EXPLORING STRATEGY

TWELFTH EDITION

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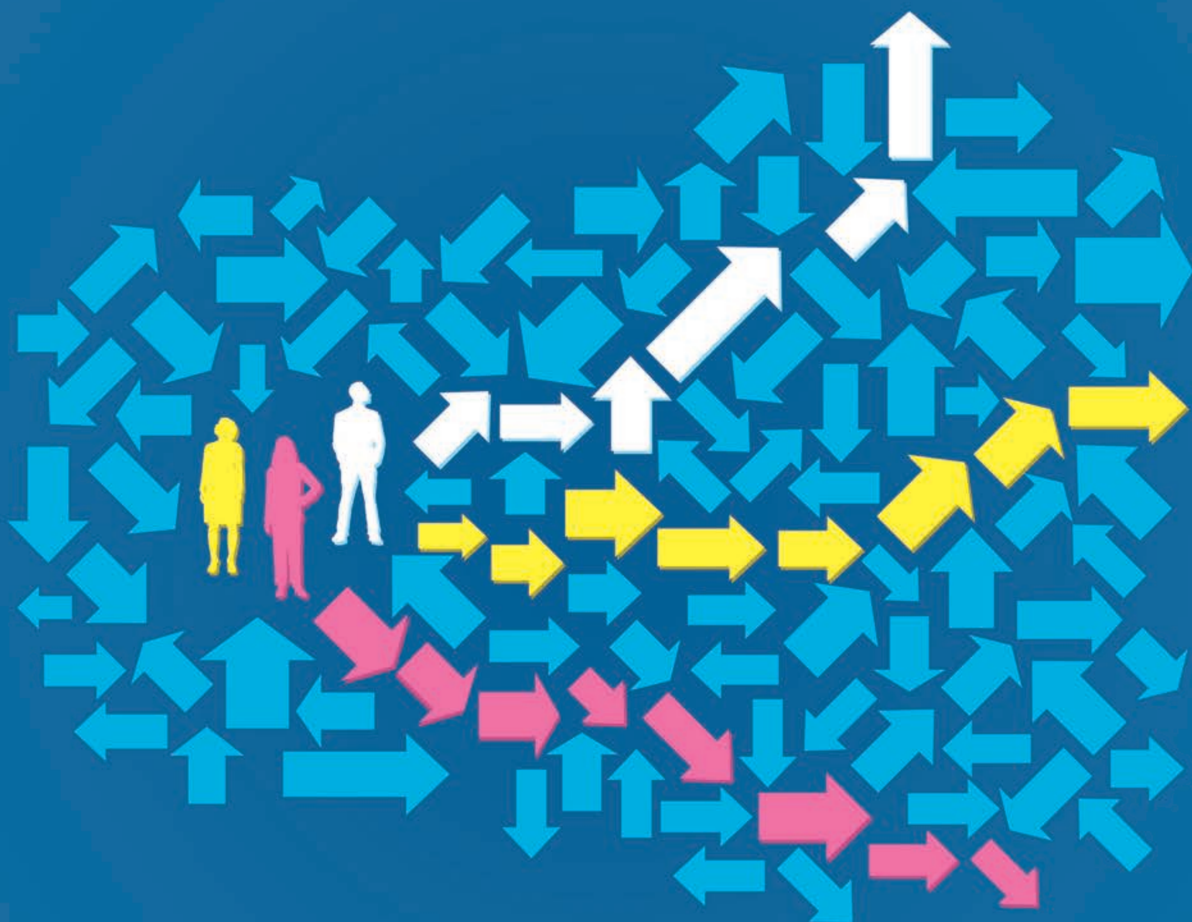

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TEXT AND CASES

Welcome to Exploring Strategy

Strategy is a crucial subject. It's about the development, success and failure of all kinds of organisations, from multinationals to entrepreneurial start-ups, from charities to government agencies, and many more. Strategy raises the big questions about these organisations – how they grow, how they innovate and how they change. As a manager or an entrepreneur, you will be involved in shaping, implementing or communicating these strategies.

Our primary aim with *Exploring Strategy* is to give you a comprehensive understanding of the issues and techniques of strategy. We can also help you get a great final result in your course. You can make the most of the text by:

- Exploring hot topics in cutting-edge issues such as business models, corporate governance, innovation, entrepreneurship and strategy practice.
- Engaging with our 'Thinking Differently' sections to access novel and distinctive perspectives on core themes in strategy
- Using the 'Strategy Lenses' to think critically and originally about key topics and to set you on your way to better grades in your assignments and exams.
- Pursuing some of the recommended readings at the end of each chapter. They're specially selected as accessible and valuable sources that will enhance your learning and give you an extra edge in your course work.

