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# HANDOUTS

# COMPETITIVE STRATEGIES IN THE CREATIVE INDUSTRIES

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# COMPETITIVE STRATEGIES IN THE CREATIVE INDUSTRIES

## SESSION 1 SETTING THE STAGE

An **industry** is a group of firms producing products or services that customers perceive as meeting the same needs. Example: Apple and Samsung both compete in the smartphone industry. Any organization that produces something for others is part of an industry (e.g., Google in search advertising, Zynga in online gaming, Greenpeace in environmental protection).

### INDUSTRY ENVIRONMENT AND PARTICIPANTS

Every industry operates within an **industry environment**, which includes:

- **Suppliers** → firms that provide inputs but are not part of the focal industry (e.g., touchscreen producers supplying smartphones).
- **Customers** → end-users or buyers of the products (e.g., retail stores selling smartphones).
- **Potential entrants** → new firms considering entry.
- **Substitute products** → different solutions that fulfill the same need (e.g., tablets or basic phones as substitutes for smartphones).
- **Complementary products** → goods that increase the value of the industry's main product (e.g., wireless carriers for smartphones).

All these actors are called **market participants**.

### PURPOSE OF INDUSTRY ANALYSIS

- Industry analysis helps explain **how profits are distributed** among market participants.
- A firm's profitability depends both on:
    - **Rivalry** inside the industry.
    - **Influence** of other players in the environment (suppliers, customers, substitutes, entrants, complements).
- All participants struggle to appropriate profits, so firms must anticipate these dynamics.

<u>Why industry analysis is essential for strategy?</u>

- It shows how industry structure influences profits.
- Strategy is a set of choices positioning a firm to generate superior returns.
- Understanding industry forces helps companies defend against threats while exploiting opportunities.
- Without a clear plan to deal with competition for profits, a company lacks a real strategy.

Industry analysis helps managers and other stakeholders to:

1. Identify opportunities to increase profits.
2. Recognize threats to profits and find countermeasures.
3. Decide whether to **enter** or **exit** a market.
4. Position the firm for long-term success in a given industry.
5. Assess the effect of **trends** (deregulation, new technology, demographic shifts, new complements).
6. Shape the industry environment itself.

Not only businesses but also **non-profits** and humanitarian organizations can apply industry analysis: for example, in the aid industry, the "profits" (aid donations) are distributed based on bargaining power among suppliers, agencies, and recipients.

**SIX STEPS OF INDUSTRY ANALYSIS:**

1. Define the industry → establish boundaries.
2. Identify the players (market participants).
3. Analyze their influence on profitability.
4. Test the analysis for robustness.
5. Develop a way to deal with the industry environment.
6. Assess future changes in factors influencing profitability and decide the strategic response.

**Frameworks used:** The most widely used tool is Porter's Five Forces framework (Harvard Business School, Michael Porter). It provides a structured way to analyze industry profitability and competitive pressures. Later discussions compare Five Forces with other strategy tools, highlight limitations, and address the broader question: *"How much does industry matter?"*

What is Strategy?

Strategy is the integrated set of choices that determines **where to compete** and **how to compete**. It is not a collection of functional plans (marketing strategy, HR strategy, etc.), but a comprehensive and coherent long-term vision that guides the firm's actions.

- Where to compete: which industries, markets, customer segments, and parts of the value chain to target.
- How to compete: which business model to adopt, how to deploy resources and capabilities, how to position against rivals.

The ultimate purpose of strategy is to achieve superior and sustainable performance compared to industry peers.

Strategy and performance

A firm's performance depends on two layers of factors:

1. **Industry effects**
   - Each industry has an average level of profitability determined by its competitive structure.
   - Some industries are structurally attractive (e.g., pharmaceuticals), while others chronically low-margin (e.g., airlines).
2. **Firm-specific effects**
   - Firms can perform above or below the industry average depending on their own resources, competences, and organizational capabilities.
   - This is where sustainable competitive advantage is built.

Competitive advantage arises from the combination of external (industry) and internal (firm-specific) factors.

Happy firms and competitive advantage

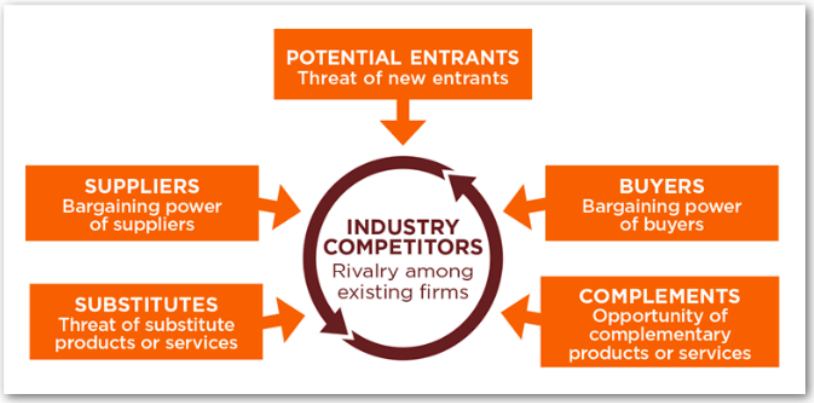
A firm is "happy" when it achieves a competitive advantage that allows it to outperform the industry average.

- **Happy firms**: share the trait of having secured a sustainable competitive advantage.
- **Unhappy firms**: may fail in many different ways — excessive costs, poor differentiation, weak brand, lack of coherence, flawed positioning.

The essence of strategy is understanding how to build and maintain sustainable competitive advantage.

External analysis – Industry attractiveness

**PORTER'S FIVE FORCES FRAMEWORK**




Introduced by **Michael Porter** in 1979 (*Harvard Business Review* article "How Competitive Forces Shape Strategy" and later in *Competitive Strategy* 1980).

Objective: explain how **industry structure determines profitability**.

- Porter argued that managers often view competition too narrowly, focusing only on direct rivals.
- In reality, profits are shaped by a broader set of **market participants**: competitors, customers, suppliers, potential entrants, substitutes, and (later) complements.
- The framework endures because it is grounded in economics and provides a clear lens to identify the structural factors influencing industry profitability.

**The Five (Plus One) Forces:**

1. Threat of New Entrants
    - New competitors can enter if barriers to entry are low.
    - Threat is higher when: low capital requirements, limited economies of scale, weak brand loyalty, limited regulation.
    - Reduces profitability by increasing rivalry and putting pressure on prices.

| Barriers to Entry | Example/Rationale |
|---|---|
| Supply-side economies of scale, scope, or experience | FedEx has a lower cost per package than a potential new entrant because of its large scale. |
| Demand-side benefits of scale | eBay is more attractive to buyers than its smaller competitors because of its large number of sellers (and sellers then also benefit from more buyers). |
| Customer switching costs | Microsoft Windows users who may want to switch to another operating system must buy new software and learn how to use a new operating system. |
| Capital costs | A large, required capital commitment can deter new entrants. |
| Incumbency advantages | Incumbent mining companies may have locked up the best reserves. |
| Unequal access to distribution channels | Movie producers with a track record and established relationships have an advantage in getting cinema distribution for their films. |
| Restrictive government policy | Patents can deter market entry by imitators. |
| High barriers to exit | High labor severance costs can deter market entry. |
| Anticipated vigorous incumbent response | The threat of price cuts or expensive advertising campaigns by incumbents with deep pockets can deter entry. |
| Slow industry growth | Newcomers must take share from incumbents. |

2. Bargaining Power of Suppliers
    - Strong suppliers can demand higher prices or impose stricter terms, raising industry costs.
    - Power is higher when suppliers are concentrated, provide differentiated inputs, or when switching costs are high.

| Factor | Example/Rationale |
|---|---|
| Suppliers are more concentrated than the industry rivals. | Microsoft and Intel have bargaining power because of their dominant market shares and fragmented PC manufacturing customers. |
| Industry participants face switching costs. | A supplier has more bargaining power if it is difficult for customers to switch to competing suppliers. |
| Suppliers offer differentiated products. | If customers believe suppliers' products differ significantly, competition is reduced and prices tend to increase. |
| Few substitutes exist for supplier products. | Suppliers of patented pharmaceuticals with unique benefits have significant bargaining power. |
| Credible threat of forward integration exists. | Suppliers who can credibly threaten to compete with their customers have more bargaining power than those who cannot. |
| Suppliers do not depend heavily on the industry. | Suppliers who do not depend on the industry have less incentive to moderate price demands. |

3. Bargaining Power of Buyers
    - Powerful customers can demand lower prices, higher quality, or better service.
    - Buyer power increases when buyers are concentrated, purchase in large volumes, or face low switching costs.

| Factor | Example/Rationale |
|---|---|
| Customers are more concentrated than the industry they buy from. | Retailers such as Walmart are more concentrated than their suppliers and thus have significant bargaining power. |
| Customers face few switching costs. | Airline customers have substantial bargaining power because they have low switching costs. |
| Industry products are undifferentiated. | If customers believe suppliers' products do not differ significantly, the customer has more pricing power. |
| Credible threat of backward integration exists. | Customers who can credibly threaten to manufacture their own inputs have more bargaining power than those who cannot. |
| Industry purchases represent a significant fraction of their cost. | Customers will be more sensitive to the price of inputs that have a bigger impact on their bottom line. |
| Customers earn low profits. | Input costs have a proportionally greater impact on the profits of low-profit customers than they do on those of high-profit customers. |
| Customer's quality is not substantially affected by the industry. | Where quality is not affected, the customer has no incentive to accept a higher-priced, higher-quality input. |

4. Threat of Substitutes
    - Substitute products fulfill the same need in a different way, limiting price-setting power.
    - The stronger the substitutes, the more they cap profitability.
    - Economics link: based on **price elasticity of demand**.

| Factor | Example/Rationale |
|---|---|
| "Closeness" of the substitute | The closer the substitute, the easier it is to switch to it. |
| Performance/price ratio of the substitute | A substitute that offers slightly lower performance at a much lower price is more of a threat than one that offers slightly lower performance with only a small reduction in price. |

5. Rivalry Among Existing Competitors
    - Intensity of competition within the industry (price wars, advertising battles, product innovation).
    - Rivalry is stronger when: many competitors of similar size, slow industry growth, low differentiation, high fixed costs.

| Factor | Example/Rationale |
|---|---|
| Product lacks differentiation. | If products are not very different, rivals must compete on price. |
| Fixed costs are high and marginal costs are low. | Rivals have an incentive to price below average cost. |
| Capacity must expand in large increments. | Owners of unused capacity have an incentive to cut prices. |
| Product is perishable. | Rivals have an incentive to cut price as the product approaches the end of its saleable life. |
| Competitors are numerous and roughly equal in size. | Numerous and equal competitors reduce the potential for tacit collusion. |
| Industry growth is slow. | Rivals must take others' market share to grow. |
| Exit barriers are high. | High exit barriers tend to slow reduction of industry overcapacity, which then produces price competition. |
| Rivals have diverse approaches. | Diverse approaches reduce the potential for collusion. |

6. Complements (extension to Porter's original model)
    - Products/services that enhance the value of the focal product (e.g., wireless carriers for smartphones).
    - Can increase industry profitability if well managed.

| Factor | Example/Rationale |
|---|---|
| Product lacks differentiation. | If products are not very different, rivals must compete on price. |
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The five forces framework explains *why* an industry has a given average profitability.

**Economic Foundations**

- Rooted in **industrial organization economics** (IO), also called the Harvard Tradition.
- Empirical studies showed structural factors (concentration ratios, barriers to entry) shape profitability.
- Microeconomics explains:
    - Substitutes → influence through price elasticity of demand.
    - Rivalry → higher when fixed costs are high and marginal costs low (firms cut prices aggressively).

- **Game theory** adds insights:
    - Firms can deter entrants by creating reputations for retaliation (e.g., lowering prices to defend market share).

**How the Five Forces Influence Profitability**

Profitability is shaped by three levers:

1. **Willingness to pay (WTP)** – what customers are willing to spend.
2. **Price** – determined through bargaining power of buyers and competitive intensity.
3. **Cost** – affected by suppliers' power, rivalry, and substitutes.

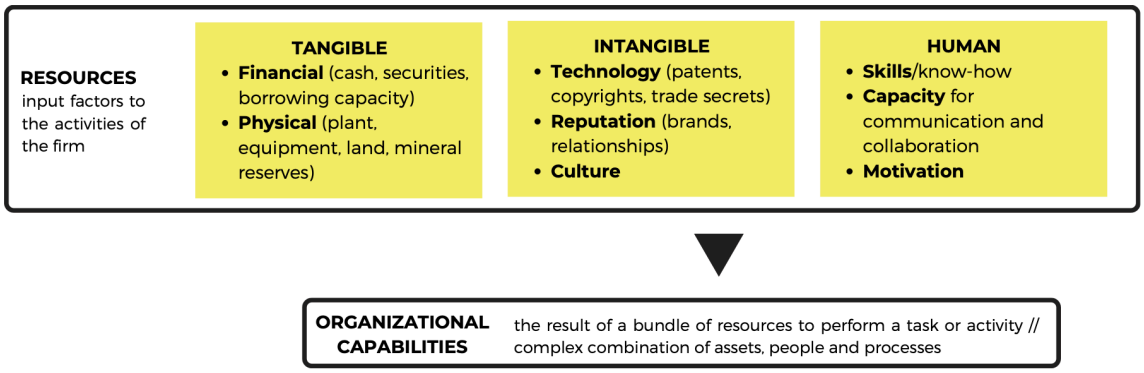
Examples: Strong buyers push prices down, reducing margins; Strong suppliers increase costs; High rivalry or substitutes reduce WTP, eroding profits.

**Why the Framework Matters?**

- Helps managers assess **profit potential of industries**.
- Clarifies **which forces to address strategically** (e.g., raising entry barriers, differentiating from substitutes, balancing supplier/buyer power).
- Explains performance differences across industries.
- Provides a systematic method for positioning firms to achieve **sustainable competitive advantage**.

Internal analysis – The Resource-Based View (RBV)

Besides industry structure, performance depends on firm-specific resources and capabilities.Types of resources:




**ORGANIZATIONAL CAPABILITIES**

The ability to combine resources, people, and processes to perform tasks in ways that competitors cannot easily replicate. They are more than the sum of resources: they reflect the firm's ability to coordinate and exploit them effectively.

**THE VRIO FRAMEWORK**

A resource is a source of **sustainable competitive advantage** if it is:

- **Valuable** → increases revenues or decreases costs.
- **Rare** → not widely held by competitors.
- **Inimitable** → difficult to copy or substitute.
- **Organized** → supported by the firm's structure and processes.

Strategy formulation: Effective strategy emerges from combining external and internal analysis:

- External analysis explains why an industry is profitable and how firms can neutralize unfavorable conditions while exploiting favorable ones.
- Internal analysis highlights which resources and capabilities enable superior performance.

The strategist's task is to design a coherent set of choices that:

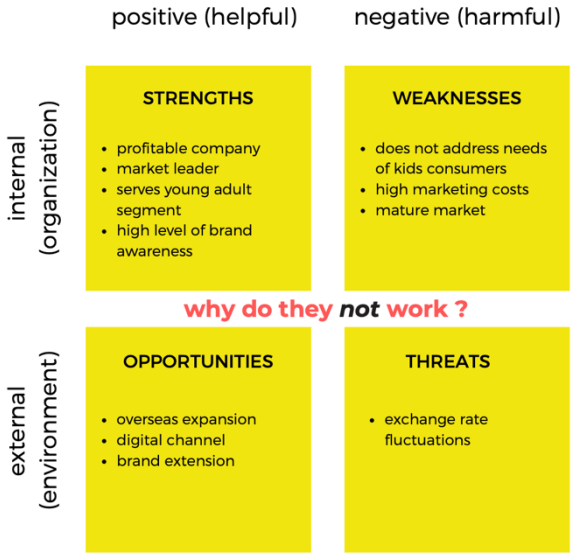
- leverage strengths and compensate weaknesses;
- exploit external opportunities and mitigate threats;
- invest in critical resources and capabilities;
- create synergies, including through partnerships.

SWOT Analysis

The SWOT framework integrates external and internal perspectives:

- **Strengths**: firm-specific resources and capabilities.
- **Weaknesses**: internal limitations that hinder performance.
- **Opportunities**: favorable conditions in the external environment.
- **Threats**: unfavorable external conditions.

**COMMON PROBLEMS WITH SWOT**




If applied superficially, SWOT is ineffective. Typical issues include:

- **Too generic**: e.g., "profitable company" is not a strength but an outcome.
- **Internal/external confusion**: e.g., "mature market" is a threat, not a weakness.
- **Describing results, not causes**: e.g., "market leader" does not explain why.
- **Trivial or universal items**: e.g., "expand abroad" as an opportunity without specifying where and why.
- **Contradictions**: e.g., "strong brand" vs. "high marketing costs" when the latter explains the former.

SWOT is useful only when it is specific, evidence-based, actionable, and directly connected to profitability (prices, costs, margins).

FRAMEWORK: integrated set of choiches

Strategy can be defined as:

"An integrated set of choices that positions the firm in its industry so as to generate superior and sustainable financial returns over the long run."

To formulate an effective strategy, managers must:

- conduct rigorous analyses with robust frameworks;
- integrate internal and external perspectives;
- develop a precise managerial language;
- take coherent, concrete decisions aimed at sustaining competitive advantage.

**1.1 The 2 fundamental questions**

From Casadesus-Masanell: strategy is the coherent answer to two questions:

**Where do we compete?**

- In which industry / segment of the business landscape

- Which customers (target market: broad vs niche)

**How do we compete?**

- **Value proposition:** differentiation or low cost?
- **Business model:** the set of activities that creates the **wedge** between WTP (willingness to pay) and cost

If you don't answer these two well, you don't have a strategy—you just have scattered tactics.

**1.2 Competitive advantage = the wedge**

In the reading: you have competitive advantage when your **wedge = WTP – cost** is larger than your competitors'.

- **Differentiation** → you increase WTP more than your costs
- **Low cost** → you reduce cost more than the price you charge
- Sometimes, if you're galaxy-brained, you do both (e.g., lock-in + economies of scale)

**1.3 The Three Consistencies (internal / external / dynamic)**

This is extremely exam-relevant.

**a) Internal consistency – internal fit**

From the reading and from the slides on *RESOURCES / INDUSTRY / STRATEGY FORMULATION*: external + internal → competitive advantage.

Internal consistency means the firm's activities:

- are coherent with the value proposition & target
- reinforce each other (like the pieces of the Southwest Airlines model)
- generate optimization of costs/effort (e.g., IKEA: self-service, out-of-town stores, flat-pack design, minimal staffing)

If you try to do everything for everyone → zero fit → "meh" strategy.

**b) External consistency – positioning on the business landscape**

Here we combine:

- **Industry structure → average industry profitability** (Porter's 5 Forces)
- **Firm's positioning → deviation from the average** (specific firm's divergence)

External consistency means your business model:

- makes sense given competitive forces (entrants, suppliers, buyers, substitutes, rivalry, complements)
- occupies an intelligent spot on the landscape (e.g., Southwest → low-cost, point-to-point, secondary airports)

**c) Dynamic consistency – long-term sustainability**

A strategy is dynamically consistent if it withstands 3 key threats:

1. **Imitation** – others copy your model/product
2. **Substitution** – customers switch to a different category (streaming vs DVD, ride sharing vs taxi)
3. **Holdup** – suppliers/buyers/complementors gain power and squeeze you (e.g., Coca-Cola vs bottlers, Apple vs app developers)

Internally: firms may suffer failures of **perception, motivation, inspiration, coordination** (Rivkin) when they don't respond well to change.

## SESSION 2 FUNDAMENTALS OF INDUSTRY ANALYSIS 1/2

The Industry Analysis session is a key component of the Business Strategy course, designed to equip participants with the essential tools and techniques to evaluate and understand the dynamics of industries. This session aims to provide a comprehensive framework for conducting thorough industry analyses, enabling students to make informed strategic decisions in the ever-changing business landscape.

Specifically, we will introduce Michael Porter's Five Forces model to assess the competitive intensity within an industry, learning how to identify and evaluate the external factors that impact a company's performance.

**Preparatory material: SoundCloud: Subscription Streaming?**

In this case study, we delve into the strategic decision-making process of SoundCloud, a well-established platform known for its user-generated music content. As the digital music landscape evolves rapidly with the advent of streaming services, SoundCloud faces a critical crossroad: whether to enter the streaming industry and compete with established giants or maintain its current user-generated content approach.

Competitive advantage means earning profits that consistently exceed the industry average. Achieving this requires more than creative intuition: it demands a disciplined understanding of both the external environment and the internal resources that allow a firm to capture value. Industry structure shapes the limits of profitability, while internal capabilities determine whether a firm can exploit the opportunities that structure creates.

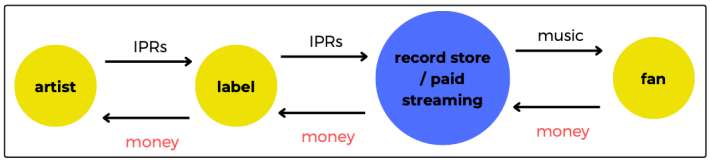
SoundCloud's strategic dilemma—whether to remain a creator-focused platform or pivot into mainstream on-demand streaming—reveals how external pressures can make entire industries fundamentally difficult to win.

