentration	Low	High – Very High		Extreme
Barriers	No barriers	Medium-High Barriers		Very high Barriers
Product Differentiation	Commodity	Products differentiation (option)		
Information Flow	No obstacle to information flow	Not perfect information flow		

Strategic Plan: Strategy

1. Strategy is the creation of a unique and valuable position, involving a different set of activities. Basically, it can derive from three sources:

    - serving few needs of many customers
    - serving broad needs of few customers
    - serving broad needs of many customers in a narrow market
    - creating new needs ?

2. Strategy requires you to make trade-offs in competing: to choose what not to do

3. Strategy involves creating fit among company's activities (the ways in which the activities interact)

(What is Strategy - Michael Porter, HBR 2000)

Strategic Plan: Strategy

- **Goals**

Identify the positioning and the unique succession and combination of activities to reach a sustainable and long-lasting competitive advantage

- **Premises**

Strategic Analysis

- **Following**

Operations

- **Tools**

Function by function strategy

Strategic Plan: Strategy

The strategy impacts every function and activity, so you must have strategic recommendations in every business unit or function (operational or functional level of strategy):

- Competitive Strategy
- Organization Strategy
- Production Strategy
- Financial and Economic Strategy
- Communication Strategy

As stated earlier, the strategy is the unique set of activities, and the unique ways in which they are related that make every company different from the other.

The goal of the strategy is to reach the strategic objectives and to guide the definition of the products/services' features, marketing positioning and activities, and finally activities in each function or business unit.

The strategy is reflected in the way companies source, produce, organize people, go to market, communicate, define prices, manage financial sources, and invest.

7 Criteria to Evaluate a Strategy

1. ROI – Return on investment
2. Risk of loosing the investment
3. Ownership and control
4. Potential for growth
5. Stability of employment and earnings
6. Prestige
7. Social Responsibility

The strategy can be valued from different points of view that depend on the business objectives and the market conditions.

Strategic Plan

- **Goals**

Identify positioning and sources of competitive advantage in the business environment; identify the strategy and the strategic objectives to guide marketing and operations

- **Premises**

Business Opportunity, Market Need, Innovation, Technology

- **Following**

Marketing Plan, Operating Plan

- **Tools**

P.E.S.T. Analysis; Porter 5 Forces; KSF; Porter's Value Chain, Competitive Analysis Maps, SWOT Analysis

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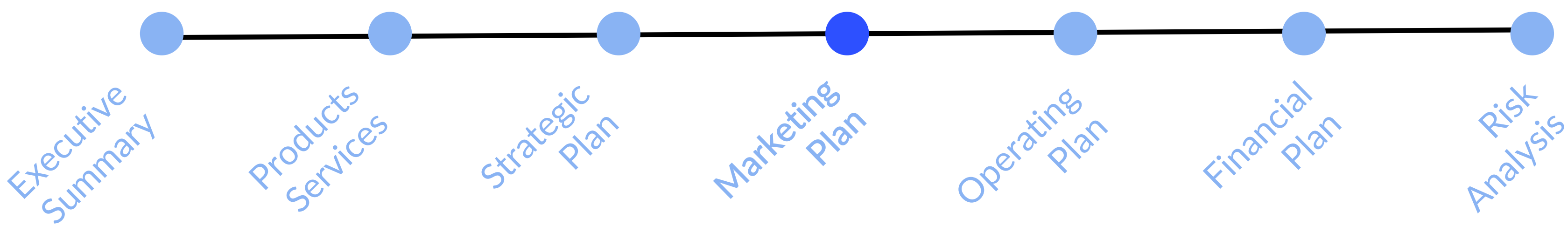
2. Business Plan Sections

Chapter 4: Marketing Plan



Marketing Plan

The marketing plan has the objective to analyze in detail the market and the competition, and to define a unique positioning of the company or its products in each of targeted segments.

Once defined Positioning and Targets, the marketing plan has the role to enact this program and to define the tangible elements (products, price, channels, points of sale, people, communication, and all the other aspects related with the go to market and the relationship with clients, partners, and competitors).

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Marketing Plan: 3 Steps

1. Product

- Physical / Technical Description (Features, Values for clients)
- Types of usage
- Product Positioning Map
    - Cost
    - Quality
    - Features
    - Values
    - Service
    - Image
- Product lifecycle stage

2. Price

How to determine your product's price

Definition of price (in a wider sense: not only monetary cost)

$$p = \frac{TotalCostforClient}{Benefits}$$

3. Place/Channels / Points of Sale

- Sales channels
- Distribution channels
- Commercial effort

4. Promotion

- Discounts, Sales, Special Offers
- Merchandising
- Events, …

In this part of the plan, there is the description of the choices and the activities to promote the products.

5. Communication

- Outbound Marketing (Adv, Press Campaigns)
- Inbound Marketing (Social Media, Newsletters, Website, SEO, SEM, …)

2. Business Plan Sections

Chapter 5: Operating Plan

Operating Plan: where we come from

The operating plan introduces the second part of the document. Let's remind what we have done so far.

- **Product**
- **Strategy**
- **Marketing**

Operating Plan: what we do now

The operating plan introduces the second part of the document.

Having a clear idea on what are:

- the main characteristics of the market
- the strategic objectives to create a competitive advantage
- the target
- the features of the products/services that create a value for the target
- the tangible elements of the offer (price, product, …) to generate value for final users and clients

Now, we have to organize things. We have to define the plan of the activities, in order to reach the strategic objectives set earlier.

The **operating plan** is the translation of the strategic plan into a set of activities.

Our operating plan has to consider the various elements of the organization.

Operating Plan

9 steps to create a winning operating plan

1. Break the project into the smallest possible components and activities
2. Identify linkages and critical paths (critical path is the longest path)
3. Order the activities with the critical and higher risk and schedule them as early as possible
4. Set measurable targets for each activity
5. Assign responsibilities
6. Set up a mechanism for tracking the reporting on each target
7. Establish a culture that encourages problem reporting
8. Execute the plan
9. Act immediately if a target is missed or a problem report is generated

Operating Plan: example

Supporting Activities: ICT, Legal, Fiscal, HRM

- Determine how and who will perform all the supporting activities
- Consider activities divided into main functions
- Define list of activities in each function
- Establish an owner of the function
- Divide and coordinate
- Establish procedures

2. Business Plan Sections

Chapter 6: Financial Statements

Business Plan – Financial Statements

This is the quantitative section of the business plan.
It's the section in which figures are put on paper and you can discover whether the strategy is executable, and if the activities are correctly organized.

The fundamental goals of the financial statement sections are:

- forecast sales
- forecast and control costs
- forecast cash flows
- valuate the return of the investment

- Through sales and costs, you can tell whether the business is profitable
- Through cash flows you manage the cash generated or burnt during the activities. This is fundamental to assess the financial needs and to control that the business has cash to operate throughout the activities
- Through the valuation of the return of the investment, you can assess whether the investments make sense or not

This section is fundamental for a potential investor and for the chief of the venture.
Here you can discover that the plans defined earlier are not sustainable from an economic or financial point of view. You could also discover that the return of the investment is not enough to justify the effort.

About

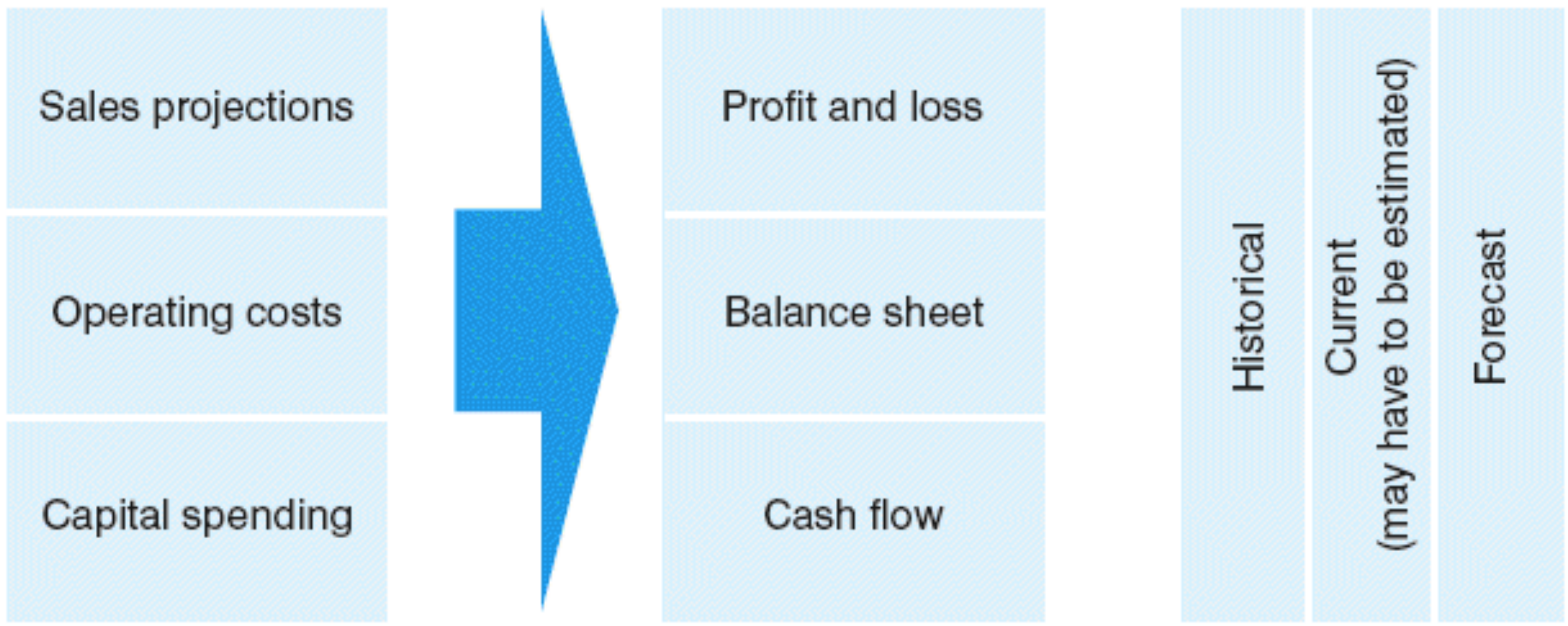
We can divide the type of information we deal with in this sections into 3 groups. Each group has 3 subspecies of information.

3 Types of Voices
Sales forecast
Operational Costs = costs to be sustained to perform activities
Capital Spending or the investment to set up the activities

3 Financial Statements
Profit and Loss – economic perspective → is your business profitable?
Balance Sheet – asset perspective → to whom do you own money?
Cash Flow – financial perspective → is the business financially sustainable?

3 Time Periods
Historical: what's done in the past; previous years performances
Current: what is the current state of the business (now and next few months)
Forecast the future: what we expect from the future

Financial Plan



Step 1: Sales Forecast

1. Describe the logic underlying the forecast
2. Show historical proofs of your method
3. Introduce the assumptions made
4. Develop your forecast
5. Explain how you changed it taking into account trends
6. Show sales forecast
7. Show costs forecast and thus the gross profit
8. Include a summary
9. Explain the key risks and possible alternative scenarios
10. Keep it simple

Step 2: Costs and Investments

1. Define your **capital investment** (spending on assets with a life of more than 1 year)

2. Define **current consumption** (current spending divided into functional areas, like R&D, marketing, sales, etc.).

3. Put everything in the **Profit & Loss** Account

Step 2: Costs

Cost classification

1. Variable vs. Fixed Costs
2. Committed Costs (fixed) vs. Discretionary Costs (fixed)
3. Semi-variable Costs
4. Mixed Costs

Step 2: Cost of Goods Sold

Once found sales, it’s time to measure the cost of goods sold.

- The first cost to measure is the Cost of Goods Sold
- Subtracting COGS from Sales, you obtain Gross Profit
- Gross Profit measure how efficient the production is

Sales – COGS = Gross Profit

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Step 2: Different Types of Cost of Sales

The direct cost of what you sell in an accounting period

1. For a *re-seller*: the price paid to acquire the goods to be re-sold

1. For a *manufacturer*: the cost of raw materials and other supplies to produce the goods, plus wages of workers directly employed in building up the product, and the factory overheads, such as factory light and energy, etc.

1. For a *software company*: one-hundredth of the original R&D cost for each unit sold

Step 2: Operating Costs and Depreciation

1. Draw up a list of capital spending
2. Determine the period and the method of depreciation
3. Draw up a depreciation method
4. Develop a detailed capital spending forecast
5. Divide current spending into functional areas
6. Divide functional areas into employees and other costs
7. Divide employees and other costs into expenditure headings
8. Work through expenditure headings forecasting
9. Bring depreciation into appropriate expenditure headings
10. Combine figures to arrive to net profit

Step 2: Depreciation, Amortization, Depletion

- Depreciation: physical assets
- Amortization: intangible assets
- Depletion: natural resources

Example

Machinery → acquisition cost € 100,000
Useful life → 10 years
Yearly depreciation cost → € 10,000

Step 3: Profit and Loss

1. Put revenues, costs, and investments in the **Profit & Loss** Account
2. Do it and compare past, current, and future P&L
3. Check whether the business is profitable

In particular, ask yourself whether you make profit and are good in:

- Producing the output through Gross Margin
- Managing current activities through EBITDA
- Exploiting investment in fixed assets through EBIT
- Financing the venture through EBT
- Manage taxation through Net Profit

Every business has specific characteristics. To compare performances in different industries, the most widely used indicator is EBITDA, which is not affected by decision regarding investments and fixed assets, funding and tax decisions.