We want *Exploring Strategy* to give you what you need: a comprehensive view of the subject, an ambition to put that into practice, and – of course – success in your studies. We hope that you'll be as excited by the key issues of strategy as we are!

So, read on and good luck!

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are likely to prefer Airbnb over competitors as guests are offered more accommodation and hosts more guests. The more customers that use their service the better it is for every customer in their network of guests and hosts and Airbnb thus has an advantage based on network effects (see Section 3.2.6 for network effects).

7.4.2 Business model patterns

Even though business model patterns often become established within industries over time companies use them competitively. New entrants often use new business models to be able to compete successfully with established players. Dell, for example, entered the PC and laptop industry many years ago based on a different business model compared to the established one. Instead of going via middlemen of retailers and wholesalers as HP, IBM and others did, they sold directly to customers. It is thus important for managers to understand what type of business model pattern their business builds on and how it may differ from other competitors. It should be noted, however, that business model patterns are described at various levels of detail and sometimes only emphasise one or two business model components.[17] There are multiple business models around, but three typical patterns include the following:

- *Razor and blade.* This is perhaps the most well-known business model pattern, but its primary focus is on the value capture component, which makes it more of a revenue model. It builds on Gillette's classic model of selling razors at a very low price and the compatible replacement blades at a quite high price.[18] This model of selling two technically interlinked products separately is quite common. For example, mobile operators offering consumers a cheap or even a free mobile phone and then catching them through a two-year fee-based subscription plan. In other industries it is the services, maintenance and parts that are priced expensively while the basic product is sold at relatively low margins. This is, for example, the case for ink-jet printers; they are sold at relatively low prices, but manufacturers make their margins on selling expensive ink. It is also common in industrial goods with an emphasis on expensive services; for example, Rolls Royce and GE and others in the jet engine industry and for Otis and Schindler and other players in the elevator industry.
- *Freemium.* This business model pattern name comes from combining 'free' and 'premium' and it primarily relates to online businesses. It refers to how a basic version of a service or product is offered for free so as to build a high volume of customers and eventually convince a portion of the customers to buy a variety of premium services. Revenue is generated by the premium buying customers. They are often only a small portion of the total user volume, but their revenues can be enough and can also be used to attract even more users. The photo sharing service Flickr uses this business model pattern. Flickr offers the basic service of uploading and sharing photos for free while generating revenues through extra services for a subscription fee including unlimited uploading and storing of photos. Flickr also uses contextual advertising and cooperation with retail chains and other photo service companies besides subscription fees to generate revenue. Other businesses that use this model are the business-oriented social networking service LinkedIn, the video chat and voice call service Skype and the streaming music service Spotify. The aim of freemium, however, is not only to convince premium customers, but to attract a larger volume of customers as the value of the service increases with more users. It means that the enterprise can gain network effects based on a large installed base of adopters (see Section 3.2.6).
- *Peer-to-peer (P2P).* This model brings people and/or businesses together without necessarily having to go through a middle man. It is based on co-operation among individuals aided by an app, website or some other online or communication service and can include all sorts of peer-to-peer transactions. Transactions include offerings of specific services

like education, lending personal things that may be rarely used but expensive such as hobby-building tools, or providing loans peer to peer. An example of the latter is California-based Kiva, an international non-profit micro-finance website that aims to alleviate poverty by allowing everyday people in developed nations to finance low-income entrepreneurs and students in developing nations. This business model pattern has even been described as a potential new economic model, a sharing economy, as it is does not necessarily require a business intermediary third party. However, business platform intermediaries often step in to make exchanges smoother. For example, within countless car-sharing organisations there are many local not-for-profit peer-to-peer intermediaries, but also global for-profit ones like Zipcar, owned by the US car rental multinational Avis. Airbnb is also a peer-to-peer model and so is Uber, but they build on for-profit platforms. This is often referred to as a 'multi-sided platform' business model, which is discussed in the next section.