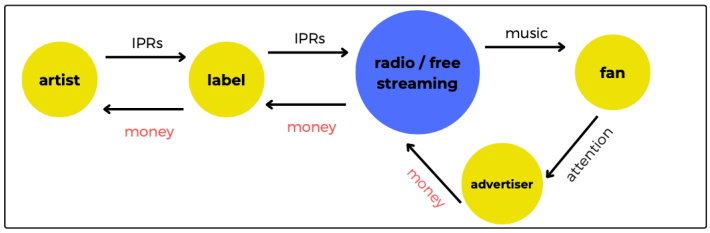
**The Economics of Online Music Platforms**

SoundCloud began as an open platform where artists uploaded audio, often remixes, DJ sets, drafts, and early versions of tracks. Listeners discovered new music for free, and artists paid to access more upload capacity and analytics. Value flowed in an unconventional direction: creators funded the platform, while listeners represented engagement rather than revenue.

By contrast, mainstream streaming platforms operate through a more traditional chain. Fans pay a subscription fee or "pay" with their attention through ads. Platforms license catalogs from record labels, and labels compensate artists according to intellectual property rights. The vast majority of revenue originates either from monthly subscriptions or advertising, while a large fraction of costs consists of royalties owed to labels.

As mainstream streaming grew, this economic logic became dominant. Any platform entering this space inherits its cost structure, its legal constraints, and its dependency on the major labels that control most global music catalogs.




**Applying the Five Forces to the Streaming Industry**

**Bargaining Power of Customers**

Music listeners are extremely fragmented, and no single listener can pressure a platform directly. Yet they still hold substantial indirect power.

Switching costs are close to zero: moving from one service to another takes seconds. Offerings are similar, prices converge around the same monthly fee, and none of the platforms control exclusive hardware. Users also vary widely in willingness to pay—heavy enthusiasts value premium features, while casual listeners remain ad-supported and price-sensitive.

This fragmentation, combined with abundant alternatives, reduces any platform's freedom to raise prices or differentiate meaningfully. Even advertisers, who fund free tiers, can shift budgets easily if engagement metrics drop.

The result is a customer base that is individually weak but collectively powerful, because they are impossible to lock in and quick to leave.

**Bargaining Power of Suppliers**

Suppliers in this industry aren't commodity producers—they are copyright holders. A handful of record labels control most globally relevant catalogs and therefore hold extraordinary leverage. Platforms need them; labels do not need any single platform.

Licensing agreements typically include high royalty rates, substantial advances, most-favored-nation clauses, and strict content controls. Streaming services cannot legally operate without contracting with these suppliers, and must build extensive monitoring systems to identify rights ownership.

Emerging artists have weaker bargaining power, but they don't reduce industry-wide costs because mainstream users expect access to major catalogs.

Supplier power is therefore extremely high, forcing platforms into a cost structure dominated by royalties and legal compliance.

**Threat of Substitutes**

Substitutes include non-interactive radio, digital downloads, and especially piracy. Pirated music offers unbeatable price–performance conditions, setting a very low ceiling on what listeners are willing to pay.

Even when illegal, substitutes are strategically relevant: they discipline pricing and reduce consumers' sensitivity to the absence of certain features or catalogs. Any legal streaming service must compete not only against other platforms but also against the expectation that music can be free.

This keeps willingness to pay—and therefore revenue potential—structurally low.

**Threat of New Entrants**

The market attracts entrants because demand is large and growing, and customers switch easily. For many tech giants, streaming is simply another component of an ecosystem strategy. They can operate at a loss for years because music strengthens their broader value proposition in hardware, cloud services, or advertising.

This creates a scenario where smaller independent platforms face entrants with deep pockets, diversified revenue sources, and no need to make profits in streaming itself.

High entry activity leads to more competition, more price pressure, and even higher royalties as suppliers benefit from multiple bidders.

**Competitive Rivalry**

Rivalry is intense. The number of players has historically been high, and the largest ones have strategic reasons to compete aggressively. Price competition pushes subscription fees down. Differentiation is limited because catalogs largely overlap, and personalization features are quickly imitated.

Because royalty payments do not decrease with scale, fixed costs remain high regardless of market share. Most platforms fail to achieve sustained profitability even with millions of users.

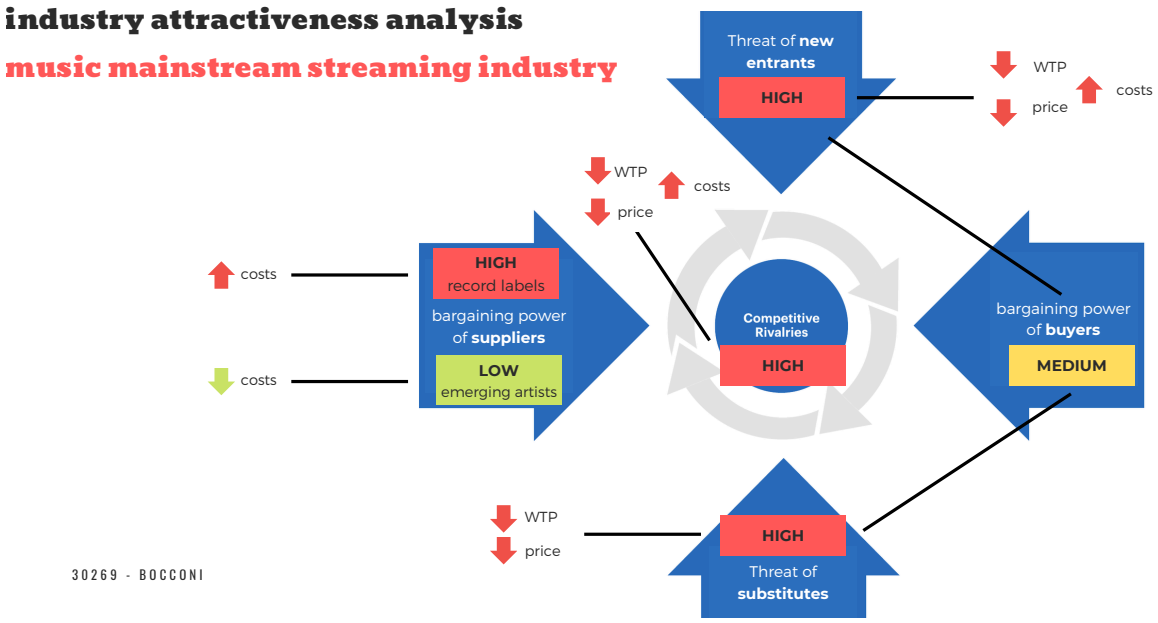
Rivalry therefore reinforces all other pressures: it compresses prices, forces investment in features that are hard to defend, and leaves little room for margin expansion.

**Is the Industry Attractive?**

Putting all forces together makes the answer clear: the mainstream on-demand streaming industry is structurally unattractive.

Costs are high due to supplier power. Prices are capped by substitutes. Switching costs are negligible, which strengthens customer power. Entry is constant and often subsidized by giants. Rivalry is sustained and aggressive.

Even large and successful companies struggle to break even. A new entrant must be prepared for persistent negative margins unless it has complementary revenue streams and massive capital reserves.




**SoundCloud's Strategic Options**

**1. Remain a Platform for Emerging Artists**

SoundCloud's original identity—an open lab where creators experiment, distribute, and connect—offers several strengths:

- A massive library of user-generated content.
- Deep cultural credibility among independent artists.
- Strong organic network effects within niche communities.
- Global audience reach far larger than most competitors.

This path preserves differentiation: SoundCloud offers something fundamentally different from mainstream services, rather than trying to replicate them.

However, it also exposes weaknesses:

- Monetization remains underdeveloped.
- Artists grow frustrated when they attract large audiences but earn little.
- The platform's interface has historically lacked dedicated tools for branded artist pages, community management, or direct fan monetization.
- Copyright enforcement becomes more complex as the platform grows.

Opportunities lie in building a creator-first ecosystem. This means developing tools that help artists earn money, offering distribution and analytics services, enabling direct-to-fan monetization, and leveraging dissatisfaction with the traditional label system.

Threats include the risk that labels demand aggressive takedowns of remixes and samples, potentially hurting the platform's culture if not managed carefully.

**2. Pivot Into Mainstream Streaming**

Moving into mainstream streaming would require SoundCloud to:

- Sign licensing deals with the major labels.
- Invest heavily in copyright detection and compliance.
- Overhaul its interface toward playlisting, personalization, and curation.
- Compete directly with Spotify, Apple Music, Amazon Music, Google, and others.

This demands enormous upfront investment, a fundamentally different business model, and capabilities that SoundCloud has not historically possessed.

The pivot would also dilute its brand identity. Much of SoundCloud's appeal comes from the experimental, community-driven, creator-centric atmosphere. Aligning with the mainstream model risks alienating the very artists and users who made the platform successful.

The financial data across the industry shows that even dominant players struggle to generate profit. It is unlikely that SoundCloud—without ecosystem synergies—could outperform them.

**What Happened Next**

After attempting the mainstream pivot and facing heavy financial distress, SoundCloud returned to its creator-focused roots. The company developed monetization tools, acquired distribution platforms, partnered with advertising networks, and expanded offerings for DJs and creators.

This shift led SoundCloud to regain strategic coherence and eventually reach profitability. It confirmed that its unique position—deep engagement with emerging and independent artists—was more defensible and aligned with its internal strengths than competing head-to-head with mainstream streaming giants.

**Key Lessons**

1. **Industry structure constrains profitability.**
   No degree of creativity can overcome a structurally hostile set of competitive forces.

2. **Streaming is dominated by powerful suppliers and unlimited substitutes.**
   This combination makes cost leadership and pricing power nearly impossible.

3. **Differentiation only works when it builds on unique resources.**
   SoundCloud's real advantage lies in creators, not catalogs.

4. **Strategic coherence matters.**
   A firm's choices must align with its capabilities, culture, and the ecosystem it can influence.

5. **Creator-centric models hold more defensible niches than catalog-centric models** for firms without massive capital or licensing power.

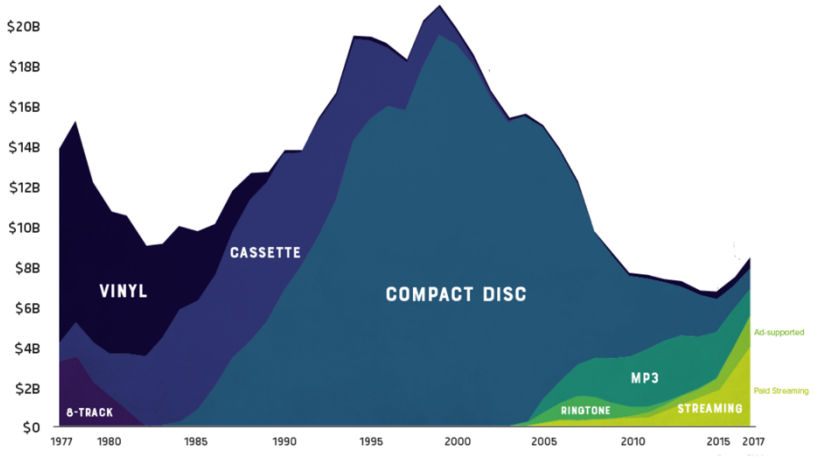
## SESSION 3 FUNDAMENTALS OF INDUSTRY ANALYSIS 2/2

This session explores the significant role of complements in adding an extra layer to insightful industry analyses. Understanding the dynamics of complements is crucial for businesses seeking to gain a competitive edge, optimize their strategies, and identify potential growth opportunities. Moreover, supervising complements is fundamental to appraise the dynamics of value appropriation among the participants to a given industry.

At the end of the session, we get back to competitive advantage concept and we ponder on the various strategies that enable organizations to outperform their competitors.

The lecture dives deeper into industry analysis by showing how industry profitability can collapse even when the total potential value available in that industry increases. The music distribution case from the 1980s to the 2010s reveals a paradox that cannot be explained by the classic five forces alone. Instead, understanding what happened requires looking at technology, complements, and how value can migrate to actors outside the original industry.

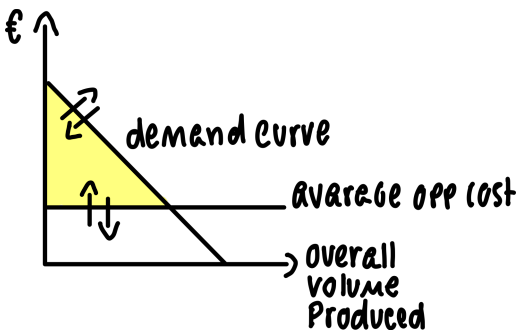
**Forces and the Starting Point**




The standard pressures affecting industry profitability still matter: new entrants push willingness to pay and prices down while increasing costs; buyers and substitutes reduce prices and WTP; suppliers can raise costs depending on their concentration. But the decline of music revenues—from around $22 billion to $7 billion in about ten years—cannot be explained only through rivalry or buyer power. The industry's collapse happened despite massive growth in global music consumption. That contradiction sets up the need for a more advanced analytical tool.

**The PIE Model: Potential Industry Earnings**

To explain the paradox, the lecture introduces the PIE model, which defines the potential value that could be generated and captured within an industry. It corresponds to the area between the demand curve and the average opportunity cost curve. These curves shift with demographic changes, technological advances, substitutes and complements, and changes in purchasing power.




In music, technology transformed both sides of the model. The average opportunity cost declined sharply because digital recording, MP3 compression, and internet-based distribution dramatically reduced the need for physical capital. Production and distribution

became cheap, fast, and accessible to anyone. At the same time, the demand for music increased because consumption became easier, more mobile, and more personalized. People listened to more music than ever before. As a result, the potential value creation in the industry grew—the PIE became larger.

**Why Revenues Fell Even as the PIE Increased**

The key puzzle is that, even with a bigger PIE, the traditional recording industry captured less value. The supply of music exploded due to the drop in production and distribution costs. Anyone could upload, share, or distribute music. Supply grew much faster than demand, pushing the equilibrium price toward zero. This phenomenon is referred to as “music deflation.” The value did not disappear; it simply shifted.

One part of the shift went directly to consumers. Piracy is framed in the lecture not as theft but as an enormous transfer of value from firms to users. When consumers access for free something they once paid for, the surplus is captured by them rather than by firms. The consumer surplus grows while industry revenues shrink.

Another part of the captured value went to Apple. With the iPod and iTunes, Apple entered an industry that was unprofitable on purpose. iTunes sold digital tracks at $0.99, with an Apple margin of just $0.07—essentially no profit. The whole point was to make music a complement that increased the attractiveness of Apple hardware. Cheap music helped sell iPods. Free music helped even more. Apple later allowed users to load any MP3 file—legally purchased or not—because the real revenue came from device sales, not from the music itself. Apple captured a large slice of the exploding PIE by using music consumption as fuel for its hardware ecosystem.


Telecommunication companies captured value as well. Internet usage increased because people downloaded, shared, and streamed music. Telcos benefited from piracy and later from streaming data consumption. The lecture highlights a moment when Warner (the label) asked Warner Cable for a list of users pirating music and Warner Cable refused, because those same users were among their most profitable customers. The interests of labels and telcos diverged completely. A similar dynamic appears with Skype and later WhatsApp: these services provided free communication, destroying long-standing telco profit pools. They are used in the lecture as an analogy showing how technological complements can reshape industries by shifting value away from incumbents and toward new digital platforms that sit next to the original service.

In short, the expanded PIE was captured by consumers, Apple, telecom providers, and digital platforms—not by the record labels who originally owned the industry.

**Complements as the Sixth Force**

This pattern motivates adding a sixth force to industry analysis: complements. A complement is a product whose consumption raises the value of another product. Formally, the willingness to pay for A and B together is higher than the sum of their standalone willingness to pay. Complements can increase the total value created in an industry, but they can also absorb a large share of that value, leaving incumbents with less.

In the music case, the key complements were digital devices (iPod, later smartphones), internet connectivity, and software platforms. These complements made music more valuable to consumers, enlarged the PIE, and then captured substantial portions of it. The lecture explicitly warns that complements can be beneficial but dangerous: they expand demand but can also eat large slices of the industry's economic potential.

**Reframing Competitive Advantage Analytically**

The second half of the lecture refines the analytical definition of competitive advantage. A firm has competitive advantage when the gap between its willingness to pay and its willingness to sell exceeds that of competitors. WTP represents the highest price customers are willing to pay; WTS represents the minimum price suppliers are willing to accept.

Competitive advantage, therefore, comes from widening the wedge between WTP and WTS more effectively than rivals. A strategist asks two questions: how to raise WTP without raising costs proportionally, and how to lower costs without reducing WTP too much. From here emerge the three trajectories of competitive advantage: differentiation (raising WTP), cost leadership (lowering WTS), and dual advantage (raising WTP while lowering WTS simultaneously).

These trajectories are illustrated in the slides as shifts that enlarge the value captured by the firm relative to competitors. The aim is always to maximize the share of the PIE the firm can keep for itself.

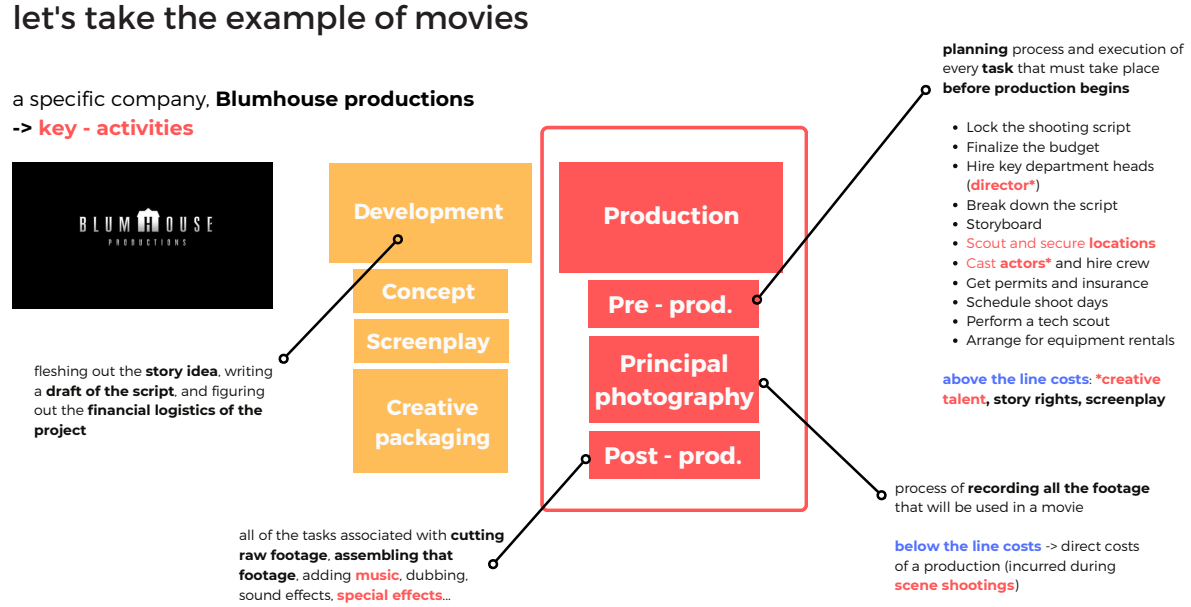
**Final Synthesis**

The lesson demonstrates that industries fail not only because competitive pressures intensify, but because value can migrate toward complements and new platforms that reshape demand, cost structures, and consumer behavior. The music industry's decline is a story of technological transformation, exploding supply, shifting value capture, and the strategic rise of actors like Apple, Skype, and telecom providers who seized opportunities that traditional incumbents could not recognize. At the same time, the analytical framework of competitive advantage deepens to show how firms must position themselves to widen the WTP–WTS gap and protect their share of the PIE in rapidly changing environments.

## SESSION 4: SOURCES AND DIMENSIONS OF COMPETITIVE ADVANTAGE

Examining different types of competitive advantage, we focus on the low cost strategy, its principles and benefits. Specifically, we learn how to perform Value Chain Analysis and its role in identifying cost drivers and opportunities for cost reduction.

### Preparatory material: Jason Blum's Blumhouse




Productions Blumhouse Productions, a renowned film studio, serves as an exemplary case study for the low-cost advantage strategy. Founded by Jason Blum in 2000, the studio quickly gained prominence by adopting an innovative approach to movie-making. Blumhouse's unique formula involves producing high-quality horror and thriller films on modest budgets, allowing them to take creative risks while minimizing financial exposure.

Blumhouse Productions, founded by Jason Blum, has become one of the most distinctive and profitable players in the contemporary film industry. Its success rests on a strategy that radically diverges from the traditional Hollywood model: instead of investing tens or hundreds of millions into a few large bets, Blumhouse produces a high volume of films at extremely low cost, concentrating mainly on horror. This approach reduces financial risk while preserving the potential for massive returns.

The broader industry context is essential to understanding Blumhouse's position. Major studios like Disney, Warner Bros., and Universal dominate global box office revenues and usually operate with very high production and marketing budgets. A typical studio film costs $60–70 million to produce and an additional $40–50 million to market. Independent companies exist, but most struggle to match the studios' scale and rely on partnership deals to secure financing and distribution.

Blumhouse enters this environment with a counterintuitive strategy: it deliberately keeps budgets under $5 million, often far below that level. It achieves these low costs through several disciplined practices: limiting shooting locations (often a single house), avoiding expensive special effects, minimizing speaking roles (which trigger union pay increases), and shortening

shooting schedules. This level of cost control dramatically reduces downside risk—if a film fails, the financial damage is minimal. But when these films succeed, the returns are extraordinary. The breakout success of *Paranormal Activity*, made for only $15,000 and grossing nearly $200 million, was early proof of the model's potential.

