Search by Alexander Hughes

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Blue Ocean Strategy

Making competition irrelevant

Corporations have long engaged in head-to-head competition in search of sustained, profitable growth. They have fought for competitive advantage, battled over market share, and struggled for differentiation. Yet in today's overcrowded, and in many cases stagnant industries, competing in such a manner often leads to limited growth at the expense of one's competitors, a zero-sum game that leaves behind a bloody "red ocean", which is unlikely to create profitable growth in the future.

In such a market environment, the obvious question is raised: is it possible for an organization to succeed by using conventional strategies in an effort to gain more of an existing market share? Or would it be more advisable to adopt a new, non-conventional approach to market its products? The authors of the book "Blue Ocean Strategy" W. Chan Kim and Renée Mauborgne, claim the latter.

They believe that an organization can generate high growth and profits by developing "blue oceans" of uncontested market space ripe for growth. Such strategic moves—termed "value innovation"—create unprecedented leaps in buyers' value, unleashing new demand and thus rendering rivals obsolete.
Don't compete in an existing market space; create a new one through a service offering that presents a tremendous value to customers and makes competition irrelevant. Don't try to fight for an existing demand; build new demand. There are many global successful examples of this strategy, yet some that stand out are:

• Cirque du Soleil, a circus that was established in 1984, redesigned drastically its service offering targeting not the traditional circus goers, children, but grown-ups along with children.

• NTT Docomo, a telecom company in Japan, introduced, in 1999, the i-mode, a service that combined mobile phone mobility and services with the PC-internet, creating thus a new service offering and a new market space that led to tremendous growth that soon reached 45 mil subscribers (in 2005).
This Search issue features an article by two people who have studied the concept of Blue Ocean in depth: Kostas Axarloglou, Associate Professor of International Business and Strategy at ALBA Graduate Business School in Greece and Alexander Paufler, President and CEO of Mercedes-Benz in Thailand.

Researching tangible examples of the Blue Ocean Theory in the business world we have selected two exceptional cases: Mr. Jean Paul Gaillard, Chairman and CEO of Ethical Coffee Company, who spearheaded the development of the coffee capsule market and Mr. Miltiades Maroulides, Chairman of Quality Brands International, who successfully led the effort to introduce and subsequently grow Milner cheese in Greece. I hope you enjoy this edition of Search.

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Managing in Highly Competitive Industries: How to Make Competition Irrelevant

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"In today's economy you have to make bold moves. You can't just wimp along and do the same thing you did last year." **Mrs. Rose Marie Bravo (former CEO of Burberry) on economic downturns.[1]**

The Idea

The globalization of markets and the rise of new world players along with the deepest global economic recession after World War II have intensified competition in all markets and industries. Obviously, managers cannot do much to overturn these trends in the world economy. However, they are asked to take important decisions on how to successfully navigate their company/division through these tough times and increasingly competitive markets. Business as usual? - absolutely not. It's "business unusual"!

This is the time when managers should defy conventional wisdom and be creative. They should think both operationally and strategically. Operationally, they should maintain their company's bottom line and cash flows. But they should not necessarily do so by implementing drastic cost cutting measures across the board. They can also consider boosting their revenue and extending their market reach, not only to existing customers but also to non-customers through superior value offerings (thus restructuring the boundaries of their market).

Managing in a Highly Competitive Market Environment

The Competitive (Red Ocean) Approach

The traditional approach to management in a stagnant and intensively competitive environment is based on the presumption that revenues are doomed to shrink. As such, cost-cutting across the board is widely implemented in order to maintain a reasonable bottom line, healthy margins and sustainable cash flows[2]. This approach suffers from several flaws. For instance, it focuses too much on operational issues in an effort to preserve key financial data, prompting managers to quickly cut costs in areas such as elastic expenses (marketing, promotion, training, travel, consulting, etc.), which of course improve financial numbers in the short-run but unfortunately undermine the strategic position of the company for the long-term.
Moreover, managers following a traditional Porterian[3] approach to strategy, perceive product value offerings as static assuming that the market boundaries of their industry are stable, if not shrinking. As such, their market shares decline due to strong competition, and in order to avoid shrinkage in their revenue, they use some of their cost cutting to support lower prices in order to attract customers from competitors. However, this strategy brings retaliation from competitors and the result is a "price war" that ultimately leads to lower sales and profit margins.

