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BLUE OCEAN STRATEGY

How to Create Uncontested Market Space and Make the Competition Irrelevant

W. CHAN KIM | RENÉE MAUBORGNE

HARVARD BUSINESS REVIEW PRESS

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W. Chan Kim
Renée Mauborgne

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Help! My Ocean Is Turning Red

"HELP! MY OCEAN IS TURNING RED" captures the sentiment echoed so frequently by managers around the world. More and more people, whether managers of companies, heads of nonprofits, or leaders of government, find themselves up against an ocean of bloody competition and want to get out. Maybe your business is seeing its margins shrink. Maybe competition is getting more intense, driving commoditization of your offering and rising costs. Maybe you know you are going to announce that salary increases won't be coming. That's not a situation any one of us wants to face. And yet that's a situation that so many do face.

How can you address this challenge? The lessons, tools, and frameworks of *Blue Ocean Strategy* will help you to meet this challenge, whatever industry or economic sector you are in. It shows how you can get out of a red ocean of bloody competition and into a blue ocean of uncontested market space characterized by new demand and strong profitable growth.

When we wrote *Blue Ocean Strategy*, we used the metaphor of red and blue oceans because red oceans seemed to capture the reality that organizations increasingly face, while blue oceans

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captured the endless possibility that organizations could create, as industry history has borne out since its inception. Today, ten years later, more than 3.5 million copies of the book have been sold. It has become a bestseller across five continents. It has been translated into a record-breaking forty-three languages. And the term "blue ocean" has entered the business vernacular. Over four thousand articles and blog posts on blue ocean strategy have come out, with new articles continuing to appear daily worldwide.

The stories they contain are fascinating. There are articles from small business owners and individuals across the globe that discuss how the book fundamentally changed their perspectives on life and took their professional successes to all new levels. In other articles, executives speak of how blue ocean strategy provided the insight to take their business out of the red ocean and create all new demand. And yet other articles detail how government leaders have applied blue ocean strategy to achieve high impact at low cost with rapid execution in areas of social importance ranging from enhancing the quality of rural and urban lives, to strengthening internal and external securities, to breaking down ministerial and regional silos.[1]

As we have reached out to organizations that have applied the ideas and have worked with many directly since the publication of the original edition of *Blue Ocean Strategy*, we have learned a lot by watching the journey people have made with these ideas. Their most pressing questions in executing their blue ocean strategies are: How do we align all of our activities around our blue ocean strategy? What do we do when our blue ocean has become red? How can we avoid the strong gravitational pulls of "red ocean thinking"—we call them "red ocean traps"—even as we're pursuing a blue ocean strategy? These are the very questions that have motivated this expanded edition. In this new preface, we first outline what's new here. We then briefly summarize the key points that define and distinguish blue ocean strategy and address why we believe blue ocean strategy is more needed and relevant than ever before.

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What's New in This Expanded Edition?

This edition adds two new chapters and expands a third. Here are the highlights that show the gist of managers' key challenges and trouble spots and how we address them.

Alignment: What it means, why it's essential, and how to achieve it. A challenge we have been told about and have seen organizations struggle with is how they can align their system of activities—including a potential web of external partners—to create a sustainable blue ocean strategy in practice. Is there a simple yet comprehensive method to ensure that the key components of an organization, from value to profit to people, are aligned to support the strategic shift blue ocean strategy requires? This is important as companies all too often focus on certain dimensions of their organizations, paying less heed to other dimensions that must support the strategy to make it a sustainable success. In recognition, this expanded edition expressly explores the issue of alignment in the context of blue oceans. We present cases of success and failure in alignment to show not only how it is achieved in action but also how it can be missed. Chapter 9 addresses this alignment challenge.

Renewal: When and how to renew blue oceans over time. All companies rise and fall based on the strategic moves they make or don't make. A challenge organizations face is how to renew blue oceans over time, as every blue ocean will eventually be imitated and turn red. Understanding the process of renewal is key to ensure that the creation of blue oceans is not a one-off occurrence but can be institutionalized as a repeatable process in an organization. In this expanded edition, we tackle how leaders can turn the creation of blue oceans from a static achievement into a dynamic renewal process both at the business level and at the corporate level for multibusiness firms. Here we articulate the dynamic renewal process for creating sustainable economic performance both for a single business that has reached for a blue ocean and for a multibusiness organization that has to balance both red and blue

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ocean initiatives. In so doing, we also highlight the complementary roles that red and blue ocean strategies play in managing a company's profit for today while building strong growth and brand value for tomorrow. Chapter 10 addresses this renewal challenge.

Red Ocean Traps: What they are and why they should be avoided. Lastly, we show the ten most-common red ocean traps we see companies fall into as they put blue ocean strategy into practice. These traps keep companies anchored in the red even as they attempt to set sail for the blue. Addressing these traps is critical to getting people's framing right to create blue oceans. With the proper grasp of the concept, one can avoid the traps and apply its associated tools and methodologies with accuracy so that right strategic actions can be produced to sail toward clear blue waters. Chapter 11 addresses the challenge of red ocean traps.

What Are the Main Points of Distinction?

The aim of blue ocean strategy was straightforward: to allow any organization—large or small, new or incumbent—to step up to the challenge of creating blue oceans in an opportunity-maximizing, risk-minimizing way. The book challenges several long-held beliefs in the field of strategy. If we had to zoom in on five key points of distinction that make the book worthy of consideration, it would be these.

Competition should not occupy the center of strategic thinking. Too many companies let competition drive their strategies. What blue ocean strategy brings to life, however, is that this focus on the competition all too often keeps companies anchored in the red ocean. It puts the competition, not the customer, at the core of strategy. As a result, companies' time and attention get focused on benchmarking rivals and responding to their strategic moves, rather than on understanding how to deliver a leap in value to buyers—which is *not* the same thing.

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Blue ocean strategy breaks from the stranglehold of competition. At the book's core is the notion of a shift from competing to creating new market space and hence making the competition irrelevant. We first made this point all the way back in 1997 in "Value Innovation," the first of our series of *Harvard Business Review* articles that form the basis of this book.[2] We observed that companies that break away from the competition pay little heed to matching or beating rivals or carving out a favorable competitive position. Their aim was not to outperform competitors. It was to offer a quantum leap in value that made the competition irrelevant. The focus on innovating at value, not positioning against competitors, drives companies to challenge all the factors an industry competes on and to not assume that just because the competition is doing something means it is connected to buyer value.

In this way, blue ocean strategy makes sense of the strategic paradox many organizations face: the more they focus on coping with the competition, and striving to match and beat their advantages, the more they ironically tend to look like the competition. To which blue ocean strategy would respond, stop looking to the competition. Value-innovate and let the competition worry about you.

Industry structure is not given; it can be shaped. The field of strategy has long assumed that industry structure is given. With industry structure seen as fixed, firms are driven to build their strategies based on it. And so strategy, as is commonly practiced, tees off with industry analysis—think five forces or its distant precursor SWOT analysis—where strategy is about matching a company's strengths and weaknesses to the opportunities and threats present in the existing industry. Here strategy perforce becomes a zero-sum game where one company's gain is another company's loss, as firms are bound by existing market space.

Blue ocean strategy, by contrast, shows how strategy can shape structure in an organization's favor to create new market space. It is based on the view that market boundaries and industry structure are not given and can be reconstructed by the actions and

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beliefs of industry players. As industry history shows, new market spaces are being created every day and are fluid with imagination. Buyers prove that as they trade across alternative industries, refusing to see or be constrained by the cognitive boundaries industries impose upon themselves. And firms prove that as they invent and reinvent industries, collapsing, altering, and going beyond existing market boundaries to create all new demand. In this way, strategy moves from a zero-sum to a non-zero-sum game, and even an unattractive industry can be made attractive by companies' conscious efforts. Which is to say a red ocean need not stay red. This brings us to a third point of distinction.

Strategic creativity can be unlocked systematically. Ever since Schumpeter's vision of the lone and creative entrepreneur, innovation and creativity have been essentially viewed as a black box, unknowable and random.[3] Not surprisingly, with innovation and creativity viewed as such, the field of strategy predominantly focused on how to compete in established markets, creating an arsenal of analytic tools and frameworks to skillfully achieve this. But is creativity a black box? When it comes to artistic creativity or scientific breakthroughs—think Gaudi's majestic art or Marie Curie's radium discovery—the answer may be yes. But is the same true for strategic creativity that drives value innovation that opens up new market spaces? Think Ford's Model T in autos, Starbucks in coffee, or Salesforce.com in CRM software. Our research suggests no. It revealed common strategic patterns behind the successful creation of blue oceans. These patterns allowed us to develop underlying analytic frameworks, tools, and methodologies to systematically link innovation to value and reconstruct industry boundaries in an opportunity-maximizing, risk-minimizing way. While luck, of course, will always play a role, as it does with all strategies, these tools—like the strategy canvas, four actions framework, and six paths to reconstruct market boundaries—bring structure to what has historically been an unstructured problem in strategy, informing organizations' ability to create blue oceans systematically.

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Execution can be built into strategy formulation. Blue ocean strategy is a strategy that joins analytics with the human dimension of organizations. It recognizes and pays respect to the importance of aligning people's minds and hearts with a new strategy so that at the level of the individual, people embrace it of their own accord and willingly go beyond compulsory execution to voluntary cooperation in carrying it out. To achieve this, blue ocean strategy does not separate strategy formulation from execution. Although this disconnect may be a hallmark of most companies' practices, our research shows it is also a hallmark of slow and questionable implementation and mechanical follow-through at best. Instead, blue ocean strategy builds execution into strategy from the start through the practice of fair process in the making and rolling out of strategy.

Over twenty-five years, we have written about the impact of fair process on the quality of execution of decisions through many academic and managerial publications.[4] As blue ocean strategy brings to light, fair process prepares the ground for implementation by invoking the most fundamental basis of action: trust, commitment, and the voluntary cooperation of people deep in an organization. Commitment, trust, and voluntary cooperation are not merely attitudes or behaviors. They are intangible capital. They allow companies to stand apart in the speed, quality, and consistency of their execution and to implement strategic shifts fast at low cost.

A step-by-step model for creating strategy. The field of strategy has produced a wealth of knowledge on the content of strategy. However, what it has remained virtually silent on is the key question of how to create a strategy to begin with. Of course, we know how to produce plans. But, as we all know, the planning process doesn't produce strategy. In short, we don't have a theory of strategy creation.