Beyond cost structure, Blumhouse differentiates itself through its treatment of creative talent. Directors are given unusual levels of autonomy, including final cut—something even top-tier directors struggle to secure from major studios. In exchange for this freedom, directors accept low upfront pay and tight budget constraints. Actors also work for union scale but receive transparent box-office bonuses tied directly to U.S. gross revenues. Unlike traditional "profit participation," which is famously opaque, Blumhouse defines and pays bonuses clearly and quickly. This creates a culture where talent is genuinely motivated and feels ownership over the film's success.

A critical pillar of the company's strategy is its long-term partnership with Universal Pictures. Under their first-look deal, Universal finances production and marketing and handles distribution. Blumhouse receives 12.5% of first-dollar gross—a highly favorable arrangement. Universal decides whether a film will receive a wide theatrical release only after seeing the first cut and test results. This sequencing minimizes marketing waste: films that do not test well move to digital release, while strong films receive full backing. The model balances creative freedom with market discipline.

The case of *Get Out* illustrates the Blumhouse formula in action. Jordan Peele's script had been rejected by multiple studios, but Blumhouse recognized its originality and potential. The film was produced for $4.5 million, shot in just 23 days, and refined collaboratively after test screenings—including a change to the original ending to increase audience appeal. Universal ultimately chose a wide release supported by a $30 million marketing campaign. The result was a cultural and commercial phenomenon, surpassing $150 million at the U.S. box office and generating substantial bonuses for the cast.


Blumhouse has extended its approach beyond film into television, digital media, live events, and publishing. These expansions aim to leverage the brand's growing cultural relevance—Blumhouse has come to symbolize innovative, accessible, and emotionally intense storytelling. Still, expansion introduces new challenges, especially as television budgets are naturally higher and as the company grows larger.

The central strategic question is whether the Blumhouse model is sustainable. On one hand, the company's advantages—low costs, strong talent relationships, high-volume portfolio logic, and partnership with Universal—are structurally difficult for competitors to replicate. Traditional studios are weighed down by high overhead and cultural norms that make cost discipline harder

to enforce. On the other hand, imitation is possible, and growth may put pressure on the very practices that make Blumhouse successful.

Overall, Blumhouse represents a distinctive and highly effective competitive strategy in the creative industries: reduce risk by minimizing cost, unlock creative potential through autonomy and aligned incentives, and rely on portfolio scale rather than blockbuster dependence. The company has demonstrated that in a market defined by unpredictability, disciplined frugality and creative trust can be more powerful than lavish budgets and rigid control.

## Reference study material: Harvard Business School: Competitive Advantage

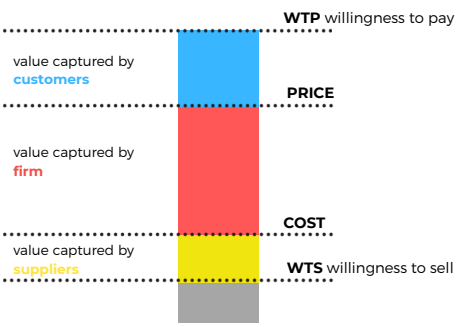
### Introduction to Competitive Advantage

Companies operating in the same environment can experience dramatically different levels of profitability. Some earn consistently high returns, while others barely cover their cost of capital. Industry differences explain part of this variation, since some sectors benefit from favorable competitive conditions while others face structural challenges. But even within the same industry, profitability varies widely. Firms facing the same customers, technologies, suppliers, and regulatory context can achieve very different outcomes.

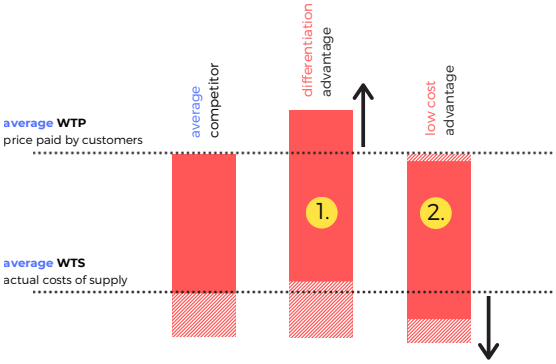
These internal differences shift the focus toward how individual companies compete. A firm outperforms rivals when it manages to create a wider gap between what customers are willing to pay and the costs required to deliver the product or service. This "value wedge" represents the firm's potential to earn superior profits. Improving this wedge requires unique choices—actions that cannot be perfectly replicated by competitors. When a firm's disappearance would reduce the total value available in the market, that firm holds something economically scarce. This scarcity is the essence of competitive advantage.

Competitive advantage emerges not from a single decision or resource but from the combined effect of many interdependent activities: how a firm designs its product, manages suppliers, structures operations, trains employees, interacts with customers, and allocates resources. When these elements reinforce each other and create a system difficult to imitate, the firm produces more value than rivals and captures a greater share of it.

### The Logic of Value Creation and Value Capture




A firm has competitive advantage when the wedge between WTP and WTS is wider than the wedge of its competitors. Value is created whenever the benefits perceived by customers exceed the economic cost of the inputs used to produce the offering. The customer's Willingness to Pay (WTP) sets the upper boundary: it reflects the most the customer would sacrifice to obtain the product instead of the next-best alternative. On the other side of the transaction lies the Supplier Opportunity Cost (SOC), the minimum payment suppliers require to make their contribution worthwhile compared with their alternatives.




The difference between WTP and SOC measures how much total value exists to be distributed among all participants in the transaction. But total value does not automatically translate into profit for a firm. A firm earns profits only when its presence is indispensable in creating part of that value. This idea is captured by the concept of Added Value. A firm has added value when removing it from the market would reduce the total value that could be created. If another competitor could provide the same product at the same cost and generate the same WTP, nothing would be lost by replacing the firm, meaning its added value would fall to zero. In such cases, even highly beneficial products do not guarantee strong profitability, because bargaining power shifts away from the firm.

A company strengthens its added value by widening the gap between WTP and cost more than its rivals can. This can happen by raising WTP without increasing costs proportionally, by lowering costs without diminishing WTP significantly, or by achieving a mix of both. Success depends on choices that differentiate the firm from competitors in a way that matters economically and is difficult to imitate.

**WTP(A) – WTS(A) > WTP(comp) – WTS(comp)**

**The Tension Between Cost and Willingness to Pay**

Improving WTP often requires investments that raise costs, while reducing costs can weaken the factors that make customers willing to pay in the first place. The challenge for any firm is to manage this tension more effectively than competitors do.

A differentiation strategy raises willingness to pay substantially while only moderately increasing costs. Firms following this approach offer superior performance, design, reliability, or service that customers value enough to justify higher prices. The goal is not simply to be different but to be different in a way that customers reward economically.

A low-cost strategy pushes costs downward aggressively while accepting some reduction in willingness to pay, as long as the cost savings exceed the loss in perceived value. This approach relies on tight operational discipline, simplified offerings, efficient processes, and often a narrower customer promise.

Occasionally, companies manage to improve WTP and reduce costs at the same time, achieving what is sometimes called a dual advantage. This outcome is rare because it requires an activity system capable of delivering superior value and superior efficiency simultaneously. When achieved, however, it creates a powerful and durable competitive position.

The tension between WTP and cost defines the strategic landscape. Firms that expand the value wedge more effectively than their competitors gain the potential for sustained superior performance.

**Activity Analysis**

Understanding competitive advantage requires looking inside the firm and examining what it actually does every day. The reading emphasizes that performance differences between companies come from differences in their activities—how they design, produce, distribute, market, and support their products or services. Activity analysis breaks the firm into its component actions to reveal how each contributes to either lower costs or higher willingness to pay.

Activity analysis is not an abstract exercise. It forces strategists to examine the concrete choices and routines that shape performance. Two firms may appear similar from the outside, but small differences in how they structure daily work—how they schedule production, source materials, serve customers, design products, or train employees—can compound into significant advantages.

The logic behind analyzing activities is rooted in three insights:

1. Competitive advantage is produced by activities, not by vague notions like "innovation" or "culture."
   Those qualities matter only if they translate into systematic differences in what the firm does.

2. The firm's cost position and willingness-to-pay position are the result of its activities.
   Activities determine resource use, process efficiency, product features, customer experiences, and all the factors that influence economic performance.

3. Activities are interconnected.
   A change in one area can strengthen or weaken others. Because of this interdependence, understanding the firm's activity system is essential before making strategic choices.

Activity analysis generally unfolds through four steps: cataloging the firm's activities, analyzing their cost implications, analyzing their impact on willingness to pay, and evaluating strategic options that emerge from this understanding. The first step—cataloging activities—lays the foundation for everything else.

**Cataloging Activities: Building an Activity Map**

Value chain as a structured tool for listing and organizing the firm's activities. The value chain divides the company's work into primary activities (such as inbound logistics, operations, outbound logistics, marketing and sales, and after-sales service) and support activities (such as procurement, technology development, human resources, and infrastructure).

The purpose of cataloging is not to record every task performed inside the firm. Instead, the goal is to identify the activities that are strategically meaningful—those that differ from rivals, enable advantage, or create constraints.

A useful activity map reveals:

- What the firm chooses to do.
  These choices may reflect investments, priorities, trade-offs, or strategic intent.
- What the firm chooses not to do.
  Omitting certain activities—luxury service elements, extensive product variety, high-end materials, direct retail presence—can be just as strategic as adding others.
- How the firm's activities reinforce each other.
  A low-cost airline that eliminates meals, simplifies its fleet, uses point-to-point routes, and relies on quick turnarounds is an example of a tightly aligned activity system.
- Where the firm departs from industry norms.
  These differences often reveal the seeds of competitive advantage.

Some firms stand out precisely because they omit activities that competitors consider standard. Others distinguish themselves by performing certain activities in a unique way—through superior technology, distinctive processes, or an unconventional organizational structure.

The reading encourages focusing on the activities that:

1. contribute significantly to costs or willingness to pay,
2. differ across competitors, and
3. reflect the company's strategic choices rather than operational details.

Once the activity map is clear, the strategist can evaluate how each activity affects both cost and willingness to pay. This evaluation becomes the basis for understanding the firm's existing competitive position and for imagining new strategic possibilities.

**Example: the airline industry**

The airline industry offers a useful example for understanding how competitive advantage depends on activities and their impact on willingness to pay and cost. At a high level, airlines provide air transportation services to paying customers, but the processes behind that service involve a long and complex value chain. Each step contributes to both the firm's cost position and the customer's perception of value.

The industry is known for structurally low profitability. Demand is volatile, fixed costs are high, and competition is intense. As a result, small differences in how companies organize their activities can produce meaningful differences in performance. Traditional full-service carriers and low-cost airlines operate in the same competitive arena but configure their value chains in very different ways. Full-service carriers invest heavily in amenities, multiple cabin classes, extensive route networks, airport lounges, and interline agreements. These activities raise both

willingness to pay and cost, creating an activity system designed for business travellers and long-haul passengers who value comfort and connectivity.

Low-cost carriers, by contrast, simplify the activity system to reduce cost drivers wherever possible. They typically fly a single aircraft model, use secondary airports, minimize turnaround times, eliminate free onboard services, and sell directly online. These choices dramatically reduce costs while lowering willingness to pay far less than the cost savings achieved. The activity system is internally coherent, focused on high utilization and efficiency, and allows these firms to offer consistently lower fares while remaining profitable.

Studying the airline industry shows how two firms in the same environment can achieve different competitive positions by making different trade-offs in their activity systems. It also illustrates how analyzing a value chain helps identify where WTP can be increased or costs reduced without disrupting the entire model. The airline example makes clear that competitive advantage comes not from a single choice, but from a system of interconnected activities that reinforce one another in a deliberate and consistent way.

**Activity Analysis: Understanding Cost Differences**

Once the firm's activities are clearly mapped, the next step is to understand how those activities translate into cost differences between competitors. Costs do not emerge randomly: they are the direct result of how activities are designed, how resources are used, and what trade-offs the firm has chosen to make.

A company's total cost position is built activity by activity. Each activity—purchasing, manufacturing, logistics, customer service, marketing—carries its own set of costs, which are influenced by cost drivers. Understanding these drivers allows strategists to identify why one firm is cheaper or more expensive than another, and whether those differences can be changed.

Cost drivers can include factors such as:

- **Scale**, which spreads fixed costs over a larger volume.
- **Learning and experience**, which reduce errors and inefficiencies over time.
- **Capacity utilization**, which measures how intensively the firm uses its assets.
- **Location**, which affects wages, transportation, and access to suppliers.
- **Process design**, which determines how smoothly activities flow.
- **Product variety**, which can complicate operations and increase waste.
- **Vertical integration**, which affects which activities are performed internally.

Even small variations in these cost drivers can generate large differences across firms. A company that simplifies its product line, for example, may reduce its manufacturing changeovers, streamline inventory management, and cut logistics costs all at once. Another company may decide to sell directly to consumers, eliminating expensive intermediaries but taking on new activities that must be managed efficiently.

Strategists analyze costs not by looking at accounting categories, but by linking costs to activities and understanding why those costs arise. Accounting reports often hide the true causes of cost differences because they aggregate expenses into broad categories that do not correspond to specific activities. Activity analysis makes the cost structure visible and shows where improvements are possible.

A powerful insight emerges from this approach: cost advantage is rarely the result of a single activity. Instead, it usually comes from a system of choices that reinforce each other. A low-cost airline such as Ryanair is not cheaper because of one factor alone; the company's entire set of activities—no seat assignments, fast turnarounds, a single aircraft type, minimal service, and secondary airports—works together to produce the lowest possible cost.

Activity-based cost analysis enables managers to:

1. Identify which activities are responsible for the firm's cost position.
2. Understand how competitors structure those same activities.
3. Evaluate whether differences in cost drivers are temporary or structural.
4. Explore whether redesigning activities can shift the firm to a lower-cost configuration.

The goal is not simply to reduce costs but to understand where cost differences come from and how the firm can reshape its activity system to produce a more favorable economic outcome. A firm that succeeds in lowering costs without damaging customer willingness to pay strengthens its competitive advantage and expands the value wedge.

**Activity Analysis: Understanding Willingness to Pay**

While cost analysis reveals how activities shape a firm's cost position, understanding competitive advantage also requires examining how activities influence willingness to pay (WTP). WTP reflects the value customers perceive in the product, and it is shaped by every element of the firm's activity system—from product design to post-purchase support.

A strong position on willingness to pay emerges when the firm's activities create experiences, features, services, or emotional responses that customers value and are ready to pay for. The key insight is that almost any activity can influence WTP, directly or indirectly. Some effects are obvious; others are subtle but equally important.

**How activities shape willingness to pay**

Activities that typically affect WTP include:

- **Product design and development**, which determine quality, performance, aesthetics, and functionality.
- **Manufacturing and operations**, which influence reliability, precision, durability, and consistency.

- **Marketing and branding**, which shape customer perceptions, expectations, and emotional attachment.
- **Sales and distribution**, which affect convenience, speed, and ease of access.
- **After-sales service**, which influences trust, confidence, support, and long-term satisfaction.
- **Technology and innovation**, which introduce new benefits or eliminate pain points.
- **Human resource practices**, which indirectly improve customer experience through employee behavior.

Some activities affect WTP in a very visible way. For example, careful design and engineering improve the functional performance of a product, while a strong brand identity increases perceived value even if the physical product remains similar. Other activities create value in ways customers do not consciously notice. A highly efficient logistics system may lead to better product availability and fresher goods, increasing satisfaction without customers understanding the underlying process.

**Understanding what customers value**

Analyzing WTP begins with identifying who the real customer is and what they genuinely care about. In many industries, the decision-maker, the user, and the payer may not be the same person. Each group values different attributes. Consequently, activities that raise WTP for one group may have limited relevance for another.

Firms then need to understand which needs are most important to their customers. Not all differences matter equally. Some attributes drive customer choices; others are irrelevant or taken for granted. The strategist must distinguish between features that meaningfully influence willingness to pay and those that merely add cost or complexity.

Once customer priorities are clear, WTP analysis explores how well the firm satisfies these needs compared with rivals. Differences in WTP must be tied back to differences in activities. For instance:

- If a competitor is known for fresher products, the reason may lie in its procurement choices, manufacturing rhythm, or delivery frequency.
- If another firm commands a premium price due to strong brand loyalty, the advantage may stem from years of consistent marketing, product design, and customer engagement.

Understanding these links helps clarify whether the firm's activity system is delivering real value or simply adding features that customers do not reward.

**Why WTP analysis matters for strategy**

A firm with a superior WTP position can charge higher prices or gain market share without resorting to price cuts. But WTP alone does not guarantee competitive advantage; the value

wedge widens only when superior WTP is achieved more effectively or more efficiently than competitors.

Through WTP analysis, managers can:

1. Identify which activities truly create value in the eyes of customers.
2. Determine whether the firm is overserving or underserving customer needs.
3. Understand how competitors create perceived value and where the gaps lie.
4. Assess whether changes in activities could meaningfully improve customer willingness to pay.

Ultimately, the goal is to uncover ways in which the activity system can be adjusted to make customers value the product more while ensuring that any increase in cost is smaller than the increase in willingness to pay.

**Activity Analysis: Strategic Options and Integrated Choices**

Once the firm understands how its activities drive both costs and willingness to pay, the final step of activity analysis is to identify **strategic options**—new ways to reconfigure activities to widen the value wedge. This phase blends analytical insight with creativity, because competitive advantage rarely emerges from small, incremental adjustments. It often requires rethinking the activity system as a whole.

A meaningful strategic option must change the configuration of activities in a way that either raises willingness to pay more than it increases costs, or lowers costs more than it reduces willingness to pay. To find such options, managers explore how activities interact, how competitors might react, and how customers define value.

**Understanding the drivers behind advantage or disadvantage**

Before generating options, firms need to identify the **essential drivers** behind competitors' strengths. For example:

- A low-cost competitor may rely on simplicity, scale, or reduced product variety.
- A differentiated competitor may succeed because of superior design, faster delivery, or a stronger emotional connection with customers.

By understanding these core drivers, managers can think more creatively about alternative ways to compete. Sometimes, a firm discovers that it could deliver the same customer value through different activities at lower cost. Other times, it recognizes opportunities to increase willingness to pay by enhancing activities that competitors overlook.

**Anticipating competitive reactions**

No strategic move exists in a vacuum. Competitors respond, especially when a proposed change threatens their position.
For this reason, firms assess whether a rival is likely to:

- start a price war,
- imitate quickly,
- defend its core customers aggressively,
- or ignore the move due to distraction or misalignment.

A good strategic option must remain attractive even when likely competitive responses are taken into account.

**Avoiding a narrow focus on the product**

Managers often make the mistake of concentrating only on physical product attributes. Yet many of the most powerful improvements in willingness to pay or reductions in cost come from activities outside the product itself—sales processes, supply chain adjustments, service innovations, or human resource practices.

A broader perspective includes examining how the firm's activities interact with:

- customers' value chains, and
- suppliers' value chains.

By understanding how the product fits into these broader systems, firms can find new ways to reduce customers' costs, improve their performance, or simplify their processes. These improvements often generate significant increases in WTP without major changes to the physical product.

**Learning from underserved or overserved customers**

Strategic opportunities frequently emerge by looking at customer groups whose needs are not fully met.
Underserved customers may crave:

- higher convenience,
- lower prices,
- more transparency,
- faster service,
- or a simpler offering.

Overserved customers, on the other hand, may be paying for features they do not value. In such cases, simplifying the offering can reduce costs while maintaining or even increasing perceived value.

**Reconfiguring scope**

One of the most powerful ways to redesign the activity system is by adjusting the scope of the firm—changing which customers it serves, which products it offers, or which activities it performs internally.
Expanding or narrowing scope affects:

- economies of scale and learning,
- product variety,
- complexity of operations,
- brand clarity,
- and bargaining power.

Strategic changes in scope often produce new activity systems that competitors may struggle to replicate quickly.

**Thinking in systems, not fragments**

Although activity analysis begins by breaking the firm into parts, strategy requires recombining these parts into a coherent whole. Activities must reinforce each other. When they do, they form a system that is far harder for competitors to imitate than any individual activity.

This leads to an important insight: incremental improvements rarely create or shift sustainable competitive advantage. The most effective strategies involve coordinated changes across many activities at once—sometimes requiring the firm to move temporarily "downhill" in performance before reaching a stronger long-term position.

When activities align around a clear strategic logic, the firm occupies a distinct "peak" in the competitive landscape. Multiple peaks may exist in an industry, but each requires a different integrated configuration of activities.

**Concluding Thoughts**

Competitive advantage does not arise from luck or from participating in an attractive industry. It emerges when a firm manages to create more value—and capture more of that value—than its rivals. This requires more than operational competence. It demands a clear understanding of how the firm's activities shape both willingness to pay and costs, and how these activities fit together into a coherent system.

A company contributes added value only if its presence makes the economic system more productive than it would be without it. Without added value, there is nothing the firm can legitimately capture. Competitive advantage exists when the firm creates a wider wedge between customers' willingness to pay and the costs it incurs. The wider this wedge relative to competitors, the stronger the firm's potential for superior performance.

Creating this wedge depends on doing things differently from rivals. Superiority rarely comes from performing the same activities slightly better; it comes from making distinct choices, accepting trade-offs, and committing to a configuration of activities that others cannot easily imitate. Strategy is about designing this set of choices deliberately, rather than relying on improvisation or incremental improvements.