7.4.3 Multi-sided platforms

Another common business model is the multi-sided platform,[19] which is behind some of the most valuable firms in the world. The so-called US 'FAANG' (Facebook, Apple, Amazon, Netflix and Google) and Chinese 'BAT' (Baidu, Alibaba and Tencent) companies all build on platforms. **A multi-sided platform brings together two or more distinct, but interdependent groups of participants to interact on a platform.** They are distinct as they perform separate functions on the platform and they are interdependent as the platform is of value to each group of participants only if the other group is also present. The platform YouTube, for example, includes creators of videos, viewers of videos, and advertisers. A multi-sided platform comes in many different shapes and can be a technology (e.g. Microsoft's PC operating system), a product (e.g. Nintendo's video game console), or a service (Uber's transportation service; see Illustration 7.4).

Multi-sided platforms often overlap with other business model patterns, as at Airbnb for instance with a peer-to-peer model or at Netflix, which primarily is a subscription model. Also, platforms are not an entirely new phenomena; malls, for example, are platforms that allow consumers and merchants to interact directly with each other and newspapers link subscribers with advertisers. As indicated by the name there are several platform sides, most commonly two, that perform different functions.[20] Uber's platform, for example, has car drivers on one side and passengers on the other (see Illustration 7.4) and Nintendo has game developers one side and gamers on the other: see Table 7.1 for further examples. In contrast, on a single-sided

Table 7.1 Platform providers

Side 1 (Customers/ Users)	Platform provider	Side 2 (Complementors)
Guests	**Accommodation rentals (e.g. Airbnb)**	Hosts
Passengers	**Personal transportation (e.g. Uber)**	Drivers
Searchers	**Search engines (e.g. Google)**	Advertisers
Shoppers	**Shopping malls**	Merchants
Readers	**Newspapers**	Advertisers
Gamers	**Game consoles (e.g. Nintendo)**	Game developers
Buyers	**On-line marketplaces (e.g. Amazon)**	Merchants
Users	**Smartphone operating systems (e.g. Apple)**	App developers

platform, like a telecommunication operator, all participants perform similar functions – making or receiving calls. Over time platforms often introduce new types of interactions and participants on the platform and thus new value creation. LinkedIn, for example, started out by linking professionals to recruiters, but is now a three-sided platform including advertisers and they have started to introduce corporations as a fourth side. Similarly, Amazon started as an online book-seller and today is a truly multi-sided platform including not only other goods, but various types of merchants, sellers and advertisers.

Network effects are intimately related to multi-sided platforms as the more participants, the better for everyone on the platform. For video games console platforms, for example, the gamers are on one side and favour consoles with a wide variety of games. This makes them dependent on the other side of the platform, the game developers, which in turn favour platforms with a large enough customer group to regain their development costs for the games. This shows that the value of the platform increases for both groups as more customers or gamers use it. It suggests a network effect as customers have a positive effect on the value of the product or platform for other customers (see Section 3.2.3). Web search companies like Google also rely on a similar pattern. For them the two sides of the platform involve consumer searchers on the one hand and advertisers that sponsor links on the search website on the other. The more searchers that use Google the better for advertisers and the better data for Google to refine search results and the better quality of the searches the better for consumers.

There are three important factors to consider for platform companies:

- *Platform distinctiveness and size.* As with any product and service a platform must have distinctive features in competition with other platforms to attract participants in the first place. Quality and quantity of content and services, reliability, speed, ease of use, trustworthiness, etc. are all important factors, but the size of the platform's network is also essential. The total potential market size has to be sufficiently large to begin with to make a platform valuable and network effects are crucial. This involves a chicken-and-egg problem: the platform attracts participants by being large, but to become large it needs to have enough participants. Besides offering superior services, one way to approach this problem and reach a critical mass network is to subsidise one or all of the sides of the platform. Uber, for example, often subsidises drivers when entering a new market. Another approach, common among technology platforms, is to offer open source software packages and services to attract software and hardware developers to join the platform (see Section 10.2.3 and Illustration 10.4). A third tactic is to piggy-back on another platform, like US PayPal initially did on eBay.
- *Choosing platform sides.* Deciding what sides to include and how many is sometimes obvious, as for Airbnb, but adding more sides may generate further growth and value as further network effects kick in. However, adding new sides may introduce competition between the platform and a participant or between platform participants or harm in other ways the relationship between participants. Amazon, for example, has other merchants selling the same goods that they sell themselves on the platform and hence, must carefully consider the balance between cooperation and competition. LinkedIn faces a challenge when inviting corporate participants in, as professionals may not want their current employers to be present when they may be searching for a new job. There is also a risk that participants allowed on the platform try to build their own platform and migrate users to it, like game producer Zynga tried to do with Facebook.[21]
- *Multi-homing costs.* A platform participant is 'multi-homing' when using more than one platform at the same time. For example, music fans that stream, download, store and share tunes on more than one music site are multi-homing. This may, however, incur transfer