While there are many theories that explain why companies fail and succeed, they are mostly descriptive, not prescriptive. There is no step-by-step model that prescribes in specific terms how

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companies can formulate and execute their strategies to obtain high performance. Such a model is introduced here in the context of blue oceans to show how companies can avoid *market-competing* traps and achieve *market-creating* innovations. The strategy-making framework we advance here is built based on our strategy practices in the field with many companies over the last two decades. It helps managers in action as they formulate strategies that are innovative and wealth creating.

Why Is Blue Ocean Strategy of Rising Importance?

When we first published *Blue Ocean Strategy* in 2005, there were many forces driving the importance of creating blue oceans. At the top of the list was the fact that competition in existing industries was getting fiercer and pressure on costs and profits was increasing. These forces have not gone away. On the contrary, they've only intensified. But beyond these, over the last ten years, several new global trends have kicked in with a speed few could have ever imagined when our book first came out. We believe that these trends make creating blue oceans an even more important strategic task in the future. Here, we highlight some of them without intending to be comprehensive in their coverage or content.

A rising call for creative new solutions. Just look at a broad swath of industries that matter fundamentally to who we are: health care, K-12 education, universities, financial services, energy, the environment, and the government, where demands are high yet money and budgets are low. In the last ten years, every one of these industries has been seriously called to task. There has hardly been a time in history when the strategies of players in so many industries and sectors needed fundamental rethinking. To remain relevant, all these players are increasingly being called on to reimagine their strategies to achieve innovative value at lower costs.

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The rising influence and use of public megaphones. It's hard to believe, but only ten years back, organizations still controlled the majority of information disseminated to the public on their products, services, and offerings. Today that's history. The surge in social network sites, blogs, micro-blogs, video-sharing services, user-driven content, and internet ratings that have become close to ubiquitous around the globe have shifted the power and credibility of voice from organizations to individuals. To not be a victim but a victor in this new reality, your offering needs to stand out as never before. That's what gets people tweeting your praises not your faults; giving five-star ratings; clicking the thumbs up, not the thumbs down; listing your offering as a favorite on social media sites; and even being inspired to positively blog about your offering. You can't hide or overmarket your me-too offering when virtually everyone has a global megaphone.

A locational shift in future demand and growth. When people around the world talk about the growth markets of the future, Europe and Japan hardly get a mention these days. Even the United States, though still the largest economy in the world, has increasingly taken a backseat in terms of future growth prospects. Instead, today China and India, not to mention countries like Brazil, top the list. In the space of the last ten years, all three have joined the ranks of the top-ten largest economies. However, this new breed of big economies is not like the large economies the world has historically looked to and counted on to consume the goods and services produced by the world. Unlike the relatively high per capita incomes enjoyed in the world's developed economies, these big emerging markets are the product of very low, though rising, per capita income for very large populations of citizens. This makes the importance of affordable low cost in organizations' offerings more critical than before. But do not be fooled. Low cost alone is not enough. For these same large populations also have increasing access to the internet, mobile phones, and TVs with global channels that raise their sophistication, demands,

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and desires. To capture these increasingly savvy customers' imaginations and wallets, both differentiation and low cost are needed.

The rising speed and easiness of becoming a global player. Historically, the major global companies came predominantly from the United States, Europe, and Japan. But that is changing at incredible speed. Over the last fifteen years, the number of companies from China in the *Fortune* Global 500 has increased more than twenty times, the number of Indian companies has increased roughly eightfold, and the number of Latin American companies more than doubled. This suggests that these big emerging economies do not only represent oceans of new demand to unlock. They also represent oceans of new potential competitors with global ambitions no different than Toyota's, General Electric's, or Unilever's.

But it's not just companies from these big emerging markets that are on the rise. That is just a tip of the iceberg of what the future portends. In the last decade, there has been a fundamental shift in the cost and ease of becoming a global player from virtually any corner of the globe. This is a trend no organization can afford to downplay. Consider just a handful of facts. With the ease and low cost of setting up a website, any business can have a global storefront; today people from anywhere can raise money via crowdfunding; with services like Gmail and Skype, communication costs have dropped significantly; trust in transactions can now be rapidly and economically achieved by using services like PayPal, while companies like Alibaba.com make searching for and vetting suppliers across the world relatively quick and easy. And there are search engines—the equivalent of global business directories—that are free. As for global advertising, there is Twitter and YouTube where you can market your offerings for free. With the low entry cost to become a global player, new players from virtually all corners of the world can increasingly participate in global markets and offer their wares or services. While, of course, these trends don't mitigate all barriers to becoming a global player, they certainly

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intensify global competition. To stand apart in these overcrowded markets, you need to be creative through value innovation.

Today both the challenges and opportunities we all face are great. By providing methodologies and tools organizations can apply to pursue blue oceans, it is our hope that these ideas will help to meet these challenges and create opportunities so we all come out better. Strategy, after all, is not just for business. It is for everyone—the arts, nonprofits, the public sector, even countries. We invite you to join us on this journey. One thing is clear: the world needs blue oceans.

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Preface to the Original Edition

THIS IS A BOOK about friendship, about loyalty, about believing in one another. It was because of that friendship, and that belief, that we set out on the journey to explore the ideas in this book and eventually came to write it.

We met twenty years ago in a classroom—one the professor, the other the student. And we have worked together ever since, often seeing ourselves along the journey as two wet rats in a drain. This book is not the victory of an idea but of a friendship that we have found more meaningful than any idea in the world of business. It has made our lives rich and our worlds more beautiful. We were not alone.

No journey is easy; no friendship is filled only with laughter. But we were excited every day of that journey because we were on a mission to learn and improve. We believe passionately in the ideas in this book. These ideas are not for those whose ambition in life is to get by or merely to survive. That was never an interest of ours. If you can be satisfied with that, do not read on. But if you want to make a difference, to create a company that builds a future where customers, employees, shareholders, and society win, read on. We are not saying it is easy, but it is worthwhile.

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Our research confirms that there are no permanently excellent companies, just as there are no permanently excellent industries. As we have found on our own tumbling road, we all, like corporations, do smart things and less-than-smart things. To improve the quality of our success we need to study what we did that made a positive difference and understand how to replicate it systematically. That is what we call making smart strategic moves, and we have found that the strategic move that matters centrally is to create blue oceans.

Blue ocean strategy challenges companies to break out of the red ocean of bloody competition by creating uncontested market space that makes the competition irrelevant. Instead of dividing up existing—and often shrinking—demand and benchmarking competitors, blue ocean strategy is about growing demand and breaking away from the competition. This book not only challenges companies but also shows them how to achieve this. We first introduce a set of analytical tools and frameworks that show you how to systematically act on this challenge, and, second, we elaborate the principles that define and separate blue ocean strategy from competition-based strategic thought.

Our aim is to make the formulation and execution of blue ocean strategy as systematic and actionable as competing in the red waters of known market space. Only then can companies step up to the challenge of creating blue oceans in a smart and responsible way that is both opportunity maximizing and risk minimizing. No company—large or small, incumbent or new entrant—can afford to be a riverboat gambler. And no company should.

The contents of this book are based on more than fifteen years of research, data stretching back more than a hundred years, and a series of *Harvard Business Review* articles as well as academic articles on various dimensions of this topic. The ideas, tools, and frameworks presented here have been further tested and refined over the years in corporate practice in Europe, the United States, and Asia. This book builds on and extends this work by providing a narrative arc that draws these ideas together to offer a

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unified framework. This framework addresses not only the analytic aspects behind the creation of blue ocean strategy but also the all-important human aspects of how to bring an organization and its people on this journey with a willingness to execute these ideas in action. Here, understanding how to build trust and commitment, as well as an understanding of the importance of intellectual and emotional recognition, are highlighted and brought to the core of strategy.

Blue ocean opportunities have been out there. As they have been explored, the market universe has been expanding. This expansion, we believe, is the root of growth. Yet poor understanding exists both in theory and in practice as to how to systematically create and capture blue oceans. We invite you to read this book to learn how you can be a driver of this expansion in the future.

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During the course of our research, we have met with corporate executives and public officers around the world who generously gave us their time and insight, greatly shaping the ideas in this book. We are grateful to them. Among many private and public initiatives for putting our ideas into practice, the Value Innovation Program (VIP) Center at Samsung Electronics and the Value Innovation Action Tank (VIAT) in Singapore for the country's government and private sectors have been major sources of inspiration and learning. In particular, Jong-Yong Yun at Samsung Electronics and all the Permanent Secretaries of Singapore Government have been valued partners. Warm thanks also to the members of the Value Innovation Network (VIN), a global community of practice on the Value Innovation family of concepts—especially to those we were unable to mention here.

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on theory-based movies, a new pedagogical approach that aims to complement conventional paper cases for classroom discussions. We are grateful for all our faculty who have taught the BOS theory, simulation, and study courses in the MBA, EMBA, and executive programs of INSEAD. Among the faculty not already cited are professors Andrew Shipilov, Fares Boulous, Guoli Chen, Ji Mi, Michael Shiel, James Costantini, and Lauren Mathys. Fellows and researchers in addition to those already cited who deserve special mention are Zunaira Munir, Oh Young Koo, Katrina Ling, Michael Olenick, Zoë McKay, Jee-eun Lee, Olivier Henry, and Kinga Petro. We appreciate their support in creating blue ocean strategy teaching materials, industry studies, and apps. We would also like to thank the Beaucourt Foundation for its generous financial support of our research.

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PART ONE

Blue Ocean Strategy

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CHAPTER 1

Creating Blue Oceans

A ONETIME ACCORDION PLAYER, stilt walker, and fire eater, Guy Laliberté is now CEO of Cirque du Soleil, one of Canada's largest cultural exports. Cirque's productions to date have been seen by some 150 million people in over three hundred cities around the world. In less than twenty years since its creation, Cirque du Soleil achieved a level of revenues that took Ringling Bros. and Barnum & Bailey—the once global champion of the circus industry—more than one hundred years to attain.

