



NBA 600
Strategy and the Internet
Class 4, Wed 10/24

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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



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Internet Age

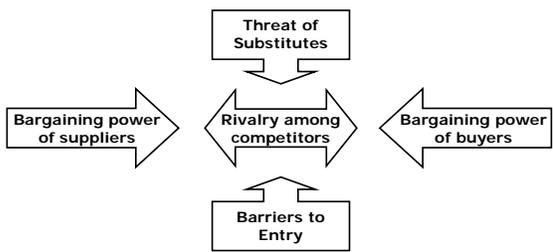
- What does Porter view as being the largest change brought on by the Internet?
 - Lower cost rather than increased capability
 - Lowering communication and transaction costs
- How does he view that change?
 - Perhaps most powerful tool for enhancing operational effectiveness, but not strategic
 - Complementary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



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Internet and Strategy

- Internet in terms of Porter's Five Forces




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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)



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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



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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

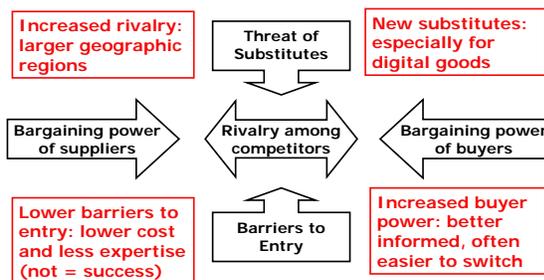
Strategic Value

- 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



Next Time

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