Understanding activities at a granular level is essential, but the goal is never to optimize each activity separately. Activities must reinforce one another. A firm whose system is internally inconsistent will struggle, even if individual activities appear strong in isolation. Sustainable advantage comes from an integrated whole, not a collection of isolated parts.

The reading closes on an important reminder: although analysis is crucial, analysis alone does not guarantee momentous strategic breakthroughs. Many great strategies emerge from insight, creativity, experimentation, and a willingness to rethink assumptions. But without a rigorous understanding of how value is created and captured, firms cannot judge which insights are viable or which experiments will lead to lasting advantage.

In the end, competitive advantage is about choosing a position, committing to it, and building an activity system that supports it. The firms that succeed do so because they embrace this discipline and shape their organizations around a coherent logic that competitors struggle to replicate.

**Value Proposition Analysis**

A firm gains competitive advantage when it offers a value wedge—between willingness to pay and cost—that is wider than competitors'. But most products and services are made up of many different attributes, and customers value these attributes in different ways. Value proposition analysis helps managers understand *which* attributes matter, *how* their firm performs on them, and *where* strategic opportunities lie.

**Understanding the Value Proposition**

A value proposition describes **why customers should choose a company's offering instead of alternatives**. It specifies the mix of attributes that the firm delivers—price, quality, convenience, design, variety, speed, service, reliability, or emotional appeal—and how this mix differs from what competitors offer.

Customers do not evaluate products by looking at a single dimension. They weigh multiple attributes at once, consciously or unconsciously. For example, in choosing a grocery store, a customer may consider price, product variety, freshness, location, waiting time, friendliness of staff, and availability of additional services. A firm's position in the market emerges from how well it combines these attributes relative to competitors.

**Mapping the Competitive Landscape**

To clarify strategic positions, managers often compare how their firm and competitors perform on several customer-relevant attributes. Even without graphs, the key insight is that each

competitor embodies a **distinct mix** of strengths and weaknesses.
For example:

- A low-cost retailer might excel in price but score lower in variety or in-store service.
- A premium retailer might offer exceptional quality and an enjoyable experience but at higher prices.
- A niche player might stand out through unique items that no one else carries.

The pattern of strengths and weaknesses reveals how each firm creates value for a specific type of customer.

**Why Trade-offs Matter**

A successful value proposition rarely scores at the top on every attribute. Attempting to excel in all dimensions usually leads to internal contradictions, higher costs, and strategic confusion. Competitive advantage typically arises when a firm:

- deliberately **chooses** the attributes it wants to excel in,
- accepts being weaker in others,
- and aligns its activities to reinforce this combination.

Southwest Airlines, for example, focused on low fares, frequent departures, and on-time performance, while intentionally offering fewer amenities than traditional airlines. The consistency of its choices created a strong, coherent value proposition.

**Evaluating and Adjusting the Value Proposition**

Managers use value proposition analysis in several ways:

1. **Diagnosing the current position**
   A firm should stand out clearly on at least one attribute that matters to its target customers. If it does not, it risks commoditization and weak profitability.
2. **Identifying opportunities for adjustment**
   Some attributes may no longer create value because customer preferences change. For example, traditional airlines realized that onboard meals added cost without increasing willingness to pay. Removing them simplified the value proposition and reduced costs.
3. **Discovering new strategic spaces**
   Sometimes the most powerful strategies arise from offering a configuration of attributes that the industry has not considered.
   Examples include:
   - simpler, more transparent pricing models,
   - radically improved convenience,

- elimination of features customers no longer value,
- or introduction of attributes that redefine the experience.

Firms that innovate in this way can sometimes shift the market to a "blue ocean"—a space with fewer direct competitors because the value proposition is fundamentally new.

**The Link to Competitive Advantage**

A strong value proposition does not automatically create a competitive advantage. Advantage occurs only when:

- the chosen attributes boost willingness to pay more effectively than competitors' attributes do,
- or when the firm can deliver its chosen mix of attributes at a lower cost than others.

Still, the value proposition is the outward-facing expression of the firm's positioning. It reflects the strategic choices that define which customers the firm targets, what it promises them, and how it organizes its activities to deliver on that promise.

A well-designed value proposition guides the firm's decisions, clarifies trade-offs, and strengthens internal coordination. Over time, it becomes a key source of advantage, helping the firm differentiate itself in meaningful ways or operate more efficiently than its rivals.

KEY TERMS

- **Added Value**: This refers to the value created by all participants in a transaction, minus the value that remains when the participant or firm in question is eliminated. Essentially, it measures the unique contribution a company makes in a market that cannot be replaced by other players.

- **Cost Drivers**: These are factors that influence the cost of performing an activity. Understanding these helps firms optimize their operations and reduce unnecessary expenses.

- **Differentiation Strategy**: A strategy where a firm offers products or services that are superior in quality, reliability, or prestige compared to competitors. This approach typically allows the firm to charge a higher price.

- **Dual Competitive Advantage**: A strategy that combines both differentiation and low-cost elements. A firm using this strategy offers a superior product while achieving lower costs than its competitors, enabling it to stand out in both quality and price.

- **Horizontal Differentiation**: A situation where different customers prefer different products. No product is seen as universally the best, and customers make choices based on their preferences.

- **Low-Cost Strategy**: A strategy focused on producing a product or service at a lower cost than competitors, enabling the firm to offer a more attractive price to customers.

- **Mass Customization**: The process of using information and production technologies to tailor products to individual customers while still serving a broad range of customers.

- **Supplier Opportunity Cost (SOC)**: The minimum amount a supplier is willing to accept for providing resources and services to produce a product. This concept helps firms understand the lowest cost at which they can operate without sacrificing quality.

- **Unrestricted Bargaining**: A condition where firms or participants can form coalitions with others without limitations, affecting the value division between the parties involved.

- **Value Chain**: An analytical tool that catalogs a firm's activities and how they contribute to the overall value of the product. It is a useful way to break down the processes of a company, from production to after-sales service.

- **Value Proposition**: A statement that outlines why a customer should choose a company's product or service. It highlights the unique benefits that the product offers compared to alternatives available in the market.

- **Vertical Differentiation**: This occurs when products differ in quality, and while all consumers prefer higher-quality goods, they vary in how much extra they are willing to pay for the quality.

- **Willingness to Pay (WTP)**: The maximum amount a customer is willing to pay for a product or service, which plays a crucial role in defining the value that can be captured by a firm.

## SESSION 5 VALUE INNOVATION AND DUAL ADVANTAGE

The session is a dynamic and thought-provoking module within the course, that aims to challenge conventional business thinking and explore the concept of value innovation as a means to create uncontested market space and achieve dual advantage - offering unique value to customers while simultaneously lowering costs. Specifically, we will introduce the concept of value innovation as proposed by W. Chan Kim and Renée Mauborgne in their Blue Ocean Strategy, and understand how value innovation transcends the traditional trade-off between differentiation and low cost, allowing businesses to break free from existing industry boundaries.

**Preparatory material: The Evolution of the Circus Industry; Even a Clown can do it, Cirque du Soleil (B)**

We explore Cirque du Soleil as a pivotal case study for new market space creation in seemingly unprofitable industries and we delve into how le Cirque revolutionized the circus entertainment industry by combining elements of multiple creative sectors

Competitive strategy in creative industries begins with a simple observation: firms do not succeed merely because they create something beautiful or innovative. They succeed when they make a set of deliberate choices that position them to earn superior financial returns over time. This principle applies even in markets defined by taste, aesthetics, cultural meaning, and fast-moving trends. Creativity changes what people want, but strategy determines who captures value from that desire.

A firm operates within an industry whose structure shapes the baseline level of profitability. Rivalry, substitutes, buyer power, supplier power, and the threat of entry all influence how difficult it is to earn a profit. The creative context alters how these forces behave. Rivalry often takes the form of competition for attention rather than price. Substitutes are not limited to direct competitors but include any experience capable of satisfying the same emotional or symbolic need. Barriers to entry can be low because ideas are cheap to generate, even if they are difficult to scale. Yet structural analysis still matters: it helps explain why some creative markets become crowded and low-margin, while others support premium positions.

Within that structure, firms must choose how to compete. They can attempt to deliver unique value that justifies a higher willingness to pay, or they can construct a model that delivers acceptable value at lower cost. In cultural markets, differentiation tends to dominate because consumers value experiences, stories, and identities as much as functional attributes. But the essence of strategy remains the same: the activity system of the firm must reinforce a clear position. Internal coherence ensures that the firm's choices fit together; external coherence aligns those choices with the realities of the industry; and dynamic coherence ensures the strategy remains viable as technologies and tastes change. When coherence breaks, strategies unravel because they become easy to imitate and difficult to operate.

A powerful illustration of strategic logic in a creative context comes from the circus industry. Historical circuses were built around equestrian performances, clowns, acrobats, and jugglers, presented either in dedicated arenas or under large tents. Over time, the circus evolved into an iconic American spectacle, with traveling troupes, elaborate parades into town, and a three-ring format that prioritized scale and sensory overload. These shows attracted huge audiences during the 19th and early 20th centuries. But as the decades passed, the industry began to stagnate. The traditional circus relied heavily on children and families, used costly trained animals, and maintained a logistical system that required constant travel, complex setup, and increasing labor expenses. Competing entertainment options—television, film, theme parks—shifted consumer expectations. Quality of experience fell as the emphasis on spectacle diluted artistic focus. By the post-war period, the circus was a declining, structurally unattractive business. Ticket revenues dominated, concession sales added little, and touring costs climbed. The industry was fragmented, aging, and losing cultural relevance.

These conditions created the perfect environment for strategic reinvention. Instead of improving the traditional circus format, innovators reimagined what “circus” could mean. They removed animals entirely, eliminating enormous costs and reputational risks. They abandoned the three-ring format and replaced spectacle with a theatrical, narrative-driven experience. They targeted adults rather than children, drawing in a segment with far higher willingness to pay. They introduced original music, staging, lighting, and choreography, blending circus techniques with performance art. By doing so, they created a value curve fundamentally different from the traditional industry. Costs fell dramatically, yet willingness to pay rose because the experience spoke to a new cultural need. This type of strategic leap demonstrates value innovation: raising some features, reducing others, eliminating outdated elements, and creating entirely new sources of value.

The success of such reinvention depends on the firm’s activity system. No single choice can deliver advantage on its own. Eliminating animals matters only if the creative direction shifts toward human artistry. Targeting adults works only if the aesthetic supports emotion, narrative, and sophistication. Permanent venues make sense only if show quality is consistent and repeatable. Each activity reinforces the others, creating a system that is difficult for rivals to imitate without redesigning their entire model. Creative industries often underestimate the power of these complementarities because they focus on ideas rather than systems. Yet the firms that achieve sustained success build coherent configurations rather than chasing trends.

Sustained competitive advantage in creative industries is rare because creative content is easy to copy, talent is mobile, and novelty decays quickly. To endure, firms rely on assets that complement their creative output: strong brands that signal trust and identity, intellectual property libraries that anchor long-term monetization, distribution networks that provide reach, and organizational routines that help teams generate repeatable creative success. Some firms benefit from network effects, such as platforms that become more valuable as more creators and consumers join. Others rely on cultural capital—the perception of prestige—that elevates willingness to pay independently of functional attributes. Advantage emerges when these elements reinforce each other and become difficult for newcomers to replicate.

The environment continues to shift rapidly. Digital technologies, streaming platforms, new forms of short-form content, and evolving consumer ethics around sustainability and animal welfare all reshape what audiences expect. Firms must adapt without losing their identity. Strategic renewal requires constant sensing, thoughtful experimentation, and occasionally the willingness to cannibalize older formats in order to create new ones. The circus example illustrates this tension: firms that clung to spectacle, animals, and tradition declined; firms that reinterpreted what a circus could offer found new demand and reignited cultural relevance.

Ultimately, winning in creative industries requires a balance between artistic innovation and strategic discipline. Creativity determines the potential for value; strategy determines who captures it. The most successful firms diagnose their environment accurately, choose a clear way to win, build a coherent system that supports that choice, and evolve with enough flexibility to face technological and cultural change without losing their core identity. Creativity fuels expression, but strategy ensures survival.

Cirque du Soleil represents one of the clearest examples of how creative reinvention, when paired with strategic discipline, can transform an entire industry. What began as a small group of street performers in Quebec became a global cultural phenomenon capable of reshaping the very definition of live entertainment. Yet this outcome was never inevitable. It emerged from a combination of artistic ambition, risky strategic bets, shrewd commercialization choices, and a carefully constructed identity that allowed Cirque du Soleil to distance itself from both the traditional circus and the conventions of theatre and opera.

The founders of Cirque du Soleil came from a world closer to counterculture than to business. Their early troupe, the Club des Talons Hauts, was a loose collection of stilt-walkers, fire-eaters, and street entertainers who shared a desire to perform, travel, and explore creative possibilities. What distinguished them from similar groups was their willingness to commercialize their artistic vision and their comfort with blending creativity and business from the very beginning. Although their initial project was supported by public funding tied to the celebration of Jacques Cartier's arrival in Quebec, the troupe quickly expanded its ambitions and invested heavily in equipment, tents, and touring capacity. These choices brought early financial strain, but they also forced the organization to adopt a professional mindset that separated Cirque du Soleil from the more intimate, family-driven new circus movements emerging at the same time.

From the outset, the artistic identity of Cirque du Soleil was intentionally unlike anything audiences associated with the circus. The troupe combined circus arts with street performance, avant-garde costumes, otherworldly lighting, and original music, all designed to evoke a dreamlike world rather than a series of feats. Unlike traditional circus, which often assembled a rotating roster of unrelated acts, Cirque began each production by defining a theme and building every element—music, staging, costumes, choreography—around it. Instead of a storyline with dialogue, each show offered a conceptual atmosphere, leaving room for interpretation but ensuring coherence. This approach made the experience seamless and immersive. It also allowed spectators to return multiple times to entirely different productions, each with its own identity, such as Saltimbanco, Quidam, Alegría, or Mystère.

Music played a pivotal role in shaping this experience. Rather than supporting the acts, the original score set the emotional tone and dictated the rhythm of movement and lighting. Creators

like René Dupéré transformed thematic ideas into full soundtracks that guided the rest of the creative process. The result was a performance in which "you see the music in the movement, and hear the movement in the music," an inversion of the traditional circus logic. Seating arrangements reinforced the theatrical feel: instead of a three-ring layout designed for spectacle, Cirque used a stage without a ring and positioned the audience on three sides to focus attention on the unfolding thematic journey.

Another defining feature was the rejection of star performers. In traditional circuses, the presence of a celebrity acrobat or animal trainer could determine the commercial success of a show. Cirque du Soleil avoided this entirely. Performers were costumed and contextualized in ways that made them anonymous. There was no ringmaster announcing acts, no grand introduction of individual stars, and the programme relegated performer names to the back pages. This choice aligned perfectly with the company's creative philosophy: the show itself was the star, not any single act. While some early performers found this anonymity unsettling, it helped build a model in which artistic cohesion mattered more than personal glory and in which the brand identity of Cirque du Soleil, rather than any individual talent, held the real value.

Perhaps the most radical break from circus tradition was the elimination of performing animals. Historically, circuses revolved around horses, elephants, and exotic creatures, which embodied spectacle but carried enormous costs and growing ethical concerns. Cirque's refusal to use animals allowed it to lower operational costs, design more flexible acts, and present itself as a contemporary, culturally sophisticated alternative to the old circus formula. Audiences embraced this shift, confirming that Cirque had tapped into a cultural moment where entertainment was increasingly expected to reflect modern sensibilities rather than nostalgia. As one circus historian noted, debating whether Cirque "counts" as a circus misses the point entirely: it is what the audience perceives it to be, and Cirque successfully defined that perception in its own terms.

Once Cirque du Soleil established its creative identity, it refined a business model that allowed it to scale. Productions typically premiered in Montreal, toured North America for several years, then expanded into Europe and Asia. This long lifecycle ensured the company extracted maximum value from each show. Unlike the seasonal, regional pattern of traditional circuses, Cirque built a mix of touring productions and permanent installations. Shows like Mystère, "O", and La Nouba occupied purpose-built theatres in major entertainment hubs such as Las Vegas and Orlando, capturing steady streams of tourists and reducing logistical complexity. Touring shows like Quidam demonstrated impressive profitability: produced for around $5.9 million, Quidam consistently exceeded expected annual revenues of $14.6 million and maintained strong performance across continents.

Cirque's ability to command high ticket prices reflected its deliberate shift in audience. Instead of families seeking affordable entertainment for children, Cirque targeted adults willing to pay premium prices for sophisticated cultural experiences. Tickets in New York reached $65–85 for Dralion, with VIP packages up to $230. In Las Vegas, "O" became one of the city's most expensive shows, with seats priced at $110 as early as 2000. High occupancy rates—typically between 85% and 95%—underscored the strong demand. Cirque also diverged from traditional circuses by keeping concessions minimal; only about 10% of revenues came from merchandise or food

sales, compared to roughly 20% for Ringling-type shows. This decision preserved the atmosphere of the performance and reinforced the premium positioning.

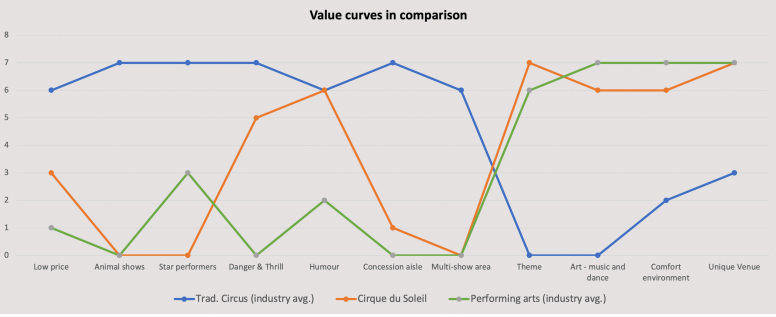
Sponsorship played a supporting but meaningful role. Instead of relying on local fundraising organizations, Cirque partnered with brands that aligned with its upscale image. Sponsors received tasteful visibility, often linked to VIP experiences rather than intrusive advertising. This approach further distinguished Cirque from mainstream circuses, whose concessions and sponsorship styles felt commercial and cluttered by comparison.

As the brand strengthened, Cirque expanded into new ventures that leveraged its artistic assets. The company produced videos, documentaries, and eventually films such as Journey of Man, an IMAX production that extended the Cirque experience into a new medium while retaining its signature aesthetic. These projects allowed Cirque to reach audiences in environments like science museums, where interactive installations deepened engagement beyond traditional cinema. Such diversification served not as a distraction but as a way to reinforce the core brand while experimenting with new forms of storytelling.

The broader circus industry, meanwhile, struggled to innovate. Traditional companies embraced novelty—adding more somersaults, more tigers, more risk—but not true innovation. They pushed existing acts to new extremes without altering the underlying experience in ways audiences could meaningfully appreciate. Costs rose while perceived value stagnated. This pattern contrasted sharply with Cirque du Soleil, which shifted the basis of competition entirely. Instead of asking performers to do more dangerous stunts, Cirque redesigned what audiences expected from live entertainment. It replaced escalation with reinvention and created a model that inspired millions while generating revenues far exceeding those of its long-established competitors. Revenue charts in the document show Cirque approaching or surpassing Feld Entertainment's financial performance over time, illustrating how innovation reshapes industry economics. Attendance figures reveal exponential growth through the 1990s into the early 2000s, demonstrating the global appeal of Cirque's reimagined creative formula.

Cirque du Soleil proves that even in industries built on creativity, true advantage does not come from novelty alone but from the ability to redefine value. By blending artistic experimentation with disciplined business strategy, the company built an experience that resonated across cultures and generations. It turned what once seemed like a declining sector into fertile ground for reinvention. Its growth shows that audiences reward not just talent, but coherence, emotional depth, and the courage to move beyond tradition. In doing so, Cirque du Soleil became not only a leader in live entertainment but also a masterclass in strategic innovation within creative industries.

Strategically, Cirque du Soleil's innovation becomes clear when mapped through a value curve—a representation of the key factors buyers care about and the level at which each industry alternative offers them.