Profit & Loss Statement

Revenues
- Cost of Goods Sold (direct labor and raw material)
= Gross Margin

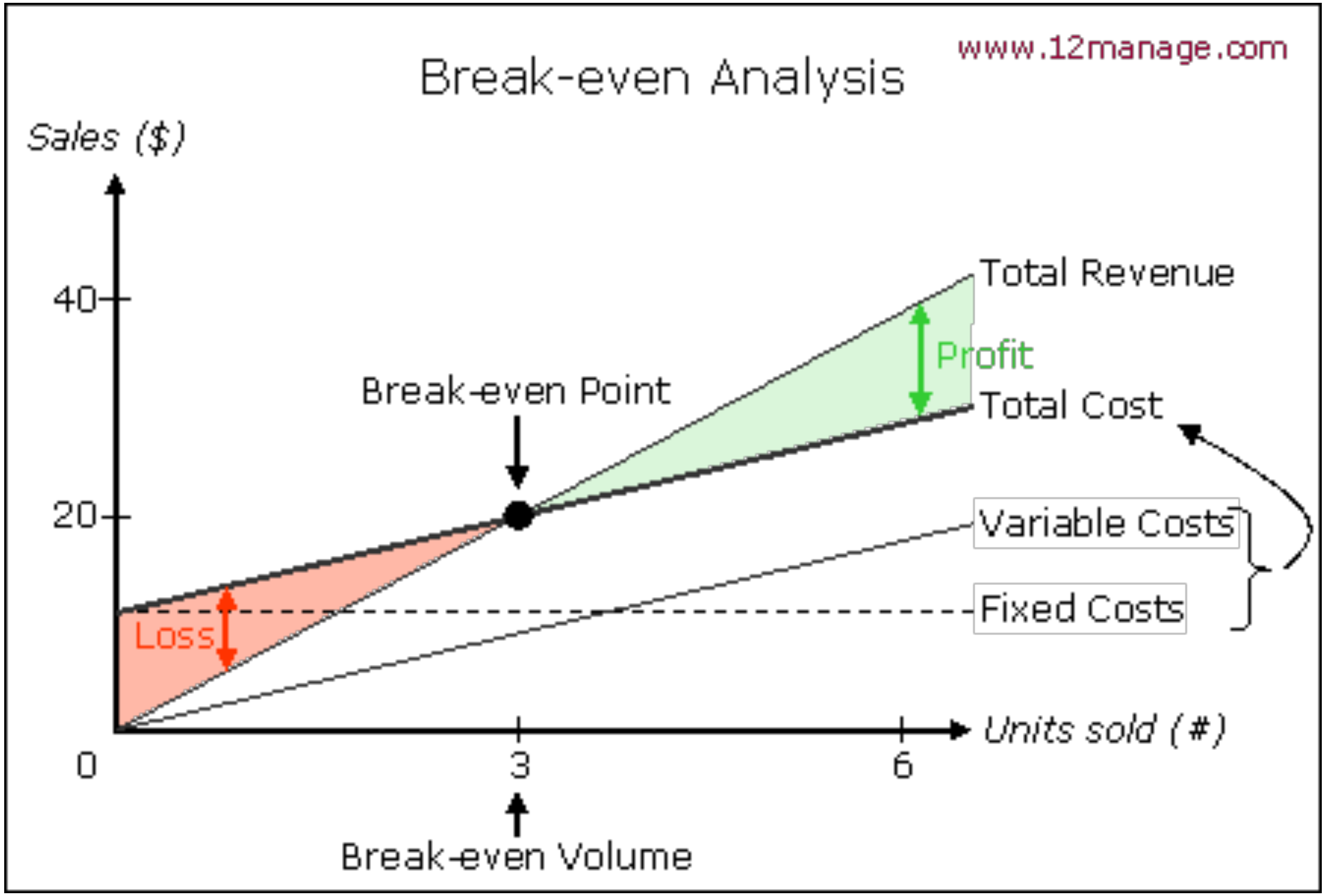
- Operative Costs
    - Marketing costs
    - Sales
    - Administration / Legal / etc
- Cost of indirect labor
= EBITDA
- Yearly depreciation
= EBIT

- Interests

- Taxes

= Net Profit

Break-even Analysis



Balance Sheet

The balance sheet can tell an analyst a lot of things regarding the company. It is especially important to assess what are the assets owned by the company and to whom the company owes money.
Through a series of indexes, you can answer many other questions, including the risk, the type of capital structure, the exploitation of the assets, etc.

Current assets Cash Inventory/stock Accounts receivable Other (prepaid expenses, deposits paid …)	**Current liabilities** Short-term loans Maturing long-term loans Accounts payable Other (accrued expenses, taxes due …) **Non-current liabilities** Long-term loans and other borrowing Pension fund
Non-current assets Investments Fixed assets (plant, machinery …) Natural resources Intangible assets (patents, goodwill …)	**Owners' equity** Paid-in share capital Retained earnings

© The Fast Track to Intelligent Planning for Executives and Entrepreneurs - Sir Richard Stutely, FT-Pearsons, 3rd Edition, 2012

Cash Flow Statement

Cash Flow is fundamental, as it shows the flows (in and out) of cash

A company goes to bankruptcy when finishes its cash, not when the profit is negative

You can create your cash flow statement from EBIT

EBIT
- CAPEX (Capital Investments)
- Taxes
- Investment Outlays
+ Depreciation/Amortization costs
- Δ Working Capital*
= FCFF (Free Cash Flow to Firm)

* Working Capital = Accounts Receivable + Inventory – Accounts Payable

Cash Flow Statement

Cash flow, first six months

Dollars

	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6
Net profit	–42 217	–60 627	–57 622	–37 430	–49 518	–36 768
Adjustments for changes in:						
Cash at bank	–1 000	0	0	0	0	0
Accounts receivable	0	–20 000	20 000	–40 000	40 000	–50 000
Deposits paid	–2 000	0	0	0	0	0
Prepayments (rents)	–11 000	1 000	1 000	1 000	1 000	1 000
Inventory	0	–15 000	–25 000	22 500	–25 000	30 000
Fixed assets	–36 500	–1 500	–750	–1 000	0	0
Depreciation	0	1 389	1 431	1 443	1 471	1 471
Accounts payable - hardware	0	10 000	–10 000	22 500	–22 500	30 000
Accounts payable - software	0	3 591	0	4 683	0	3 979
Accrued pensions	417	417	417	417	417	417
Equity	1 000	0	0	0	0	0
Cash flow	**–91 300**	**–80 731**	**–70 525**	**–25 887**	**–54 130**	**–19 902**
Cumulative cash flow	–91 300	–172 031	–242 556	–268 443	–322 573	–342 475

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Cash Flow Statement

Cash flow, first six months

Dollars

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Cumulative cash flow	–91 300	–172 031	–242 556	–268 443	–322 573	–342 475

2. Business Plan Sections

Chapter 7: Risk Analysis

Methodologies

- Financial Ratios (Liquidity, Debt Burden, etc.)
- Break-even analysis
- What-if analysis
- Worst-case analysis
- NPV
- Distribution of observations (mean, standard deviation, skewness)

Financial Statement Analysis: Financial Ratios

Different types of ratios, offering different perspectives and interpretations of financial statements.

1. Liquidity Measurements Ratios
2. Profitability Indicator Ratios
3. Debt Ratios
4. Operating Performances Ratios
5. Cash Flow Indicator Ratios
6. Investment Valuation Ratios

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Funding Rounds for Startups

Antonio Ghezzi

Politecnico di Milano

Question # 1

How much money do I really need?

Question # 2

When collecting funds?

Question # 3

Who are the investors?

Question # 4

What's the value of my company?

Question # 5

How to present a business to potential investors?

1. How much money do I really need?

Question # 1 How much money do I really need?

- You have to determine the “right” size of the investment

- Right means that you have enough money to sustain the activities before financial break-even, but not too much too early

- The most widely used indexes to calculate financial needs are **Cash Burn Rate** and **Runaway**

- **Cash Burn Rate** is the average monthly cash flows (if negative): it indicates what is your monthly financial need

- To calculate the Cash Burn Rate you have to determine the monthly cash flow statement

- **Runaway** is the correspondent number of months covered by your existing funds with the current cash burn rate

- Runway is calculated dividing the funds by the Cash Burn Rate

2. When collecting funds?

Question # 2 When collecting funds?

- In general, the later the better, when the value of your company has grown and the risk is lower
- The type and size of funds and the sources changes along the startup lifecycle
- Investors always try to delay their entrance
- At each stage the goal of fund raising (and the startup itself) is different
- At each stage, the size and the types of investors are different

Startup Lifecycle & Funding – How the organization changes

The search of a business model | The execution of a business model

Scalable Startup → Transition → Company

Source
http://steveblank.com/2010/01/25/whats-a-startup-first-principles/

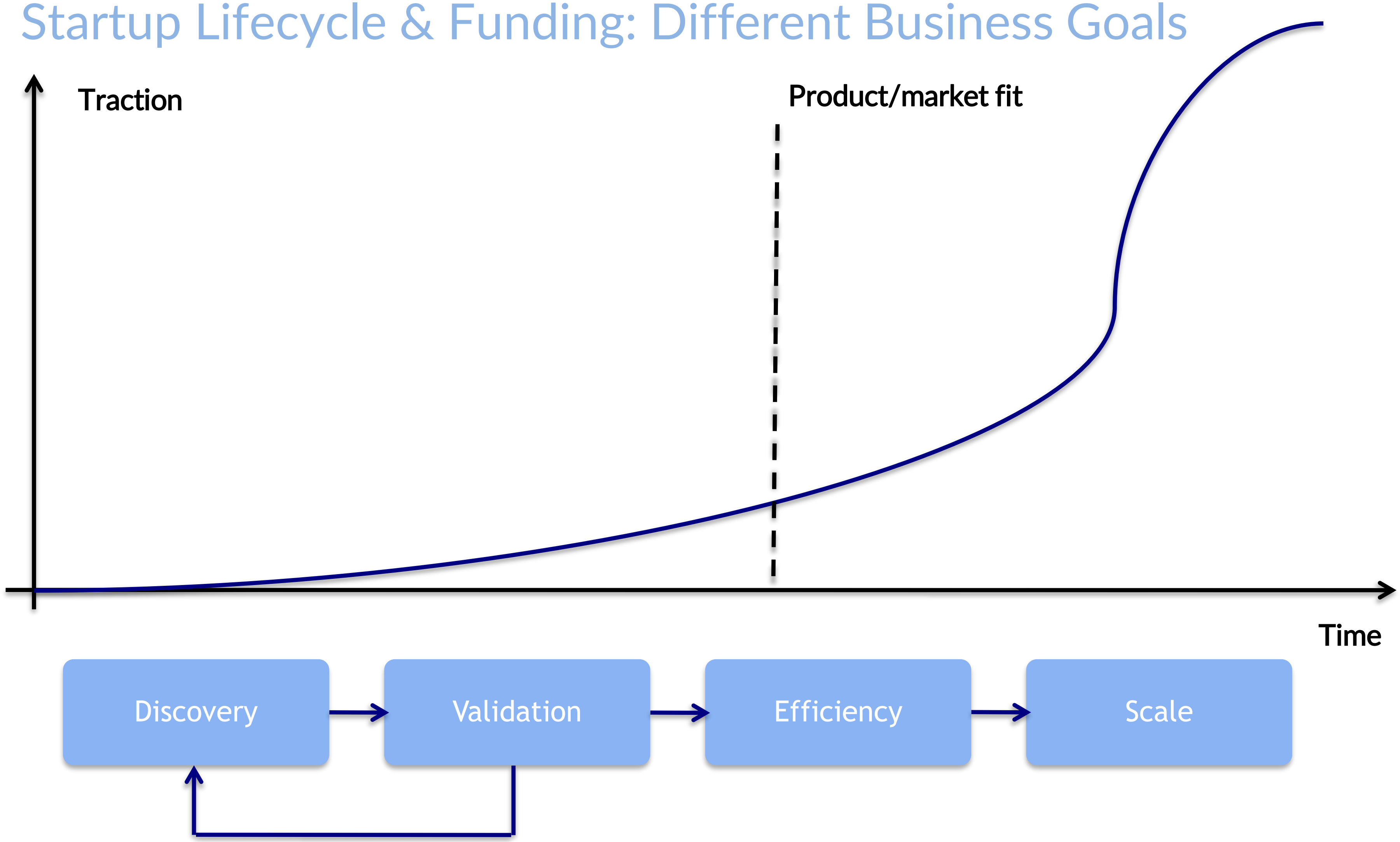
Startup Lifecycle & Funding – Different Approaches

Each stage has a different business goal
Each stage has different financial needs
Each stage you have to contact different types of investors
Each stage has a different **traction**: a **“Quantitative evidence of market demand”. Traction is proof that somebody wants your product. Ideally, it should communicate momentum in market adoption**