costs for some platforms, like the inconvenience of transferring all photos from Instagram to Flickr on image-hosting service platforms. Multi-homing costs are thus costs of being affiliated with and maintaining presence on multiple platforms.[22] Platform companies aim for high multi-homing costs for platform participants to keep them generating value on their platform rather than on competing ones. It can thus be quite costly for participants to use multiple platforms. Besides costs of finding and joining more than one there may be costs for additional competences to operate on another platform and the time and effort it takes to use multiple platforms may also incur costs. For example, it's very expensive for an app and software developer to build simultaneously for both Apple and Android. There are also user switching costs of permanently leaving one platform for another. For example, for users to move from an Android to an iPhone smartphone platform there are transferring costs of moving apps, contacts, messages, files, etc. besides learning a different operating system. The size of multi-homing costs differs between platforms. Facebook, for example, has quite high multi-homing costs for users as transferring all data is extremely cumbersome, but Uber has very low multi-homing costs. A taxi driver can exist simultaneously on Uber, Lyft or any other service; she or he can even have two or multiple phones on at the same time, and riders can clearly switch.

Thinking differently Transient rather than sustainable advantage

Some question to what extent sustainable competitive advantage is possible at all in today's fast changing world.

Section 7.4.1 indicated that in hypercompetitive environments it may not be possible to form business strategies that provide for sustainable competitive advantage. Some argue that the era of sustainability in competitive advantage is over altogether as most industries today are too turbulent. It is claimed that competitors and customers have become too unpredictable to form any single long-term strategy. Companies with strong and long-lasting positions like IKEA are argued to be exceptions (see end-of-chapter case example). In this view then, it is a waste of effort to invest in sustainable advantages; better to invest in a series of *transient advantages.*[23]

In this new era managers thus need to constantly start new strategic initiatives and have a portfolio of several transient competitive advantages. They need to think of advantages as fleeting and going through a life cycle. Each competitive advantage has a launch stage that identifies an opportunity and raises resources to capitalise on it. Next is a ramp-up period in which the business is brought to scale, which leads into a phase of exploitation where market shares and profits are gained. Finally, there is a phase of inevitable erosion as competitors enter and weaken the advantage, which may force the company to exit. A company thus needs to catch new advantages continuously as old ones expire; freeing up resources from the old to invest in the new. Even if each advantage is temporary a portfolio of several different advantages would always provide an advantage somewhere. Hence, if managers continuously start strategic initiatives and build many transient advantages they could still get ahead of competitors.

Question

If IKEA chose not to build on sustainable competitive advantage, how could it build on many transient advantages?

Summary

- Business strategy is concerned with seeking competitive advantage in markets at the *business* rather than *corporate* level.
- Porter's *generic strategy* framework and the Strategy Clock define various *business strategies,* including *cost-leadership, differentiation, focus* and *hybrid* strategies.
- In *hypercompetitive* conditions sustainable competitive advantage is difficult to achieve and competitors need to carefully consider moves and counter-moves.
- *Game theory* encourages managers to get in the mind of competitors and think forwards and reason backwards about competitive as well as cooperative strategies.
- A *business model* describes the business logic of an enterprise including the domains of *value creation, value configuration* and *value capture.*
- *Multi-sided platforms* bring together two or more distinct, but interdependent groups of participants to create value on a platform.

Work assignments

✱ Denotes more advanced work assignments.
* Refers to a case study in the Text and Case edition.

7.1 What are the advantages and what are the disadvantages of applying principles of business strategy to public-sector or charity organisations? Illustrate your argument by reference to a public-sector organisation of your choice.

7.2 Using either Porter's generic strategies or the Strategy Clock, identify examples of organisations following strategies of differentiation, low cost or low price, and stuck-in-the-middle or hybrid. How successful are these strategies?

7.3✱ You have been appointed personal assistant to the chief executive of a major manufacturing firm, who has asked you to explain what is meant by 'differentiation' and why it is important. Write a brief report addressing these questions.

7.4✱ Choose a company that you are familiar with (e.g. Spotify, Netflix, Apple). How do the business model components (value creation, configuration and capture) apply to the company?

7.5✱ Drawing on Section 7.3.2 (on game theory) write a report for the chief executive of a business in a competitive market (e.g. pharmaceuticals* or Formula One*) explaining when and in what ways cooperation rather than direct competition might make sense.

