Today’s Class
- Porter’s view of Internet in terms of his Five Forces competitive strategy model
  - Historical view from dot-com collapse
  - Lessons that remain valid today
  - Degree of change and opportunity of Internet
- Tapscott’s view that Porter underestimates magnitude of change due to Internet
  - Particular focus on partnerships and weakening of the dominant vertical corporation
  - Changes in business models

Internet Age
- What does Porter view as being the largest change brought on by the Internet?
  - Lower cost rather than increased capability
    - Lowering communication and transaction costs
- How does he view that change?
  - Perhaps most powerful tool for enhancing operational effectiveness, but not strategic
  - Complementary rather than disruptive
    - Success comes from using Internet to leverage existing strategy

Internet and Strategy
- Internet in terms of Porter’s Five Forces
  - Threat of Substitutes
  - Bargaining power of suppliers
  - Rivalry among competitors
  - Bargaining power of buyers
  - Barriers to Entry

Bargaining Power of Buyers
- Increases consumer power through better access to information
  - Web search, opinions and reviews
- Increases consumer choice through new channels and competitors
  - Parallel to stores, catalogs, ...
  - Larger geographic reach increases choice
- Good for consumers, bad for business?
  - Perhaps some good things such as increase in switching costs (e.g., online bill pay)

Substitutes and Barriers to Entry
- Increases opportunity for substitutes
  - E.g., online auctions vs. classified ads and flea markets
- Lowers barriers to entry
  - Reduced communication and coordination costs, lower capital requirements
  - Individuals or small groups can in principle reach large markets
- Except perhaps in markets where strong network or scale effect
  - Auctions a prime example
Inter-Firm Rivalry

- Increase in rivalry between firms
  - Internet a powerful tool for increasing operational efficiency
    - Necessary cost of business
    - Larger geographic regions increases competition
- But offers new opportunities to establish distinctive strategic positions
  - Providing defensible value proposition, such as closer integration with customers
    - E.g., FedEx, Amazon

Predictions in Early 2001

- Internet brands are hard to build
- Interbrand/Business Week Top 100 Global Brands in 2007 (06)
  - 20 (24) Google
  - 48 (47) eBay
  - 55 (55) Yahoo
  - 62 (65) Amazon
  - All above “recent” brand Starbucks at 88 (91)
- Most others long established and with much higher advertising and branding budgets

Predictions in 2001 (Cont’d)

- Lower advertising rates
  - Thus critical to focus on direct revenue from users rather than advertising revenue
- US Internet advertising ~$10B in 1H07
  - Up 27% over 1H06 (IAB/PwC study)
    - Down from 37% growth rate previous year
    - 41% keyword search ads (stable past few years)
    - 32% display ads
    - 17% classifieds
- Industry concentration
  - 70% top 10, 82% top 25, 91% top 50

Predictions in 2001 (Cont’d)

- First mover advantage
- In auction market has been critical
  - Ebay moved early and dominant in US and many countries
    - In Japan Yahoo dominates
- Elsewhere not so important
  - Google latecomer to search (e.g., AltaVista)
  - MySpace, Facebook latecomers to social networks
- Amazon in retail
  - Early mover, but strategy highly important

Tapscott’s “Response”

- Qualitatively new communications and coordination medium
  - Not just incremental or lower cost
  - Universal and powerful
    - E.g., MIT’s curriculum on the Web
- Internet changing business models in many industries
  - Partnerships are key, “b-webs”
    - Reaching outside the expertise of the corporation
    - Fundamentally tighter relationships from Internet

Example of Partnerships

- IBM, perhaps quintessential large vertical corporation
  - CRM software business, partner with Siebel systems despite own offerings
  - Operating systems business, endorse and support Linux open source
    - Replacing own AIX Unix system
    - Providing universal OS across all product lines
- More broadly contract manufacturing, outsourcing and integrated supply chain trends
Dog Days of Strategy
- Tapscott says that in 1997-2000
  - Get-rich quick mentality
    - “Internet changes everything” which is true was taken to mean “anything on the Internet will make money” which is not
  - But now that realize latter is false should not also discard former
    - Internet still changes everything
      - Both operationally and strategically
    - Good that Internet can expose flaws in old ways of doing business
      - Good for customers but also strategic opportunity

Six Reasons for a “New Economy”
- Tapscott argues
  - New infrastructure for wealth creation, new networks
  - New business models, network/web-based
  - New sources of value, knowledge outstripping both physical and monetary assets
  - New ownership of wealth, increased entrepreneurship
  - New educational models, colleges nodes of communication networks
  - New governance, through being more informed

Current Trends in Internet Age
- Mapping and earth imaging technologies
- Images and video
  - Mobile devices
- Community as authority
  - Modern search engines use link structure
- User created content and interaction
  - Blurring line of expert and amateur
- Copy protection failures
  - Market rejection, not just technology

Highlights Business Models
- Tapscott says traditionally strategy is not concerned with business models
  - An industry has one or a small number and they are relatively stable
- Internet has changed that
  - Can create opportunity/need for new models
- What is business model?
  - Drucker’s age old questions
    - Who is customer
    - What do they value
    - How make money (capture value)

Business Models
- How profitable revenue obtained for value
- Example of travelers checks
  - Information business
    - This person is good for the money
    - Letters of credit cumbersome, cash dangerous
  - New model
    - Customer pre-pays for safety and convenience
    - Firm makes money on “float”
  - Dominant form until global information networks (for ATM’s, credit card point of sale)

New Business Models
- Need for new ones relatively rare
  - New technological capabilities can drive need for new models but not often
- Can get trapped in a particular view of the business model
  - Nobody could see value of xerography because of cost structure
    - New model of lease plus click
  - What customer really values, how they prefer to pay, match to cost structure
  - Content industries: movies, music, news?
Porter & Tapscott
- Both view Internet as important for operational efficiencies
- Tapscott goes beyond to say qualitative changes that afford big opportunities
  - May require new business models and destabilize existing industries
- More informed customers
  - Good because increases focus on true value
  - But can lower margins through increased competition and lower switching costs

Opportunities Created by Internet
- Key to understand which of two categories
- Operational effectiveness
  - Quickly adopted by entire industry rather than providing advantage for one company
    - Improving products/services or lowering costs
- Strategic differentiation
  - Disruptive to the industry
    - Changing the structure
      - Digital goods: news, books, music, movies, tv
  - Enabling a strategy but not structural change
    - E.g., partnering as part of strategy

Strategic Value
- Companies with clear articulation of strategic use of Internet
  - Value they provide and relentless focus on it
    - Amazon
      - Selection and convenience
    - Ebay
      - Online community of sellers (at least early on)
    - Fedex, Amazon
      - Reaching out to the customer
    - IBM
      - Embracing open source and partnerships

Business on the Internet
- How is it different
  - Low transaction costs
  - Low (perhaps zero marginal) communication costs
  - Broad geographic markets (often global)
- How is it the same
  - Value for customers is key
    - Without artificial subsidies
    - Another channel
    - Need strategy not just first mover and eyeballs

Internet and Porter’s 5 Forces
- Increased rivalry: larger geographic regions
- Threat of Substitutes
- New substitutes: especially for digital goods
- Bargaining power of suppliers
- Rivalry among competitors
- Bargaining power of buyers
- Lower barriers to entry: lower cost and less expertise (not = success)
- Barriers to Entry
- Increased buyer power: better informed, often easier to switch

Next Time
- Digital goods
  - Britannica Blown to Bits, Capmag
  - Versioning Information Goods, Varian and Shapiro
- Final project proposals due at beginning of class