BLUE OCEAN STRATEGY
Making competition irrelevant

"Blue oceans are defined untapped market space, demand creation and the opportunity for highly profitable growth. It's about risk minimization and not risk taking"

Preparado por: R. Ramírez, 2005

Driving forces behind the imperative to create blue ocean

→ **Accelerated technological advances** → improved industrial productivity → Supply exceeds demand

→ **Globalization:** Trade barriers decrease, prices became instant and globally available, mkts. and heavens for monopoly disappear.

→ **Demand increase** worldwide is not clear and population in developed markets is decreasing.

→ **Accelerated commoditization** of products and services, increasing price wars, and shrinking profit margins.

Red Ocean Strategy	Blue Ocean Strategy
•Compete in existing market space and the same best practice rule	•Create uncontested market space and new best practice rules
•Beat the competition	•Make the competition irrelevant
•Exploit existing demand	•Create and capture new demand
•Make value-cost trade-off	•Break value-cost trade-off
•Align the whole system of a firm's activities with its strategic choice of differentiation or low cost	•Align the whole system of a firm's activities in pursuit of differentiation and low cost

Traditional assumptions of companies' strategies

- Define their industry similarly and focus on being the best within it.
- Look at their industries trough the lens of generally accepted strategic groups, and strive to stand out in the strategic group they play in.
- Focus on the same buyer group, be the purchaser, the user, or the influencer.
- Define the scope of the products and services offered by their industry similarly.
- Accept their industry's functional or emotional orientation.
- Focus on the same point in time – and often in current competitive threats – in formulating strategy.

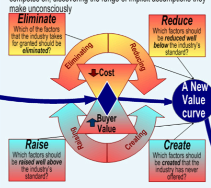
The Six Principles of Blue Ocean Strategy

Formulation Principles	Risk factor each principle attenuates
• Reconstruct market boundaries	↓ Search risk
• Focus on the big picture not the numbers	↓ Planning risk
• Reach beyond existing demand	↓ Scale risk
• Get the strategic sequence right	↓ Business model risk
Execution principles	**Risk factor each principle attenuates**
• Overcome key organizational hurdles	↓ Organizational risk
• Build execution into strategy	↓ Management risk

It will be important to swim successfully in the red ocean by outcompeting rivals. Red oceans will always matter and will always be a fact of business life, but won't be sufficient to sustain high performance. Red ocean is therefore to accept the key constraining factors of war – limited terrain and the need to beat an enemy succeed – and to deny the distinctive strength of e business world: the capacity to create new market space that is uncontested

The four action framework

- Simultaneous pursue differentiation & low cost to brake value-cost trade-off.
- Flags companies focused only in raising and creating and thereby lifting their cost structure and often over engineering products and services.
- Easy understood by managers (any level), creates high level of engagement in its application.
- Drives companies to robustly scrutinize well every factors to competes on, discovering the range of implicit assumptions they make unconsciously



Value Innovation

- Focus on making competition irrelevant → creating leap in value to buyers and your company, → opening up new and uncontested market space
- **Value without innovation** tends to focus on value creation on an incremental scale.
- **Innovation without value** tends to be technology-driven, market pioneer or futuristic → beyond what buyers are ready to accept and pay for.
- Value innovation is opposed to technology innovation or market pioneer
- Pursuit of differentiation and low cost simultaneously
- Based on: Market boundaries and industry structure are not given and can be reconstructed by actions and beliefs of industry players

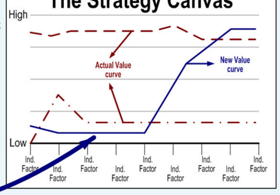
"Value innovation occurs only when companies align innovation with utility, price and cost position"

Three characteristics of a good strategy

- ***Focus:*** a company's strategic profile, or value curve should clearly show it. When it lacks its cost structure tend to be high and its business model complex in implementation and execution.
- ***Divergence:*** a strategy should always stand apart, it should be avoided to keep up with the competition. When it lacks a strategy is a me-too, with no reason to stand apart in the marketplace.
- ***Compelling tagline:*** must not only deliver a clear message but also advertise an offer truthfully. When it lacks it is likely to be internally driven or a classic example of innovation for innovation's sake with no grate commercial potential and no natural take-off capability.