Cirque repositioned itself between circus and performing arts, lifting artistic elements while removing the costly legacy features of the traditional circus.

| | Big League | Small League |
|---|---|---|
| ***Threats from entry*** | ***Extremely low***. *Big league is highly capital-intensive (huge facilities and equipment, star performers, travel expenses and insurance, advertising); brand name already established by main players. Very hard to enter industry group* | ***Very high*** *(only few structural and regulatory obstacles, e.g. ban of performance with wild animals; ask for licenses for street performances). Negative effect on WTP and Prices* |
| ***Rivarly*** | ***Fierce monopoly competition*** *from the dominant players (-> the series of consolidating M&A testify that profitability is viable only to few players). Existing players dominate in terms of size (talent attraction, reputation and brand name) at national level. Negative effect on Costs, WTP and Prices* | ***Highly fragmented*** *industry (many small regional/local players), with limited annual or bi-annual tours; trying to limit competition by locating a geo segment or not offering the shows at the same time in the same location. Positive effect on Costs, WTP and Prices* |
| ***Supplier bargaining power*** | ***Very high.*** *Subcontractors model (i.e. no emolyees, yet talent contracted for show); demand for significant salaries and bonuses; star acts advertised in billboards; each performance tied to specific talent, rare in supply. Negative effect on Costs* | ***A priori irrelevant.*** *Those talent that choose inidependence (from Big League) built one-man / one-family show; the entire show is carried by few names' exceptional acts* |
| ***Buyer bargaining power*** | ***High.*** *Family with pre-teenage children + adult circus lovers can shift to other forms of entertainment (live sports, DVD, video games). Pressure on issues of animal welfare and protection. Negative effect on WTP and Prices* | ***High.*** *Family with pre-teenage children + organized audience groups (schools, associations, etc.). The first: pressure on prices; the second: more loyal and repeat buyer. As for the national level, more pressure on issues of animal welfare and protection. Negative effect on WTP and Prices* |
| ***Threats from substitutes*** | ***Very high.*** *Cable TV, video rentals, home video games (Nintendo, Playstation); professional sporting events -> fairgrounds were increasinigly being replaced by city arenas -> ask to move from tent to rent such venues. Negative effect on WTP and Prices* | ***Very high.*** *Same reasons as for Big League, plus that second-tier cities (Pittsburgh, Cleveland, etc.) were looking to expand their cultural offerings (with more high-end performing arts). Negative effect on WTP and Prices* |

A crucial part of Cirque du Soleil's success lies in its ability to combine, within a single strategic model, both strong differentiation and significant cost reduction. The company does not innovate only on the experiential side; it also redesigns its cost structure. On one hand, Cirque raises customers' willingness to pay (WTP) by delivering a more sophisticated artistic experience—original music, cohesive themes, curated scenography, and a theatrical atmosphere drawn from opera and contemporary performing arts. On the other hand, it lowers its cost to serve (WTS) by eliminating the most expensive elements of the traditional circus, such as animal acts, star performers, and the heavy logistical apparatus required for large touring infrastructures.

The result is an expanded gap between what audiences are willing to pay and what it actually costs to deliver the experience—a widened value–cost margin that translates into superior profitability compared to industry rivals. Cirque du Soleil therefore operates on a dual front: it increases WTP through artistic upgrading and it reduces WTS by stripping away legacy cost drivers. Through this dual advantage, the company does not simply outperform the traditional circus; it reshapes the value curve entirely, opening a new competitive space where premium pricing and a lean cost structure can coexist without contradiction.

Cirque du Soleil's redesign of the circus can be interpreted through the eliminate–reduce–raise–create logic, crystallizing its shift to a blue ocean space.

Cirque du Soleil widens the value–cost gap: by raising willingness to pay through artistic sophistication, and lowering cost-to-serve by removing the most expensive elements of the traditional circus.

Cirque exemplifies the eliminate–reduce–raise–create logic: it strips out legacy circus elements while creating new artistic attributes that shift the basis of competition.

**Reference study material: W. Chan Kim and Renée Mauborgne, 1999. "Creating New Market Space", Harvard Business Review, January-February**

Competing directly with rivals inside an established industry often leads to a dead end: margins shrink, differentiation evaporates, and every new move is rapidly matched. Managers know this intuitively—they feel the squeeze of rivalry and the stagnation of markets that grow too slowly to support everyone. Yet, even when they recognize the trap, they often struggle to imagine genuine alternatives. They are told to "think outside the box," but the advice rarely comes with a method. What Kim and Mauborgne propose instead is a systematic way to break free: companies can create new market space not by predicting the future or relying on flashes of genius, but by looking across the conventional boundaries that define competition. Their research identifies recurring patterns in how successful firms reconstruct industries rather than compete within them. These patterns challenge the assumptions that anchor firms in head-to-head rivalry.

Most industries converge around shared beliefs about who the customer is, which needs matter, and how products should be configured. Managers imitate each other, adopt the same KPIs, attend the same trade shows, benchmark the same rivals, and gradually create an environment where innovation becomes incremental rather than transformative. When everyone improves along the same dimensions, the result is sameness. The alternative is not to innovate *within* those dimensions but to redefine them. Companies do this by looking across substitute industries, strategic groups, buyer groups, complementary offerings, the emotional–functional orientation of their industry, and the evolution of trends over time—six lenses that reveal opportunities hidden in plain sight. Each lens provides a different way to escape industry logic and uncover unmet demand.

Looking across substitutes is the first lens. Customers always make trade-offs between industries, not just between companies. When someone decides how to spend a night out, the alternatives might include cinema, dining, theatre, or staying home—very different businesses solving the same underlying need. But sellers rarely think this way; they focus only on direct competitors. The example of Home Depot captures how powerful the substitute lens can be. Instead of viewing its competition as other hardware stores, Home Depot recognized that homeowners were choosing between hiring contractors and doing the work themselves. Contractors offered expertise but at high cost and with substantial inconvenience. Hardware stores offered affordability but little guidance. By combining the low cost of DIY with the expert knowledge usually offered by contractors, Home Depot converted latent demand—people who wanted to improve their homes but lacked skills—into an entirely new customer base. Its value innovation came from raising some factors, reducing others, and eliminating what didn't matter, a logic illustrated in the value curve diagrams presented in the article.

Intuit did something similar with Quicken. Instead of viewing other software as the main competitor, Intuit realized that its true substitute was the pencil. People didn't reject software because they preferred complexity; they rejected it because it was too expensive, too technical, and too hard to use. The pencil was cheap and intuitive. By combining the pencil's simplicity and price advantage with the speed and accuracy of the computer, Intuit created a breakthrough product, expanding the market a hundredfold. Again, the key insight came not from technology but from understanding the real basis on which customers made trade-offs.

The second lens is looking across strategic groups within the same industry. Strategic groups are clusters of firms with similar business models. In fashion, haute couture and classic lines represent two groups differentiated by price and design orientation. Ralph Lauren succeeded by understanding the reasons consumers move between groups. Customers are drawn to haute couture for the emotional value of exclusivity and craftsmanship, but they rarely want extreme avant-garde fashion. Classic lines offer durability and quality but lack emotional resonance. Ralph Lauren blended the best of each—offering timeless styles with aspirational branding—and created new demand not by splitting the difference, but by combining decisive advantages of each group. Other examples follow the same pattern: the Toyota Lexus offered high-end performance at lower luxury prices; the Walkman fused the cool image of boomboxes with the portability of radios, creating a new market of personal audio.

The third lens looks across the chain of buyers. Industries often fixate on a single buyer group—purchasers, users, or influencers—even when these groups have different priorities. Bloomberg transformed the financial information industry by shifting attention from IT managers (who purchased the systems) to traders (who used them). Traders needed speed, analytical tools, and intuitive keyboards, not standardization and technical elegance. By designing for the user rather than the purchaser, Bloomberg created a value proposition so compelling that users pressured their firms to adopt it. Similarly, Philips Lighting shifted from purchasers to influencers like CFOs and PR managers when it launched the Alto bulb, recognizing that disposal costs and environmental concerns mattered far more to them than to purchasing departments. A small shift in focus unlocked entirely new demand.

The fourth lens involves looking across complementary products and services. A product is rarely used in isolation; its full value is shaped by what happens before, during, and after use. Movie theaters suffer when babysitting is expensive or parking is difficult, even though those issues technically lie outside their business. Borders and Barnes & Noble built their superstore model by recognizing that buying books involves searching, browsing, sampling, and enjoying a quiet space. By offering knowledgeable staff, large inventories, comfortable seating, long opening hours, and coffee bars, they didn't improve the book—they improved the *experience of reading*. New demand emerged the moment the boundary of the "product" expanded beyond the transaction. The superstore diagrams in the article show how raising staff knowledge, extending hours, and adding cafés created massive value while reducing other factors like price.

The fifth lens considers the emotional–functional orientation of the industry. Some industries compete on functionality, others on emotion, but these orientations are not fixed. Starbucks turned coffee—a commodity—into an emotional experience centered on atmosphere, identity, and ritual. Swatch turned budget watches into fashion accessories instead of timekeeping

devices. Both cases show how infusing emotion into functional markets can unlock new demand. Conversely, The Body Shop stripped away the emotional glamour of the cosmetics industry and focused on natural ingredients, ethical sourcing, and simple packaging. By eliminating the costs tied to luxury imagery, it offered a new value curve that appealed to customers who cared more about function and values than fantasy. The graph in the document shows this divergence clearly.

The final lens asks companies to look across time. Trends such as deregulation, digitalization, or environmentalism reshape industries, but firms often view these trends passively, trying to keep up rather than anticipate how they will shift value for customers. The method described in the article is not about predicting the future but identifying trends that are decisive, irreversible, and moving along a clear trajectory. Enron—before its collapse for unrelated reasons—succeeded initially by anticipating the consequences of gas deregulation. It built a national pipeline network to exploit regional price differences once markets opened. Cisco did something similar by recognizing that the explosion of Internet traffic demanded faster, seamless data exchange; its routers and switches became the backbone of the emerging digital world. These companies did not predict technology—they interpreted how trends would redefine value.

Across all these cases, the underlying logic remains constant: industries trap themselves within boundaries of their own making. Companies that create new market space challenge those boundaries by shifting perspective. Instead of asking how to compete better, they ask how to redefine what customers value. The diagrams in the article summarize this contrast: traditional competition focuses on improving within the industry's existing rules; market creators rewrite those rules by looking across industries, groups, buyers, complements, orientations, and time.

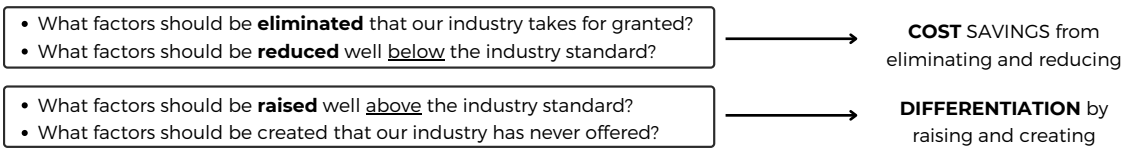
Ultimately, the ability to create new market space is not limited to start-ups or creative sectors. It is how large, established companies regenerate themselves and how small players become global leaders. As markets become more saturated and traditional growth slows, this capability becomes not an advantage but a necessity. Market creation enables firms to escape the gravitational pull of competition and build uncontested space—where they can, at least temporarily, shape the terms of demand rather than respond to them.

## theoretical wrap up

shifting the focus of strategy

| ***conventional boundaries of competition*** | FROM ***head to head competition*** | *TO* ***creating new market space*** |
|---|---|---|
| industry | focuses on rivals within its industry | looks across substitute industries |
| buyer group | focuses on better serving the buyer group | redefines the buyer group of the industry |

value innovation and dual advantage



## SESSION 6 SUSTAINING COMPETITIVE ADVANTAGE

The session focuses on the importance of continuously adapting and evolving to maintain a competitive edge in a dynamic marketplace. Participants will explore the urgent need for businesses to react to competition effectively while leveraging data as a new and powerful source of advantage.

### Preparatory material: MRC's House of Cards

Netflix, the renowned streaming giant, serves as an illuminating case study of leveraging data as a new source of competitive advantage within the TV industry of the 2010s. Through the analysis of the offer Netflix made for financing the series House of Cards, participants will learn about competitor analysis, the impact of disruptive innovation, and strategies for staying ahead in the face of rapidly changing market dynamics.

**Sustaining Competitive Advantage — The Broader Frame of the Session**


The strategic dilemma facing MRC and Netflix only makes full sense when seen through the broader lens of how firms sustain a competitive advantage over time. The television industry in the early 2010s was in the middle of a structural shift: new technologies, new viewing behaviors, and new entrants were eroding the old boundaries of competition. Traditional networks mainly focused on protecting their existing revenue streams—advertising for broadcasters, subscription fees for premium cable—and treated the online ecosystem as a secondary space. Netflix, by contrast, operated with a forward-looking logic: it was born in the online world and sought to expand aggressively within it.

The strategic question at the heart of Session 6 is therefore not only whether MRC should trust Netflix, but also how Netflix is trying to build a sustainable strategic position in an industry being reshaped by digital consumption. House of Cards becomes the vehicle through which Netflix attempts to transform itself from a mere content aggregator into a differentiated, high-value creator—one capable of constructing a long-term competitive advantage.

**Why Netflix Needed Original Programming to Sustain Its Advantage**

Although Netflix was growing rapidly, its business model in 2010–2011 faced a structural vulnerability: it depended almost entirely on licensing content from studios and networks that increasingly viewed Netflix as a threat. The cost of content acquisition was rising steeply, and Netflix lacked negotiating leverage because it had no proprietary content of its own. As competitors (Amazon, Hulu, cable networks, and eventually HBO itself) began moving into online distribution, Netflix risked being trapped in a commodity position—an interchangeable aggregator of other people's shows.

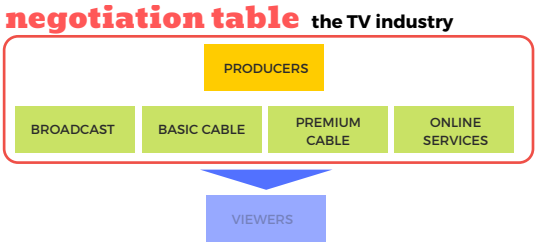
Original programming became essential for two core strategic reasons:

**Differentiation logic**

Without exclusive content, SVOD services look identical. The slides explicitly emphasize that aggregators struggle to differentiate in consumers' minds. Netflix needed content that no competitor could replicate—a clear identity that would build brand strength, reduce churn, and increase switching costs. House of Cards was designed to function as a flagship, a signal of brand elevation.

**Negotiation leverage logic**

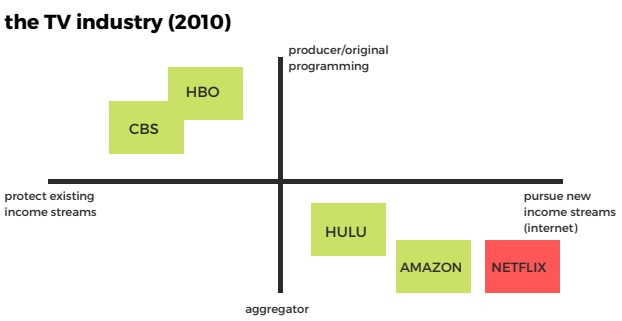
Studios had increasing power over Netflix in licensing deals. By producing original content, Netflix could reduce its dependence on those studios. Originals serve as a fallback option in negotiation, allowing Netflix to walk away when prices rise. This is a classic move for sustaining margins in the long run: reduce supplier power by controlling strategic assets.

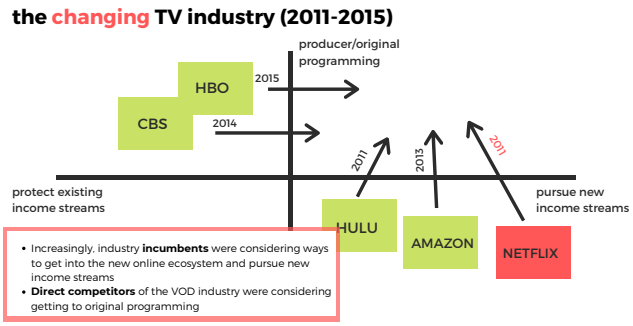



**Positioning in the Evolving TV Landscape**

Where does Netflix stand in the TV industry?

How is the industry evolving in early 2010s?




Conceptual map of the television industry: one axis represents the shift from protecting traditional revenue streams to exploring new, internet-based ones. The other axis represents the continuum between aggregators and producers.

In 2010:

- HBO, Showtime, and traditional networks were still operating primarily in their legacy models.
- Hulu and Amazon were entering the streaming world.
- Netflix occupied the most advanced position in the "online aggregator" quadrant—but did not yet produce content.

Between 2011 and 2015, all major competitors began shifting diagonally: streaming platforms moved toward production, while traditional networks explored online distribution. Netflix needed

to move faster and more decisively than any of them. Original programming was the strategic leap that moved Netflix into a new category: not just an online service, but a full-fledged premium network with unique content, delivered through a radically different user experience.

**Netflix's Data Advantage as a Source of Sustainable Competitive Advantage**

While all networks had access to ratings data, Netflix possessed something fundamentally more powerful: granular behavioral data at the individual level. The slides list dozens of variables Netflix could track—device type, time of viewing, search patterns, rewatches, pauses, even micro-level engagement with specific scenes. This data produced a **taste profile** for each user, enabling Netflix to personalize recommendations and marketing materials in a way absolutely impossible for linear broadcasters.

This creates a reinforcing cycle:
More viewing → more data → better recommendations → more engagement → more retention → even more data.

This feedback loop is path dependent and cumulative, meaning that once Netflix builds this advantage, latecomers cannot replicate it quickly. House of Cards was one of the first major projects to be selected *because* the data suggested a strong overlap in audience interest for Fincher, Spacey, and political thrillers. Netflix's betting logic was therefore not speculative—it was analytically grounded. This data-driven model helps sustain Netflix's advantage by making its content decisions more accurate and its user experience more addictive.

**Deep Strategic Fit Between Netflix's Distribution Model and House of Cards' Creative Design**

Oneof the core ideas of the case: traditional networks and Netflix optimize value in fundamentally different ways.

**Netflix (SVOD) vs other TV networks**

| | *NETFLIX* | *OTHER NETWORKS* |
|---|---|---|
| TIMING OF WATCHING | **Economically neutral.** Subscribers can watch it anytime in the life of the license | **Economically relevant.** Wed night at 9PM. Precise slot to sell advertising against it // instill return on a fix (schedule) basis |
| VALUE LOGIC | **Demand fulfillment.** The most watched episode of any given series on a given day is episode one, season one. **Invest in entire series.** | **Demand creation.** The most watched episode of any given series on a given day is episode one, season one. **Invest in pilot.** Opportunity cost of a show's failure is very high. |
| MATCH CONTENT AND AUDIENCE | **Individual viewer.** Know exactly each single viewer preference, so to propose the best content for them. | **Critical mass.** Make sure content match the tastes of the vast majority of your audience. |
| BUSINESS LOGIC | **Maximize satisfaction.** Assemble the best collection of content to meet the taste of each viewer. | **Maximize volume.** Get together the max number of viewers for each individual show. |

## House of cards and Netflix are a perfect match

### Netflix as a MODEL for content DISTRIBUTION (on demand - subscription-based)

Screen intimacy:
we are video-conferencing with the narrative

MRC interest in story and characters complexity

13-hour movie
the series is conceived as a cinematic product

chapters
the episodes are as seen as sequential steps of a book

This way, the product increases it perceived quality

## House of cards and Netflix are a perfect match

### Netflix as a MODEL for content DISTRIBUTION (on demand - subscription based)

Binge-viewing
the practice of watching multiple episodes of a single television show in one sitting versus watching an episode a week on traditional networks

MRC interest in getting the highest creative freedom as possible

**Episodes do not require**:
- precise length fit to 22-44mins (30/60 TV slot)
- act breaks to accomodate commercials
- mini cliff-hangers to build interest in the next episode

**It allows talent to engage more with the work, and expand their creative potential**

Traditional networks depend on:

- fixed scheduling
- weekly releases
- advertising slots
- mass-market appeal
- pilot testing
- cliffhangers and episodic structure

Netflix operates with:

- no scheduling constraints
- simultaneous release
- subscription revenue
- individualized viewing
- no need for pilots
- no need for artificial act breaks or cliffhangers

This makes Netflix uniquely suited for serialized, long-arc storytelling. House of Cards was conceived as a 13-hour narrative, closer to a film than a sequence of standalone episodes. Its structure assumes binge viewing. Episodes can vary in length. The pacing is controlled creatively, not by commercial breaks.

This match reinforces the strategic logic:
*The project that traditional networks would have constrained is exactly the one that maximizes Netflix's unique strengths*.

**How MRC's Creative Philosophy Aligns Perfectly with Netflix's Distribution Philosophy**

MRC is a "director-driven" company. It believes in artistic control, minimal interference, and long-form creative development. Netflix, for this deal, offered complete creative freedom and no pilot requirement. For MRC, such freedom is unique: almost no network—premium or otherwise—allows a studio to develop an entire season without executive oversight.

Thus, the partnership aligns not only economically but ideologically. MRC gains the autonomy it prizes; Netflix gains a prestige product that signals its entry into a higher creative tier. Their interests converge around the idea of trusting top-tier creators to deliver cinematic storytelling at scale.

**How Netflix Uses House of Cards as a Strategic Move to Preempt Competitors**

The slides make clear that Netflix expected rising competition in online streaming. To avoid being trapped in a commodity market, Netflix used House of Cards to:

- acquire scarce assets (exclusive rights to a high-prestige series)
- secure early mindshare with consumers
- establish itself not as a rerun library but as a premium destination
- build taste-based loyalty early, before competitors expanded
- create switching costs by tying subscribers emotionally to a narrative unavailable elsewhere

This preemptive strategy helped Netflix lock in a long-term advantage.

**Sustaining Netflix's Competitive Advantage in the Long Run**

The central thread connecting the entire session is the idea that a company does not merely seek competitive advantage in a static sense—it must find a way to *sustain* that advantage as industry conditions evolve. For Netflix, House of Cards was not just a content investment; it was a foundational move aimed at repositioning the company in the rapidly transforming TV ecosystem. As new entrants, new distribution models, and rising licensing costs threatened Netflix's margins and identity, the company needed a strategy that would remain robust despite competitive pressure.