The Blue Ocean Approach

The "business as usual" approach is too myopic since it assumes a static market environment. Instead, managers should reshape their value offerings in a creative way (adding some features and dropping others) in order to entice their customers to spend more and also to reach non-customers or potential customers. This approach was followed by a small Australian winery, J. Cassella, which entered the highly competitive and rather stagnant U.S. wine market with their Yellow Tail wine label in 2000. With an initial target of 25,000 cases in annual sales, Yellow Tail reached 500,000 cases within 6 months of its launch in the U.S. market. In 2003, Yellow Tail sales totaled 4.5million cases, and in 2005 that number rose to 7.5 million – quite an achievement when considering the fact that the combination of all French wine sales in the U.S. market totaled 11 million cases!

How did a small Australian winery manage such an immediate business success in a highly competitive and stagnant U.S. wine market? By simply reshaping Yellow Tail 's value offering, simplifying its packaging, making its taste appealing to non-wine drinkers (who were more likely to drink beer or soft drinks), offering Yellow Tail in only two varieties (a relatively simple selection from which to choose) and thus making Yellow Tail an every-day drink (as opposed to an occasional drink). Yellow Tail, through a creative value offering, appealed to non-wine drinkers and thus restructured the boundaries of the U.S. wine industry.

Recent experience indicates that companies adopt strategies of this nature in times of economic difficulty. For instance, in the fall of 2008, when the world economic recession was unfolding, consumers, in an effort to save money, showed a tendency to stay home more often.[4] Video game providers immediately redesigned some of their video games, initially targeted at younger age groups, in order to appeal to those adults who were staying at home more frequently and who perceived video games as a good entertainment alternative.

This strategy (introduced by Kim and Mauborgne as "Value Innovation Strategy" or "Blue Ocean Strategy")[5] reconstructs the industry's market boundaries by making value offerings attractive to non-customers (opening up new market space), thus leading to higher revenues (not necessarily at the expense of traditional competitors), reducing unnecessary costs, maintaining profitability and margins, and finally resulting in business success in a highly competitive and stagnant market environment.

Implementation

The Value Innovation strategy appears more suitable for consumer products and depends on innovatively reshaped value offerings that are appealing to loyal customers as well as to non-customers. This approach is the outcome of managerial innovation as opposed to technological innovation.

Managers can innovate their value offerings by,
> Preparing a sense of positive urgency by communicating to their team with empathy. Managers should ensure that 'angst' is not killing their team's creativity, but instead get the message across that the input of everybody is needed and appreciated.

> Asking their team to redesign the value offering of their product/service by dropping potential product attributes that are not essential for customers, reducing some other attributes and finally developing new product attributes

> Deciding on the above restructuring of their value offering after studying carefully the dramatic changes in consumers' behaviors and tastes. As an example, consumers, who were becoming health conscious, but remained passionate cheese-eaters, like the Greeks proved to be an excellent target audience for the new low-fat cheese Milner.

This strategic mindset results in reshaped and new value offerings that reconstruct traditional market boundaries, thus unveiling massive revenue sources, and depends on managerial innovation that reaches beyond existing customers.

1 - Fortune, December 8, 2008, pp. 70.
2 - In a recent McKinsey study (February 2009), 75% of managers that participated in a survey mentioned that they are taking cost cutting measures in response to the "global economic turmoil".
3 - Porter, M.E. (1980) Competitive Strategy, Free Press, New York, 1980
4 - See for instance the relevant Booz & Company study "Rethink Your Strategy: An Urgent Memo to Your CEO," in the fall of 2008.
5 - Blue Ocean Strategy - How To Create Uncontested Market Space And Make The Competition Irrelevant, W. Chan Kin and Renée Mauborgne, Harvard Business Press 2005

INTERVIEW

Jean-Paul Gaillard Founder and Chairman of Ethical Coffee Company SA

Former CEO of Nespresso

How to reinvent the industry and create a new market space...

... with the capsule coffee concept

WHAT WAS THE STATE OF THE COFFEE INDUSTRY BEFORE THE LAUNCH OF CAPSULE COFFEE? HOW QUICKLY AND BY HOW MUCH DID THE CAPSULE COFFEE SEGMENT GROW?