1 Search → 2 Build → 3 Grow

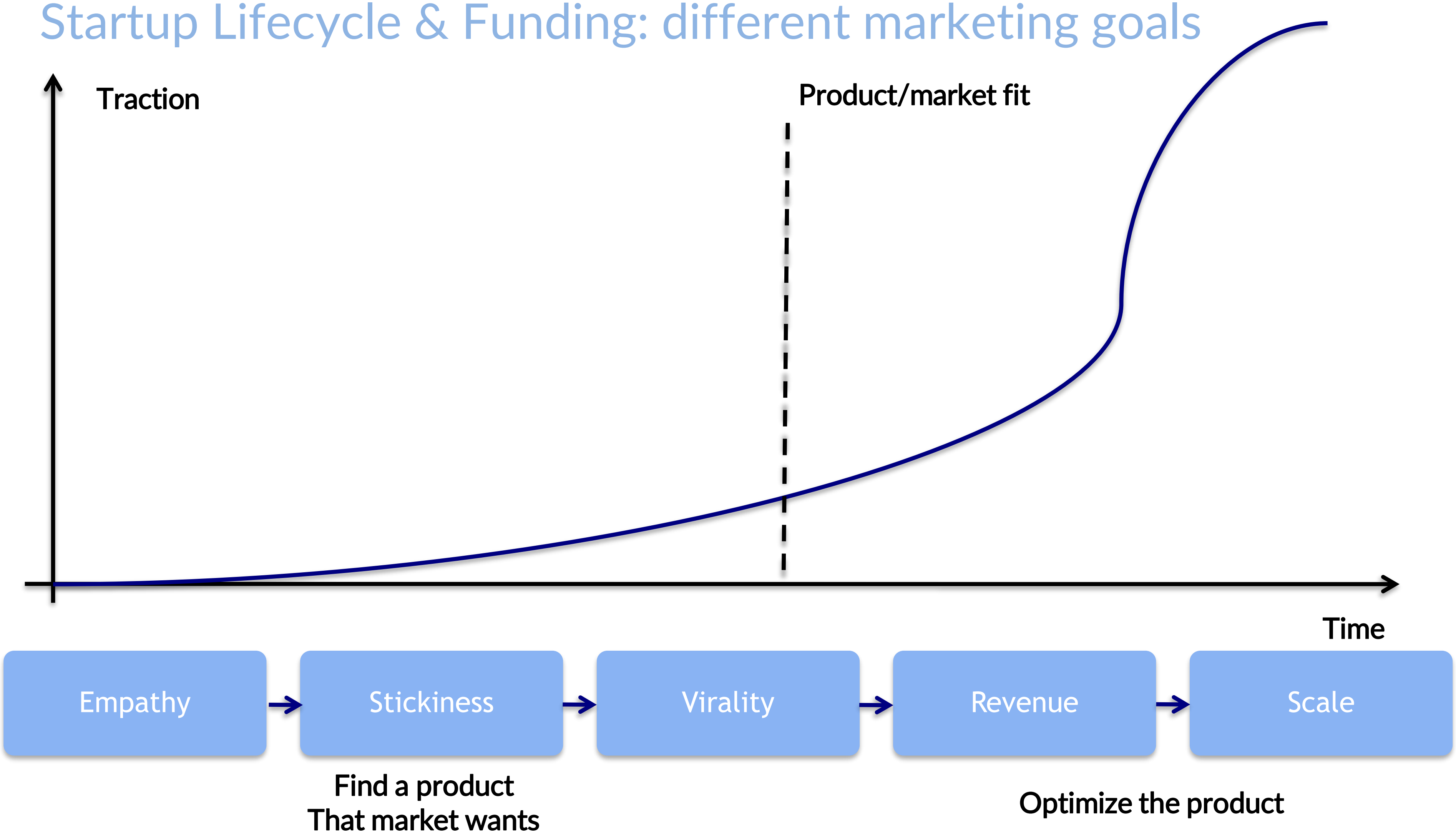
Source: http://steveblank.com/2015/02/12/what-do-i-do-now/

Startup Lifecycle & Funding: Different Business Goals



© Steve Blank

Startup Lifecycle & Funding: different marketing goals



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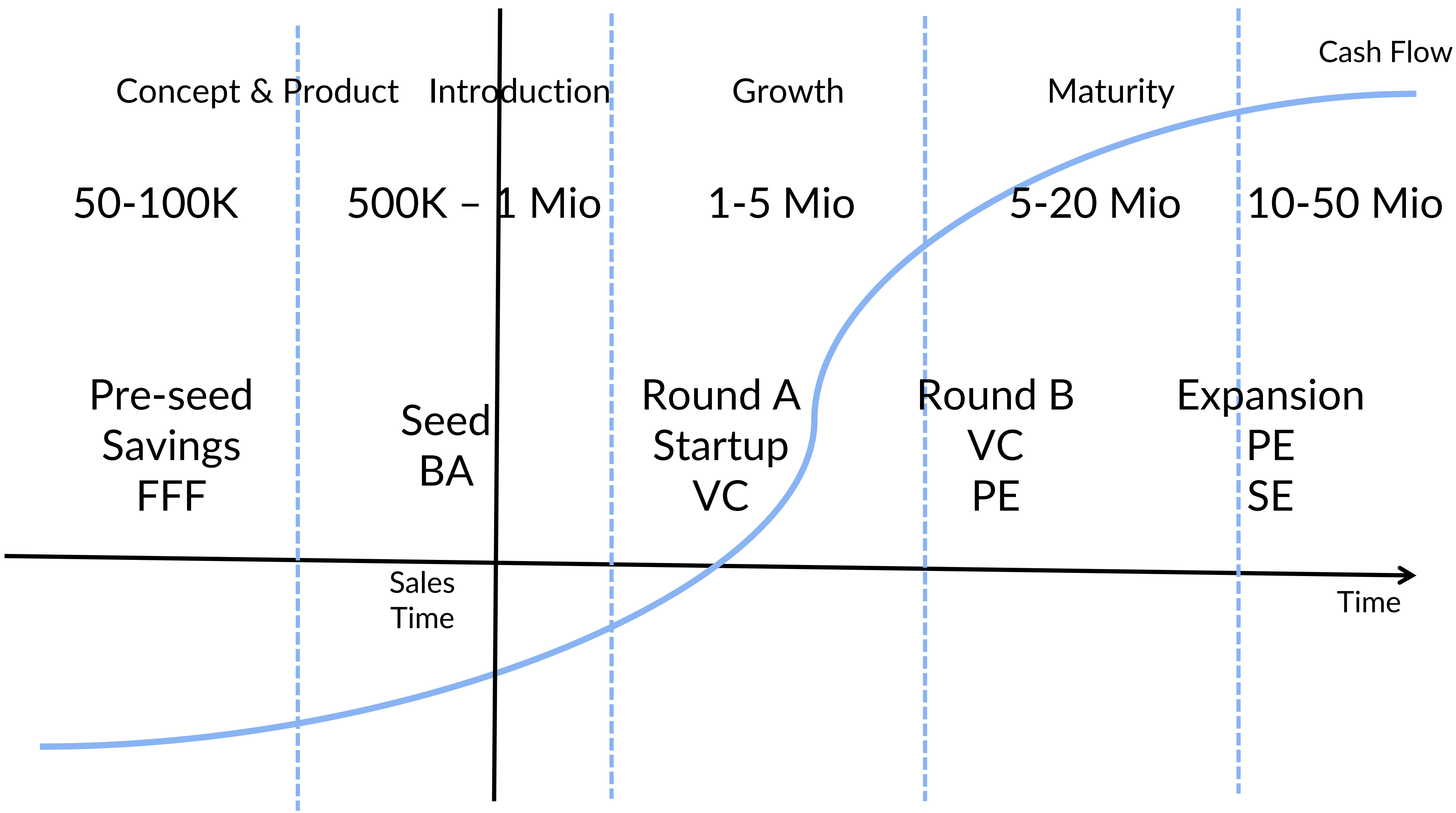
Startup Lifecycle & Funding



Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

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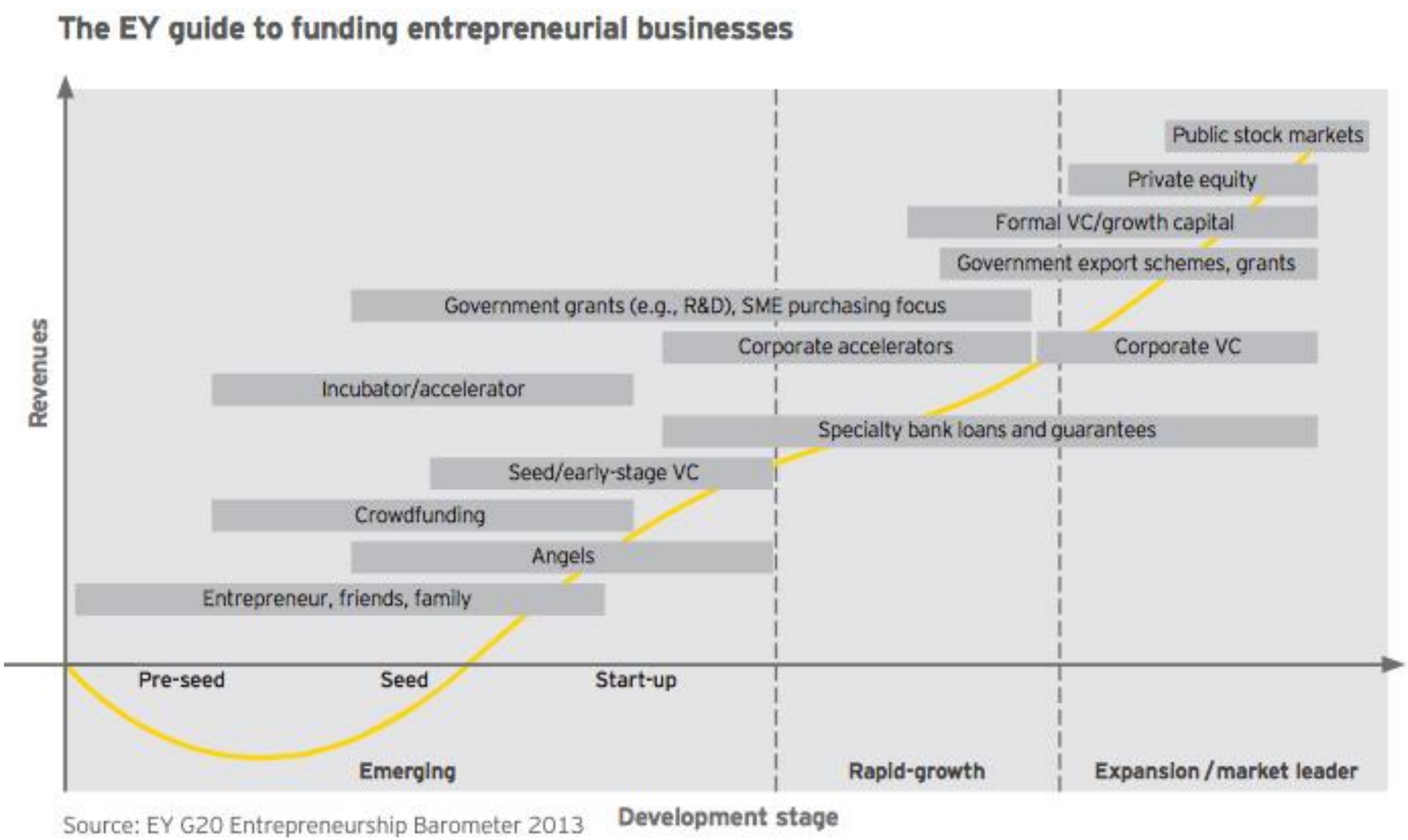
Startup Lifecycle & Funding – Different Approaches



Source: EY – VC Report
http://www.ey.com/Publication/vwLUAssets/Global_venture_capital_insights_and_trends_2014/$FILE/EY_Global_VC_insights_and_trends_report_2014.pdf

Startup Investment Phases

Funding Rounds
1. Pre-seed
2. Seed
3. Round A
4. Round B
5. Later Stages

During these first stages, the founders don’t sell their shares, they are locked in and must work in developing products and market

Exit
1. Trade Sale
2. Buyout
3. IPO

During these 3 stages, founders and first investors sell their shares. Founders usually are locked in for a while and can’t create a competitive business for a period.

Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

Pre-seed

- Funding: from savings, FF, crowdfunding, grants
- Size: € 10K – € 100K
- Business Plan, Prototype
- No revenues (or very small)
- Teams formed by founders who develop the product
- Financial objective: Cash Burn Rate (as low as possible)
- Corporate objective: conceive and develop the product; test and understand the market

Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

Seed (early-stage)

- Funding: from savings, FF, crowdfunding, Business Angels
- Size: € 500K – € 1 Mio
- Very small revenues
- Prototype, product
- Teams formed by founders who develop the product
- Financial objective: Cash Burn Rate (as low as possible)
- Corporate objective: develop the product and match the market

Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

Startup (early stage and Round A)

- Funding: Business Angels, Venture Capitalist Funds
- Size: € 1-5 Mio
- First revenues, toward breakeven
- Teams formed by founders and first contributors
- Financial objective: Prove the revenue model works
- Corporate objective: find the product-market fit, search of customers, business model test

Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

Round B

- Funding: Operating Profit and/or Venture Capital Funds, Private Equity
- Size: € 5-20 Mio
- Operating Profit
- Boards with founders, VC, other experienced C-Levels
- Teams formed by engineers and business developers
- Objective: Break-even, operating profit, scale-up

Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

Later Stages: Expansion

- Funding: Private Equity, Stock Exchange
- Size: € 10-50 Mio
- Stabilization of cash flows
- Boards with founders, VC, other experienced C-Levels
- Structured team
- Corporate organization
- Founders can have a minority stake
- Objective: Cash Flows, stabilization, exit (for early stage investors, ventures and founders)

Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

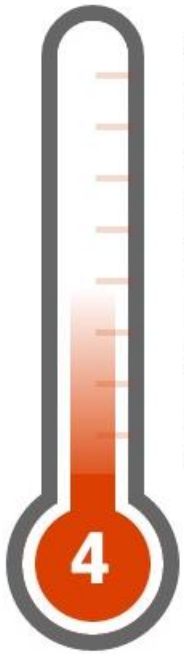
Italian Market – pending issues

Pre-seed	Early Stage	Round B/Expansion
Seed investments are (as average) too small	Few VC's active in the startup phase (they manage capitals too small). Gap filled with seed investments	Too few exits. There is the need to involve big Italian and international firms to increase exit opportunities for ventures

Source: AIFI
http://www.netval.it/static/media/uploads/files/13_27032015_Alessandra_Bechi_Winter_School.pdf

Investment Readiness Level

Is your startup ready for investment?
Steven Blank invented this tool to measure whether your startup is ready to get funds.
The steps are the phases defined for the Customer Development Model.
Check where you are, and consider that the size and the type of funds should be aligned with the phase in the life of the startup.