What makes this growth all the more remarkable is that it was not achieved in an attractive industry but rather in a declining industry in which traditional strategic analysis pointed to limited potential for growth. Supplier power on the part of star performers was strong. So was buyer power. Alternative forms of entertainment—ranging from various kinds of urban live entertainment to sporting events to home entertainment—cast an increasingly long shadow. Children cried out for video games rather than a visit to the traveling circus. Partially as a result, the industry was suffering from steadily decreasing audiences and,

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in turn, declining revenue and profits. There was also increasing sentiment against the use of animals in circuses by animal rights groups. Ringling Bros. and Barnum & Bailey had long set the standard, and competing smaller circuses essentially followed with scaled-down versions. From the perspective of competition-based strategy, then, the circus industry appeared unattractive.

Another compelling aspect of Cirque du Soleil's success is that it did not win by taking customers from the already shrinking circus industry, which historically catered to children. Cirque du Soleil did not compete with Ringling Bros. and Barnum & Bailey. Instead it created uncontested new market space that made the competition irrelevant. It appealed to a whole new group of customers: adults and corporate clients prepared to pay a price several times as great as traditional circuses for an unprecedented entertainment experience. Significantly, one of the first Cirque productions was titled "We Reinvent the Circus."

New Market Space

Cirque du Soleil succeeded because it realized that to win in the future, companies must stop competing with each other. The only way to beat the competition is to stop *trying* to beat the competition.

To understand what Cirque du Soleil achieved, imagine a market universe composed of two sorts of oceans: red oceans and blue oceans. Red oceans represent all the industries in existence today. This is the known market space. Blue oceans denote all the industries *not* in existence today. This is the unknown market space.

In the red oceans, industry boundaries are defined and accepted, and the competitive rules of the game are known.[1] Here, companies try to outperform their rivals to grab a greater share of existing demand. As the market space gets crowded, prospects for profits and growth are reduced. Products become commodities, and cutthroat competition turns the red ocean bloody.

Blue oceans, in contrast, are defined by untapped market space, demand creation, and the opportunity for highly profitable growth.

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Although some blue oceans are created well beyond existing industry boundaries, most are created from within red oceans by expanding existing industry boundaries, as Cirque du Soleil did. In blue oceans, competition is irrelevant because the rules of the game are waiting to be set.

It will always be important to swim successfully in the red ocean by outcompeting rivals. Red oceans will always matter and will always be a fact of business life. But with supply exceeding demand in more industries, competing for a share of contracting markets, while necessary, will not be sufficient to sustain high performance.[2] Companies need to go beyond competing. To seize new profit and growth opportunities, they also need to create blue oceans.

Unfortunately, blue oceans are largely uncharted. The dominant focus of strategy work over the past thirty years has been on competition-based red ocean strategies.[3] The result has been a fairly good understanding of how to compete skillfully in red waters, from analyzing the underlying economic structure of an existing industry, to choosing a strategic position of low cost or differentiation or focus, to benchmarking the competition. Some discussions around blue oceans exist.[4] However, there is little practical guidance on how to create them. Without analytic frameworks to create blue oceans and principles to effectively manage risk, creating blue oceans has remained wishful thinking that is seen as too risky for managers to pursue as strategy. This book provides practical frameworks and analytics for the systematic pursuit and capture of blue oceans.

The Continuing Creation of Blue Oceans

Although the term *blue oceans* is new, their existence is not. They are a feature of business life, past and present. Look back 120 years and ask yourself, How many of today's industries were then unknown? The answer: many industries as basic as automobiles, music recording, aviation, petrochemicals, health care,

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and management consulting were unheard of or had just begun to emerge at that time. Now turn the clock back only forty years. Again, a plethora of multibillion- and trillion-dollar industries jumps out—e-commerce; cell phones; laptops, routers, switches, and networking devices; gas-fired electricity plants; biotechnology; discount retail; express package delivery; minivans; snowboards; and coffee bars to name a few. Just four decades ago, none of these industries existed in a meaningful way.

Now put the clock forward twenty years—or perhaps fifty years—and ask yourself how many now unknown industries will likely exist then. If history is any predictor of the future, again the answer is many of them.

The reality is that industries never stand still. They continuously evolve. Operations improve, markets expand, and players come and go. History teaches us that we have a hugely underestimated capacity to create new industries and re-create existing ones. In fact, the more than half-century-old Standard Industrial Classification (SIC) system published by the US Census was replaced in 1997 by the North America Industry Classification Standard (NAICS) system. The new system expanded the ten SIC industry sectors into twenty sectors to reflect the emerging realities of new industry territories.[5] The services sector under the old system, for example, is now expanded into seven business sectors ranging from information to health care and social assistance.[6] Given that these systems are designed for standardization and continuity, such a replacement shows how significant the expansion of blue oceans has been.

Yet the overriding focus of strategic thinking has been on competition-based red ocean strategies. Part of the explanation for this is that corporate strategy is heavily influenced by its roots in military strategy. The very language of strategy is deeply imbued with military references—chief executive "officers" in "headquarters," "troops" on the "front lines." Described this way, strategy is about confronting an opponent and fighting over a given piece of land that is both limited and constant.[7] Unlike war, however, the

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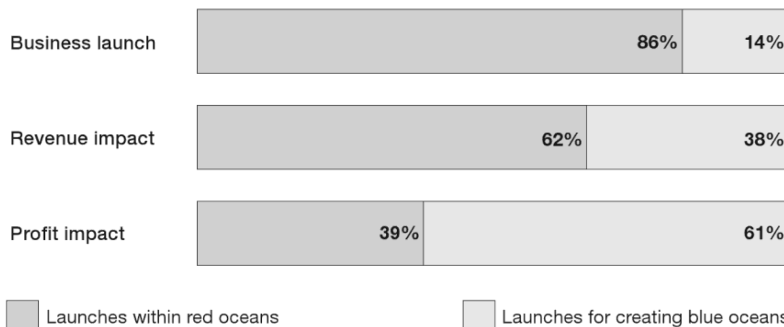
history of industry shows us that the market universe has never been constant; rather, blue oceans have continuously been created over time. To focus on the red ocean is therefore to accept the key constraining factors of war—limited terrain and the need to beat an enemy to succeed—and to deny the distinctive strength of the business world: the capacity to create new market space that is uncontested.

The Impact of Creating Blue Oceans

We set out to quantify the impact of creating blue oceans on a company's growth in both revenues and profits in a study of the business launches of 108 companies (see figure 1-1). We found that 86 percent of the launches were line extensions, that is, incremental improvements within the red ocean of existing market space. Yet they accounted for only 62 percent of total revenues and a mere 39 percent of total profits. The remaining 14 percent of the launches were aimed at creating blue oceans. They generated 38 percent of total revenues and 61 percent of total profits. Given that business launches included the total investments made for creating red and

FIGURE 1-1

The profit and growth consequences of creating blue oceans



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blue oceans (regardless of their subsequent revenue and profit consequences, including failures), the performance benefits of creating blue waters are evident. Although we don't have data on the hit rate of success of red and blue ocean initiatives, the global performance differences between them are marked.

The Rising Imperative of Creating Blue Oceans

There are several driving forces behind a rising imperative to create blue oceans. Accelerated technological advances have substantially improved industrial productivity and have allowed suppliers to produce an unprecedented array of products and services. The result is that in increasing numbers of industries, supply exceeds demand.[8] The trend toward globalization compounds the situation. As trade barriers between nations and regions are dismantled and as information on products and prices becomes instantly and globally available, niche markets and havens for monopoly continue to disappear.[9] While supply is on the rise as global competition intensifies, there is no clear evidence of an increase in demand relative to supply, and statistics even point to declining populations in many developed markets.[10]

The result has been accelerated commoditization of products and services, increasing price wars, and shrinking profit margins. Industrywide studies on major American brands confirm this trend.[11] They reveal that for major product and service categories, brands are generally becoming more similar, and as they are becoming more similar, people increasingly select based on price.[12] People no longer insist, as in the past, that their laundry detergent be Tide. Nor will they necessarily stick to Colgate when Crest is on sale, and vice versa. In overcrowded industries, differentiating brands becomes harder in both economic upturns and downturns.

All this suggests that the business environment in which most strategy and management approaches of the twentieth

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century evolved is increasingly disappearing. As red oceans become increasingly bloody, management will need to be more concerned with blue oceans than the current cohort of managers is accustomed to.

From Company and Industry to Strategic Move

How can a company break out of the red ocean of bloody competition? How can it create a blue ocean? Is there a systematic approach to achieve this and thereby sustain high performance?

In search of an answer, our initial step was to define the basic unit of analysis for our research. To understand the roots of high performance, the business literature typically uses the company as the basic unit of analysis. People have marveled at how companies attain strong, profitable growth with a distinguished set of strategic, operational, and organizational characteristics. Our question, however, was this: Are there *lasting* "excellent" or "visionary" companies that continuously outperform the market and repeatedly create blue oceans?

Consider, for example, *In Search of Excellence* and *Built to Last*.[13] The bestselling book *In Search of Excellence* was published some thirty years ago. Yet within two years of its publication, a number of the companies surveyed began to slip into oblivion: Atari, Chesebrough-Pond's, Data General, Fluor, National Semiconductor. As documented in *Managing on the Edge*, two-thirds of the identified model firms in the book had fallen from their perches as industry leaders within five years of its publication.[14]

The book *Built to Last* continued in the same footsteps. It sought out the "successful habits of visionary companies" that had a long-running track record of superior performance. To avoid the pitfalls of *In Search of Excellence*, however, the survey period of *Built to Last* was expanded to the entire life span of the companies, while its analysis was limited to firms more than forty years old. *Built to Last* also became a bestseller.

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But again, upon closer examination, deficiencies in some of the visionary companies spotlighted in *Built to Last* have come to light. As illustrated in the book *Creative Destruction*, much of the success attributed to some of the model companies in *Built to Last* was the result of industry-sector performance rather than the companies themselves.[15] For example, Hewlett-Packard (HP) met the criteria of *Built to Last* by outperforming the market over the long term. In reality, while HP outperformed the market, so did the entire computer-hardware industry. What's more, HP did not even outperform the competition within the industry. Through this and other examples, *Creative Destruction* questioned whether "visionary" companies that continuously outperform the market have ever existed.

If there is no perpetually high-performing company and if the same company can be brilliant at one moment and wrongheaded at another, it appears that the company is not the appropriate unit of analysis in exploring the roots of high performance and blue oceans.

