

**NBA 600: Day 3**  
**Strategy and the Internet**  
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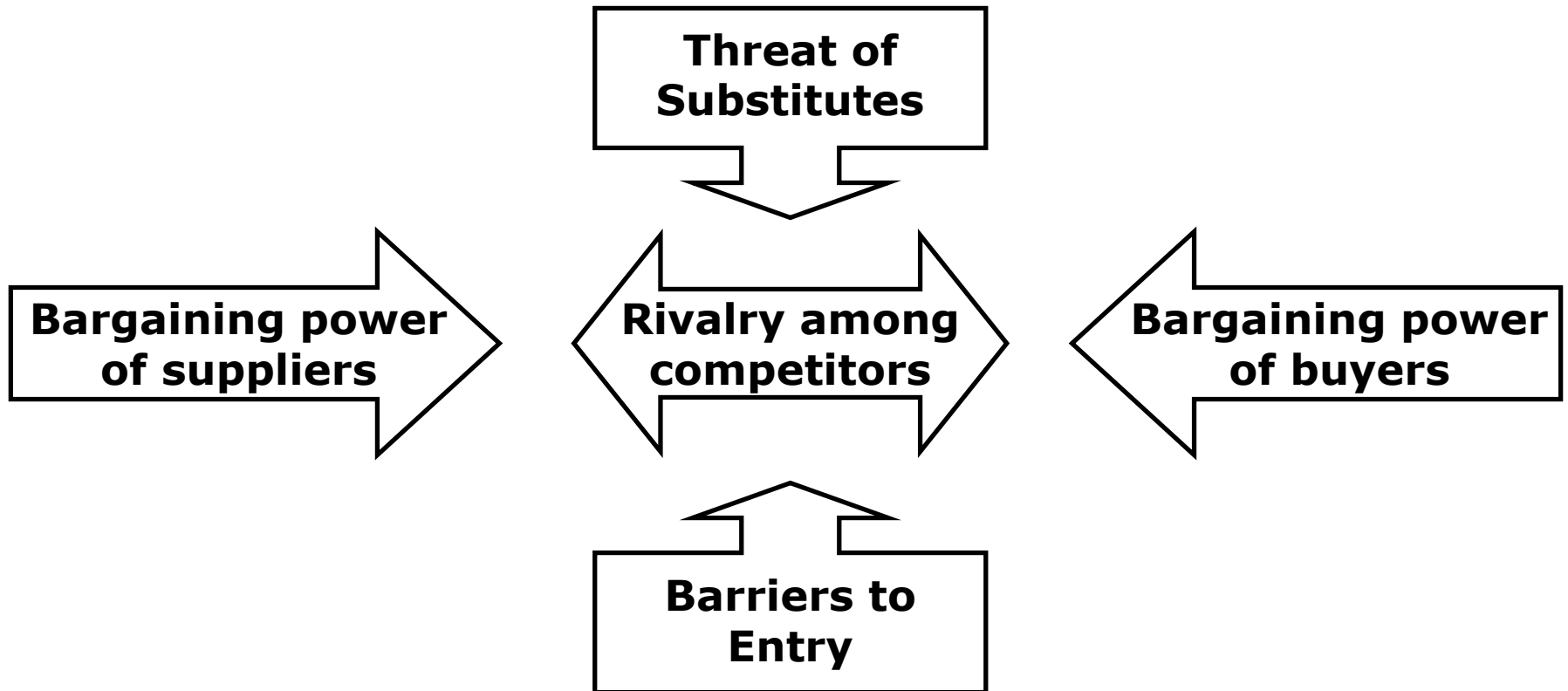


# Porter: Strategy and Internet

- Internet has been used as excuse to ignore strategy – yielded bad decisions
  - Forfeit proprietary advantage by rushing online
  - Focus on price rather than quality/features
- Winners will use Internet as complement to, not cannibal of, traditional competition
  - Simply another step in IT evolution, like object oriented programming or relational databases
- Internet not necessarily a blessing
  - Tends to dampen profitability and have leveling effect on business practices

# Porter: Strategic Landscape

- Sees strategy in terms of five forces



# Porter: Internet Trends

- Rising power of customers
  - Better informed, easier comparison/substitutes
  - Lower switching costs, less loyalty
- Real value not just gimmicks
  - Only evidenced by sustained profitability
- First-mover not an advantage
- Dis-intermediation not much of a threat
- Enhancing operational effectiveness
  - Decrease in communication/coordination costs
- Harder to sustain competitive advantage

# Porter: Impact of Internet

- Communication technology
  - Analogous to other new information technologies
- Mainly affecting industries that were constrained by high cost of communication or information gathering (search)
  - Has created some “new industries” such as online auctions and marketplaces
- What do you think?
  - Examples supporting or refuting

# Impact of the Internet

- Are precursors to online auctions fairly characterized as having primarily high communication and search costs?
  - Substitutes: classified ads, flea markets
- Sales of computers
  - E.g., Internet and success of Dell's model
- Retail
  - Amazon, communication and search costs?
- Others? Music?
- If accurate, how universal?

# Porter: No First Mover Advantage

- Right strategy not being first is important
  - E.g., EBay had with right strategy
  - Few substitutes
  - Did not compete on price
    - Brought value and stuck to charging for it
  - Strong network effect
    - Increasing benefits with more users
  - Keep costs down by not handling payment or fulfillment
    - Broker as the key value
- Where else this combination?

# First Mover

- Small investor financial services
  - Schwab, Etrade
- Retailing
  - Amazon, buy.com, Mercata, Webvan, etc.
  - Many early movers
    - Amazon had distinct strategy of achieving world's largest selection and greatest convenience
      - In certain segments, e.g., books, then audio/video, then electronics, ...
- Any network effects? Other “stickyness”?



# Network Effects

- What businesses have network effects?
  - Where value to user increases with more users
  - Attempts to create where are none
- When is it easy to charge for this value?
  - Email?
  - IM?
  - Gaming?
- What structures
  - Single provider
  - Single standard, multiple providers
  - Multiple incompatible standards

# Porter: Partnering Dangerous

- Internet technology makes it easier to partner and outsource
  - By improving communication and lowering costs
- But partnering and outsourcing cause companies to lose control of their business
- Examples
  - Retail leader Amazon
    - Built own infrastructure, sells to others
  - EBay initially outsourced all payment processing then bought PayPal

# Porter: Internet a Complement

- Internet initially viewed as cannibalizing existing businesses and channels
  - Should be viewed as complement
- For instance retailers
  - Walgreens finds online presence increases in-store sales
- How broadly true?
  - Music, movies, broadcast tv?
  - Online marketplaces, other retail segments?
- Related to communication and search costs?

# Porter: On Disintermediation

- Notion of Internet connecting producers and consumers directly
  - Eliminating brokers or other middlemen
- Most such businesses have failed
  - Except some online marketplaces with strong backing from dominant players in and industry
- Value of intermediaries
  - Expertise that counterparties may not have
  - Not addressed by just bringing people together
  - Cost of developing the expertise

# Porter: On Business Models

- Destructive way of thinking
  - Loose terminology, far cry from creating economic value
  - Invitation to faulty thinking and self delusion
- What matters is strategy
  - Critical to consider competitive forces and industry structure
- Notions of e-business and e-strategy similarly problematic
  - Encourage consideration of Internet in isolation rather than as complement to existing business

# Next Time

- Many of these issues arise in information technology more broadly, not just on the Internet
  - First mover
  - Value proposition
  - Business models
  - Technology strategy
  - Incremental vs. disruptive change
- Magretta article optional background
- For next week: read Carr article and letters