9. Validate Metrics That Matter
8. Validate Left Side of Canvas
7. Prototype High Fidelity MVP
6. Validate Right Side of Canvas
5. Validate Product/Market Fit
4. Prototype Low Fidelity MVP
3. Problem/Solution Validation
2. Mkt Size/Competitive Analysis
1. Complete First-Pass Canvas

Source:http://steveblank.com/2014/02/25/is-this-startup-ready-for-investment/

How to get funds

• Raise money only if necessary in the right moment (startups don't raise money! Startups grow fast)
• Stay focused on fund raising when you are raising funds (and vice versa: don't get distracted by fund raising if the goals are some others)
• Get introduction to investors
• Talk to investors in parallel (non serially)
• Judge yourself (where are you now?)
• Get first commitment
• Have multiple plans
• Underestimate what you want
• Be profitable
• Understand how to evaluate the company
• Don't sell more than 25% in phase 2
• Stop fundraising if it's not working
• …

Source: http://paulgraham.com/fr.html

3. Sources of Funds & Investors

Question # 3: Which types of Funds & Investors exist?

- There are different sources of funds that a startup can rely on
- Different types of investors invest at different stages of startup lifecycle
- Each investor has a different impact on the life of the startup
- External investors get “shares” of your company
- You need a valuation of your company to decide the share of ownership sold
- Ideally, the startup should receive the minimum amount of money to enforce plan activity till next round or break-even
- There are many overfunded and underfunded startups

Sources of funds

The source of funding can have a different impact on your financial structure, composition of the ownership, level of risk, etc.

Financial resources are in the right part of the balance sheet and are part of 2 main families:

- Equity
- Debt

Debt can be financial (loans, short term debts) or commercial (accounts payable)

Sources of funds

Ultimately, a company can fund itself via:

- Commercial debt
- Financial debt
- Operating activities
- Grants
- Equity

Each of them has a different impact on the structure of the company, the balance sheet, the ownership, the level of risk and the cost.

It’s possible to add grants, prizes, and forms of incentives. These usually don’t have an impact on the ownership and have no monetary costs if you don’t have to pay interests on them

Equity

The majority of the funds collected by startups have an impact on the ownership, as they are equity. This means that, if these are external people or entities, the company is giving away part of the ownerships. The founders loose part of the control. It is pretty delicate, because the size and the type of resources and funders can have a strong impact in following funding rounds.

At the beginning, the best is to rely on personal savings and resources, then the startup can involve external people, like FF, BA, etc.

During first rounds (seed, early stage, round A&B) with VC's and BA's, the founders are locked in: they cannot sell their shares and monetize the investment, but they get diluted, giving away part of the ownership and control during the increase of capital.

- Founders' savings → seed
- Family & Friends → seed
- A Job (Consulting) → seed
- Business Angels → Early Stage / Round A
- Seed Funding Firms (incubators or others) → Early Stage / Round A
- Venture Capital Funds → Round A / B
- Private Equity → Later Rounds and Exit
- Trade Sale → Exit
- Stock Market → Exit

Savings → seed

- Founders keep complete ownership
- First phases (idea generation, first prototypes, sometimes first product)
- The risk is high
- The fund raising would be meaningless
- Don’t waste time in fund raising when you don’t have the product yet
- Typical size: € 10/20 K

As a general rule, it is better to postpone the entrance of external investors, when the value of startup is a bit higher. The value of an idea is Zero

Family and Friends → seed

- First phases (concept, business plan, prototype, or MVP, Test A/B, etc.)
- They know you
- They usually don’t ask too much for their money
- You don’t have to provide metrics, business plans, results
- They could be a problem in later rounds as they are not professional investors
- They don’t offer any additional support
- Typical size of investment (in total): € 20-50 K

Angel Investors → early stage & round A

- Seed stage (product ready, market entry, first metrics)

- They are private, like former managers or entrepreneurs, with a large savings that want to invest (in part) in startup

- They can offer managerial or entrepreneurial support

- They have networks

- They are much tougher than FF and you need an Exit Strategy

- They want to see some data but most of all "fall in love" with founders and eventually their product

Angel Investors → early stage & round A

- They invest in the team (even more than in the product)
- You have to negotiate their participation: size and share of the ownership
- Sometimes they keep a strategic role and you can be tight
- Giving them more than 20% in this stage can block future capital increases
- Often they invest in group (IAG for example)
- Often fixed criteria in early stage (if they are in group)
- Their interest is to delay the entrance (the later they enter the lower the risk)
- In Italy, they invest between € 50K to € 1M

Seed Funding Firms → seed & early stage

- Seed stage (product ready, market entry, first metrics)
- They are similar to Business Angels but are companies
- They offer you services and consulting
- Part of their investment can be in services like the office, the internet connection, mentorship, etc.
- Difficult to assess the value of non monetary services

Seed Funding Firms → seed & early stage

- Usually they have similar behaviors as business angels

- But they are company and can be more strict on some terms

- The deal is the result of a bargain, there are no fixed rules

- Although, in seed investment, seed funding firms (and business angels) often have fixed policies like the size of the investment and the valuation of the startups, and thus the share of the ownership

- This is because giving a value to a early stage startup is like guessing, and it makes no sense to waste time in negotiation

- Most famous one are rigorous, second tiers can be more aggressive

Venture Capital Funds→ round A/B

- Round A / B
- They are companies and have fixed rules to select investments
- They manage portfolios of their clients and follow guidelines
- You must have a competitive exit strategy
- They are valued by their success stories
- Most of the startups fail, but few outperform and repay all the other investments

Venture Capital Funds → round A/B

- They become parts of the board, and sometimes they assign the CEO role to an experienced manager and not to a founder, especially if she/he has a technical background
- You must create a relationship with them
- If you speak with a junior, she/he can have genuine enthusiasm (they want to discover the next Uber)
- Senior fund managers are more objective
- They invest some millions
- Founders are usually not allowed to sell their shares till final exit

Private Equity, Stock Exchange, Private Sales → Exit

- This is the phase of exit
- Usually founders can sell part of their shares and monetize
- At the same time, they are locked into the company for a few years
- In this case the company is no more a startup, and thus ready for PE funds and even the stock exchange
- Competitors, incumbents, bigger entrants can buy the company through a private deal to acquire products, markets, technologies

Venture Capital Process

Let's have a look at the process of proposing a VC the investment in our startup. Remember that this is a deal. They must see the opportunity to multiply in few years the value of their investment.

1. **Business Plan Submission**: entrepreneurs get in touch with investors and present their business plans, or metrics, or MVP and tests, etc.
2. **Due Diligence**: analysis if company's management team, market, products and services, operating history, corporate governance documents, and financial statements. This step can include developing a term sheet describing the terms and conditions under which the fund would make an investment.
3. **Deal - Valuation and Negotiation**: there is a pre-money valuation to assess what's the share of the new investors; the valuation can be as analytical as possible, but the price is the result of a negotiation.
4. **Investment**: VC enter the company and board, founders sign term sheets
5. **Execution** with VC control: usually investment is released in batches if targets are reached
6. **Exit**: VC's final objective is to exit within a few years through mergers, acquisitions, and IPOs (Initial Public Offerings)

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5. What's the value of my startup and how can I assess it?

The Value of Ideas

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Why assessing value

Once defined the financial need, and matched the need with the stage in the startup lifecycle, founders must find the right counterpart.

If you finance the company with your savings, operating activities, debt, grants, you don’t have to share the ownership of the company with anyone else: founders remain the only owners of the whole company.

Instead, if you have to open your equity to external investors, you have to define what is the share of ownership given away for the money (or services collected).

How does this process happen? How to make this price? How to assess the value? Is it the same with FF, Business Angels, and Venture Capitalists?

Valuation, Price and Deal

Basically, the process is simple:

1. What is the pre-money value of the company?
2. How much do external investors put into the company?
3. What is the post-money value of the company?
4. How to define the price and share of ownership?

Consider that this is a deal: you have to start from a value, but at the end the final price is the result of many other factors, including the bargaining power (and interest) of the parties.

Main actors that can be involved into first stages of investment (FF, BA, VC) have different objectives, cultures, politics.

Pre-money and post-money valuation

$$\text{post-money valuation} = \text{new investment} \cdot \frac{\text{total post investment shares outstanding}}{\text{shares issued for new investment}}$$

$$\text{pre-money valuation} = \text{post-money valuation} - \text{new investment}$$

Pre-money and post-money valuation

Shareholders of Startup, Inc. own 100 shares, which is 100% of equity. If an investor makes a $10 million investment (Round A) into Startup, Inc. in return for 20 newly issued shares, the implied post-money valuation is:

$10 million * (120 / 20) = $60 million

This implies a pre-money valuation equal to the post-money valuation minus the amount of the investment. In this case, it is:

$60 million – $10 million = $50 million

The initial shareholders dilute their ownership to 100/120 = 83.33%.

Source: Wikipedia

General Advices

- Share the ownership with non-founders the later the better (when your company's value is bigger)
- Don't give away too much too early: the risk is to make the following rounds impossible
- Don't undervalue or overvalue your startup: in the former case, you give away too much, in the latter, you could devalue the startup in future rounds. This is odd and usually a bad message for investors
- Have a long term plan: you probably need future rounds
- Select the investors not just for the money: firstly, because you will have to deal with them, second, because they can offer other assets, like networks, expertise, …

A Deal with FF

- Family and Friends are not professional investors.
- If they invest in your startup is because they believe in you and your team.
- They usually don’t have an idea on how to evaluate a startup.
- They usually have doubts about your valuation and tend to pay attention to the percentage of ownership they gain with their money.
- They invest few money in very early stages, when you usually have just the idea, the business plan and eventually a prototype.
- Be careful not to give them too much for too few, even if it’s early, if you block large percentage of ownership with these types of investors, you could have problems in future rounds.
- If you are an Italian “Startup Innovativa”, you cannot pay dividends for the 4 years in which you are a startup innovativa.
- But, if you are a startup innovativa, investors have fiscal benefits (discount of 20% of the capital invested from taxes)

A Deal with a BA

- Business Angels are affluent private people
- Usually, they are former managers or entrepreneurs
- Often, they want to do something exciting, making some money, and with a “social role”, to stimulate economy
- They often act in teams
- They value your company in different ways
- Their goal is the final exit
- They try to enter later, when the risk is lower
- They invest in seed and early stages
- Startup should have at least a product ready for the market
- Often, they need to be sure that the business model is validated
- Considering the difficulties in assessing a value of something so early, they usually have general politics; e.g.: they invest € 50K for 10% of startups in seed stages (thus, the startup’s value is € 500K
- They perform light due diligence, but they judge above all the team

A Deal with a VC Fund

- They are professional investors
- They invest money of other people
- They have politics on how to manage risk
- They have strict due diligence recommendations
- They want to see your deck (elevator pitch)
- If interested, they want to read the business plan as well
- They start from the valuation, but then it is a matter of negotiation (it is a deal at the end)
- They judge the team, but want to see metrics

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When startups have to value the company

1. Fund raising: evaluate the share of ownership to sell during a round
2. Work for Equity and other 3rd parties participations; in order to match the value of labor and the value of ownership
3. Exit: evaluation of the price to sell parts of the company

6. How to present your business to investors? Elevator Pitch vs. Business Plan

Question # 6 – How to present a business?
Elevator PITCH vs. Business Plan

• The Elevator Pitch is brief presentation to introduce your business idea, your product, your service, to summarize who you are, what you do and why an investor should invest in your venture

• Its name reflects the fact that you can deliver its content in the time span of an elevator ride

• Elevator Pitch is a short graphic and catchy presentation of the business; it is more emotional than rational, and its goal is to attract interest

• Business Plan is an analytical document, with analysis, plans, premises, and consequences, and all the details

Elevator PITCH

• The main goal of an elevator pitch is to persuade an investor to put some money in the venture and become owner of a part of the company

• You have to show her / him that your business is profitable, you have the skills to manage a company, you know the market, you will have positive cash flow after a while, you can control your costs, your business is scalable, you can create and sustain competitive advantages, the market is growing, you have a long-term strategy, etc.

• Your Deck gives the potential investors the first impression of you and your company

Elevator Pitch Deck – The sections - SLIDE 1

Introduce yourself!

- Name of the startup and slogan
- Brief history (founded on …, in…, by name of founders)
- A brief statement to introduce the activity:
  Example:
  Buy from emerging designers
  Create your digital wardrobe
  Share your style with friends
- Contact

Elevator Pitch Deck – The sections – SLIDE 2

Introduce the problem, client’s pain, need / opportunity

- Describe the market need
- Describe the clients pain
- Explain why current solutions don’t work or are fully satisfactory

Elevator Pitch Deck – The sections – SLIDE 3

Your Solution: your product

- What do we offer?
- Benefits of the product / services
- How do we relieve the customers' pain?
- What's the source of our competitive advantage? (types: market, technology, relationships, ...)
- Describe the product (and show in picture, if you can)

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Elevator Pitch Deck – The sections – SLIDE 4

Your Team

- For each member: name, role, experiences
- Organizational chart of the company
- Capitalization table (major shareholders %)

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Elevator Pitch Deck – The sections – SLIDE 5

What's done so far?