Netflix sustains its competitive advantage through three mutually reinforcing mechanisms:

**A. Exclusive Original Content as a Differentiation Engine**

Before House of Cards, Netflix risked appearing interchangeable with other aggregators like Hulu or Amazon. Exclusive originals eliminate that risk. They become "destination content"—the kind audiences subscribe *specifically* to access. The more originals Netflix accumulates, the stronger the psychological switching costs: leaving Netflix means losing access to shows unavailable anywhere else.

House of Cards served as the first large-scale commitment to this strategy, signalling to the market that Netflix was not just a digital library but a premium content brand. This marked a structural shift in its identity and created a foundation for future originals, making differentiation self-reinforcing.

**B. Data as a Self-Amplifying Source of Advantage**

No competitor in 2011 had a comparable understanding of individual viewers. Traditional networks saw anonymized ratings. Cable operators saw subscription numbers. Netflix saw *behavioral fingerprints*. With every hour watched, the company refined its recommendation engine, prediction accuracy, and content development logic.

This creates a flywheel:
More subscribers → more viewing → more data → better recommendations → higher satisfaction → lower churn → more subscribers.

House of Cards fits the flywheel perfectly: its casting, tone, and themes were aligned with data patterns Netflix already possessed. As viewers watched, Netflix learned even more about what serialized, prestige drama consumers preferred. Over time, this advantage becomes nearly impossible for competitors to replicate quickly, ensuring sustainability.

**C. Strategic Preemption and Control of Scarce Assets**

In the slides (59–60) it becomes clear that Netflix is reacting to a shifting competitive environment where Amazon, Hulu, HBO Go, and broadcasters entering online distribution all represent threats. Originals allow Netflix to preemptively lock up scarce resources—elite creative talent, compelling IP, and viewer attention—before competitors can.

House of Cards also generates intellectual property that Netflix partially controls, giving the company future reuse possibilities across international windows and future seasons. The more Netflix controls unique IP, the less negotiating leverage studios and networks can exert over the company in licensing deals. This mitigates supplier power and stabilizes margins—a classic component of long-run sustainability.

**Why the MRC–Netflix Deal Represents a Perfect Strategic Fit**

When integrating the logic of the case with the theory of sustaining advantage, the partnership becomes easier to understand. MRC seeks artistic autonomy and long-form storytelling. Netflix seeks differentiation, leverage, data enrichment, and subscriber retention. House of Cards bridges these needs seamlessly.

MRC gains a platform that embraces creative freedom, avoids the pilot system, and supports a cinematic structure. Netflix gains a prestige asset that strengthens its brand, energizes its data flywheel, and positions it as a premium destination in the streaming landscape.

This is why the slides emphasize that House of Cards was not simply a TV show—it was a **strategic turning point**. It allowed Netflix to break out of its "last-class citizen" status in the TV industry (Slides 41–42) and reposition itself among premium networks while operating on a completely different set of economic and technological assumptions.

**The Logic of Why the Deal Was a Risk for MRC—but Worth Taking**

From MRC's perspective, saying yes to Netflix required accepting uncertainties: How would the international market perceive a Netflix-led release? Could Netflix market prestige drama effectively? Would awards organizations recognize streaming content? Would Netflix even exist in the same form by the time the second season aired?

But strategically, MRC could see that Netflix was offering something the cable networks could not:

- a 26-episode guaranteed commitment
- full creative freedom
- retention of IP ownership
- no interference from executives
- alignment with MRC's "director-driven" philosophy
- an opportunity to shape a groundbreaking industry shift

In an industry defined by risk and unpredictability, this was a rare combination: a partner willing to treat MRC's vision not as a product to be controlled but as a flagship to be elevated. The upside potential—in prestige, in visibility, and in future bargaining power—outweighed the short-term anxieties.

**Measuring Success: A New Paradigm for a New Model**

How Netflix and the industry evaluated House of Cards' success. Without Nielsen ratings, the metrics shifted toward:

- awards recognition
- critical reception
- social media buzz
- subscriber engagement
- viewership patterns captured internally
- cultural resonance


The show's Emmy nominations, Golden Globes, and widespread online discussion confirmed that streaming originals could compete at the highest artistic level. This validation did more than boost MRC's credibility—it strengthened Netflix's brand and positioned streaming as a legitimate premium format. It also signaled to top-tier talent that Netflix could be a creative home, reinforcing the long-term pipeline for future originals.

**The Ultimate Strategic Insight**

The story of MRC and Netflix is not just about a deal. It is a case about **strategic transformation** and **the sustainability of competitive advantage in creative industries**.

Netflix used House of Cards to:

- redefine its industry boundaries
- preempt rivals
- build differentiation
- deepen switching costs
- accumulate a data advantage
- strengthen bargaining power
- attract world-class talent
- shift consumer expectations permanently

MRC used Netflix to:

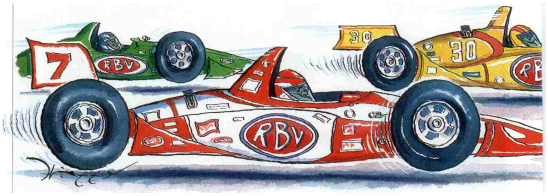
- elevate its creative ambitions
- secure unprecedented freedom
- maintain ownership
- gain visibility in a new distribution frontier

House of Cards becomes a perfect illustration of how a strategic move can realign an industry's trajectory and create a new paradigm of competition—one anchored not only in content quality but in distribution logic, data capabilities, and long-term ecosystem design.

## SESSION 7 COMPETING ON RESOURCES AND CAPABILITIES

The session explores the critical role that resources and capabilities play in the development and execution of effective business and corporate strategies. Participants will gain insights into identifying, analyzing, and leveraging these strategic assets to achieve sustainable competitive advantage.

**Reference study material: D.J. Collis and C.A. Montgomery, 1995. "Competing on Resources", Harvard Business Review**




Strategic thinking has long focused on industries and external forces, assuming that profitability depends mainly on the competitive environment and the firm's position within it. Yet firms operating side by side in the same market often show strikingly different levels of performance. These persistent differences point toward a deeper explanation: what determines long-term success is not only where a firm competes but what it uniquely possesses and how it uses those assets. Strategy becomes a question of understanding, developing, and protecting the resources and capabilities that set one company apart from another.

Resources include far more than physical assets. They encompass intangible elements like brand reputation, proprietary knowledge, technological expertise, employee talent, organizational routines, and the capacity to coordinate complex activities. Some firms accumulate these resources through history and path dependence; others create them deliberately through investment and managerial choices. But only a subset of resources truly matters for competitive advantage. To be strategically meaningful, a resource must satisfy an important market need, be scarce relative to competitors, and allow the firm to capture the economic benefits it generates. Value arises at the intersection of demand, scarcity, and appropriability; without this combination, even impressive assets cannot support superior performance.

The strategic importance of a resource is always relative, not absolute. What counts is whether it is stronger, more advanced, or more effectively deployed than what competitors have. Many companies fall into the trap of describing their strengths in vague terms—calling something a "core competence" even when it does not differentiate them. A real competitive resource must be both valuable and distinctive. It must also be difficult to imitate. Competitors may attempt direct imitation, but even more dangerous is indirect substitution: achieving the same outcome through alternative technologies, business models, or organizational approaches. The value of any resource decays unless it is continuously refreshed.

Some of the clearest illustrations come from firms that have built tightly integrated systems of resources, rather than relying on a single asset. A strong brand, for example, becomes more powerful when reinforced by superior product design, consistent customer experience, and a well-managed distribution network. Likewise, a firm with exceptional supply-chain capabilities gains an advantage not only from coordination efficiency but from the way these capabilities interact with purchasing expertise, store operations, and labor practices. Competitors may be

able to copy isolated elements, yet struggle to replicate the entire system because its components are mutually reinforcing.

The durability of competitive advantage depends on how easily a resource can be reproduced. Brands rooted in decades of customer trust, deeply embedded organizational cultures, or proprietary technologies often resist imitation. However, even seemingly durable resources can be undermined by shifts in technology or consumer preferences. Companies that rely on past sources of strength without renewing them risk watching those strengths erode. Technological capabilities must evolve; brands must adapt to new audiences; operational routines must be updated to reflect changing competitive conditions.

Understanding resources also helps explain why some strategies succeed in one context but fail in another. A capability that delivers exceptional performance in a specific industry may offer little value elsewhere. Effective expansion requires assessing whether a firm's existing resource base aligns with the structural characteristics of a new market. When the fit is strong, firms can transfer and scale their capabilities to generate advantage across multiple businesses. When the fit is weak, expansion efforts can drain resources and dilute competitive position. Successful multi-business companies often thrive because they consistently redeploy a clear, well-honed set of skills into markets where those skills matter.

Ultimately, the pursuit of superior performance is a matter of constructing and renewing a portfolio of distinctive resources. Strategy involves identifying which resources genuinely create value, strengthening them through ongoing investment, combining them into integrated systems that competitors cannot easily reproduce, and shaping the firm's market choices around the assets that offer the greatest leverage. Long-term advantage emerges from clarity about what the firm can uniquely do and from the discipline to protect and evolve these capabilities as industries change. Sustainable success is not the result of reacting to competitors or chasing market trends, but of building a foundation of resources that remains powerful over time while continuously adapting to new opportunities and threats.

**Study case: nokia**



Nokia illustrates how strategic advantage depends on the development and renewal of a firm's resource base. Founded as a paper mill in 1865, the company evolved into a highly adaptive organization capable of moving across industries such as electricity, rubber goods, and eventually telecommunications. This adaptability was itself a capability rooted in organizational flexibility and technological competence.

In the early 1990s, anticipating the potential of mobile phones, Nokia divested all non-telecom activities and concentrated its resources on a single strategic trajectory. This reallocation allowed the company to deepen its technological capabilities, accelerate product development, and become one of the global leaders in mobile devices. The early prototype of a touchscreen device in 1996 shows how forward-looking resource investment positioned Nokia at the frontier of innovation.

The case demonstrates the essence of the resource-based view: long-term success stems from building distinctive capabilities, focusing resources where they matter most, and continuously upgrading them to align with emerging opportunities.

A resource-based strategy becomes truly powerful when a firm not only accumulates valuable resources but also learns how to extend them across markets. Leveraging resources means understanding how far the firm's distinctive capabilities can travel before losing effectiveness. Some capabilities—such as supply-chain excellence, design capabilities, or brand reputation—can be transferred across multiple product categories or business units. Others are deeply tied to a specific technological trajectory or customer segment and lose value once the competitive context shifts. Effective strategy requires clarity about these limits: a firm must recognize when its strengths can scale and when entering a new market would push those strengths beyond their natural boundaries.

This idea of leverage connects to a broader question: *what makes an advantage sustainable?* Valuable and rare resources may generate superior performance for a time, but sustainability depends on their resistance to imitation and on the firm's ability to exploit them effectively. The VRIO framework provides a structured way to evaluate this. A resource creates value when it contributes meaningfully to customers' needs or cost efficiency. It becomes a source of competitive advantage when it is also rare among competitors. If rivals can easily replicate or substitute the resource, any advantage will be temporary. Inimitability—stemming from unique histories, tacit knowledge, complex coordination mechanisms, or large investments—is what protects the advantage from erosion. Yet even inimitable resources can fail to generate superior performance unless the firm is organized to capitalize on them. Structures, processes, incentives, and leadership must be aligned to deploy the resource effectively. When all four conditions—valuable, rare, inimitable, and supported by organizational capability—are met, the firm achieves a sustained competitive advantage. Otherwise, the outcome ranges from parity to temporary advantage to complete disadvantage.

The trajectory of Nokia illustrates both the power and the fragility of resource-based advantage. During the late 1990s and early 2000s, the company dominated the global mobile phone market. By August 2000, it had sold 128 million phones, generating more than $26 billion in sales and over $5 billion in pre-tax profits. A year later, Nokia controlled 35% of the worldwide mobile phone market—nearly three times the volume of its nearest competitor. Even by 2009, as smartphones became mainstream, it still held 38.6% of the global market. These achievements reflected a formidable set of resources: exceptional hardware engineering capabilities, a highly efficient supply chain, a strong brand, and an organizational culture oriented toward reliability, manufacturing excellence, and large-scale global distribution. For more than a decade, these capabilities met all VRIO conditions. They were valuable and rare; they were deeply embedded in Nokia's history and routines; and the firm was well organized to exploit them.

Yet these same strengths became liabilities when the technological paradigm shifted. The rise of smartphones transformed the basis of competition from hardware engineering to software ecosystems, user experience design, and developer networks. Nokia remained fundamentally a hardware-centric company—its culture, skills, and internal priorities were oriented toward physical devices, not software innovation. Management adopted a transactional approach

focused on incremental performance improvements rather than strategic renewal. As the competitive environment evolved, the firm's resource base no longer aligned with market demands. What had once been valuable became less relevant; what had once been rare became commoditized; and the firm was not organized to build or acquire the new capabilities required to compete with emerging platforms like Apple's iOS or Google's Android. The result was a profound misalignment between resources and the competitive environment—a breakdown of the very conditions that had supported Nokia's earlier advantage.

The Nokia case underscores the central insight of the resource-based view: competitive advantage is not a static possession but a dynamic relationship between a firm's resources and the world around it. Even the most impressive resource portfolio loses value when market needs shift or when competitors introduce new, superior configurations. Sustaining advantage requires not only building valuable, rare, and inimitable resources but also continuously upgrading them, leveraging them thoughtfully across markets, and ensuring that the organization remains capable of deploying them effectively as industries evolve.

| is it valuable? | is it rare? | is it inimitable? | is the firm organized around it? | what is the result |
|---|---|---|---|---|
| V | R | I | O | ? |
| | | | | |
| NO | | | | competitive disadvantage |
| YES | NO | | | competitive parity |
| YES | YES | NO | | temporary competitive advantage |
| YES | YES | YES | NO | unused competitive advantage |
| YES | YES | YES | YES | sustainable advantage |

## SESSION 8 FUNDAMENTALS OF CORPORATE STRATEGY

In this meeting we will develop a shared understanding of corporate strategists' mission. We will analyze ways for assessing the value generated by operating two or more businesses together, defining the concept of synergy and appraising how that works concretely.

Corporate strategy sits above business-unit strategy. While business strategy focuses on *how* a firm wins within a single market, corporate strategy asks *where* the firm should compete—across industries, geographies, and value-chain stages—and *how* the combination of businesses can create more value jointly than individually. The fundamental idea is that a multi-business firm must generate a corporate advantage, meaning the total value of its portfolio exceeds the sum of the standalone businesses.

A strong corporate strategy coordinates decisions about the firm's scope: which businesses to enter, which to exit, and how to structure relationships among units. The aim is to raise the **average competitiveness** of all business units, not just one. This happens either by linkages among existing units or by recombining assets—both tangible and intangible—in ways that competitors cannot easily replicate.

Every corporate strategy is rooted in the firm's business model, which reflects policies, assets, and governance systems. For example, choices over compensation, procurement, facility locations, vertical integration, or contract structures shape the boundaries of the firm. Firms in the same industry often operate with different business models, so they perceive different opportunities for coordination—and experience different levels of corporate advantage. What is a core activity for one firm might be peripheral for another.

A central lens for analyzing corporate strategy is value creation and value capture. Value creation is defined as the difference between customer willingness to pay (WTP) and supplier opportunity cost (SOC). Value capture concerns how much of the value created the firm can keep—through pricing power, contracting, or bargaining. Corporate strategy becomes relevant when a firm can alter WTP or SOC through the way it links, coordinates, or reorganizes its businesses.

**Corporate scope and portfolio decisions**

The slides expand this logically: managing a multi-business firm means continuously evaluating where the corporation competes. This evaluation spans the product/customer dimension (horizontal diversification), the value chain (vertical integration), and the geographic footprint (internationalization). Entering or operating a business requires owning or accessing key resources in its value chain—so scope choices always imply new commitments.

Different portfolio compositions reflect different strategic logics. Some firms remain in a single industry but operate multiple segments or geographies. Others spread across industries using shared technologies (technology-driven) or shared capabilities (capability-driven). At the extreme, conglomerates operate unrelated businesses with minimal resource similarity, and therefore face weaker potential for synergies.

The concept of relatedness becomes important: related businesses allow resource sharing or transfer—manufacturing, logistics, branding, or general management processes—while

unrelated businesses typically cannot. Strategic relatedness influences how easy it is to coordinate resource allocation, formulate strategy, and monitor performance across units.

**The corporate advantage test and synergies**

Corporate advantage exists when the joint NPV of owning two businesses exceeds the NPVs of owning them separately. This can happen because the corporation influences cash flows directly (higher revenues, lower costs) or reduces the discount rate by lowering risk.

Value creation through corporate strategy happens via two mechanisms: portfolio selection (which businesses the firm chooses to own) and business modification (changing how units operate together to extract synergies). A synergy occurs when operating two businesses jointly—through shared operations and coordinated decisions—creates more value than operating them independently. Importantly, synergies do not require common ownership; they emerge from joint operations. But corporate advantage requires that such synergies are best captured *under joint ownership* rather than contracts.

Finding synergies means looking inside the value chain. Every activity—procurement, manufacturing, R&D, distribution, marketing—uses specific resources. Synergy potential lies where the coordination of activities across units can alter WTP or SOC. To structure this search, the reading and slides use "synergy operators," which categorize how resources can be linked.

**Spotting synergies: the four operators**

Synergy operators combine two dimensions: similarity of resources and the degree of modification required. This yields four types:

Consolidation occurs when similar resources allow rationalization, such as merging departments, sharing logistics, or jointly using facilities. It typically lowers SGA, Capex, or COGS.

Combination refers to pooling similar resources to benefit from scale—like volume discounts, shared procurement, or increased bargaining power. It affects cost drivers and may occasionally increase revenues.

Customization happens when dissimilar resources are co-specialized to create differentiated offerings: joint R&D, shared knowledge, or cross-unit product development. This can affect all drivers including revenue growth.

Connection integrates outputs without heavy modification, such as bundling products, cross-selling, linking distribution channels, or using a shared brand. This is primarily revenue-enhancing.

These operators explain how synergy affects profitability. Consolidation and combination mostly influence costs, while customization and connection often shape customer-facing value. A corporate strategist must consider which operator is relevant, whether it is feasible, and whether

**Long-term relationships vs spot markets**

The reading then shifts from identifying synergies to evaluating whether two firms should coordinate through market transactions, long-term contracts, or ownership. Spot markets, typical in competitive environments with many buyers and sellers, allow flexibility. Firms trade only when doing so is beneficial, and switching partners is easy. In this setting, value comes from taking the best match available at a given moment.

If BU1 and BU2 interact in the spot market, they choose partners that maximize their own WTP–SOC difference. Exclusive long-term relationships, by contrast, commit the firms to each other. This raises the question: does a long-term arrangement create more value than the spot alternative? A long-term contract will persist only if both parties receive extra value relative to the market. If synergies are negative, they exit.

Positive synergies in long-term exchanges arise when coordination increases WTP (e.g., better product reliability, joint feature development) or decreases SOC (e.g., scale efficiencies, improved processes). A dual competitive advantage occurs when both happen simultaneously.

But long-term relationships also risk negative synergies. Culture clashes, misaligned expectations, rigid incentives, or innovation bottlenecks can reduce value. The AOL–Time Warner merger illustrates how overestimating synergies and underestimating integration challenges destroys shareholder value. Similarly, AT&T's acquisition of DirectTV did not achieve the intended cross-unit benefits due to poor complementarities.

**Conditions favoring positive synergy in long-term exchanges**

Not every pair of firms benefits from exclusive relationships. For a long-term exchange to outperform the spot market, coordination must create a unique product or process that competitors cannot replicate without raising costs. Three conditions make this more likely:

Asset specificity refers to how re-deployable the required assets are. When investments are specific—such as machines, processes, or relationships that cannot be reused elsewhere—the firm needs assurance of continued collaboration. Long-term contracts make such investments feasible.

Frequency matters because repeated interactions justify the cost of coordination. If exchanges happen frequently, contract-writing costs become low relative to the value at stake. Industries with recurring procurement cycles benefit more from long-term coordination.

Uncertainty increases the value of stable relationships. When the environment is volatile or quality requirements unpredictable, firms prefer coordination that reduces risk. High uncertainty pushes firms toward exclusive contracts, deeper integration, or ownership.

These conditions shaped classic examples like Toyota and its first-tier suppliers. Long-term collaboration enabled co-specialization of production processes, quality improvements, learning-by-doing, and shared investments that would not have been economical in spot markets.

**The ownership test**

The reasoning so far explains why long-term contracts might outperform spot markets. Ownership goes further: why integrate two businesses into one firm rather than coordinate externally? Ownership becomes preferable when the governance costs of cooperation exceed what contracts can handle, or when value creation depends on deep coordination that cannot be credibly sustained without shared control. This connects to transaction cost economics and the idea that firms exist when markets fail.

Ownership resolves bargaining problems, reduces opportunism, and allows full alignment of incentives. However, it introduces managerial complexity: the firm must now monitor and integrate units, allocate resources, and design processes that match the strategic objectives.

**The organizational test**

Even when managers understand how value can be created or captured, the organization must be structured to support the strategy. Structure defines authority, reporting lines, resource allocation, and how tasks are differentiated or integrated. Misalignment between strategy and structure produces corporate failures: Dupont's historical restructuring or Jacobs Suchard's centralization illustrate how firms adjust structure to match market needs.

Culture also plays a key role. It provides a shared frame that guides employees' behavior in ambiguous situations and helps coordinate across units. Without cultural alignment, even well-designed strategies can collapse. This is especially visible during acquisitions, where differences in norms lead to resistance, knowledge loss, or slow integration.