As discussed earlier, history also shows that industries are constantly being created and expanded over time and that industry conditions and boundaries are not given; individual actors can shape them. Companies need not compete head-on in a given industry space; Cirque du Soleil created a new market space in the entertainment sector, generating strong, profitable growth as a result. It appears, then, that neither the company nor the industry is the best unit of analysis in studying the roots of profitable growth.

Consistent with this observation, our study shows that the strategic move, and not the company or the industry, is the right unit of analysis for explaining the creation of blue oceans and sustained high performance. A strategic move is the set of managerial actions and decisions involved in making a major market-creating business offering. Compaq, for example, was acquired by Hewlett-Packard in 2001 and ceased to be an independent company. As a result, many people might judge the company as unsuccessful.

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This does not, however, invalidate the blue ocean strategic moves that Compaq made in creating the server industry. These strategic moves not only were a part of the company's powerful comeback in the mid-1990s but also unlocked a new multibillion-dollar market space in computing.

Appendix A, "A Sketch of the Historical Pattern of Blue Ocean Creation," provides a snapshot overview of the history of three representative US industries drawn from our database: the auto industry—how we get to work; the computer industry—what we use at work; and the cinema industry—where we go after work for enjoyment. As shown in appendix A, no perpetually excellent company or industry is found. But a striking commonality appears to exist across strategic moves that have created blue oceans and have led to new trajectories of strong, profitable growth.

The strategic moves we discuss—moves that have delivered products and services that opened and captured new market space, with a significant leap in demand—contain great stories of profitable growth as well as thought-provoking tales of missed opportunities by companies stuck in red oceans. We built our study around these strategic moves to understand the pattern by which blue oceans are created and high performance achieved. The original research for our book covered more than one hundred fifty strategic moves made from 1880 to 2000 in more than thirty industries. In conducting our research, we closely examined the relevant business players in each event. Industries ranged from hotels, the cinema, retail, airlines, energy, computers, broadcasting, and construction to automobiles and steel. We analyzed not only winning business players who created blue oceans but also their less successful competitors.

Both within a given strategic move and across strategic moves, we searched for convergence among the group that created blue oceans and within less successful players caught in the red ocean. We also searched for divergence across these two groups. In so doing, we tried to discover the common factors leading to the creation of blue oceans and the key differences separating those

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winners from the mere survivors and the losers adrift in the red ocean.

Our analysis of more than thirty industries confirms that neither industry nor organizational characteristics explain the distinction between the two groups. In assessing industry, organizational, and strategic variables, we found that the creation and capturing of blue oceans were achieved by small and large companies, by young and old managers, by companies in attractive and unattractive industries, by new entrants and established incumbents, by private and public companies, by companies in B2B and B2C industries, and by companies of diverse national origins.

Our analysis failed to find any perpetually excellent company or industry. What we did find behind the seemingly idiosyncratic success stories, however, was a consistent and common pattern across strategic moves for creating and capturing blue oceans. Whether it was Ford in 1908 with the Model T; GM in 1924 with cars styled to appeal to the emotions; CNN in 1980 with real-time news 24/7; or Compaq Servers, Starbucks, Southwest Airlines, Cirque du Soleil, or more recently Salesforce.com—or, for that matter, any of the other blue ocean moves in our study—the approach to strategy in creating blue oceans was consistent across time regardless of industry. Our research also reached out to embrace famous strategic moves in public-sector turnarounds. Here we found a strikingly similar pattern. As our database and research have continued to expand and grow over the last ten years since the first edition of our book was published, we have continued to observe similar patterns.

Value Innovation: The Cornerstone of Blue Ocean Strategy

What consistently separated winners from losers in creating blue oceans was their approach to strategy. The companies caught in the red ocean followed a conventional approach, racing to beat the

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competition by building a defensible position within the existing industry order.[16] The creators of blue oceans, surprisingly, didn't use the competition as their benchmark.[17] Instead, they followed a different strategic logic that we call *value innovation*. Value innovation is the cornerstone of blue ocean strategy. We call it value innovation because instead of focusing on beating the competition, you focus on making the competition irrelevant by creating a leap in value for buyers and your company, thereby opening up new and uncontested market space.

Value innovation places equal emphasis on value and innovation. Value without innovation tends to focus on *value creation* on an incremental scale, something that improves value but is not sufficient to make you stand out in the marketplace.[18] *Innovation* without value tends to be technology-driven, market pioneering, or futuristic, often shooting beyond what buyers are ready to accept and pay for.[19] In this sense, it is important to distinguish between value innovation as opposed to technology innovation and market pioneering. Our study shows that what separates winners from losers in creating blue oceans is neither bleeding-edge technology nor "timing for market entry." Sometimes these exist; more often, however, they do not. Value innovation occurs only when companies align innovation with utility, price, and cost positions. If they fail to anchor innovation with value in this way, technology innovators and market pioneers often lay the eggs that other companies hatch.

Value innovation is a new way of thinking about and executing strategy that results in the creation of a blue ocean and a break from the competition. Importantly, value innovation defies one of the most commonly accepted dogmas of competition-based strategy: the value-cost trade-off.[20] It is conventionally believed that companies can either create greater value to customers at a higher cost or create reasonable value at a lower cost. Here strategy is seen as making a choice between differentiation and low cost.[21] In contrast, those that seek to create blue oceans pursue differentiation and low cost simultaneously.

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Let's return to the example of Cirque du Soleil. Pursuing differentiation and low cost simultaneously lies at the heart of the entertainment experience it created. At the time of its debut, other circuses focused on benchmarking one another and maximizing their share of already shrinking demand by tweaking traditional circus acts. This included trying to secure more famous clowns and lion tamers, a strategy that raised circuses' cost structure without substantially altering the circus experience. The result was rising costs without rising revenues, and a downward spiral of overall circus demand.

These efforts were made irrelevant when Cirque du Soleil appeared. Neither an ordinary circus nor a classic theater production, Cirque du Soleil paid no heed to what the competition did. Instead of following the conventional logic of outpacing the competition by offering a better solution to the given problem—creating a circus with even greater fun and thrills—it sought to offer people the fun and thrill of the circus *and* the intellectual sophistication and artistic richness of the theater at the same time; hence, it redefined the problem itself.[22] By breaking the market boundaries of theater and circus, Cirque du Soleil gained a new understanding not only of circus customers but also of circus noncustomers: adult theater customers.

This led to a whole new circus concept that broke the value-cost trade-off and created a blue ocean of new market space. Consider the differences. Whereas other circuses focused on offering animal shows, hiring star performers, presenting multiple show arenas in the form of three rings, and pushing aisle concession sales, Cirque du Soleil did away with all these factors. These factors had long been taken for granted in the traditional circus industry, which never questioned their ongoing relevance. However, there was increasing public discomfort with the use of animals. Moreover, animal acts were one of the most expensive elements, including not only the cost of the animals but also their training, medical care, housing, insurance, and transportation.

Similarly, while the circus industry focused on featuring stars, in the mind of the public the so-called stars of the circus were

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trivial next to movie stars or famous singers. Again, they were a high-cost component carrying little sway with spectators. Gone, too, are three-ring venues. Not only did this arrangement create angst among spectators as they rapidly switched their gaze from one ring to the other, but it also increased the number of performers needed, with obvious cost implications. And although aisle concession sales appeared to be a good way to generate revenue, in practice the high prices discouraged audiences from making purchases and made them feel they were being taken for a ride.

The lasting allure of the traditional circus came down to only three key factors: the tent, the clowns, and the classic acrobatic acts such as the wheelman and short stunts. So Cirque du Soleil kept the clowns but shifted their humor from slapstick to a more enchanting, sophisticated style. It glamorized the tent, an element that, ironically, many circuses had begun to forfeit in favor of rented venues. Seeing that this unique venue symbolically captured the magic of the circus, Cirque du Soleil designed the classic symbol of the circus with a glorious external finish and a higher level of comfort, making its tents reminiscent of the grand epic circuses. Gone were the sawdust and hard benches. Acrobats and other thrilling acts are retained, but their roles were reduced and made more elegant by the addition of artistic flair and intellectual wonder to the acts.

By looking across the market boundary of theater, Cirque du Soleil also offered new noncircus factors, such as a story line and, with it, intellectual richness, artistic music and dance, and multiple productions. These factors, entirely new creations for the circus industry, are drawn from the alternative live entertainment industry of theater.

Unlike traditional circus shows having a series of unrelated acts, for example, Cirque du Soleil creations have a theme and story line, somewhat resembling a theater performance. Although the theme is vague (and intentionally so), it brings harmony and an intellectual element to the show—without limiting the potential for acts. Cirque also borrows ideas from Broadway shows. For

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example, it features multiple productions rather than the traditional "one for all" shows. As with Broadway shows, too, each Cirque du Soleil show has an original score and assorted music, which drives the visual performance, lighting, and timing of the acts rather than the other way around. The shows feature abstract and spiritual dance, an idea derived from theater and ballet. By introducing these new factors into its offering, Cirque du Soleil has created more sophisticated shows.

Moreover, by injecting the concept of multiple productions and by giving people a reason to come to the circus more frequently, Cirque du Soleil dramatically increased demand.

In short, Cirque du Soleil offers the best of both circus and theater, and it has eliminated or reduced everything else. By offering unprecedented utility, Cirque du Soleil created a blue ocean and invented a new form of live entertainment, one that is markedly different from both traditional circus and theater. At the same time, by eliminating many of the most costly elements of the circus, it dramatically reduced its cost structure, achieving both differentiation and low cost. Cirque strategically priced its tickets against those of the theater, lifting the price point of the circus industry by several multiples while still pricing its productions to capture the mass of adult customers, who were used to theater prices.

Figure 1-2 depicts the differentiation–low cost dynamics underpinning value innovation.