- Phase of the product /service development
- Date of foundation
- Capital invested
- Employees
- Revenues
- Gross Margin, Operating Profit, Net Profit
- Cash Burn Rate
- Metrics
- Clients
- Partnerships
- Patents, trademarks, licenses

Elevator Pitch Deck – The sections – SLIDE 6

Market (TAM) & Competitors

- TAM (Total addressable market)
- Size of the market
- Trends
- Main characteristics
- Potential Market – Available Market – Target Market
- Key Success Factors
- Description of main direct* and indirect* competitors
- Competitive Advantages
- Benchmark

Elevator Pitch Deck – The sections – SLIDE 7

Users / Sales / Cost Forecast

- Clients Forecast
- Sales Forecast
- Costs
- Metrics
- Targets (milestones)

If you have historical data is (relatively) easy, otherwise, you have to do assumptions and create your own plan

Elevator Pitch Deck – The sections – SLIDE 8

Cash Burn Rate / Runaway / Use of proceeds

- Monthly, yearly Cash Burn Rate
- Financial Need
- Use of proceeds (activity, objectives, milestones, …)

Elevator Pitch Deck – The sections – SLIDE 9

Valuation and Exit

- Valuation Method
- Comparables
- Analytical Method
- Exit Strategy

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Elevator Pitch Deck – The sections – SLIDE 10

Call to action

- Who you are
- Where you want to go
- What you need
- Add your contact details
- Add your logo, payoff, name of the company

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Strategy and the strategy formulation process

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Agenda

- What is strategy?
- How is value being created?
- Value shifts downstream
- From product to experience
- Strategy definition and implementation: the logical flow

The concept of “strategic decision” and “strategy”

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- **Strategic decision**: a decision that
  - has **long term**, **significant** and **non-reversible** effects on the **final goal** of the organisation (decision maker)
  - (usually) requires **large amounts of resources**
  - requires **top management involvement**

- **Strategy**: an integrated, comprehensive plan which
  - identifies the **scope** and the **direction** of the organisation (decision maker)
  - is aimed at obtaining **long term performance superior to competitors** (in relation to the **goal**)
  - integrates a **coherent set of strategic decisions**

- The concept of strategy **originates where the objective is to destroy the enemy**
- Today, we see military metaphors used everywhere in business: price “wars”, market share “battles”, marketing “campaigns”, promotional “blitzes”, and even “bullet” points

Definition of strategy

- “Strategy” comes from the Greek word “Strategos” which means generalship
- The art of war, especially the planning of movements of troops, ships, aircraft etc. into favorable positions. A plan of action or policy in business or politics etc.
    - Oxford Dictionary

Military strategy: definition

- The military way of looking at strategy is to view it as **the space between policy and tactics**:
  - **policy** is derived from a purpose or cause
  - **strategy** is concerned with how to achieve the policy or goal with the means available
  - **tactics** are the particular movements and actions while engaged in battle

Ten decisive factors for victory:

1. Invincibility lies in the defense, the possibility of victory in the attack.
2. Know the enemy and yourself.
3. Strike only when the situation assures victory.
4. Strike the enemy when he is least prepared.
5. Weight the situation before moving.
6. Be flexible.
7. Recognize the hazard and the weather.
8. Deceive the enemy.
9. Surprise the enemy.
10. Separate the enemy from his allies.

Sun Tzu, **The Art of War**, circa 500 B.C.

Business strategy: Ohmae

- What business strategy is all about **is, in a word, competitive advantage**… The sole purpose of strategic planning is to enable a company to gain, as efficiently as possible, a sustainable edge over its competitors. **Corporate strategy thus implies an attempt to alter a company's strength relative to that of its competitors in the most efficient way.**

Ken Ohmae, The Mind of Strategist, 1983

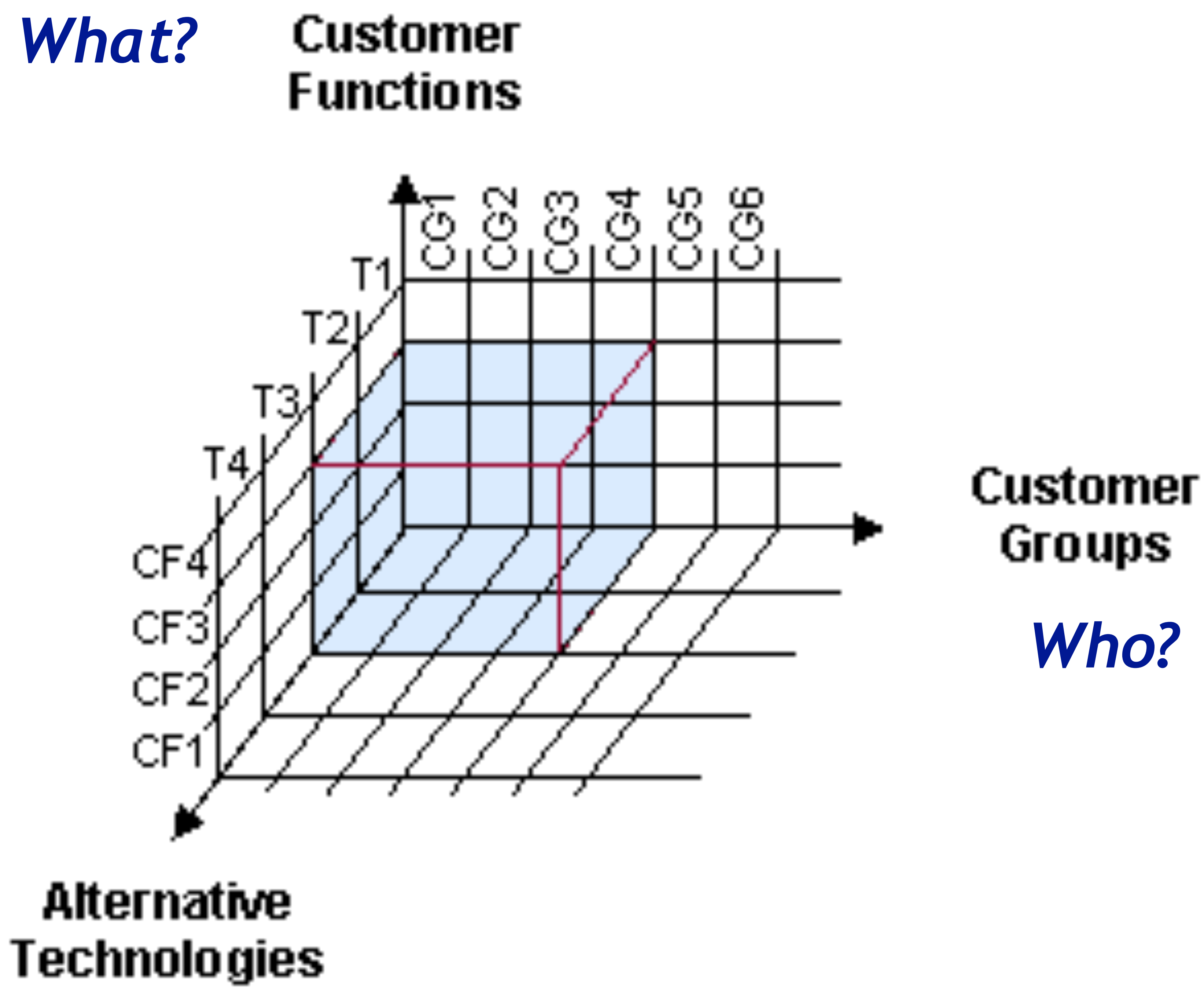
Strategy is a deliberate **search for a plan of action that will develop a business's competitive advantage and compound it**… The difference between you and your competitors are the basis for your advantage… The objective is to enlarge the scope of your advantage, which can only happen at someone else's expenses...

Bruce Henderson, **The Origin of Strategy**, 1989

Strategy is not only about the competition

- War is mostly a zero-sum game, business is mostly not
- Business is not war or sport. Strategy in business is different than strategy in war and sport. **It's not about competitors. It's about the customer**, your value proposition, and the capabilities you need to deliver it better than anyone else

What?



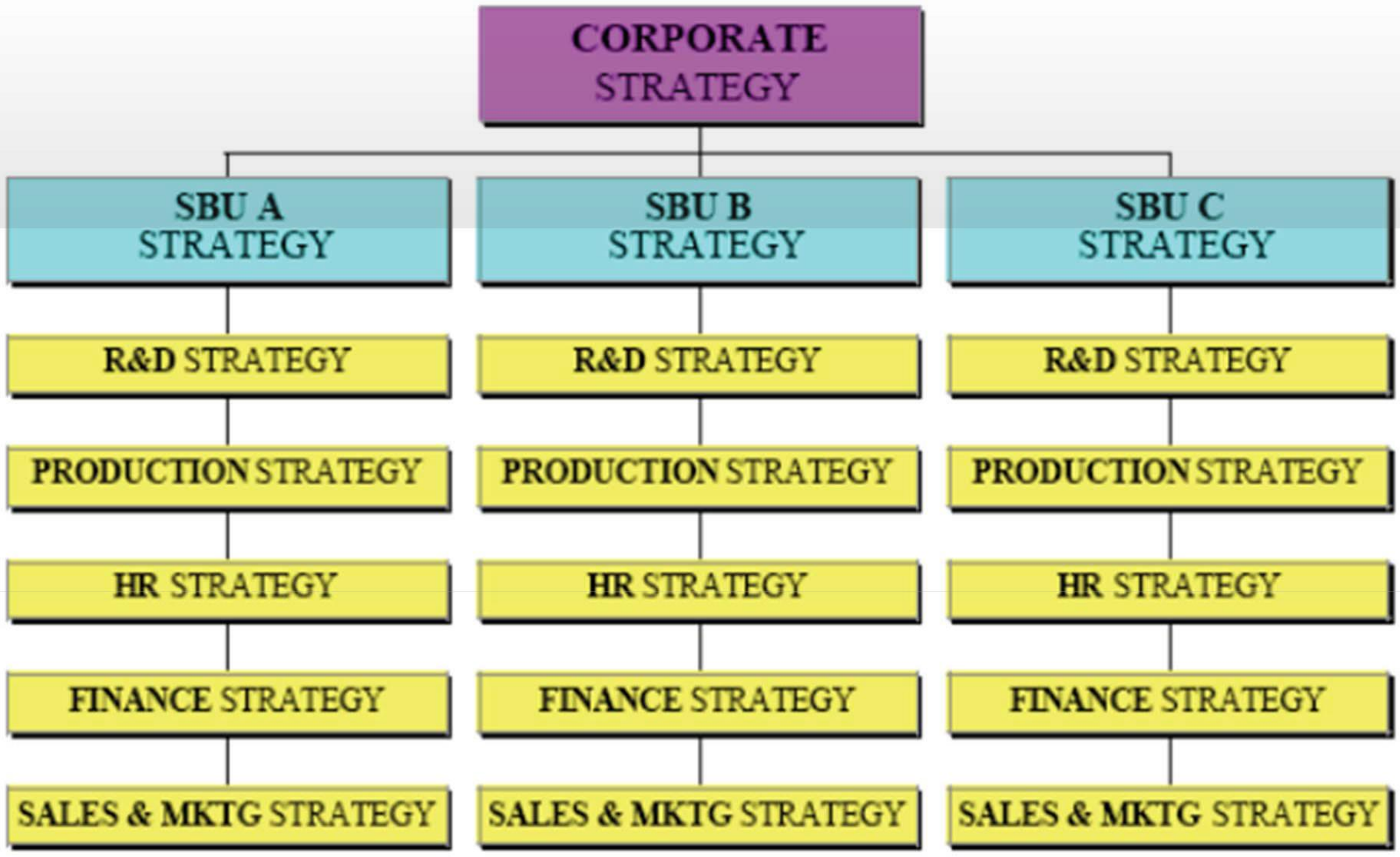
Who?

Made/served how?