Managing interdependencies is one of the hardest organizational challenges. If units act autonomously without considering how their choices affect the broader firm, corporate value is destroyed. Conversely, forcing coordination where synergies do not exist wastes time and resources. Corporate strategy therefore requires balancing autonomy and interdependence, designing incentive systems that reward cooperation, and allocating capital across units according to strategic priorities.

**The diversification discount**

For years, empirical research suggested that diversified firms tended to underperform more focused firms. The so-called diversification discount showed that conglomerates often destroy value relative to holding the same businesses independently. Studies like Berger and Ofek found value losses of 13–15% for diversified firms, leading many to conclude that diversification itself is inherently inefficient.

However, newer analyses push back on this simplistic view. The decision to diversify is not random: firms diversify when opportunities within their core business become limited and new adjacent opportunities seem more attractive. Their lower profitability relative to non-diversified peers may reflect the difficult environment of their core business rather than an inherent flaw in diversification. When correcting for this selection bias, the discount tends to shrink or even reverse; in some studies it becomes a premium.

Understanding diversification requires a clear sense of relatedness. Diversifying into industries with similar resource needs, similar capabilities, or similar strategic logics increases the potential for synergies. This is because the firm can transfer knowledge, share assets, and leverage management capabilities. When diversification is unrelated, however, coordination becomes costly, synergies are scarce, and the corporation may add complexity without improving competitiveness.

Misinterpretations also come from the coarse way diversification is measured. Many studies rely on SIC codes, which often do not accurately capture true strategic relatedness. Two industries may appear unrelated in classification systems but share deep technological or market linkages—while other industries with similar codes may require totally different capabilities. The real performance impact of diversification depends on how well the new business aligns with existing strengths and whether the firm can actually exploit potential synergies.

**Conclusion: how firms must think about corporate scope**

A coherent corporate strategy requires clarity about when expanding the firm's scope creates value and when it destroys it. Multi-business firms succeed only when they can extract synergies across units or exploit opportunities that external market mechanisms cannot capture. The firm must identify activities where coordinated decision-making or shared resources meaningfully increase WTP or decrease SOC. At the same time, it must be selective: excessive scope dilutes focus, overloads the organization, and raises costs of integration.

Creating corporate advantage is not just about spotting potential synergies; it is about understanding the conditions under which they become real. Managers need to assess asset specificity, frequency of exchange, and uncertainty to determine whether activities are best coordinated through spot markets, long-term contracts, or full ownership. They must also recognize that synergies are not guaranteed: cultural mismatches, incentive misalignment, and integration challenges often make potential synergies illusory.

Implementation is as important as strategic diagnosis. Strategy must be supported by the right organizational structure and processes—clear reporting lines, aligned incentives, and effective monitoring systems. Culture must enable collaboration across units without suppressing initiative. Acquisitions especially require sensitivity to the intangible elements of integration: mutual trust, shared practices, and knowledge transfer.

Ultimately, corporate strategy succeeds when the whole truly becomes greater than the sum of the parts. This depends on choosing the right businesses, designing the right relationships among them, and managing the human and organizational systems that turn synergies from theoretical possibilities into concrete value.

The slides emphasize portfolio strategy as the ongoing evaluation of *where* the firm competes—across value chain stages, geographies, and product markets. They introduce the taxonomy of portfolio compositions, from single-industry national players to global multi-industry conglomerates. This taxonomy helps categorize different scope choices, which the reading then explains through the lens of value creation and synergies.

Both materials converge on three central tests:

1. Does diversification rely on relatedness that enables synergies?
2. Can those synergies be captured better inside the firm than through contracts or markets?
3. Is the organization capable of implementing and sustaining the strategy?

The slides also reinforce the corporate advantage test (NPV[A,B] > NPV[A] + NPV[B]), connecting directly with the reading's framing of value creation as WTP − SOC. The synergy operators illustrate how specific coordination mechanisms create this wedge, while the reading deepens the analysis by explaining the contractual and organizational conditions necessary for these synergies to materialize.

Combined, the materials offer a full framework for thinking about corporate strategy: identify potential synergies, test whether they require ownership, analyze the organizational fit, and avoid diversification that lacks strategic logic or is too costly to implement. The firm's scope should expand only when value creation exceeds the complexity added to the system.

Evaluating synergies

| Synergy operator | examples | value driver affected |
|---|---|---|
| Customization | • create customize bundle of product/services to meet the needs of particular clients<br>• joint R&D/new product development<br>• transfer intangible assets such as best practice, knowledge or IP from one business to another | SGA; Capex; COGS; Revenues |
| **Connection** | • bundling products or services to reduce search and transaction costs for customers - one-stop shopping<br>• cross-selling of products to each other customers<br>• linking different parts of the two value chains such as distribution channels to production capabilities<br>• sharing intangible assets such as a common brand | Revenues |

## SESSION 9 DECISIONS ABOUT BUSINESS PORTFOLIO COMPOSITION

This session is dedicated to understanding the intricacies of diversification strategy within the context of corporate planning. Participants will explore how corporations expand their businesses into new markets and industries to mitigate risks, capture growth opportunities, and create a well-balanced portfolio of businesses. As well, we explore frameworks and criteria for evaluating business portfolios composition and realize how sometimes divestment and restructuring become necessary to optimize an underperforming diversified portfolio.

### Preparatory material: AT&T: an underperforming conglomerate?

AT&T, a multinational conglomerate with a diverse portfolio of telecommunications and media businesses, is a pivotal case for developing the assessment of corporate portfolios, in terms of both managerial and financial performance.

### Ownership, Transaction Design, and the Boundaries of the Firm

A firm's decision about whether to buy assets, rely on market exchanges, or form long-term relationships with other organizations shapes its ability to create and capture value. Spot market transactions may be efficient for simple, standardized goods, but they often break down when assets are highly specific, when uncertainty is substantial, or when the strategic importance of a transaction is high. In these settings, firms must decide whether ownership—rather than contracting—is necessary to secure positive synergies and avoid value destruction.

### Why Ownership Is Not Always Attractive

Even if owning assets can theoretically generate synergies, ownership often carries heavy costs. Acquisitions require large financial commitments and place demanding managerial burdens on the acquirer. Many acquisitions fail to generate value, partly because asset combinations do not automatically create meaningful synergies and partly because investment banks advising the deals may have misaligned incentives. Moreover, ownership introduces indirect costs: overseeing unfamiliar operations, monitoring newly acquired units, and maintaining discipline across diverse divisions can stretch a firm's attention and dilute its competitive focus.

Post-acquisition integration can cause internal opportunism as well. Units may attempt to appropriate a disproportionate share of value from internal transactions, particularly when the inputs they control are strategic. If leaders mandate cost-plus pricing or rigid internal transfer rules, investment incentives inside the merged firm may weaken. A unit that is protected from external competition may invest less aggressively, innovate more slowly, and pay less attention to shifting technologies or customer needs. Coordination difficulties can also force senior managers to expend time on disputes that a well-designed contract might have resolved more cleanly.

### Vertical Integration and Its Mixed Outcomes

Firms sometimes choose ownership because they aim to integrate vertically across the value chain. Vertical integration can move the firm upstream (toward suppliers) or downstream (toward distributors or customers). Examples range from Apple's investments in chip design and

retail stores, to Tesla's entry into battery manufacturing, to Ford's historic strategy of creating a fully integrated production system.

Vertical integration can protect the firm against supply disruptions, preserve technological secrets, and ensure access to critical inputs. When assets are strongly complementary—such as a manufacturer's technology and a supplier's production capabilities—ownership may be needed to capture the full value of innovation.

However, vertical integration can also lock a firm into high-cost structures, making adaptation more difficult when markets change. The resources tied into internal production may be less flexible than those available through external partners. Over-integration can also produce negative synergies: the combined organization may become slower, more bureaucratic, and less incentivized to experiment or take risks. Automobile companies illustrate this dynamic: Japanese manufacturers learned to rely on specialized external suppliers, often achieving better outcomes than U.S. competitors who remained more vertically integrated.

**Alliances and Joint Ventures as Alternatives to Ownership**

When full ownership is costly or unnecessary, firms may form alliances or joint ventures to access complementary assets. Alliances can range from simple licensing agreements—like using a brand name in exchange for royalties—to complex partnerships involving shared technologies, pooled investment, and co-development of new products. Such arrangements are common when entering foreign markets or exploring emerging technologies. Disney's creation of Tokyo Disneyland with Japanese partners exemplifies how alliances allow firms to combine local market knowledge with strong global brands.

Joint ventures and alliances allow firms to diversify risks, tap into new capabilities, and reduce the financial burden of full asset ownership. Yet they also bring challenges: partners can disagree on priorities, underinvest in shared projects, or attempt to appropriate knowledge that later turns them into competitors. Governance mechanisms mitigate some risks, but alliances require constant coordination and cannot fully eliminate the potential for negative synergies.

**The Limits of Contracts and the Role of Asset Specificity**

Contracts can help govern exchanges when ownership is unnecessary, but contracts are incomplete by nature. They cannot specify every future contingency or perfectly allocate responsibilities when complex, interdependent tasks are involved. Asset specificity—situations where investments have value only within a particular relationship—makes these challenges more severe. If one party fears that the other might later "hold up" the relationship to extract more value, investments that would have created positive synergies may never be made.

Uncertainty intensifies contractual limits. When technologies evolve rapidly or when outcomes cannot be predicted in advance, specifying obligations in a legally enforceable way becomes nearly impossible. Under these conditions, ownership can allow managers to resolve conflicts internally, reallocate resources more flexibly, and capitalize quickly on unexpected opportunities. Historical cases such as IBM's early 1990s reorganization or Apple's move into chip production highlight how owning interdependent assets can accelerate innovation and improve performance when complexity is high.

**Context and Institutional Environment**

The value of ownership also depends on the environment in which a firm operates. Where legal and economic institutions are weak—such as in many emerging markets—contracts can be difficult to enforce, reducing the viability of long-term exchanges. Large business groups in countries like India, Indonesia, and Korea historically used internal capital markets, cross-shareholding, and managerial resource sharing to replace missing institutional infrastructures. In such contexts, ownership allowed firms to coordinate more effectively, allocate capital more efficiently, and create a common culture across business units.

As institutions strengthen, the benefits of ownership shrink. Mature financial markets reduce the need for internal resource allocation. Strong legal systems make complex contracts more feasible. Firms in developed economies therefore tend to specialize more, relying on markets and alliances rather than conglomerate structures.

**Designing Corporate Strategy: When Should a Firm Own?**

Ultimately, a firm must weigh two core insights in setting its corporate boundaries. First, there are many ways that ownership can destroy value—through overintegration, managerial overload, and stifled incentives. Second, ownership is justified only when there are clear reasons to believe that positive synergies cannot be realized through contracts or market exchanges.

An effective strategy needs to consider factors such as asset specificity, transactional uncertainty, the frequency of interactions, the trustworthiness of partners, and the robustness of local institutions. When these factors push against contract-based governance, ownership becomes more attractive.

**Diversification and the Question of Value**

Research historically showed that diversified firms often trade at a discount relative to more focused firms, suggesting that diversification destroys value. However, these findings can reflect selection bias: firms diversify when their existing business lines offer limited opportunities, meaning lower performance may stem from their starting position rather than diversification itself.

Value creation through diversification depends heavily on relatedness—the extent to which the new business shares technologies, customers, or capabilities with the existing organization. Related diversification can unlock economies of scope and bargaining power. Examples include automobile manufacturers using common platforms across multiple models, or consumer goods companies leveraging shared distribution systems. In contrast, unrelated diversification, common among old conglomerates like ITT, often struggled due to limited managerial understanding across disparate businesses and weak strategic discipline.

**Open Innovation and Evolving Boundaries**

Since the 1990s, firms have increasingly engaged in open innovation—collaborating with external communities, users, and specialists to develop new products. Digital technologies allow companies to share information more efficiently, coordinate distributed contributors, and

reduce the costs of experimentation. Platforms like Topcoder demonstrate how firms can outsource problem-solving to global networks of experts.

Open innovation expands the set of organizational choices available, but it also raises concerns about control and value capture. When external contributors develop core elements of a firm's products, the firm must ensure that it retains adequate rights and can integrate the resulting innovations into its strategy. Firms adopting open innovation must therefore design governance structures that clarify ownership, residual rights, and the firm's central role in coordinating contributions.

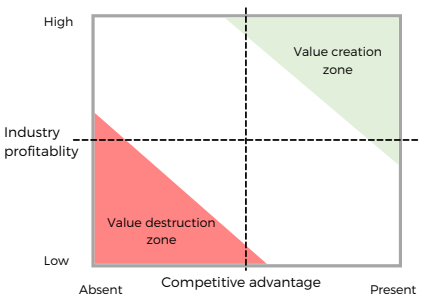
**Corporate Strategy and Decisions About Business Portfolios**

Corporate strategy concerns how a multi-business firm creates value across the collection of activities it owns. While business strategy focuses on how a firm competes within a single market, corporate strategy addresses the broader question of which businesses to own, how they should be combined, and how the corporate center can generate advantages that individual units could not achieve independently. A diversified company is one that operates in more than one business domain, meaning it owns at least part of the resources and capabilities required to compete in these markets and can access the remaining ones through external exchanges. Decisions about a firm's portfolio therefore include where to invest further, which new businesses to enter, and when to divest.

A corporate strategy is valuable only when the combination of businesses generates more value under common ownership than the same businesses would create separately. This logic is captured by the corporate advantage test, which states that the joint value of businesses A and B must exceed the sum of their stand-alone values. Value creation can occur either by increasing future cash flows or by lowering the discount rate applied to them. Both mechanisms depend on the firm's ability to assemble a portfolio that makes sense and to modify its businesses in ways that extract synergies across activities.

Synergies arise when the joint operation of businesses creates benefits that independent ownership cannot achieve. These benefits may derive from coordinated decision-making, shared access to critical resources, or integration of complementary capabilities. Importantly, synergies do not require ownership in principle; what matters is the ability to coordinate deeply and make joint decisions across activities. Still, ownership often becomes the practical way to realize these gains.

A corporate portfolio can generate several forms of synergies. Some derive from consolidation, such as merging support functions like HR, legal, or administrative activities. When these functions are pooled across business units, the organization reduces redundancies, shares talent more effectively, and leverages economies of scale. Others arise from combination, where joint procurement enhances buying power and enables renegotiation with suppliers, resulting in lower operating costs. Additional synergies stem from connection, particularly when content, distribution



channels, and customer-facing activities reinforce one another. For instance, combining media content with distribution platforms can reduce transaction costs, enable more effective bundling, and increase customer willingness to pay. Finally, customization-related synergies emerge through shared consumer data and integrated CRM systems, which improve cross-selling opportunities and allow the firm to tailor offerings more precisely, ultimately supporting both higher revenues and lower long-term capital expenditures.

The breadth of these synergies also expands opportunities for cross-promotion. A firm that owns multiple content or product lines can promote offerings across companies, customers, media platforms, products, and even within the content itself. By leveraging shared consumer insights and integrated distribution, cross-promotion can deepen customer engagement, attract new audiences, and strengthen loyalty, thereby improving both reach and monetization.

These concepts become especially vivid when analyzing a complex organization like AT&T. Over the past decade, AT&T expanded from a traditional telecommunications company into a diversified conglomerate spanning telecom services, media and entertainment, advertising, and analytics. The strategic rationale behind this expansion rested on the idea that great content could drive deeper engagement on AT&T's distribution networks, while direct relationships with customers would create a rich stream of data that improved both advertising relevance and content personalization. In theory, this integrated model promised strong synergies: richer customer insights, broader monetization opportunities, more efficient distribution of premium content, and the ability to bundle services to reduce churn.

However, the firm's subsequent performance highlighted the difficulty of turning theoretical synergies into realized value. AT&T underperformed both the S&P 500 and its primary telecom competitors, raising questions about whether its diversification strategy actually improved the corporate portfolio. From a business logic perspective, both telecommunications and traditional media were facing structural challenges. Telecom is a mature, capital-intensive industry with limited differentiation and price-sensitive demand, while linear and satellite television have experienced declining profitability. Although the shift toward mobile video consumption created an opportunity for AT&T's media assets, the company lacked clear competitive advantage in either domain. Moreover, the complexity of managing businesses that operate in fundamentally different environments, each with intense competition and rapid technological change, increased the difficulty of executing a coherent strategy.

From a capital markets perspective, AT&T's acquisitions of DirecTV and Time Warner were executed at very high valuations, raising doubts about whether the firm could earn a return above the prices paid. When a firm acquires businesses for more than their fair value, the portfolio must generate extremely strong synergies to justify the premium. If these synergies fail to materialize, the corporate center absorbs the value destruction, and investors may discount the firm accordingly. This dynamic contributed to external pressure on AT&T's leadership, culminating in a series of divestitures.

Divestiture decisions reflect situations in which a business no longer contributes positively to the corporate portfolio. A unit may be divested because it fails to deliver the expected synergies, because its economic performance falls short of targets, or because capital markets consistently penalize the parent firm for owning it. External actors — financial analysts,

regulators, or activist investors — may exert pressure when the corporate structure appears misaligned with value creation. Leadership changes can also shift strategic priorities, prompting firms to streamline their portfolios. Divestitures can occur in multiple forms: a sell-off transfers ownership to another company, a spin-off distributes shares of the business to existing shareholders, an equity carve-out sells only a portion of shares through an IPO, and a split-up dissolves the parent entirely, redistributing ownership across its underlying businesses.

AT&T's recent strategic retreat illustrates how divestiture can reshape a corporate portfolio. The firm separated DirecTV and later spun off WarnerMedia in a merger with Discovery, effectively reducing its scope and returning its focus to its core telecommunications operations. These moves reflect the broader logic of corporate strategy: ownership should be justified only when the firm can extract synergies that exceed the costs of combining businesses. Otherwise, divestiture may restore clarity, improve financial performance, and align the company more closely with opportunities it is best equipped to pursue.

The overarching insight is that diversification is not merely a question of choosing attractive industries but of determining whether the firm can create value by coordinating multiple businesses better than the market could through contracts. A strong corporate strategy identifies where synergies genuinely exist, understands how costly they are to unlock, and avoids expanding into areas where integration offers little more than complexity. Ultimately, the boundary of the firm must reflect its ability to generate advantages through ownership that are otherwise unobtainable.

## SESSION 10 GETTING READY FOR A NEGOTIATION (PART OF PACIFIC REVIEW SIMULATION)


In this session we will understand what a negotiation is about and how managers can effectively prepare for it. We will appraise that a crucial part of the preparatory work required for a negotiation is drawing the BATNA (best alternative to the negotiated agreement), i.e. carefully pondering on the alternatives a company has rather than engaging with its counterpart.

The relationship between Disney and Pixar illustrates how complex partnerships can evolve into negotiations that reshape how two companies work together. Pixar built its identity on advanced technologies such as Renderman, Marionette, and Ringmaster, tools that enabled the studio to create worlds that resonate with both children and adults. Disney, with its diversified corporate structure spanning studio entertainment, media networks, parks and resorts, and consumer products, engaged with Pixar not only as a creative partner but as a strategic counterpart. By 2005, both companies were considering a new long-term agreement, and the shift from “Pixar” to “Disney–Pixar” symbolized a deeper, more governed relationship.

Negotiation becomes relevant in exactly this kind of situation: two clearly defined parties who need to reach an agreement that works for both sides. A negotiation can only exist when there is actual room to negotiate — not in monopoly conditions, not in perfect competition, and not when the cost of negotiating outweighs the value at stake. It also requires a reasonably balanced information environment and the ability to monitor and enforce whatever decisions are made. Ultimately, negotiation exists to reduce conflict by addressing the incompatibilities between parties.

Preparing for a negotiation means understanding, at a granular level, what is being negotiated. Any proposal is made of multiple items — essentially, anything to which one can assign value. Breaking a proposal into these items is the first step toward evaluating interests, positions, and priorities on both sides. A position describes what a party wants (“we want X”), while an interest explains why they want it (“we want X because…”). Good preparation requires mapping both the substance and the motivations, and locating which elements are essential versus negotiable.

Another key aspect is understanding who the relevant parties actually are. Not every representative has the authority or strategic perspective needed in a negotiation, and misalignment in participants can stall or distort the process. Some organizations are hierarchical, others more horizontal, and tactics such as sending low-influence delegates may even be used to exhaust or confuse the opponent. Proper preparation means identifying who holds decision-making power and shaping communication accordingly.

The value at stake must also be evaluated. Negotiators need a clear sense of the consequences of reaching an agreement, failing to reach one, or delaying the decision altogether. This

assessment clarifies the incentives of each side and frames the impact that the negotiation outcome will have on broader strategic goals.

From here, the boundaries of a potential deal can be constructed. This is where the Zone of Possible Agreement (ZOPA) becomes crucial. It is defined by the opening point — the upper limit of what one party hopes to obtain — and the break point — the lower limit beyond which an agreement is no longer acceptable. Between these boundaries lie possible outcomes that both sides might accept. The benchmark for evaluating these boundaries is the BATNA: the best alternative to a negotiated agreement. BATNA represents the fallback option, the scenario you can pursue if negotiations fail, and it helps determine how much flexibility you actually have.

Understanding your BATNA, and the other party's, reveals what resources or capabilities you can access outside the negotiation and what gaps genuinely require cooperation to fill. It is both a strategic safeguard and a source of bargaining power.