As shown in figure 1-2, the creation of blue oceans is about driving costs down while simultaneously driving value up for buyers. This is how a leap in value for both the company and its buyers is achieved. Because buyer value comes from the utility and price that the company offers to buyers and because the value to the company is generated from price and its cost structure, value innovation is achieved only when the system of the company's utility, price, and cost activities is properly aligned. To sustain value innovation, however, people working for and with the company need to support it. For value innovation to be a sustainable strategy, then, the alignment of the company's utility, price, cost, and people is

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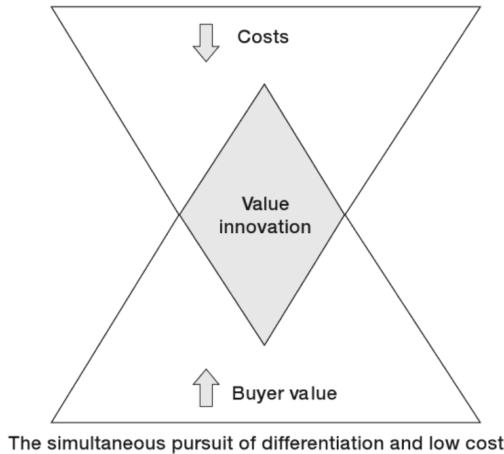
FIGURE 1-2

Value innovation: The cornerstone of blue ocean strategy

Value innovation is created in the region where a company's actions favorably affect both its cost structure and its value proposition to buyers. Cost savings are made by eliminating and reducing the factors an industry competes on. Buyer value is lifted by raising and creating elements the industry has never offered. Over time, costs are reduced further as scale economies kick in due to the high sales volumes that superior value generates.



The simultaneous pursuit of differentiation and low cost

needed. It is this whole-system approach that makes value innovation *strategic* rather than *operational* or *functional*.

In contrast, innovations such as production innovations can be achieved at the subsystem level without impacting the company's overall strategy. An innovation in the production process, for example, may lower a company's cost structure to reinforce its existing cost leadership strategy without changing the utility proposition of its offering. Although innovations of this sort may help to secure and even lift a company's position in the existing market space, such a subsystem approach will rarely create a blue ocean of new market space.

In this sense, value innovation is a distinct concept. It is about *strategy* that embraces the entire system of a company's activities.[23] Value innovation requires companies to orient the whole

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system toward achieving a *leap* in value for both buyers *and* themselves. Absent such an integral approach, innovation will remain divided from the core of strategy.[24] Figure 1-3 outlines the key defining features of red and blue ocean strategies.

Competition-based red ocean strategy assumes that an industry's structural conditions are given and that firms are forced to compete within them, an assumption based on what the academics call the *structuralist* view, or *environmental determinism*.[25] In contrast, value innovation is based on the view that market boundaries and industry structure are not given and can be reconstructed by the actions and beliefs of industry players. We call this the *reconstructionist* view. In the red ocean, differentiation raises costs because firms compete with the same best-practice rule. Here, the strategic choices for firms are to pursue either differentiation or low cost. In the reconstructionist world, however, the strategic aim is to create new best-practice rules by breaking the existing value-cost trade-off and thereby creating a blue ocean. (For more discussions on this, see appendix B, "Value Innovation: A Reconstructionist View of Strategy.")

FIGURE 1-3

Red ocean versus blue ocean strategy

Red ocean strategy	Blue ocean strategy
Compete in existing market space.	Create uncontested market space.
Beat the competition.	Make the competition irrelevant.
Exploit existing demand.	Create and capture new demand.
Make the value-cost trade-off.	Break the value-cost trade-off.
Align the whole system of a firm's activities with its strategic choice of differentiation *or* low cost.	Align the whole system of a firm's activities in pursuit of differentiation *and* low cost.

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Cirque du Soleil broke the best practice rule of the circus industry, achieving both differentiation and low cost by reconstructing elements across existing industry boundaries. Is Cirque du Soleil, then, really a circus, with all that it eliminated, reduced, raised, and created? Or is it theater? And if it is theater, then what genre—a Broadway show, an opera, a ballet? It is not clear. Cirque du Soleil reconstructed elements across these alternatives, and, in the end, it is simultaneously a little of all of them and none of any of them in their entirety. It created a blue ocean of new, uncontested market space.

Formulating and Executing Blue Ocean Strategy

Although economic conditions indicate the rising imperative of blue oceans, there is a general belief that the odds of success are lower when companies venture beyond existing industry space.[26] The issue is how to succeed in blue oceans. How can companies systematically maximize the opportunities while simultaneously minimizing the risks of formulating and executing blue ocean strategy? If you lack an understanding of the opportunity-maximizing and risk-minimizing principles driving the creation and capture of blue oceans, the odds will be lengthened against your blue ocean initiative.

Of course, there is no such thing as a riskless strategy.[27] Strategy will always involve both opportunity and risk, be it a red ocean or a blue ocean initiative. But at present the playing field is dramatically unbalanced in favor of tools and analytical frameworks to succeed in red oceans. As long as this remains true, red oceans will continue to dominate companies' strategic agendas even as the business imperative for creating blue oceans takes on new urgency. Perhaps this explains why, despite prior calls for companies to go beyond existing industry space, companies have yet to act seriously on these recommendations.

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This book seeks to address this imbalance by laying out a methodology to support our thesis. Here we present the principles and analytical frameworks to succeed in blue oceans.

Chapter 2 introduces the analytical tools and frameworks that are essential for creating and capturing blue oceans. Although supplementary tools are introduced in other chapters as needed, these basic analytics are used throughout the book. Companies can make proactive changes in industry or market fundamentals through the purposeful application of these blue ocean tools and frameworks, which are grounded in the issues of both opportunity and risk. Subsequent chapters introduce the principles that drive the successful formulation and implementation of blue ocean strategy and explain how they, along with the analytics, are applied in action. There are four guiding principles for the successful formulation of blue ocean strategy. Chapters 3 through 6 address these in turn. Chapter 3 identifies the paths by which you can systematically create uncontested market space across diverse industry domains, hence attenuating *search risk*. It teaches you how to make the competition irrelevant by looking across the six conventional boundaries of competition to open up commercially important blue oceans. The six paths focus on looking across alternative industries, across strategic groups, across buyer groups, across complementary product and service offerings, across the functional-emotional orientation of an industry, and even across time.

Chapter 4 shows how to design a company's strategic planning process to go beyond incremental improvements to create value innovations. It presents an alternative to the existing strategic planning process, which is often criticized as a number-crunching exercise that keeps companies locked into making incremental improvements. This principle tackles *planning risk*. Using a visualizing approach that drives you to focus on the big picture rather than to be submerged in numbers and jargon, this chapter proposes a four-step process whereby you can build a strategy that creates and captures blue ocean opportunities.

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Chapter 5 shows how to maximize the size of a blue ocean. To create the greatest market of new demand, this chapter challenges the conventional practice of aiming for finer segmentation to better meet existing customer preferences. This practice often results in increasingly small target markets. Instead, this chapter shows you how to aggregate demand, not by focusing on the differences that separate customers but by building on the powerful commonalities across noncustomers to maximize the size of the blue ocean being created and new demand being unlocked, hence minimizing *scale risk*.

Chapter 6 lays out the design of a strategy that allows you not only to provide a leap in value to the mass of buyers but also to build a viable business model to produce and maintain profitable growth. It shows you how to ensure that your company builds a business model that profits from the blue ocean it is creating. It addresses *business model risk*. The chapter articulates the sequence in which you should create a strategy to ensure that both you and your customers win as you create new business terrain. Such a strategy follows the sequence of utility, price, cost, and adoption.

Chapters 7 through 10 turn to the principles that drive effective execution of blue ocean strategy. Specifically, chapter 7 introduces what we call *tipping point leadership*. Tipping point leadership shows managers how to mobilize an organization to overcome the key organizational hurdles that block the implementation of a blue ocean strategy. It deals with *organizational risk*. It lays out how leaders and managers alike can surmount the cognitive, resource, motivational, and political hurdles in spite of limited time and resources in executing blue ocean strategy.

Chapter 8 argues for the integration of execution into strategy making, thus motivating people to act on and execute a blue ocean strategy in a sustained way deep in an organization. This chapter introduces what we call *fair process*. Because a blue ocean strategy perforce represents a departure from the status quo, this chapter shows how fair process facilitates both strategy making

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and execution by mobilizing people for the voluntary cooperation needed to execute blue ocean strategy. It deals with *management risk* associated with people's attitudes and behaviors. People here include both internal and external stakeholders who work for and with an organization.

Chapter 9, new in this expanded edition, tackles the overarching concept of alignment and the critical role it plays for the sustainability of a strategy. Here we provide a simple but comprehensive framework to fully develop and align an organization's three strategy propositions from value to profit to people. It deals with how to manage *sustainability risk*. While this chapter starts with the importance of alignment for the sustainability of any strategy, whether blue or red, it shows how alignment works in the context of blue ocean strategy by illustrating and contrasting cases of success and failure.

Chapter 10 addresses the issue of renewal and the dynamic aspects of blue ocean strategy at both the business level and the corporate level for multibusiness firms. Here we expand our original discussion on how to manage and monitor your individual business and your corporate portfolio over time to achieve continuing high performance. In so doing, this chapter deals with the important issue of managing *renewal risk* so that the blue ocean strategy process can become institutionalized rather than a one-off occurrence. This chapter shows how red and blue ocean strategies fit together and complement each other in the context of managing a corporate portfolio over time.

Figure 1-4 highlights the eight principles driving the successful formulation and execution of blue ocean strategy and the risks that these principles attenuate.

Lastly, we end our expanded edition with a new chapter where we zoom in on the ten most-common red ocean traps that keep organizations anchored in the red even as they set out to sail into the blue. Here we expressly address how to avoid each of these traps. We highlight and set straight the misconceptions behind these red ocean traps to ensure people have not only the right

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FIGURE 1-4

The eight principles of blue ocean strategy

Formulation principles	Risk factor each principle attenuates
Reconstruct market boundaries.	↓ Search risk
Focus on the big picture, not the numbers.	↓ Planning risk
Reach beyond existing demand.	↓ Scale risk
Get the strategic sequence right.	↓ Business model risk

Execution principles	Risk factor each principle attenuates
Overcome key organizational hurdles.	↓ Organizational risk
Build execution into strategy.	↓ Management risk
Align the value, profit, and people propositions.	↓ Sustainability risk
Renew blue oceans.	↓ Renewal risk

framing but also the proper application of blue ocean strategy tools to achieve success in practice.

Let's now move on to chapter 2, where we lay out the basic analytical tools and frameworks that will be used throughout this book in the formulation and execution of blue ocean strategy.