The Strategy Canvas

- Is both diagnostic and action framework for building a compelling blue ocean strategy
- Captures current state of play in the known market space
- Allows to understand where the competition is currently investing
- Factors the industry currently compete on in products, services, and delivery
- What customers receive from the existing competitive offering on the market
- Enables companies to see the future in the present



Strategy canvas does

- Show strategic profile of an industry by depicting very clearly the factors (and the possible ones).
- Show the strategic profile of current and potential competitors, identifying which factors they invest in strategically.
- Show the company's strategic profile – value curve - depicting how it invests in the factors of competition and how it might invest in them in the future.

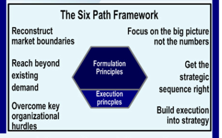
Reading Value Curves

- Should meets the 3 characteristics of a **"good strategy"**
- Company Caught in the Red Ocean: tends (explicit or implicit) to be trying to outdo its competition on the basis of cost or quality.
- **Over delivery Without Payback:** Strategy canvas is shown to deliver high levels at all factors, and signal that the company may be oversupplying its customer, offering too much of those elements that add incremental value to buyers.
- **An Incoherent Strategy:** Signal is, value curve looks like a spaghetti bowl.
- **Strategic Contradictions:** are areas where a company offering a high level on one competing factor while ignoring others that support that factor.
- **An internally Driven Company:** Language used in strategy canvas gives insight as to whether a company's strategic vision is built on an "outside-in" perspective, driven by the demand side, or an "inside-out" perspective that is operationally driven

Imitation Barriers to Blue Ocean Strategy

- Value innovation does not make sense to a company's conventional logic.
- Blue ocean strategy may conflict with other companies brand image.
- Natural monopoly: The market often cannot support a second player.
- Patents or legal permits block imitation.
- High value volume leads to rapid cost advantage for the value innovator, discouraging followers from entering the market.
- Network externalities discourage imitation.
- Imitation often requires significant political, operational, and cultural changes.
- Companies that value innovate earn brand buzz and a loyal customer following that tends to shun imitators.

The Six Path Framework



FORMULATION PRINCIPLES

I Reconstruct Market Boundaries

The six conventional boundaries of competition:

1- **Alternative industries:** Companies competes in its own industry and with others that produce alternative products or services (alternatives are broader than substitutes). → ***Substitutes*** products or services different forms but same functionality (software v/s pencil to calculate personal finance) or core utility are often → ***Alternatives:*** Products or services that have different functions and forms but the same purpose (Restaurants v/s cinema → entertainment).
In purchase decision, buyers implicitly weigh alternatives, often unconsciously.

2- **Strategic groups:** Group of companies within an industry that pursue a similar strategy. The fundamental strategic difference among industry players are captured by a small number of strategic groups, an can be ranked in an order built on two dimensions: price and performance → each jump in price tends to bring a corresponding jump in some dimension of performance (i.e. luxury car industry).

3- **Buyers groups:** Competitors tends to converge around a common definition of who the target buyer is. There are a "chain of buyers" who are directly or indirectly involved in the buying decision → Purchaser – user – influencers they often differs, and when they do, they frequently hold different definitions of value, this helps to redesign their value curves.

4- **Complementary products and service offering:** The key is to define the total solution buyers seek when they choose a product or service. → A simple way: think what happens before, during and after your product is used.

5- **Functional -emotional orientation of an industry:** aside of product and service, there are two bases of appeal, a) principally on price and in function largely calculations of utility; their appeal is rational, b) compete largely on feelings; their appeal is emotional. This approach tend to be more of the same for each base, and when consumers are surveyed a reinforced cycle is created. Industries have trained customers in what to expect. When surveyed, they echo back: more for less. → Companies should include both aspects.

6- **Time:** Managers tend to focus on projecting the trend itself, and they pace their own actions to keep up with the development of the trend they're tracking. Key insight rarely come from projecting the trend itself. Instead they arise from business insights into how the trend will change value to customers and impact the company's business model → Finding insight in trends that are observable today .