In 1988, Nespresso represented a tremendous opportunity in the capsule coffee market. It was a new market, entirely untapped. It offered a really unexplored potential for growth.
We launched Nespresso as a small scale operation and introduced the product in only one Swiss city. At that time, the coffee market was dominated by the traditional products with high volume but low value with slim profit margins and low growth potential.
When starting the Nespresso business, the entire operation had 15 employees and 456 thousand Swiss Francs turnover, while when 10 years later the business unit was employing 1,500 people and was bringing 400 million Swiss Francs in sales. But besides volume, Nespresso commanded a very healthy profit margin of approximately 38%.
We achieved this phenomenal growth despite the minimal initial investment, since the entire operation was self-financed. Right from the beginning, the business was fully independent from headquarters, physically and also in terms of business culture and management style.

We also implemented a number of innovations in order to manage costs more effectively: we dramatically lowered the cost per capsule by decreasing the quantity of aluminum per capsule. We raised the price of Nespresso by 45%. Our positioning was that Nespresso is the best coffee in the world, so the price had to match the offered value proposition. It had to be expensive! We believed that customers would embrace Nespresso not because it was cheap but due to its attributes.

WHAT TYPE OF CONSUMERS DID AND DOES CAPSULE COFFEE ATTRACT?

The new coffee concept captured an entirely new market of consumers. We attracted consumers who highly appreciated good coffee, usually found in upscale cafés. They were mostly affluent consumers who did not have the time to swing by a café and enjoy a good cup of coffee but would love to have this opportunity at home. Obviously, this target group would not mind paying a significant premium for the convenience of having their favorite coffee served in their living room!

In promoting this value proposition we were carefully focusing on our target group. Thus, we used direct mail, focusing on upscale neighborhoods. We also installed free of charge coffee machines in places which had a little sign on the coffee handle with the Nespresso brand. So in the beginning it was all pinpointing, no TV, no wide media, only targeted marketing, just like a rifle shot!

WHAT WAS NEW IN THE VALUE OFFERING OF CAPSULE COFFEE?

It was a new market, a different consumer. We were not cannibalizing the Nescafe products: the increase in sales for Nestle was all incremental!

Nespresso reached breakeven in 1994.

HOW DID YOU CONCEPTUALIZE THE IDEA OF ETHICAL COFFEE CAPSULES?

Seeing the success of Nespresso, I realized that there was a need to further segment the market. Thus, I proposed the idea to launch a "middle of market type of machine" and also a "lower end of market machine". However, Nestle did not wish to proceed with further market segmentation. Thus, in 2008, I pursued my idea to further segment the capsule coffee market by offering a cheaper, better, easy to buy and biodegradable product, through Ethical Coffee Company!

HOW DID YOU STRUCTURE YOUR BUSINESS STRATEGY?

Ethical Coffee Company's strategy is very simple. Instead of trying to create a new machine, I decided to adapt my product to make them compatible with Nespresso's machine. The idea was to create a biodegradable and environmentally friendly alternative to their capsules, thus creating an opportunity for Ethical Coffee Co.

At Ethical Coffee Co., we target the most affluent market, the €300,000 per year income individuals. We do not use any mass media advertising but we put all the money in the quality of the coffee, "what you buy is what you see."

WHAT WERE YOUR EXPECTATIONS CONCERNING THE POTENTIAL ACCEPTANCE OF YOUR BRAND BY THE MARKET?

Initially we did some market research and the acceptance of our offering was really good. To achieve higher coffee quality, and thus enhance customer satisfaction, we pay more for our coffee than our competition and we roast it for a longer time. Consumers immediately embraced the Ethical Coffee capsules since they were better products, biodegradable (which was particularly important in certain Northern countries) and priced about 20% lower. With such a value proposition, what could people ask for more? **Total Blue Ocean!**

WHAT WERE THE NEW PRODUCT ATTRIBUTES THAT MADE THE NEW VALUE OFFERING ATTRACTIVE TO CONSUMERS?

Our product has attributes that in general will not appeal to the show-off types eager to purchase the latest and most expensive fashion item. Our target group is people who don't need to show that they belong somewhere by owning a branded product. They just wish to enjoy a high quality cup of coffee.