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CHAPTER 2

Analytical Tools and Frameworks

WE SPENT A DECADE DEVELOPING a set of analytical tools and frameworks in an attempt to make the formulation and execution of blue ocean strategy as systematic and actionable as competing in the red waters of known market space. These analytics fill a central void in the field of strategy, which has developed an impressive array of tools and frameworks to compete in red oceans, such as the five forces for analyzing existing industry conditions and three generic strategies, but has remained virtually silent on practical tools to excel in blue oceans. Instead, executives have received calls to be brave and entrepreneurial, to learn from failure, and to seek out revolutionaries. Although thought provoking, these are not substitutes for analytics to navigate successfully in blue waters. In the absence of analytics, executives cannot be expected to act on the call to break out of existing competition. Effective blue ocean strategy should be about risk minimization and not risk taking.

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To address this imbalance, we studied companies around the world and developed practical methodologies in the quest of blue oceans. We then applied and tested these tools and frameworks in action by working with companies in their pursuit of blue oceans, enriching and refining them in the process. The tools and frameworks presented here are used throughout this book as we discuss the eight principles of formulating and executing blue ocean strategy. As a brief introduction to these tools and frameworks, let's look at one industry—the US wine industry—to see how these tools can be applied in practice in the creation of blue oceans.

Here is the situation. Up until 2000, the United States had the third largest aggregate consumption of wine worldwide with an estimated $20 billion in sales. Yet despite its size, the industry was intensely competitive. California wines dominated the domestic market, capturing two-thirds of all US wine sales. These wines competed head-to-head with imported wines from France, Italy, and Spain and New World wines from countries such as Chile, Australia, and Argentina, which increasingly targeted the US market. At the same time, the supply of wines was increasing from Oregon, Washington, and New York State and with newly mature vineyard plantings in California, the number of wines was exploding. Yet the US consumer base had essentially remained stagnant. The United States remained stuck at thirty-first place in world per capita wine consumption.

The intense competition fueled ongoing industry consolidation. The top eight companies produced more than 75 percent of the wine in the United States, and the estimated one thousand six hundred other wineries at the time produced the remaining 25 percent. The dominance of a few key players allowed them to leverage distributors to gain shelf space and put millions of dollars into above-the-line marketing budgets. A simultaneous consolidation of retailers and distributors was also underway across the United States, something that raised their bargaining power against the plethora of wine makers. Titanic battles were being fought for retail and distribution space. It is no surprise that weak,

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poorly run companies were increasingly being swept aside. Downward pressure on wine prices had set in.

In short, the US wine industry in 2000 faced intense competition, mounting price pressure, increasing bargaining power on the part of retail and distribution channels, and flat demand despite overwhelming choice. Following conventional strategic thinking, the industry was hardly attractive. For strategists, the critical question is, How do you break out of this red ocean of bloody competition to make the competition irrelevant? How do you open up and capture a blue ocean of uncontested market space?

To address these questions, we turn to the *strategy canvas*, an analytic framework that is central to value innovation and the creation of blue oceans.

The Strategy Canvas

The strategy canvas is both a diagnostic and an action framework for building a compelling blue ocean strategy. It serves two purposes. First, it captures the current state of play in the known market space. This allows you to understand where the competition is currently investing, the factors the industry currently competes on in products, service, and delivery, and what customers receive from the existing competitive offerings on the market. Figure 2-1 captures all this information in graphic form. The horizontal axis captures the range of factors the industry competes on and invests in.

In the case of the US wine industry, it had long competed on seven principal factors:

- Price per bottle of wine
- An elite, refined image in packaging, including labels announcing the wine medals won and the use of esoteric enological terminology to stress the art and science of wine making

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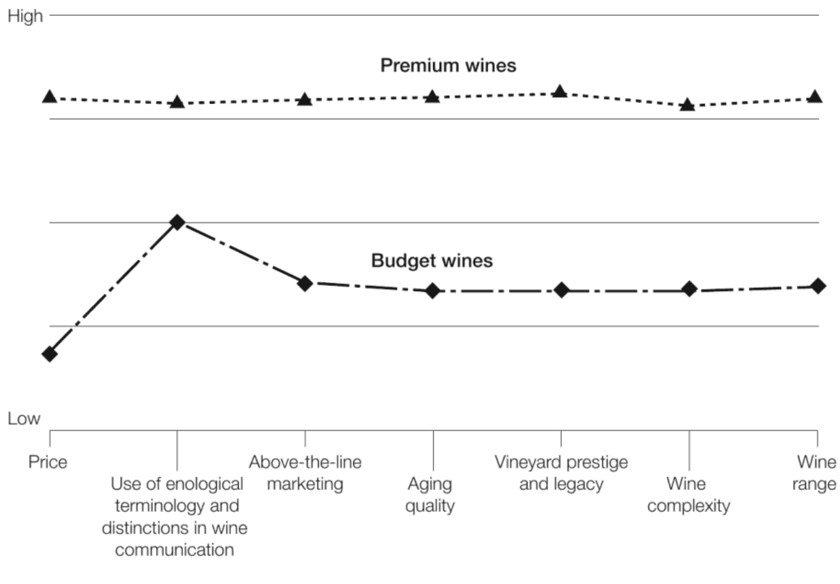
FIGURE 2-1

The strategy canvas of the US wine industry in the late 1990s



- Above-the-line marketing to raise consumer awareness in a crowded market and to encourage distributors and retailers to give prominence to a particular wine house
- Aging quality of wine
- The prestige of a wine's vineyard and its legacy (hence the appellations of estates and chateaux and references to the historic age of the establishment)
- The complexity and sophistication of a wine's taste, including such things as tannins and oak
- A diverse range of wines to cover all varieties of grapes and consumer preferences from Chardonnay to Merlot, and so on

These factors were viewed as key to the promotion of wine as a unique beverage for the informed wine drinker, worthy of special occasions.

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That was essentially the underlying structure of the US wine industry from the market perspective. Now let's turn to the vertical axis of the strategy canvas, which captures the offering level that buyers receive across all these key competing factors. A high score means that a company offers buyers more, and hence invests more, in that factor. In the case of price, a higher score indicates a higher price. We can now plot the current offering of wineries across all these factors to understand wineries' strategic profiles, or value curves. The *value curve*, the basic component of the strategy canvas, is a graphic depiction of a company's relative performance across its industry's factors of competition.

Figure 2-1 shows that, although more than one thousand six hundred wineries participated in the US wine industry in 2000, from the buyer's point of view there was enormous convergence in their value curves. Despite the plethora of competitors, when premium brand wines are plotted on the strategy canvas, we discover that from the market point of view all of them essentially have the same strategic profile. They offered a high price and presented a high level of offering across all the key competing factors. Their strategic profile follows a classic differentiation strategy. From the market point of view, however, they are all different in the same way. On the other hand, budget wines also have the same essential strategic profile. Their price was low, as was their offering across all the key competing factors. These are classic low-cost players. Moreover, the value curves of premium and low-cost wines share the same basic shape. The two strategic groups' strategies marched in lockstep, but at different altitudes of offering level.

To set a company on a strong, profitable growth trajectory in the face of industry conditions like these, it won't work to benchmark competitors and try to outcompete them by offering a little more for a little less. Such a strategy may nudge sales up but will hardly drive a company to open up uncontested market space. Nor is conducting extensive customer research the path to blue oceans. Our research found that customers can scarcely imagine how to create uncontested market space. Their insight also tends toward

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the familiar "offer me more for less." And what customers typically want "more" of are those product and service features that the industry currently offers.

To fundamentally shift the strategy canvas of an industry, you must begin by reorienting your strategic focus from *competitors* to *alternatives*, and from *customers* to *noncustomers* of the industry.[1] To pursue both value and low cost, you should resist the old logic of benchmarking competitors in the existing field and choosing between differentiation and cost leadership. As you shift your strategic focus from current competition to alternatives and noncustomers, you gain insight into how to redefine the problem the industry focuses on and thereby reconstruct buyer value elements that reside across industry boundaries. Conventional strategic logic, by contrast, drives you to offer better solutions than your rivals to existing problems defined by your industry.

In the case of the US wine industry, conventional wisdom caused wineries to focus on overdelivering on prestige and the quality of wine at its price point. Overdelivery meant adding complexity to the wine based on taste profiles shared by wine makers and reinforced by the wine show judging system. Wine makers, show judges, and knowledgeable drinkers concur that complexity—layered personality and characteristics that reflect the uniqueness of the soil, season, and wine maker's skill in tannins, oak, and aging processes—equates with quality.

By looking across alternatives, however, Casella Wines, an Australian winery, redefined the problem of the wine industry to a new one: how to make a fun and nontraditional wine that's easy to drink for everyone. Why? In looking at the demand side of the alternatives of beer, spirits, and ready-to-drink cocktails, which captured three times as many US consumer alcohol sales as wine at the time, Casella Wines found that the mass of American adults saw wine as a turnoff. It was intimidating and pretentious, and the complexity of wine's taste created flavor challenges for the average person, even though it was the basis on which the industry fought to excel. With this insight, Casella Wines was ready to explore how

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to redraw the strategic profile of the US wine industry to create a blue ocean. To achieve this, it turned to the second basic analytic underlying blue oceans: the four actions framework.

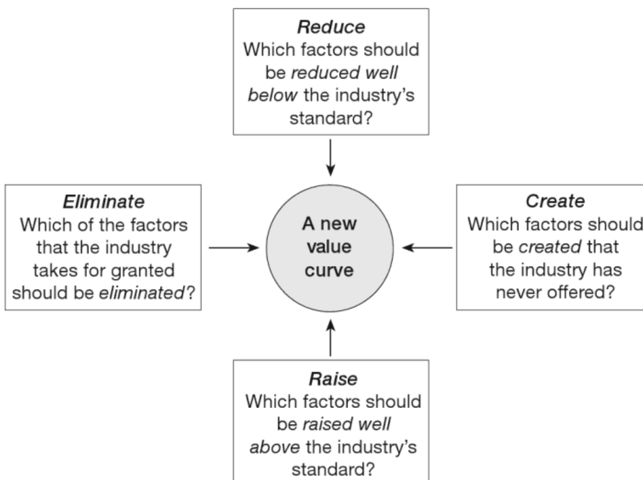
The Four Actions Framework

To reconstruct buyer value elements in crafting a new value curve, we have developed the *four actions framework*. As shown in figure 2-2, to break the trade-off between differentiation and low cost and to create a new value curve, there are four key questions to challenge an industry's strategic logic and business model:

- Which of the factors that the industry takes for granted should be *eliminated*?
- Which factors should be *reduced well below* the industry's standard?