→ Key principles to asses trends: a) must be decisive to your business, b) must be irreversible, and c) must have a clear trajectory.

Conceiving New Market Space

	Head-to-Head Competition	Blue Ocean Creation
Industry	Focuses on rivals within its industry	Looks across alternative industries
Strategic groups	Focuses on competitive position within strategic groups	Looks across strategic groups within industries
Buyer group	Focuses on servinfg the buyer group	Redefine the industry buyer group
Scope of product Or service offering	Focuses on maximizing the value of product and service offering within the bounds of its industry	Looks across complementary product and service offering
Functional – Emotional Orientation	Focuses on improving price performance within the functional – emotional orientation of its industry	Rethinks the functional-emotional orientation of its industry
Time	Focuses on adapting to external trends as they occurs	Participates in shaping external trends over time

II Reach Beyond Existing Demand

By aggregating the greatest demand for a new offering, this approach attenuates the scale risk associated with creating a new market.

Conventional strategy practices should be challenge: Focusing on existing customers, and drive for finer segmentation to accommodate buyer differences, This could create too small target markets.

To maximize the size, instead of concentrating on customers, they need to look to noncustomers. And instead of focusing on customer differences, they need to build on powerful commonalities in buyers value. This allows companies to unlock a new mass of customers that did not exist before.

You should focus on the tier that represents the biggest catchments at the time. But you should also explore whether there are overlapping commonalities across the three tiers of noncustomers.

The natural strategic orientation of many companies is toward retaining existing customers and seeking further segmentation opportunities. This is especially true in the face of competitive pressure. Although this might be a good way to gain focus competitive advantage and increase share of the existing market space, it will not expand and create new demand.

You should also be aware that when your competitors succeed in attracting the mass of noncustomers with a value innovation move, many of your existing customers may be attracted away because they too may be willing to put their differences aside to gain the offered leap of value.

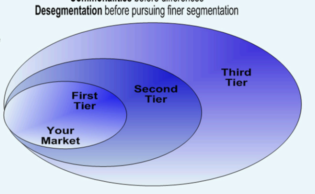
Think

Noncustomers before customers
Commonalities before differences
Desegmentation before pursuing finer segmentation

First Tier Noncustomers
These soon-to-be noncustomers are those who minimally use the current market offering to get by as they search for something better. Upon finding any better alternative, they eagerly jump ship → sit on the edge of the market

Second Tier Noncustomers
These are refusing noncustomers, people who either do not use or cannot afford to use current market offerings because they find the offering unacceptable or beyond their means. Their needs are either dealt with by other or ignored

Third Tier Noncustomers
Is the farthest away from an industry's existing customers. These unexplored noncustomers have not been targeted or thought of as potential customers by any player in the industry. That's because their needs and the business opportunities associated with them have somehow always been summed to belong to other markets



III Focus on the Big Picture, Not the Numbers

Drawing your Strategy Canvas:
The Four Steps of Visualizing Strategy

1- Visual Awakening	2- Visual Exploration	3- Visual Strategy Fair	4- Visual Communication
• Compare your business with your competitors by drawing your "as is" strategy canvas. • See where your strategy needs to change.	• Go into the field to explore the six path to creating blue oceans. • Observe the distinctive advantages of alternative products and services. • See which factors you should eliminate, create or change • A company should never outsource its eyes • For each visual strategy a team should write a tagline that capture the essence of the strategy and speaks directly to buyers	• Draw your "to be" strategy canvas based on insights from field observations. • Get feedback on alternative strategy canvases from customers, competitors and noncustomers. • Use feedback to build the best "to be" future strategy	• Distribute your before – and – after strategic profiles on one page for easy comparison. • Support only those projects and operational moves that allow your company to close the gaps to actualize the new strategy.

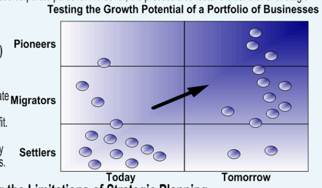
Visualizing Strategy at the Corporate Level

Visualizing the strategy can also greatly inform the dialogue among individual business units and the corporate center in transforming a company into a blue ocean player. This helps to business units to present their strategy and deepen the understanding of the businesses corporate portfolio. Moreover, the process also foster the transfer of strategic best practices across units.