The Strategic Business Unit (SBU)

- An **SBU:**
  - consists of **a specific offer** is addressed towards a specific group of **customers**
  - has its own **competitors**
  - it can be managed separately from the rest of the company
  - it can stand alone
  - it has distinct objectives, it is a profit centre, and has a manager responsible for its strategy/performance

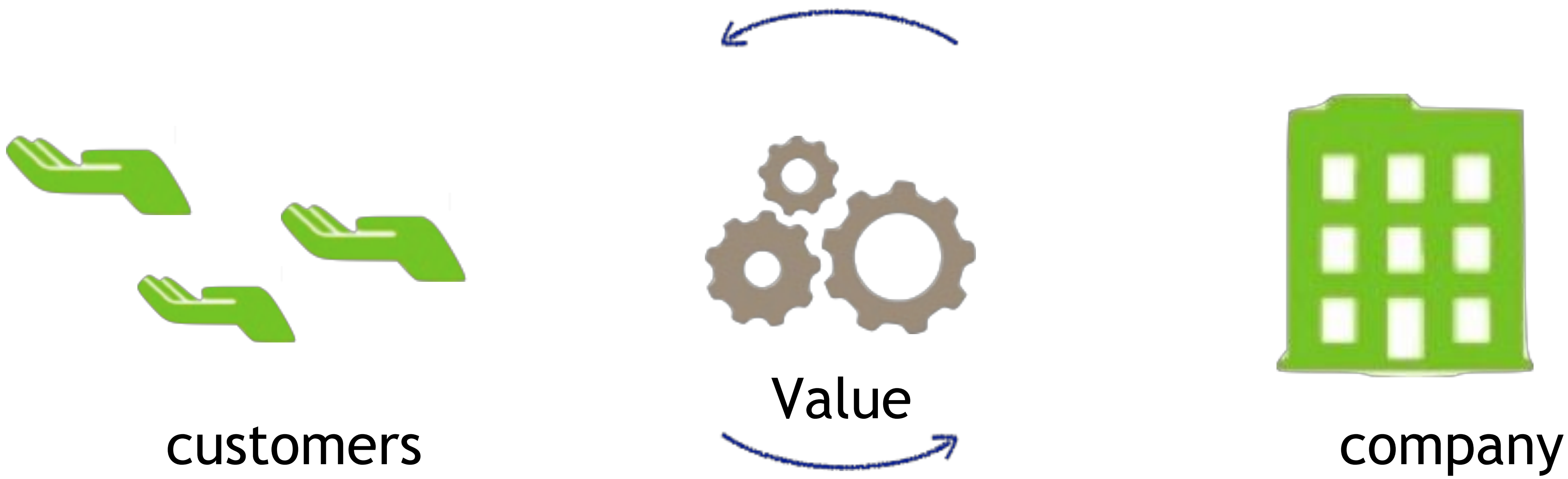
Level of strategy



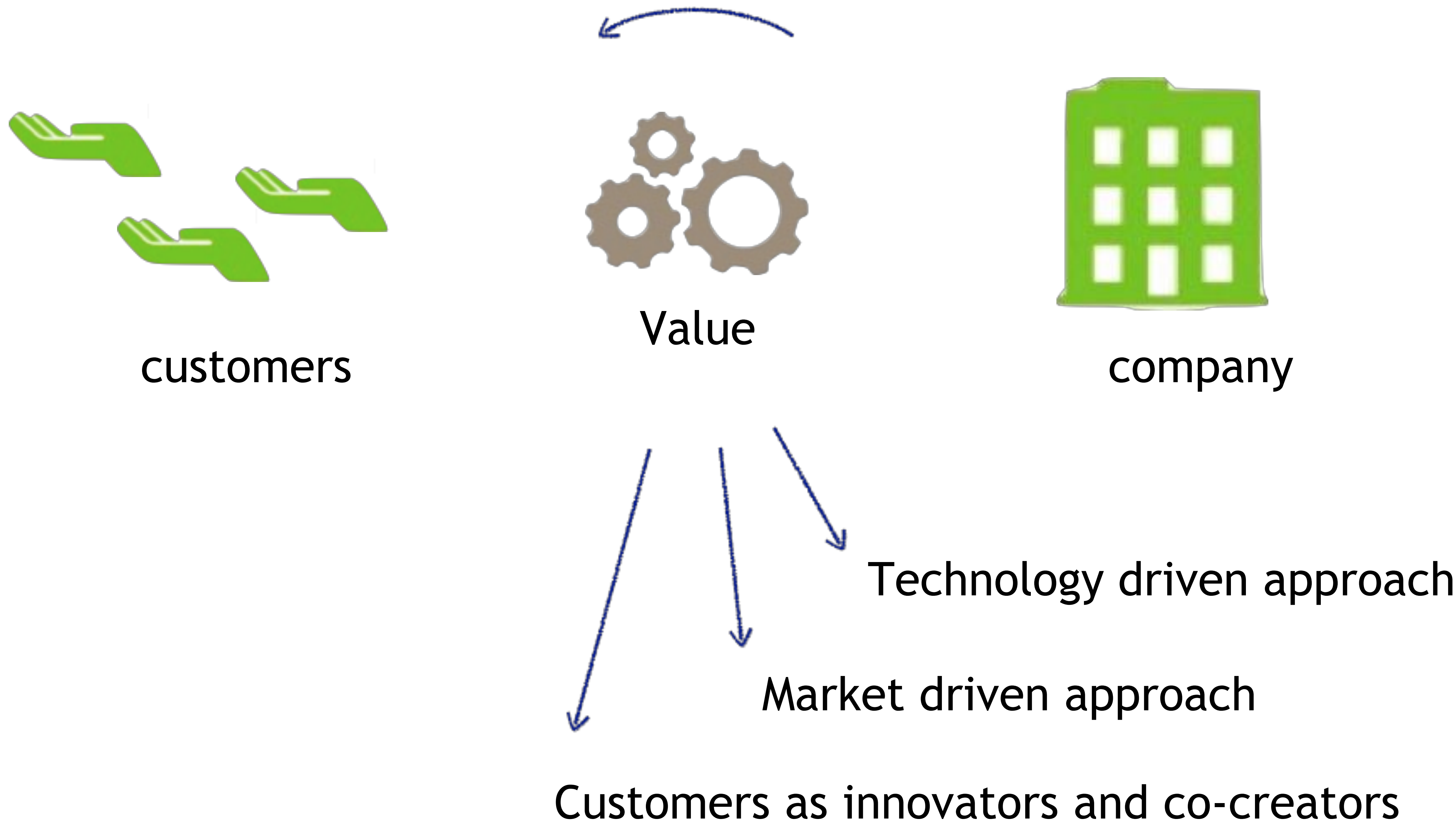
Level of strategy

- **Corporate Strategy** defines in which industries and markets the company is going to compete
- **Business Unit Strategy** is concerned with how the company competes within a particular industry or market
- **Functional Strategies** are the elaboration and implementation of business strategies through individual functions.

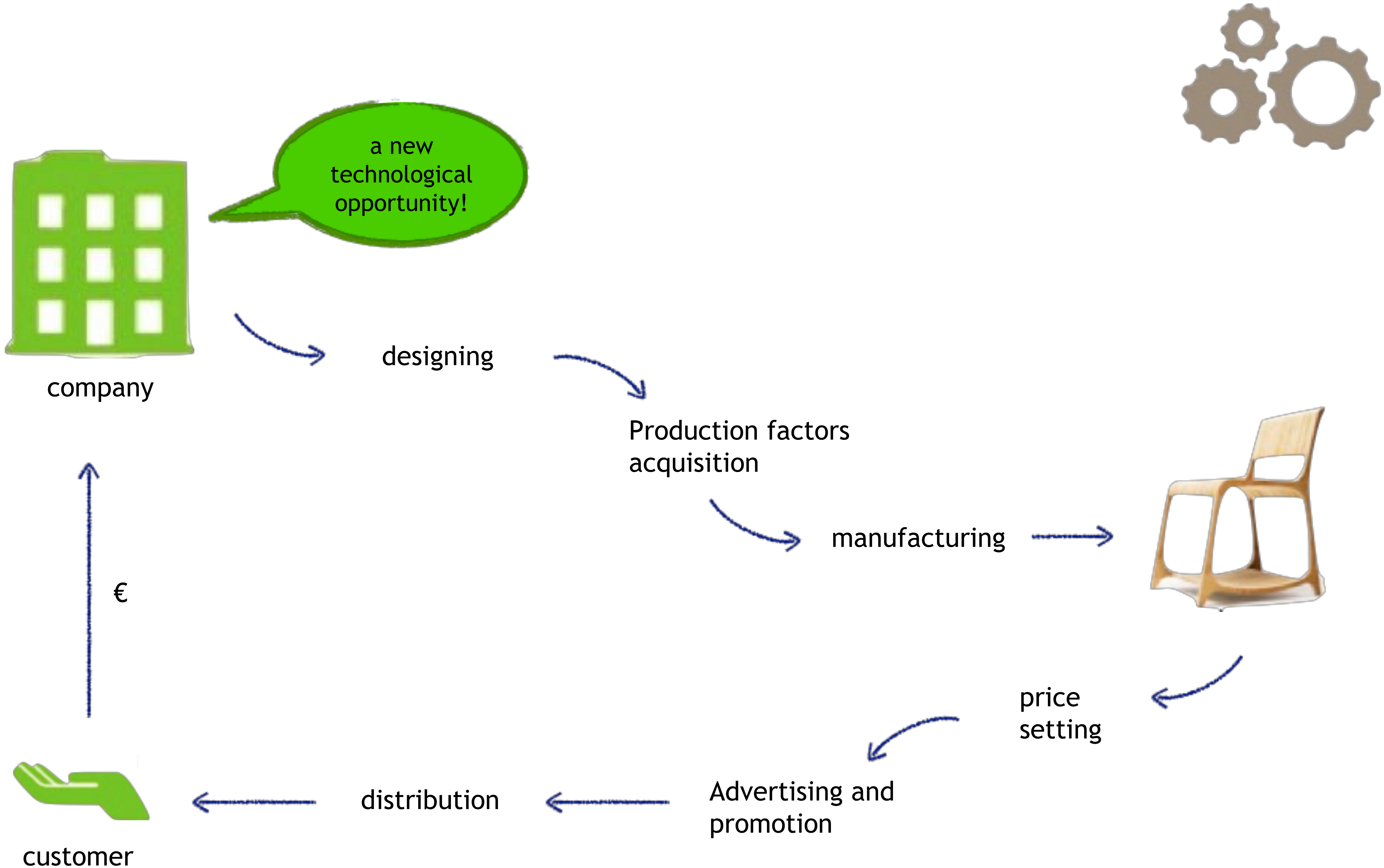
Strategy's aim: value creation



How is value being created?



Technology driven approach (1/3)



Technology driven approach (2/3)

Step 1: a new technological opportunity!

innovation is driven by a scientific breakthrough or a technological opportunity

Step 2:
- design
- productive factors acquisition
- manufacturing

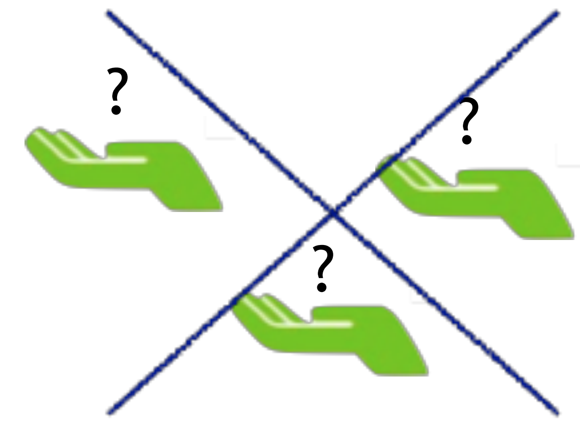
product realization follows

Step 3:
- price definition
- advertising and promoton
- distribution

then selling

Technology driven approach (3/3)

The market doesn't directly affect the value generation process.



The product/service is introduced on the market only after its realization.

Customers are considered passive subjects.

Marketing just intervenes in the last part of value generation.

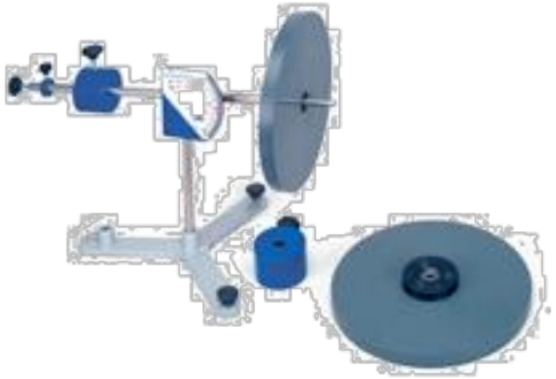
Step 3:
- price definition
- advertising and promotion
- distribution

Optical Gyroscope

Step 1:

1960, scientific breakthrough: **laser**
(Light Amplification by Stimulated Emission of Radiation)

Step 2:

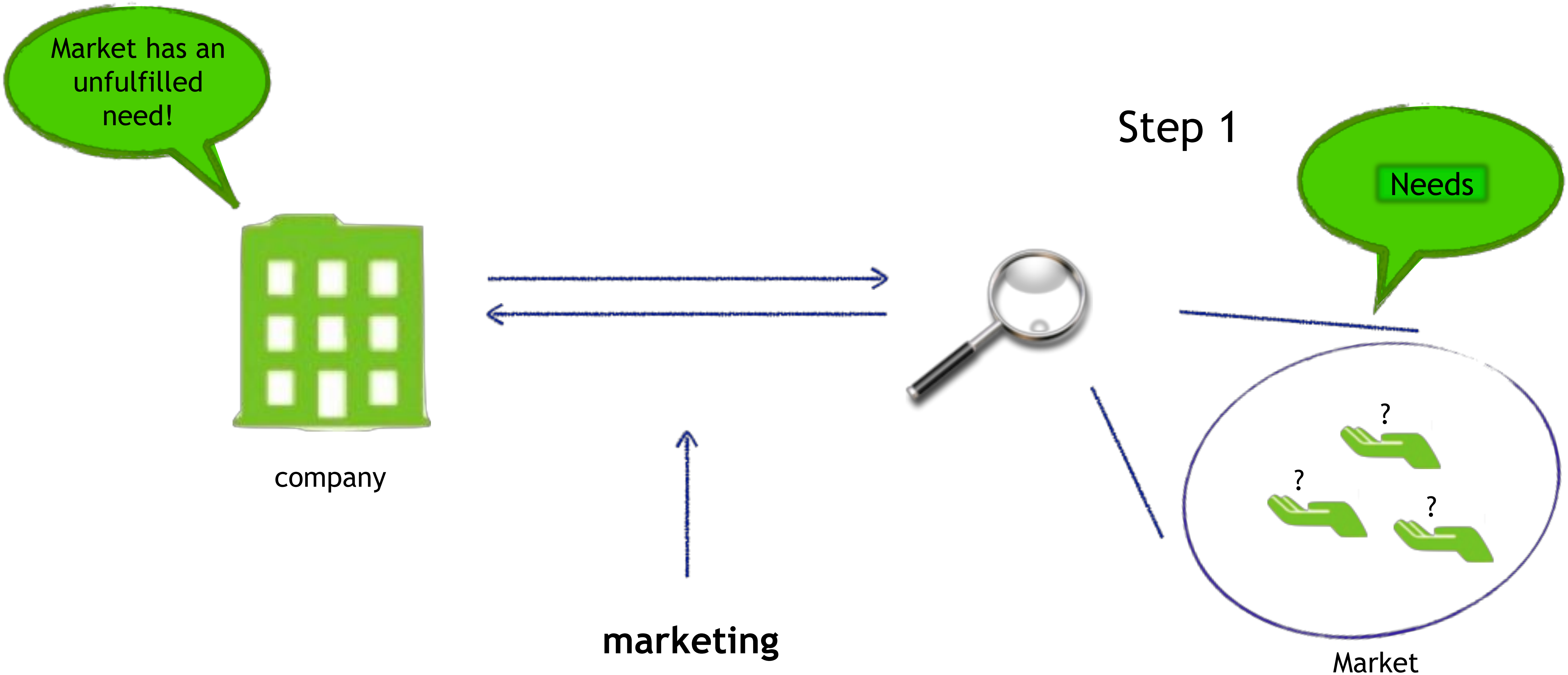


Optical Gyroscope design: it uses laser technology to measure angles coming from spatial movements