FIGURE 2-2

The four actions framework



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- Which factors should be *raised well above* the industry's standard?
- Which factors should be *created* that the industry has never offered?

The first question forces you to consider eliminating factors that companies in your industry have long competed on. Often those factors are taken for granted even though they no longer have value or may even detract from value. Sometimes there is a fundamental change in what buyers value, but companies that are focused on benchmarking one another do not act on, or even perceive, the change.

The second question forces you to determine whether products or services have been overdesigned in the race to match and beat the competition. Here, companies overserve customers, increasing their cost structure for no gain.

The third question pushes you to uncover and eliminate the compromises your industry forces customers to make. The fourth question helps you to discover entirely new sources of value for buyers and to create new demand and shift the strategic pricing of the industry.

It is by pursuing the first two questions (of eliminating and reducing) that you gain insight into how to drop your cost structure vis-à-vis competitors. Our research has found that rarely do managers systematically set out to eliminate and reduce their investments in factors that an industry competes on. The result is mounting cost structures and complex business models. The second two factors, by contrast, provide you with insight into how to lift buyer value and create new demand. Collectively, they allow you to systematically explore how you can reconstruct buyer value elements across alternative industries to offer buyers an entirely new experience, while simultaneously keeping your cost structure low. Of particular importance are the actions of eliminating and creating, which push companies to go beyond value maximization exercises with existing factors of competition. Eliminating

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and creating prompt companies to change the factors themselves, hence making the existing rules of competition irrelevant.

When you apply the four actions framework to the strategy canvas of your industry, you get a revealing new look at old perceived truths. In the case of the US wine industry, by thinking in terms of these four actions vis-à-vis the current industry logic and looking across alternatives and noncustomers, Casella Wines created [yellow tail], a wine whose strategic profile broke from the competition and created a blue ocean. Instead of offering wine as wine, Casella created a social drink accessible to everyone: beer drinkers, cocktail drinkers, and traditional drinkers of wine. In the space of only two years, the fun, social drink [yellow tail] emerged as the fastest-growing brand in the histories of both the Australian and the US wine industries and the number-one imported wine into the United States, surpassing the wines of France and Italy. By August 2003, it was the number-one red wine in a 750-ml bottle sold in the United States, outstripping California labels. By mid-2003, [yellow tail]'s moving average annual sales were tracking at 4.5 million cases. In the context of a global wine glut, [yellow tail] was racing to keep up with sales. Today, ten years later, [yellow tail] is available in more than fifty countries with more than 2.5 million glasses of [yellow tail] enjoyed around the world each day. In the space of a decade, it emerged as one of the top-five most powerful wine brands in the world.[2]

What's more, whereas large wine companies developed strong brands over decades of marketing investment, [yellow tail] leapfrogged tall competitors with no promotional campaign, mass media, or consumer advertising for the initial years. It didn't simply steal sales from competitors; it grew the market. [yellow tail] brought nonwine drinkers—beer and ready-to-drink cocktail consumers—into the wine market. Moreover, novice table wine drinkers started to drink wine more frequently, jug wine drinkers moved up, and drinkers of more expensive wines moved down to become consumers of [yellow tail].

Figure 2-3 shows the extent to which the application of these four actions led to a break from the competition in the US wine

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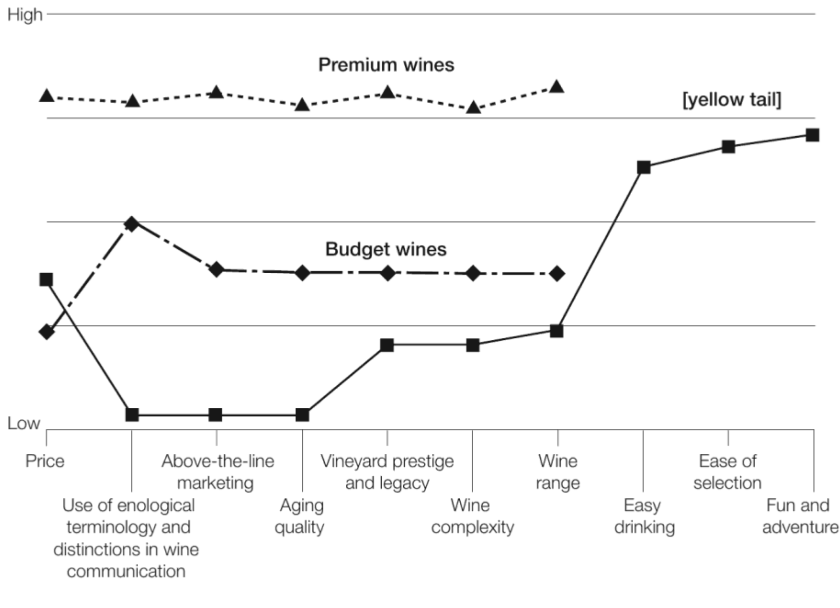
FIGURE 2-3

The strategy canvas of [yellow tail]



industry. Here we can graphically compare [yellow tail]'s blue ocean strategy with the more than one thousand six hundred wineries competing in the United States at the time. As shown in figure 2-3, [yellow tail]'s value curve stands apart. Casella Wines acted on all four actions—eliminate, reduce, raise, and create—to unlock uncontested market space that changed the face of the US wine industry in a span of two years.

By looking at the alternatives of beer and ready-to-drink cocktails and thinking in terms of noncustomers, Casella Wines created three new factors in the US wine industry—easy drinking, ease of selection, and fun and adventure—and eliminated or reduced everything else. Casella Wines found that the mass of Americans rejected wine because its complicated taste was difficult to appreciate. Beer and ready-to-drink cocktails, for example, were much sweeter and easier to drink. Accordingly, [yellow tail] was a completely new combination of wine characteristics that produced an

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uncomplicated wine structure that was instantly appealing to the mass of alcohol drinkers. The wine was soft in taste and approachable like ready-to-drink cocktails and beer, and had up-front, primary flavors and pronounced fruit flavors. The sweet fruitiness of the wine also kept people's palate fresher, allowing them to enjoy another glass of wine without thinking about it. The result was an easy-drinking wine that did not require years to develop an appreciation for.

In line with this simple fruity sweetness, [yellow tail] dramatically reduced or eliminated all the factors the wine industry had long competed on—tannins, oak, complexity, and aging—in crafting fine wine, whether it was for the premium or the budget segment. With the need for aging eliminated, the needed working capital for aging wine at Casella Wines was also reduced, creating a faster payback for the wine produced. The wine industry criticized the sweet fruitiness of [yellow tail] wine, seeing it as significantly lowering the quality of wine and working against proper appreciation of fine grapes and historic wine craftsmanship. These claims may have been true, but customers of all sorts loved the wine.

Wine retailers in the United States offered buyers aisles of wine varieties, but to the general consumer the choice was overwhelming and intimidating. The bottles looked the same, labels were complicated with enological terminology understandable only to the wine connoisseur or hobbyist, and the choice was so extensive that salesclerks at retail shops were at an equal disadvantage in understanding or recommending wine to bewildered potential buyers. Moreover, the rows of wine choice fatigued and demotivated customers, making selection a difficult process that left the average wine purchaser insecure with their choice.

[yellow tail] changed all that by creating ease of selection. It dramatically reduced the range of wines offered, creating only two at the start: Chardonnay, the most popular white in the United States, and a red, Shiraz. It removed all technical jargon from the bottles and created instead a striking, simple, and nontraditional

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label featuring a kangaroo in bright, vibrant colors of orange and yellow on a black background. The wine boxes [yellow tail] came in were also of the same vibrant colors, with the name [yellow tail] printed boldly on the sides; the boxes served the dual purpose of acting as eye-catching, unintimidating displays for the wine.

[yellow tail] hit a home run in ease of selection when it made retail shop employees the ambassadors of [yellow tail] at its launch by giving them Australian outback clothing, including bushman's hats and oilskin jackets to wear at work. The retail employees were inspired by the branded clothing and having a wine they themselves did not feel intimidated by, and recommendations to buy [yellow tail] flew out of their mouths. In short, it was fun to recommend [yellow tail].

The simplicity of offering only two wines at the start—a red and a white—streamlined Casella Wines' business model. Minimizing the stockkeeping units maximized its stock turnover and minimized investment in warehouse inventory. In fact, this reduction of variety was carried over to the bottles inside the cases. [yellow tail] broke industry conventions. Casella Wines was the first company to put both red and white wine in the same-shaped bottle, a practice that created further simplicity in manufacturing and purchasing and resulted in stunningly simple wine displays.

The wine industry worldwide was proud to promote wine as a refined beverage with a long history and tradition. This is reflected in the target market for the United States: educated professionals in the upper-income brackets. Hence, the continuous focus on the quality and legacy of the vineyard, the chateau's or estate's historical tradition, and the wine medals won. Indeed the growth strategies of the major players in the US wine industry were targeted at the premium end of the market, with tens of millions invested in brand advertising to strengthen this image. By looking to beer and ready-to-drink cocktail customers, however, [yellow tail] found that this elite image did not resonate with the general public, which found it intimidating. So [yellow tail] broke with tradition and created a personality that embodied the characteristics

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of the Australian culture: bold, laid back, fun, and adventurous. Approachability was the mantra: "The essence of a great land . . . Australia." There was no traditional winery image. The lowercase spelling of the name [yellow tail], coupled with the vibrant colors and the kangaroo motif, echoed Australia and made people smile. And indeed no reference to the vineyard was made on the bottle. The wine promised to jump from the glass like an Aussie kangaroo.

The result is that [yellow tail] appealed to a broad cross section of alcohol beverage consumers. By offering this leap in value, [yellow tail] raised the price of its wines above the budget market, pricing them then at $6.99 a bottle, more than double the price of a jug wine at the time. From the moment the wine hit the retail shelves in July 2001, sales took off. Today, over a decade later, its price stands at $7.49 in the United States.