Testing the Growth Potential of a Portfolio of Businesses

Using the Pioneer–Migrator – Settler (PMS) Map

Visualizing the strategy help managers responsible for corporate strategy predict and plan the company's future growth and profit. Pioneers means not only new technology but pushing value they offer to customers to new frontiers.



Overcoming the Limitations of Strategic Planning

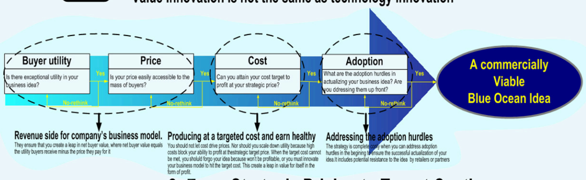
Strategic planning should be more about:

- Collective wisdom building than top-down or bottom-up planning.
- Building the big picture than about number crunching exercises.
- Having a creative component instead of being strictly analysis driven.
- Motivational, invoking willing commitment, than bargaining driven, producing negotiating commitment.

"The soul never think without an image", Aristotle.

IV Get the Strategic Sequence Right

Value innovation is not the same as technology innovation



1- From exceptional Utility to Strategic Pricing

Key: Know from the start what price will quickly capture the mass of target buyers. 1. Companies are discovering that volumes generate higher returns than it use to. As the nature of goods becomes more knowledge intensive, companies bear more of their costs in product development than in manufacturing. 2. The value of a product or service may be closely tied to the total number of people using it. People will not buy a product or service when is use by few others, this is called ***network externalities*** → It's an all or nothing proposition.

The raise of knowledge intensive products also creates potential for free riding. This relates to the nonrival and partially excludable nature of knowledge. The use of a rival good by one firm precludes its use by another. In contrast the use of a nonrival good by one firm doesn't limit its use by another, i.e. ideas. The cost and risk of innovative idea are borne by the initiator, not the follower..

Excludability: is a function both of the nature of the good and of the legal system. The challenge is to exacerbate it. A good is excludable when can prevent other from using it, for example, limited access or patent protection.. The lack of excludability reinforces the risk of free riding.

The ***Strategic Price*** you set for your offering must not only attract buyers in large numbers but also help you to retain them. Given the high potential for free riding, an offering's reputation must be earned on day one, because brand building increasingly relies in word of mouth recommendations spreading rapidly through our networked society. Companies must therefore start with an offer that buyers can't refuse and must keep it that way to discourage any free riding imitations. Exceptional utility + Strategic Price → imitation discourage.

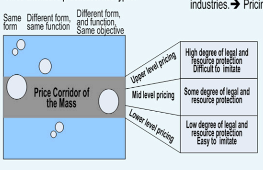
Step 1: Identify the Price Corridor of the Mass
Determine strategic price and understand price sensitivities of those who will compare the new product or service with a host of very deferent looking products & services offered outside the group of traditional competitors.
List products and services that fall into categories: 1-Those that take different forms but perform the same function, 2- Different forms and functions, same objective.
Alternative products & services allow managers to see the full range of buyers they can poach from other industries.
Key is to pursue pricing against substitutes and alternatives across industries and nonindustries.

Step 2: Specify a Level Within the Price Corridor
Determine how high a price can afford to set within the corridor without inviting competition from imitations.
The assessment depends on the degree to which : 1- The product or service is protected legally (patents, copyrights), and 2- Company owns some exclusive assets or core capability.
Companies should pursue mid to lower boundary strategic pricing from the start if:

- Offering has high fixed cost and marginal variable costs.
- Their attractiveness depends heavily on network externalities
- Their cost structure benefits from steep economies of scale and scope.

In these cases, volume brings with the significant cost advantages, something that makes pricing for volume even more key.

The Price Corridor of the Mass



2- From Strategic Pricing to Target Costing

Key to determine the margin: price minus costing, and not cost plus pricing → cost structure that is both profitable and hard potential followers to match.