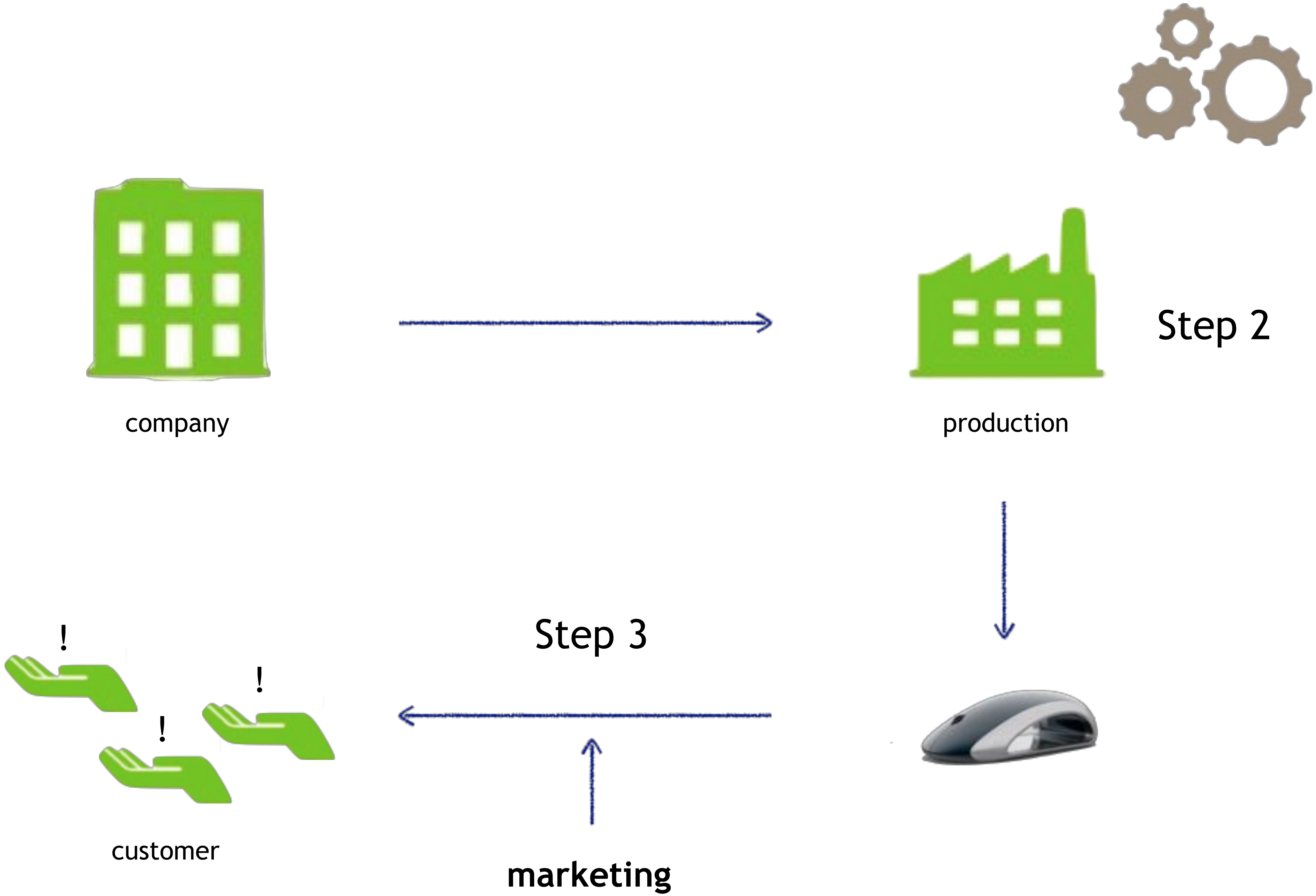
Step 3:

Fields of application: automobile navigation systems and aircraft navigation

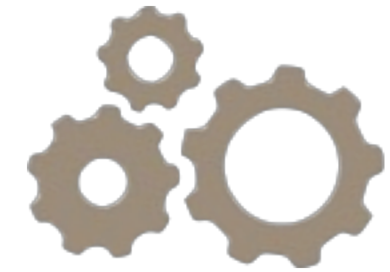
Market driven approach (1/4)



Market driven approach (2/4)



Market driven approach (3/4)



Value definition

Step 1

- identification and segmentation of the benefits customers look for
- target market selection
- value positioning

Value realization

Step 2

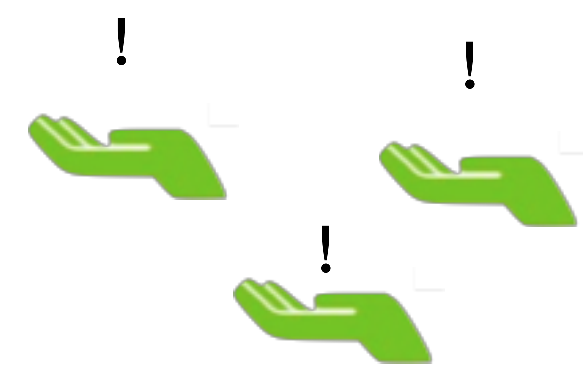
- product development
- service development
- price definition
- production factors acquisition and manufacturing
- distribution and service

Value communication

Step 3

- personal selling
- promotion
- advertising

The market directly affects the value generation process: **key** role of the market.



Marketing takes part in the first and in the final phase of the value generation process.

Value definition

Value communication

The market becomes an input for the company: it is the source of ideas

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M&M’s

Step 1:

The market showed the need of chocolate sweets that didn’t melt once held in hands

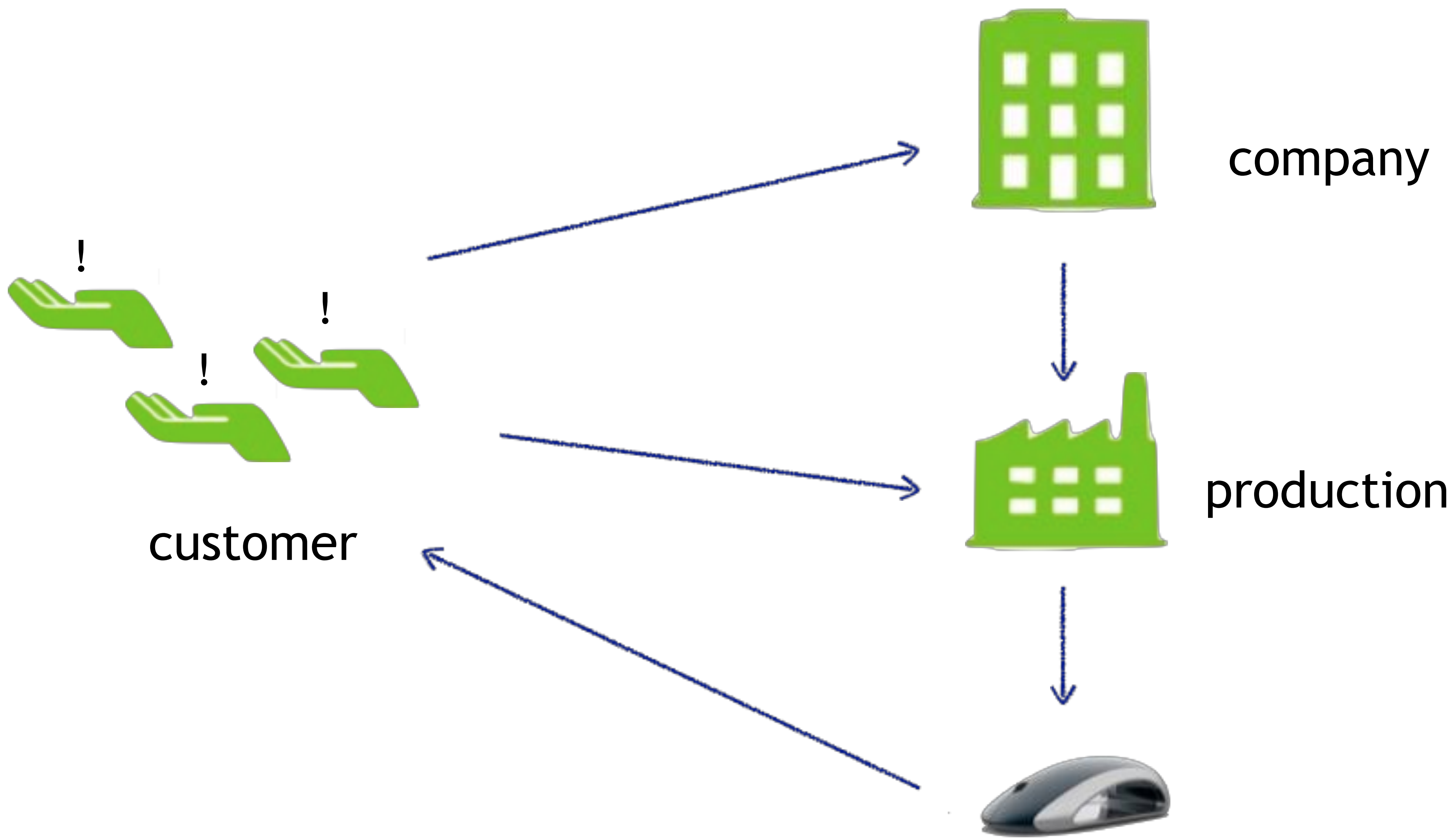
Step 2:

Forrest Mars covered chocolate sweets with a sugar coat: possibility of holding the candy without getting dirty

Step 3:

Commercialization of the product M&M’s

The role of marketing in value creation: customers as innovators and co-creators



Customers as the **functional source** of innovation

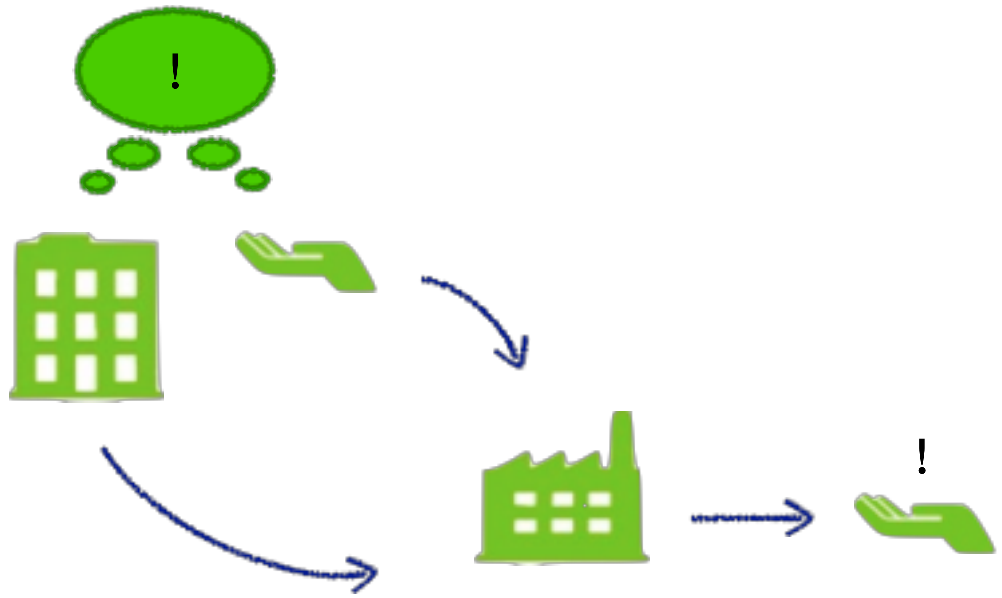
The market influences the value generation process during **all** the development of the product/service

Value definition

Value realization

Value communication

The customer becomes an innovator by personally **co-creating** the value and by being one of the principal actors in the development of the product concept



A company's business: a classical party cocktail question

"So what business are you in?"