The Eliminate-Reduce-Raise-Create Grid

There is a third tool that is key to creation of blue oceans. It is a supplementary analytic to the four actions framework called the *eliminate-reduce-raise-create grid* (see figure 2-4). The grid pushes companies not only to ask all four questions in the four actions framework but also to *act* on all four to create a new value curve. By driving companies to fill in the grid with the actions of eliminating and reducing as well as raising and creating, the grid gives companies four immediate benefits:

- It pushes them to simultaneously pursue differentiation and low costs to break the value-cost trade-off.
- It immediately flags companies that are focused only on raising and creating and thereby lifting their cost structure and often overengineering products and services—a common plight in many companies.
- It is easily understood by managers at any level, creating a high level of engagement in its application.

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FIGURE 2-4

Eliminate-reduce-raise-create grid: The case of [yellow tail]

Eliminate	Raise
Enological terminology and distinctions Above-the-line marketing Aging qualities	Price versus budget wines
Reduce	**Create**
Vineyard prestige and legacy Wine complexity Wine range	Easy drinking Ease of selection including retail store support Fun and adventure

- Because completing the grid is a challenging task, it drives companies to robustly scrutinize every factor the industry competes on, making them discover the range of implicit assumptions they make unconsciously in competing.

Figure 2-5, the eliminate-reduce-raise-create grid for Cirque du Soleil, provides another snapshot of this tool in action and shows what it reveals. Worth noting is the range of factors that an industry has long competed on that companies discover can be eliminated and reduced. In the case of Cirque du Soleil, it eliminated several factors from traditional circuses, such as animal shows, star performers, and multiple show arenas. These factors had long been taken for granted in the traditional circus industry, which never questioned their ongoing relevance. However, there was increasing public discomfort with the use of animals. Moreover, animal acts are one of the most expensive elements; not only is there the cost of the animals, but also their training, medical care, housing, insurance, and transportation. Similarly, although the circus industry focused on featuring stars, in the mind of the

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FIGURE 2-5

Eliminate-reduce-raise-create grid: The case of Cirque du Soleil

Eliminate	**Raise**
Starp erformers Animalsho ws Aisle concession sales Multiple show arenas	Price Unique venue
Reduce	**Create**
Funa ndhumo r Thrill and danger	Theme Refined environment Multiple productions Artistic music and dance

public the so-called stars of the circus were trivial next to movie stars or famous singers. Again, they were a high-cost component carrying little sway with spectators. Gone, too, are three-ring venues. Not only did these create angst among spectators as they rapidly switched their gaze from one ring to the other, but they also increased the number of performers needed, with the obvious cost implications.

Three Characteristics of a Good Strategy

[yellow tail], like Cirque du Soleil, created a unique and exceptional value curve to unlock a blue ocean. As shown in the strategy canvas, [yellow tail]'s value curve has *focus*; the company did not diffuse its efforts across all key factors of competition. The shape of its value curve *diverged* from the other players', a result of not benchmarking competitors but instead looking across alternatives. The *tagline* of [yellow tail]'s strategic profile was clear: a fun and simple wine to be enjoyed every day.

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When expressed through a value curve, then, an effective blue ocean strategy like [yellow tail]'s has three complementary qualities: focus, divergence, and a compelling tagline. Without these qualities, a company's strategy will likely be muddled, undifferentiated, and hard to communicate with a high cost structure. The four actions of creating a new value curve should be well guided toward building a company's strategic profile with these characteristics. These three characteristics serve as an initial litmus test of the commercial viability of blue ocean ideas.

A look at Southwest Airlines' strategic profile illustrates how these three qualities underlie the company's effective strategy in reinventing the short-haul airline industry via value innovation (see figure 2-6). Southwest Airlines created a blue ocean by breaking the trade-offs customers had to make between the speed of airplanes and the economy and flexibility of car transport. To achieve this, Southwest offered high-speed transport with frequent and flexible departures at prices attractive to the mass of buyers. By eliminating and reducing certain factors of competition and raising others in the traditional airline industry, as well as by creating new factors drawn from the alternative industry of car transport, Southwest Airlines was able to offer unprecedented utility for air travelers and achieve a leap in value with a low-cost business model.

The value curve of Southwest Airlines differs distinctively from those of its competitors in the strategy canvas. Its strategic profile is a typical example of a compelling blue ocean strategy.

Focus

Every great strategy has focus, and a company's strategic profile, or value curve, should clearly show it. Looking at Southwest's profile, we can see at once that the company emphasizes only three factors: friendly service, speed, and frequent point-to-point departures. By focusing in this way, Southwest has been able to price against car transportation; it doesn't make extra investments in meals, lounges, and seating choices. By contrast, Southwest's traditional

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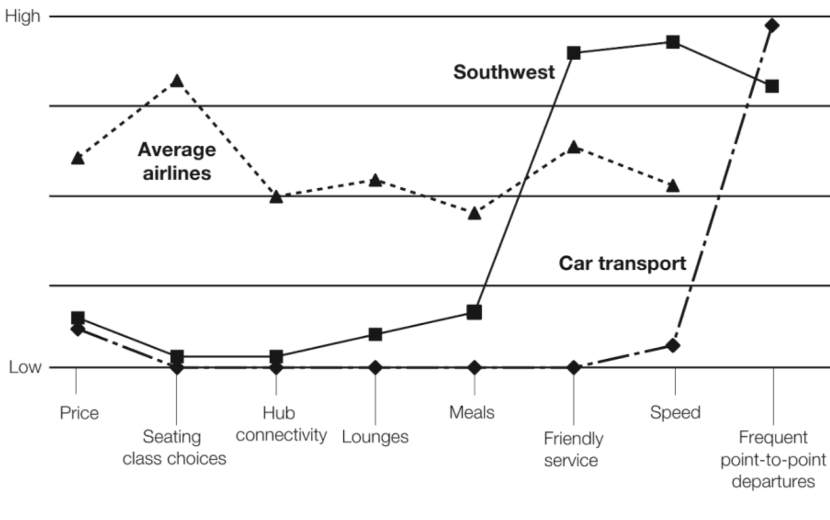
FIGURE 2-6

The strategy canvas of Southwest Airlines



competitors invest in all the airline industry's competitive factors, making it much more difficult for them to match Southwest's prices. Investing across the board, these companies let their competitors' moves set their own agendas. Costly business models result.

Divergence

When a company's strategy is formed reactively as it tries to keep up with the competition, it loses its uniqueness. Consider the similarities in most airlines' meals and business-class lounges. On the strategy canvas, therefore, reactive strategists tend to share the same strategic profile. Indeed, in the case of Southwest, the value curves of the company's competitors are virtually identical and therefore can be summarized on the strategy canvas with a single value curve.

In contrast, the value curves of blue ocean strategists always stand apart. By applying the four actions of eliminating, reducing, raising, and creating, they differentiate their profiles from

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the industry's average profile. Southwest, for example, pioneered point-to-point travel between midsize cities; previously, the industry operated through hub-and-spoke systems.

Compelling Tagline

A good strategy has a clear-cut and compelling tagline. "The speed of a plane at the price of a car—whenever you need it." That's the tagline of Southwest Airlines, or at least it could be. What could Southwest's competitors say? Even the most proficient ad agency would have difficulty reducing the conventional offering of meals, seat choices, lounges, and hub links, with standard service, slower speeds, and higher prices into a memorable tagline. A good tagline must not only deliver a clear message but also advertise an offering truthfully, or else customers will lose trust and interest. In fact, a good way to test the effectiveness and strength of a strategy is to look at whether it contains a strong and authentic tagline.

As shown in figure 2-7, Cirque du Soleil's strategic profile also met the three criteria that define blue ocean strategy: focus, divergence, and a compelling tagline. Cirque du Soleil's strategy canvas allows us to graphically compare its strategic profile with those of its major competitors. The canvas shows clearly the extent of Cirque du Soleil's departure from the conventional logic of the circus. The figure shows that the value curve of Ringling Bros. and Barnum & Bailey is the same basic shape as those of smaller regional circuses. The main difference is that regional circuses offer less of each competing factor because of their restricted resources.

By contrast, Cirque du Soleil's value curve stands apart. It has new and noncircus factors such as theme, multiple productions, refined watching environment, and artistic music and dance. These factors, entirely new creations for the circus industry, are drawn from the alternative live entertainment industry of theater. In this way, the strategy canvas clearly depicts the traditional factors that affect competition among industry players, as well as new factors that lead to creation of new market space and that shift the strategy canvas of an industry.

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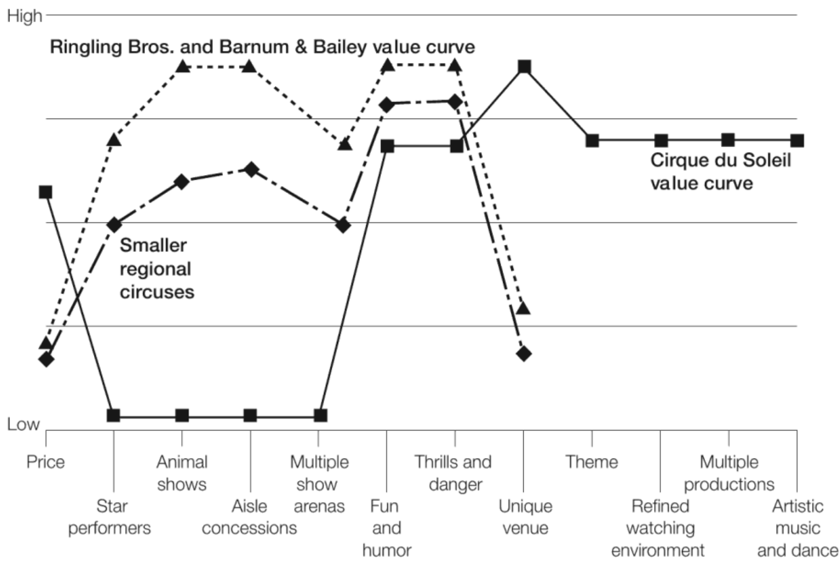
FIGURE 2-7

The strategy canvas of Cirque du Soleil



[yellow tail], Cirque du Soleil, and Southwest Airlines created blue oceans in very different business situations and industrial contexts. However, their strategic profiles shared the same three characteristics: focus, divergence, and a compelling tagline. These three criteria guide companies in carrying out the process of reconstruction to arrive at a breakthrough in value both for buyers and for themselves.

Reading the Value Curves

The strategy canvas enables companies to see the future in the present. To achieve this, companies must understand how to read value curves. Embedded in the value curves of an industry is a wealth of strategic knowledge on the current status and future of a business.

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