Principal levers:

→ **Streamlining operations** and introducing cost innovation from manufacturing to distribution

→ **Partnering**, provide a way for companies to secure needed capabilities fast and effectively while dropping their cost structure. Allow companies to leverage others expertise and economies of scale. Including closing gaps in capabilities through making small acquisitions when doing so is faster and cheaper, providing access to needed expertise that has already been mastered.

→ **Changing pricing model** of the industry – and not the level of strategic price – this could generate other standard pricing model in other industries.→ Pricing innovation

3- Testing for Exceptional Utility

The Buyer Utility Map
Helps to look utility from the right perspective.
It outlines all the levers compies can pull to deliver exceptional utility (product or service). Allows managers to identify the full range of utility spaces.

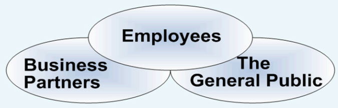
Six Utility Levers	1. Purchase	2. Delivery	3. Use	4. Supplements	5. Maintenance	6. Disposal
Customer Productivity	In which stage are the biggest blocks to customer productivity?					
Simplicity	In which stage are the biggest blocks to simplicity?					
Convenience	In which stage are the biggest blocks to convinience?					
Risk	In which stage are the biggest blocks to reducing risk?					
Fun and image	In which stage are the biggest blocks to fun and image?					
Environmental friendliness	In which stage are the biggest blocks to environmental friendliness?					

Buyer Experience Cycle

1. **Purchase:** How long does it takes to find the product you need? Is the place of purchase attractive and accessible? How secure is the transaction environment? How rapidly can you make a purchase?
2. **Delivery:** How long does it take to get the product delivered? How difficult is to unpack and install the new product? Do buyers have to arrange delivery themselves? If yes, how costly and difficult is this?
3. **Use:** Does the product require training or expert assistance? Is product easy to store when not in use? How effective are the product's features and functions? Does the product, service deliver far more power or options than required by the av. user?
4. **Supplements:** Do you need other products and services to make the product work? If so, how costly are they? How much time do they take? How much pain do they cause? How easy are they to obtain?
5. **Maintenance:** Does the product require external maintenance? How easy is it to maintain and upgrade the product? How costly is maintenance?
6. **Disposal:** Does use of the product create waste items? How easy is it to dispose of the product? Are there legal or environmental issues in disposing of the product safely? How costly is disposal?

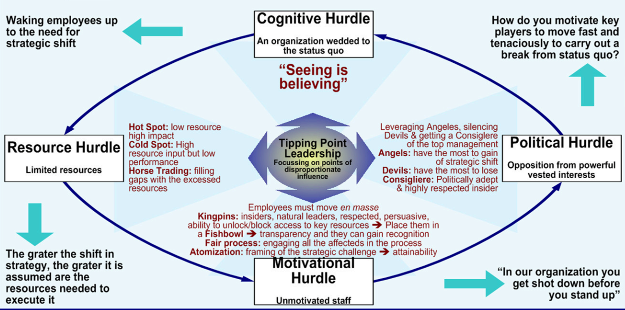
4- From Utility, Price, and cost to Adoption

Companies should overcome fears and resistance from the stakeholders

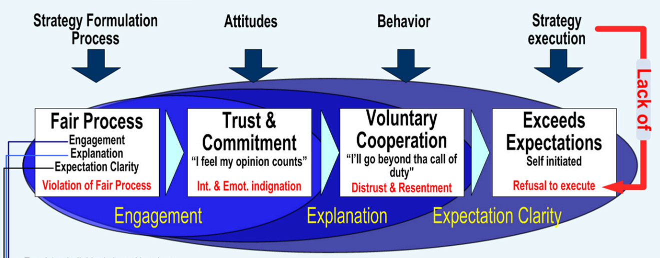


EXECUTION PRINCIPLES

V Overcome Key Organizational Hurdles



VI Build Execution into Strategy



→ Envolving individuals by asking them
→ Envolving individuals by making them understand
→ Envolving individuals by explaning clearly the new rules

"Emotionally, individuals seek recognition of their value as human beings. Intellectually, individuals seek recognition of their ideas"