Integrative assignment

7.6✱ Applying game theory ideas from Section 7.3.2 to issues of international strategy (Chapter 9), how might a domestic player discourage an overseas player from entering into its home market?

Recommended key readings

- The foundations of the discussions of generic competitive strategies are to be found in the writings of Michael Porter, which include *Competitive Strategy* (1980) and *Competitive Advantage* (1985), both published by Free Press.
- Hypercompetition, and the strategies associated with it, are explained in Richard D'Aveni, *Hypercompetitive Rivalries: Competing in Highly Dynamic Environments,* Free Press, 1995.
- There is much written on game theory but a good deal of it can be rather inaccessible to the lay reader. Exceptions are R. McCain, *Game Theory: a Non-technical Introduction to the Analysis of Strategy,* South Western, 2003; and P. Ghemawat, *Games Businesses Play,* MIT Press, 1998.
- An introduction to business models including a long list of various model types is included in O. Gassman, K. Frankenberger and M. Csik, *The Business Model Navigator,* Pearson, 2014. An early and much cited paper is C. Zott, R. Amit, R. and L. Massa, 'The business model: recent developments and future research', *Journal of Management,* vol. 7, no. 4 (2011), pp. 1019–42. For an evaluation of research on business models, see L. Massa, C.L. Tucci and A. Afuah, 'A critical assessment of business model research', *Academy of Management Annals,* vol. 11, no. 1 (2017), pp. 73–104.

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2. P. Conley, *Experience Curves as a Planning Tool,* available as a pamphlet from the Boston Consulting Group. See also A.C. Hax and N.S. Majluf, in R.G. Dyson (ed.), *Strategic Planning: Models and Analytical Techniques,* Wiley, 1990.
3. B. Sharp and J. Dawes, 'What is differentiation and how does it work?', *Journal of Marketing Management,* vol. 17, nos 7/8 (2001), pp. 739–59, reviews the relationship between differentiation and profitability.
4. C. Markides and C. Charitou, 'Competing with dual business models: a contingency approach', *Academy of Management Executive,* vol. 18, no. 3 (2004), pp. 22–36.
5. See D. Faulkner and C. Bowman, *The Essence of Competitive Strategy,* Prentice Hall, 1995.
6. For empirical support for the benefits of a hybrid strategy, see E. Pertusa-Ortega, J. Molina-Azorín and E. Claver-Cortés, 'Competitive strategies and firm performance: a comparative analysis of pure, hybrid and "stuck-in-the-middle" strategies in Spanish firms', *British Journal of Management,* vol. 20, no. 4 (2008), pp. 508–23.
7. R. D'Aveni, *Hypercompetition: Managing the Dynamics of Strategic Maneuvering,* Free Press, 1994.
8. This analysis is based on N. Kumar, 'Strategies to fight low cost rivals', *Harvard Business Review,* vol. 84, no. 12 (2006), pp. 104–13.
9. For readings on game theory, see B. Nalebuff and A. Brandenburger, *Co-opetition,* Profile Books, 1997; R. McCain, *Game Theory: A Non-technical Introduction to the Analysis of Strategy,* South Western, 2003; and, for a summary, S. Regan, 'Game theory perspective', in M. Jenkins and V. Ambrosini (eds), *Advanced Strategic Management: a Multi-Perspective Approach,* 2nd edn, Palgrave Macmillan, 2007, pp. 83–101. A recent practical example is in H. Lindstädt and J. Müller, 'Making game theory work for managers', *McKinsey Quarterly,* December (2009).
10. Useful books on collaborative strategies are Y. Doz and G. Hamel, *Alliance Advantage: The Art of Creating Value through Partnering,* Harvard Business School Press, 1998; *Creating Collaborative Advantage,* ed. Chris Huxham, Sage, 1996; and D. Faulkner, *Strategic Alliances: Cooperating to Compete,* McGraw-Hill, 1995.
11. For discussion about business models and how they differ from business strategy see: D.J. Teece, 'Business models, business strategy and innovation', *Long range planning,* vol., 43, no. 2 (2010), pp. 172–94; J. Magretta, Joan 'Why business models matter', *Harvard Business Review,* May (2002), pp. 86–92; C. Zott and A. Raphael, 'The fit between product market strategy and business model: implications for firm performance', *Strategic Management Journal,* vol. 29, no. 1 (2008), pp. 1–26 and H. Chesbrough and R.S. Rosenbloom, 'The role of