The answer highlights the center of gravity of the business: the emphasis in the response hints at which part of the business the managers see as the primary driver of value and where management attention is concentrated

Upstream value

- The most common answer describes the product or the production facilities…
- Firms continue to spend inordinate amounts of time, effort and resources on their products
- **but is this center of gravity still sustainable?**

Upstream value: a successful strategy in the past

- **Businesses have traditionally sought competitive advantage in the upstream**- the value creation activities related to production and products
- The upstream has been **historically very profitable**:
  - **Ford** built such a huge and streamlined factory that it drove per-unit cost of production for the Ford Model T far below that of competitor’s cars
  - **Walmart** built an unbeatable network for moving inventory between its global supply chain and its stores, allowing the company to underprice competitors due to efficiency savings
  - **De Beers** pulverized its competitors as regard diamond market by gaining control of much of the world’s supply of diamonds….
  - …

Value shifts downstream

- But **now the business world is suffering from the erosion of upstream competitive advantage**
- Why?
  - Rapid **commoditization** of products and production
  - **Outsourcing** of the upstream activities
  - **Short product life-cycle**
  - …
- In this **new scenario, value is created in the interactions with customers**, competitive advantage is built and sustained in the marketplace, and the primary costs reside in acquiring, satisfying and retaining customers

Value shifts downstream: an example

Many ways of buying a can of Coca-Cola

1)A consumer goes to a supermarket and buys a twenty-four-pack of Coca-Cola. The pack might be priced at $5.99 (0.25$ per can)

2)The same customer, the next day, finds herself in a park on a blazingly hot summer day and pays $2 for a chilled single-serve can of Coke sold at the point of thirst through a vending machine

The premium price is due to a perceived added value in the eyes of the consumer. The product (What) is the same, but the purchase and consumption is different (how)

VALUE = WHAT + HOW

so

VALUE shifts from Product to Experience

Competition is everywhere…

- Today, competitors:
  - Come from all over the world
  - Struggle all over the world
  - Try to sell their products/deliver their service either in a sluggish (west) or in a fast-growing, largely undefined market (BRIC)
  - Turbulently innovate to succeed

…and customers do not want to be just a "member" of a market (1/2)

- In the most developed economies, customers:
  - Ask for more and more customized offers
  - May handle and process a huge amount of information
  - Look at the intangible and symbolic components of offerings
  - May interconnect with peers and companies all over the world (brand communities, social networking, etc.)
  - Are more interested than ever in their hedonic- and social-self

…and customers do not want to be just a “member” of a market (2/2)

- And the emerging markets are running fast:
  - By 2030, 1.5 billion people will have an annual income > $ 30,000 (toady: 1 billion)
  - Out of the 500 million new riches, approx. the 80% will come from BRICS (source: Confindustria)
    - Approx. 150 million from China
    - Approx 50 million from India
    - Approx. 20 million from Brazil
- These new customers bring their own culture, heritage and tastes

What do customers want?

- Growing relevance of the hedonic-self (especially in the high-end segments)
- Emerging focus on brand lifestyle (e.g. brand tattoo)
- Connectivity and relevance of the network (from one-to-one to one-to-many)
- Attitude towards co-creation

Thus, firms must look at a **widened concept of relationship with the customer** in which hedonism, focus on the intangibles, interactivity and many-to-many approach coexist

In two words, firms must look at Customer Experience

Some definitions of customer experience

Customer experience is the internal and subjective response customers have to any direct or indirect contact with a company

(Meyer and Schwager, 2007)

Customer experience originates from a set of interactions between a customer and a product, a company, or part of its organization, which provoke a reaction. This experience is strictly personal and implies the customer's involvement at different levels (rational, emotional, sensorial, physical, and spiritual)

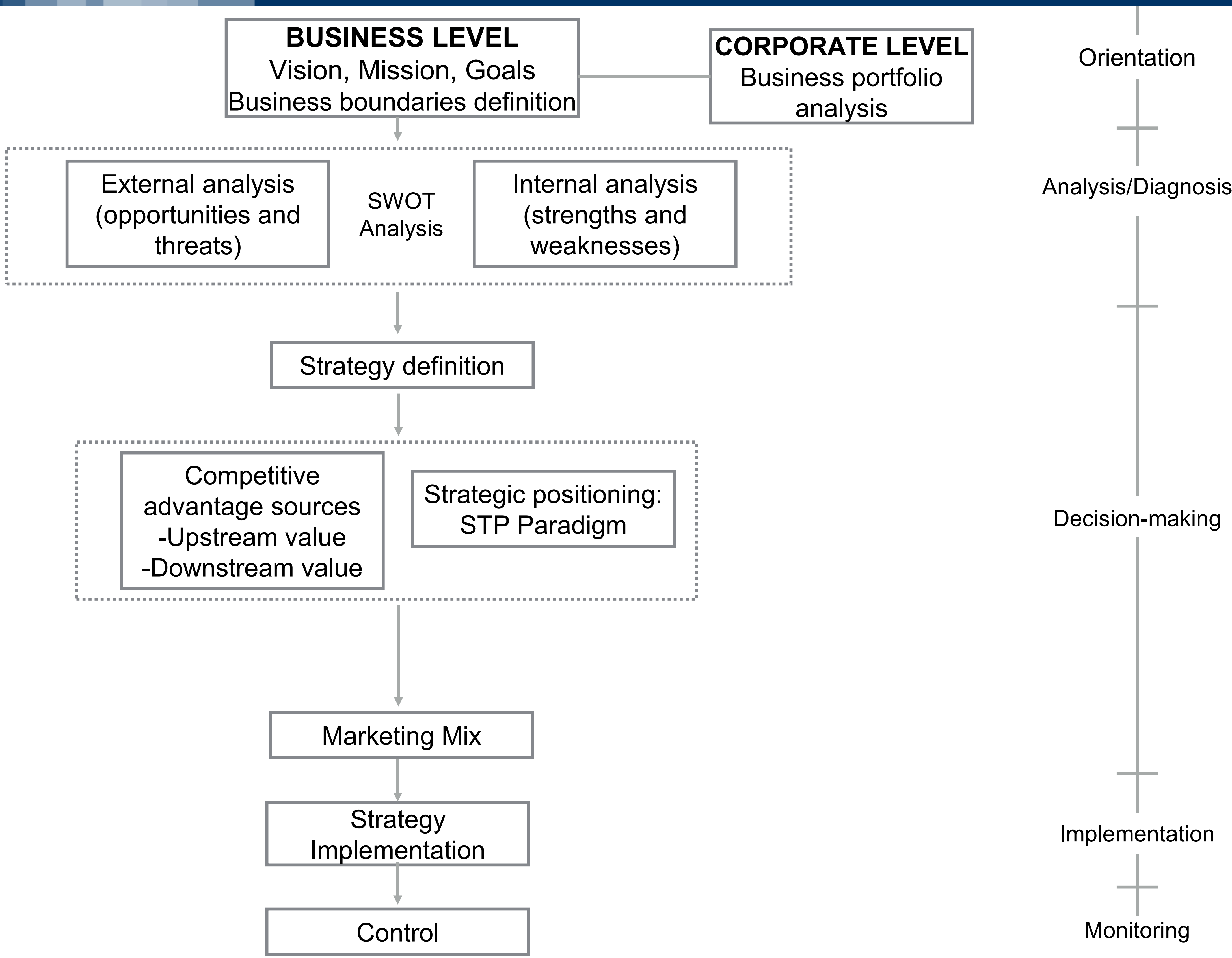
(Gentile *et al.*, 2007)

Why is customer experience so important?

We live in a world in which **attention** and **retention** are the real scarce resources…

…customers remember and value great experiences

Strategy formulation: the logical flow



Strategy formulation : the logical flow

POLITECNICO DI MILANO

Vision, Mission, Goals Business boundaries definition:
- Abell Model
- Macro- Segmentation

Business portfolio analysis
- BCG Matrix
- Mc Kinsey Matrix

External analysis (opportunities and threats)
- PEST analysis
- Demand analysis
- 5 Porter's Forces

SWOT Analysis

Internal analysis (strengths and weaknesses)
- Porter's Value Chain
- Core Competences Analysis

Strategy definition

Competitive advantage sources
- Upstream value
- Downstream value

Strategic positioning: Segmentation
- Targeting
- Positioning

Marketing Mix
- Product
- Place
- Prize
- Promotion

Strategy Implementation
- Business Model

Control
- Balance Score Card

Orientation

Analysis/Diagnosis

Decision-making

Implementation

Monitoring

External and internal environments

INTERNAL ENVIRONMENT

-the company's values and goals;

-the company's resources and capabilities

-the company's organizational structure and systems

EXTERNAL ENVIRONMENT

All the economic, social, political and technological factors that influence the company's decisions and its performance.

What are the organization's **Strengths**, in terms of capabilities and resource?

What **Opportunities** exist which we can act upon?

What are the organization's **Weaknesses** and capability gaps?

What **Threats** could lead to performance deterioration?

SWOT's content

STRENGTHS	WEAKNESSES
- a specialist marketing expertise - a new and innovative product or service - a strategic business location - the quality of the processes ...	- lack of marketing expertise - undifferentiated products or services - poor quality of products or services - damaged reputation ...
OPPORTUNITIES	**THREATS**
- new markets - demand increase - a new patent or license ...	- new restrictive regulations - new technologies available that makes my product obsolete - potential new market players ...

SWOT's content- Mc Donald's

STRENGTHS	WEAKNESSES
• Largest fast food market share in the world • Brand recognition valued at $40 billion • $2 billion advertising budget • Locally adapted food menus • Partnerships with best brands • More than 80% of restaurants are owned by independent franchisees • Children targeting	• Negative publicity • Unhealthy food menu • Mac Job and high employee turnover • Low differentiation
OPPORTUNITIES	**THREATS**
• Increasing demand for healthier food • Home meal delivery • Full adaptation of its new practices • Changing customer habits and new customer groups	• Saturated fast food markets in the developed economies • Trend towards healthy eating • Local fast food restaurant chains • Currency fluctuations • Lawsuits against McDonald's

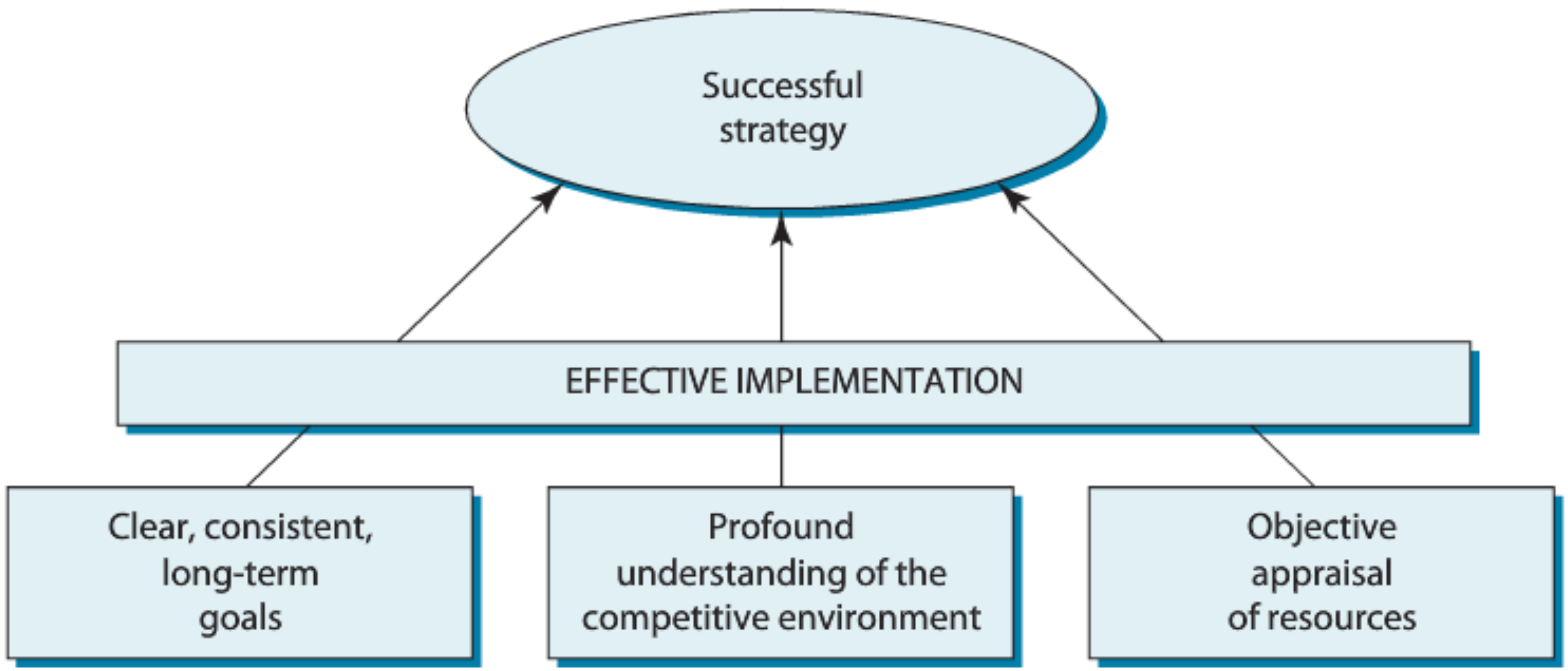
Strategy as a link between Internal and External Environment

INTERNAL ENVIRONMENT
Goals & Values
Resources & Capabilities
Structure & Systems

STRATEGY

EXTERNAL ENVIRONMENT
Economic and social context
Business area
Competitors
Customers
Suppliers

Common elements of successful strategies



Source: Grant (2010)