HOW DID YOU MANAGE THE LAUNCH AND IMPLEMENTATION OF YOUR BRAND STRATEGY? WHAT WAS YOUR COMMERCIAL POLICY?

We don't use advertising; we do have a very discreet and up-market web presence. Quality and taste say it all. Paid advertising is much less efficient, 'word of mouth' is far more important, since the best way to try something new is by following the recommendation of somebody you really trust.

In addition, we use high-level merchandizing and distribute the product to upscale locations. We emphasize packaging, putting our product in modern boxes with an ecological flair since our target audience cares about the environment. We appeal to the responsibility of the consumer and the consumer is happy to fulfill, even to a small part, his or her duty to the planet.

In terms of pricing, we started low just to make a statement. Today we are priced at 20% less than Nespresso.

WHAT WAS THE MARKET RESPONSE TO THE NEW OFFERING?

The customers' response to our value offering was excellent. We expect to sell more than Nespresso in a number of countries next year. Our planned capacity for next year is above 1.2 billion capsules. For the year 2013, it will be over 2.5 billion capsules! It's indeed a high growth business.

"

Miltiades Maroulides Chairman of Quality Brands International

How to reinvent the industry and create a new market space...

...at Milner

HOW DID YOU CONCEPTUALIZE THE IDEA OF THE MILNER CHEESE?

I have always been actively interested in discovering new products, particularly any product that could have potential for the Greek market. At that time, I was traveling frequently to the Netherlands where the Milner product, a "low fat" yellow cheese, was successful. As I was interested in products suitable for a healthy diet, I quickly became familiar with the pleasant taste and "low fat" attributes of the cheese. I sensed an opportunity and decided with my company FrieslandCampina to invest in it and take responsibility of sales and marketing for the Greek marketplace. I felt that the general social trends in Greece of the time were creating a possibility for a successful launch of this new concept, provided it could receive an adequate amount of investment to advertise its taste and health benefits.

HOW DID YOU THINK AND STRUCTURE YOUR STRATEGY?

The Greek market was ready for such a product that focused on a "healthy lifestyle" approach. Our strategy was to emphasize the potential weight loss benefits of the cheese, but we realized very quickly that a strategy focusing on its good taste along with a healthy lifestyle would be more effective. We fine-tuned our strategic approach, putting more emphasis on 'healthy living' and a 'balanced diet', which finally proved to be much more effective. Our motto became "rich taste – less fat".

WHAT WERE YOUR EXPECTATIONS CONCERNING THE POTENTIAL ACCEPTANCE OF THE BRAND BY THE GREEK CONSUMER?

At the time, such a product-concept was practically non-existent in Greece. Using my insight as an entrepreneur, I decided to take the risk since I believed that only a substantial amount of promotional support, below and above the line, could make it a success. The initial idea of combining the pleasure of eating a rich and tasty cheese, all the while still promoting a healthy lifestyle, proved to be working. Extensive consumer research led us to slightly modify our initial position. Thus, we came up with the unique selling proposition of "rich taste, less fat".

HOW DID MILNER ATTRACT NON-CUSTOMERS (I.E. CUSTOMERS THAT TRADITIONALLY WERE NOT CONSUMING THE PRODUCT?)

There were many non-customers who, for various health and other reasons, were not consuming yellow cheese. But our unique selling proposition of "rich taste, less fat" attracted new consumers. The advertising strategy was geared not only to attract the attention of those consumers but we also emphasized Milner`s wonderful taste, which is quite surprising for a low-fat cheese. Thus, we established the idea of a healthy diet that included good cheese.

WHAT WAS THE MARKET RESPONSE TO THE NEW OFFERING? HOW DID THE SALES OF THE NEW PRODUCT GROW AND AT WHAT PACE?

Consumers reacted positively right from the beginning. Sales showed a substantial upward trend from year to year. Now we can say that the Milner brand is perhaps one of the 3 most well-known cheese brands in Greece, if not number 1.

More recently, sales in 2009 were 100 times higher than sales realized during the first year of Milner's already successful launch! By branding products in this product-category, Milner created a new market space in which it is still the leader even today.

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