Negotiation preparation, then, is fundamentally about clarity — clarity of structure, parties, incentives, value, and alternatives. Without this groundwork, negotiation becomes guesswork rather than strategy. With it, companies like Disney and Pixar can manage their interdependence in ways that create value for both sides while navigating the challenges inherent in creative collaboration.

## SESSION 11 GOVERNANCE STRUCTURES (PART OF PACIFIC REVIEW SIMULATION)

Following up on the framework we developed in the previous session, we will understand what options for a firm expansion exist, starting from the internal development opportunity (organic growth) and continuing with inorganic modes - precisely, when looking for resources that are outside the scope of the firm, we will understand which governance structure is best among two organizations that come to jointly operate a business.

A strategist deciding how a company should enter a new business begins by examining how firms actually gain access to the resources that define performance in that industry. A helpful illustration is the long-running Disney–Pixar relationship. Each company held a resource the other needed: Disney relied on Pixar's computer graphics capabilities for animated content, while Pixar relied on Disney's distribution infrastructure and the downstream exploitation machine that transforms films into global commercial franchises. Their negotiations were shaped by a simple but fundamental question: *what alternatives does each party have to access the other's resource base?* This same logic applies to any diversification or growth decision.

The first major choice concerns the **mode of growth**, which can follow either an organic or an inorganic trajectory. Organic growth means that the firm builds internally the bundle of resources it currently lacks. Inorganic growth, instead, means borrowing or acquiring the needed resources from external partners. In both trajectories, the strategist begins by identifying the **resource gap**: the set of capabilities required to operate effectively in the target business that the firm does not yet possess. Entering a new market is essentially a question of whether these missing elements can be developed, substituted, borrowed, or bought.

**Organic growth as an option**

To understand whether organic development is feasible, firms analyze both the properties of the *target* resources and the properties of their *current* resource base. On the target side, three questions structure the assessment.

The first question is **how easy the target resources are to copy**. Formal obstacles such as patents, contractual restrictions, or proprietary rights might prevent imitation. Even when there are no formal barriers, some resources are deeply embodied in tacit knowledge, informal routines, or ambiguous learning paths that are difficult to document. The more tacit and ambiguous the accumulation process, the harder it is for a late entrant to reproduce the resource.

The second question is whether the firm can **catch up** with incumbents. This requires distinguishing between *stocks* of capabilities—stable accumulations that underlie value-chain activities—and *flows*, the investments required to build or replenish those stocks. The catch-up problem hinges on whether enhanced flows can compensate for the time advantage of first movers. For many capabilities, investments are path-dependent: stocks developed gradually over time cannot be replicated instantly through intense short-term spending. This leads to what we call **time compression diseconomies**, where the actual passage of time, rather than the financial magnitude of investment, shapes the accumulation of expertise. Asset stocks also

interconnect with each other—internal and target resources often co-evolve—so catching up requires replicating not just a single capability but the whole network of mutually reinforcing assets.

The third question concerns **substitutability**. Even if the targeted resource is scarce or hard to copy, the firm may develop a different resource that performs the same function. Strategic substitution matters especially when direct imitation is blocked, but functional equivalence can still enable entry.

On the side of the firm's current capabilities, two additional assessments matter. The first is **knowledge fit**, meaning the degree to which the firm's existing competences align with the skills required in the new business. High knowledge fit allows the firm to leverage what it already knows and reduces the cost of building new stocks. The second is **organizational fit**, meaning whether the firm's systems, culture, processes, and values can host and support the development of the new resource. Some organizations simply lack the structural compatibility needed to build a certain capability internally, even when the knowledge gap seems bridgeable.

If the target resources are hard to imitate, difficult to catch up to, or impossible to substitute, and if the firm's internal knowledge and organizational fit are weak, then organic growth becomes an unattractive or infeasible option.

**When organic growth is not viable: the need for inorganic growth**

In these cases, the strategist turns to **inorganic growth**. The question becomes: *how can the firm access the missing resource externally, and through which governance arrangement?* There is a continuum of possible governance structures, ranging from simple market transactions to full mergers and acquisitions.

The simplest arrangement is a **spot market contract**, which involves a one-off purchase of a resource already produced by another firm. More complex and relational solutions include **non-equity alliances** and **equity alliances**, and at the far end of the continuum lie **M&A**, where transactions stop being inter-firm and become internal corporate transfers.

Even when synergies exist, they do not automatically translate into value. **Governance costs** can erode or even offset potential gains. These costs arise because two firms must cooperate and coordinate effectively to unlock synergies.

**Cooperation costs** reflect the challenge of aligning incentives and ensuring both partners genuinely want to work together. The absence of a shared future, asymmetric benefits, or one-sided synergies can erode willingness to collaborate. Encouraging cooperation demands drafting contracts, monitoring quality, resolving disputes, and sometimes enforcing the agreement legally. Direct costs include shirking, free riding, cheating, or misrepresentation. Cooperation collapses when one party becomes highly dependent on the other.

**Coordination costs** arise from the need to align systems, routines, and processes so that joint activities run smoothly. Working across geographical distance, different expertise domains, or firms without a shared history increases coordination friction. Encouraging coordination requires lengthy meetings, detailed project manuals, communication systems, designated coordination

roles, and substantial time spent resolving misunderstandings. Direct costs show up as miscommunication, delays, and integration failures, especially when interdependence between partners becomes too high.

These two categories combine into **governance costs**, which can be either **transaction costs** (when the firms are independent) or **ownership costs** (when the activities are integrated under common corporate control). Choosing the best governance structure therefore requires comparing which arrangement unlocks the highest synergies *net* of the costs required to manage the relationship.

**Choosing among governance structures**

When growth must be inorganic, the strategist faces two subsequent decisions. First: *Should the firm borrow resources through a contract or through an alliance?* Second: *If an alliance is needed, should it be non-equity or equity?*

The contract–alliance decision depends on **resource tradability**, which itself depends on **clarity** and **protection**.

**Clarity** has two dimensions. One involves the nature of the resource: whether its characteristics can be clearly defined, whether it can be separated cleanly from its organizational context, and whether the firm has enough internal expertise to evaluate what it is buying. The second involves the future value of the resource: if the firm requires substantial learning or ongoing assistance from the partner, contracts are unlikely to work, because they cannot specify all future contingencies.

**Protection** concerns the risk of opportunism and knowledge leakage. The strategist must ask whether the partner can be trusted, whether legal institutions can protect against exploitation, and whether proprietary knowledge can be kept from leaking bi-directionally. If the resource is hard to protect—because working together inevitably reveals tacit knowledge—then contracts cannot safeguard the relationship, and an alliance becomes necessary.

If the answers suggest high clarity and strong protection, contracts are feasible. If clarity is low and protection is weak, alliances become the safer choice.

**Choosing between non-equity and equity alliances**

If an alliance is needed, the firm then decides how *close* the partnership should be. Here, Capron and Mitchell distinguish between dimensions of **scope and closeness**.

The **scope of collaboration** depends on how many functions, units, or people must be involved, how complex the coordination requirements are, and whether contributions require high specialization. If collaboration spans few activities, involves limited co-learning, and requires few points of contact, a non-equity alliance is sufficient. When collaboration is wide in scope, coordination is complex, and joint learning is critical, an equity alliance offers more stability.

**Competitive overlap** also plays a role. When partners compete directly, alliances require added safeguards to avoid misuse or misalignment of incentives. Sometimes equity participation stabilizes expectations and prevents opportunistic behavior.

**Goal compatibility** matters as well. The strategist evaluates whether contributions are symmetric, whether the alliance is equally important to both firms, and whether both sides have the managerial skills to operate the alliance over time. Balanced contributions and strong execution skills reduce relational risks; when these are lacking, equity deepens commitment and strengthens governance.

If scope is narrow, coordination is simple, overlap is low, and goals align well, a non-equity alliance is sufficient. When these answers lean negative—when closeness and integration must be greater—equity alliances are preferable.

Across the entire continuum, from simple sourcing arrangements to acquisitions, the strategist makes a single overarching judgment: **which governance structure allows the firm to access needed resources at the highest net value, after accounting for the real-world frictions of cooperation and coordination?**

This is why choosing a governance structure is not merely an operational decision; it is a fundamental strategic choice shaping the firm's long-term diversification path.

## SESSION 13 MARKET VS. HIERARCHY (DEBRIEF PART OF PACIFIC REVIEW SIMULATION)

Discussing the simulation results, we will have the chance to wrap up the main theoretical milestones of our series of meetings and appraise under which conditions governance structures which favor higher equity stakes in the counterpart (hierarchy) are preferred over structures that govern two firms' transactions via contractual arrangements (market).

The Disney–Pixar relationship illustrates why, in creative industries, collaboration through contracts often collapses under its own weight and pushes firms toward ownership. The negotiation between the two companies exposes how difficult it is to align incentives when partners sit at different stages of the value chain, bring complementary assets, yet pursue divergent objectives.

Negotiation itself is far more complex than the sanitized version people imagine. It involves managing conflicts of interest, handling uncertainty, and navigating hidden asymmetries. Academic research identifies five common negotiation styles—avoid, compete, accommodate, collaborate, and compromise—each defined by how much a party values the relationship versus the outcome. Avoidance works only when buying time is useful; competition works when time is scarce and no relationship must be preserved; accommodation protects relationships at the cost of one's own interests; collaboration requires trust and time; compromise splits value but often ignores superior solutions. In practice, styles tend to shift depending on pressure, information, and incentives, making real negotiations messier and more strategic than the stereotypes imply.

This framework becomes especially relevant when examining the structural weaknesses in the Disney–Pixar agreement. Many clauses in the contract reveal deep informational asymmetries, risks of opportunism, difficulties in monitoring, and unpredictable future contingencies. These issues aren't cosmetic—they fundamentally shape whether value can be created and fairly divided.

A major issue is the **economic structure of the collaboration**. Although Pixar generates the creative foundation of each film, it captures only a limited share of the total value. Revenue breakdowns (page 40–41) show that Disney absorbs the bulk of the economic gains because it controls distribution, home entertainment, licensing, merchandising, television, and theme parks. Pixar contributes extraordinary creative and technical capabilities, yet many revenue streams—often the most lucrative—are realized inside Disney's broader corporate ecosystem. The result is a structural imbalance: Pixar enables value creation, but Disney captures most of it.

This imbalance links directly to the core strategic variable: **IP ownership**. Ownership determines how net revenues are split and who gets to exploit properties across existing and future channels. Pixar tries to increase its share of ownership to capture more value; Disney pushes in the opposite direction because owning the IP allows it to activate synergistic businesses far beyond filmmaking. For both sides, this is a non-negotiable priority, which is why bargaining over ownership consistently leads to stalemate. Neither actor can concede without undermining its core strategy.

The conflict deepens with **derivative works**, which comprise sequels, prequels, episodic content, games, theatrical adaptations, and more. Pixar aims to protect the integrity of its storytelling and brand equity, avoiding sequels produced only for short-term commercial gain. Disney, on the other hand, relies on franchises: sequels reduce uncertainty, strengthen bargaining power with exhibitors, require lower marketing investment, and generate stable profits across all divisions. This creates a fundamental incompatibility of objectives—what protects Pixar's long-term brand damages Disney's economic model, and vice versa.

Another critical area is **coverage**, meaning which current and future revenue streams the contract should include. Pixar seeks strict boundaries to avoid giving up rights to unknown future channels. Disney wants the broadest possible coverage ("in perpetuity anywhere in the universe"), ensuring full monetization of properties across media and technologies that may not even exist yet. The unpredictability of future distribution channels makes it nearly impossible to design a contract that is complete and incentive-compatible.

The same structural tension appears in the domain of **control**.
In distribution, Pixar wants the best release dates; Disney must optimize across its entire portfolio, not just Pixar films. Disney possesses superior information, relationships with exhibitors, and forecasting capabilities, creating opportunities for opportunistic behavior.
In marketing, Pixar wants maximum investment on its titles; Disney must allocate budgets across competing internal projects. The uncertainty about film quality ex-ante and the discretionary nature of budget allocation ex-post make full alignment impossible.
In the creative process, Pixar wants autonomy to preserve culture, morale, and artistic standards. Disney wants marketable content and "toyetic" characters that feed merchandising and franchises. The cost of giving up control is too high for both parties, and no contract can fully anticipate or regulate every creative disagreement.

These recurring problems illustrate that **transaction costs in the partnership are extremely high**. The environment is unpredictable, information is unevenly distributed, opportunism is possible at every stage, and incentives are misaligned by design. Contracts—even complex ones—cannot solve these issues because the creative industry is full of uncertainties, intangible outputs, and rapidly evolving revenue models.

According to the logic of governance theory, when:

- uncertainty about future events is high,
- information asymmetries are strong,
- gains from cooperation are uneven,
- incentives cannot be aligned contractually,
- and control over key assets is essential for value extraction,

then firms tend to shift from **market governance (contracts)** to **hierarchical governance (ownership)**.

The Disney–Pixar trajectory follows this path exactly. Over time, synergies between the companies increase significantly, while the cost of coordinating through contracts rises even faster. Graphs on governance costs (page 63–64) illustrate how, beyond a certain point, equity ownership becomes more efficient than external contracting because it reduces failures of coordination and cooperation. This tipping point marks the moment when acquisition becomes strategically rational.

Disney's acquisition of Pixar in 2006, worth $7.4 billion, represents this transition from market to hierarchy. But owning Pixar creates a new challenge: how to secure control without destroying the culture that generates its value. Disney must reduce ownership costs—particularly the risk of demotivating creative talent—while still achieving integration.

The solution is **soft integration**. Policy documents shown near the end of the file confirm this approach: Pixar retains its brand, creative leadership (Catmull and Lasseter), organizational identity, location in Emeryville, and compensation practices. Disney gains strategic oversight while minimizing disruption to Pixar's internal dynamics. In other words, Disney purchases control where it matters—rights, revenue participation, and strategic coordination—while preserving the operational independence that sustains Pixar's innovation.

Taken together, the Disney–Pixar case demonstrates the fragility of collaborative governance in industries characterized by creativity, uncertainty, and interdependence. When partners generate high synergies but have misaligned incentives and asymmetric information, contracts become too costly and incomplete to sustain cooperation. Ownership becomes the only governance structure capable of unlocking full value and ensuring long-term coordination.

## SESSION 14 OPERATIONS STRATEGY AND MANAGEMENT

In this session we will analyze the difference between a market driven operations strategy and a resource-based operations strategy, underlying the long-term and short- term decisions that need to be made in order to carry out the operations strategy. Moreover, the session will illustrate the main strategic success factors that characterize the operations.

Operations sit at the core of every organization because they transform inputs into outputs that create value for customers. Whether the context is luxury jewelry, hospitality, fast food, or manufacturing, the logic is the same: operations convert resources—materials, information, customer interactions, facilities, and human capabilities—into products or services that fulfill specific needs. The slides frame this through the Slack et al. model, which positions operations as a system structured around **Direct**, **Design**, **Deliver**, and **Develop**, showing how firms steer processes, shape offerings, run day-to-day activities, and continuously improve their capabilities.

This model highlights that operations are not an isolated function. They intersect with strategy and performance. Operations strategy defines the long-term decisions shaping how the firm competes; operations management handles the daily execution; and operations performance refers to the measurable outcomes that customers experience. These three elements are tightly interdependent: strategy determines priorities, management executes them, and performance signals whether the system is truly delivering value.

**Operations Strategy as Functional Strategy**

The slides stress that operations strategy is a **functional strategy** within the broader corporate architecture. Corporate strategy defines the long-term direction of the business portfolio; business strategy defines how a specific unit competes; and functional strategies (marketing, finance, operations) translate those competitive ambitions into concrete actions.

For operations, this translation involves deciding which capabilities must be developed to support the market positioning. If a jewelry brand like Bulgari claims superior craftsmanship and attention to detail, operations must secure access to the finest raw materials, guarantee artisanal precision, and ensure reliable delivery timing—converting brand promises into operational realities. Similarly, if a hotel business wants to scale its luxury clientele, operations must shape the restaurant experience, room standards, service protocols, and wellness offerings to embody its strategic goals.

The underlying message is that strategy without corresponding operational coherence is empty. A differentiating idea becomes real only when operations embed it into processes, capabilities, and resource allocation.

**Two Perspectives for Defining Operations Strategy**

**Market-Driven vs. Resource-Based**

The slides distinguish two complementary lenses for developing operations strategy:

**1. The Market-Driven Perspective**
This approach starts from external demand. Firms analyze what customers value—speed, low price, consistent quality, convenience—and design operations accordingly. Fast-food chains exemplify this logic. Short lunch breaks, predictable quality, simple menus, and low prices shape the entire operational design of McDonald's, KFC, and Burger King. Their kitchens, staffing models, supply chains, and facility layouts are optimized to satisfy these external requirements.

**2. The Resource-Based (Process-Driven) Perspective**
Here the starting point is not the market but the firm's unique capabilities. A company leverages internal strengths—tradition, know-how, proprietary technology, or craftsmanship—to define how and where it can outperform competitors. The Coca-Cola example shows this well: a secret formula, distinctive product design, and strong process discipline became key engines of competitive advantage, shaping its operations and allowing the company to compete in a unique way.

In creative industries, this perspective is especially prominent. Many Made in Italy clusters, illustrated in the slides, show how craftsmanship, industrial districts, and specialized know-how become the foundation of operational and strategic differentiation. These clusters integrate tradition and industrial organization in ways that cannot be easily replicated elsewhere. Ferrari's "MANOfactory" idea captures this hybridization: operations blend the precision and scalability of industrial production with the creative sensitivity and attention to detail of artisanship.

**Operations Management: The Activity of Coordinating Resources**

Operations management concerns the day-to-day orchestration of the resources involved in producing goods or services. It spans manufacturing plants, retail stores, restaurants, back-office banking operations, hotels, and any system where inputs are transformed into outputs. The slides illustrate this diversity—from automobile assembly lines to kitchen manufacturing, restaurants, and retail environments—and emphasize that all of them follow the same operational logic even if their outputs differ.

Good operations management ensures reliability, efficiency, and consistency. It keeps activities flowing, minimizes variability, controls inventory, manages capacity, and guarantees that the promises embedded in the strategy are delivered in reality.

**Operations Performance: Competitive Priorities**

A central section of the slides breaks down **operations competitive priorities**, which define how operations contribute to competitive advantage. These priorities express what customers value and what the firm must excel at. The main categories are **cost, quality, speed, dependability, flexibility, sustainability, and customization**. These priorities must be ranked and coordinated depending on the firm's competitive strategy.

1. Cost: Competing on cost requires efficient processes and tight control over manufacturing, logistics, transportation, inventory, supplier relationships, and post-sales activities. The goal is producing outputs at a cost that supports attractive pricing while still generating returns. Cost

competitiveness often demands scale, standardization, and waste reduction. Luxottica, shown in the slides, exemplifies how integrated operations give firms strong cost control.

2. Quality: Quality appears in multiple dimensions. It includes producing error-free goods, ensuring that products conform to technical specifications, and guaranteeing that they are fit for purpose. Another dimension is durability—products must maintain performance over time. The Hermès bag example underlines longevity as a form of perceived quality. Country of origin, raw materials, and craftsmanship reinforce authenticity and excellence, but they also create complexity: errors at any stage of the supply chain multiply and affect the final customer experience.

3. Speed: Speed refers to minimizing the time between a customer request and the delivery of the product or service. Companies can pursue speed in two ways:
– **Over-stocking or over-resourcing** to ensure immediate availability
– **Reducing lead times** across the supply chain so that goods and services flow rapidly through the system

The trade-off is structural. Stocking improves responsiveness but raises costs; reducing lead times requires deep process reengineering. Different industries choose different balances depending on their competitive positioning.

4. Dependability: Dependability is about delivering **on time and in full**. Poor dependability encourages customers to overorder or order early to compensate for uncertainty. This behavioral reaction contributes to the **bullwhip effect**, which amplifies fluctuations in inventory up the supply chain because companies lack visibility over real end-customer demand. Operations that prioritize dependability develop stable processes, accurate forecasting, and strong coordination across stakeholders.

5. Flexibility: Flexibility has three dimensions:

– **Product Flexibility:** the ability to introduce new products efficiently
– **Mix Flexibility:** the ability to offer a wide range of items within a product family
– **Volume Flexibility:** the ability to scale production up or down in response to market fluctuations

Creative industries often require all three, especially when collections change frequently or demand is highly seasonal. Flexibility requires adaptable machinery, skilled labor, modular design, and responsive suppliers.

6. Sustainability: Sustainability increasingly shapes operational choices. It influences sourcing, energy usage, waste reduction, logistics, and product design. While the slides do not over-define sustainability, they imply that it is becoming a structural competitive priority rather than a peripheral concern. Sustainable operations must balance environmental, social, and economic outcomes without undermining cost, quality, or speed.

7. Customization: Customization depends heavily on the firm's production model. The slides outline the spectrum of fulfillment methods:
– **Make to Stock (MTS)** offers little customization but extremely fast delivery.

– **Assemble to Order (ATO)** allows some tailoring while keeping lead times moderate.
– **Make to Order (MTO)** and **Purchase to Order (PTO)** increase customization but require longer planning and production windows.
– **Engineering to Order (ETO)** sits at the extreme, where products are developed according to customer specifications, resulting in the longest lead times.

The degree of customization fundamentally shapes the structure of the entire supply chain, determining how quickly and efficiently a firm can respond to demand.

**Order Qualifiers and Order Winners**

To tie everything together, the slides return to an essential conceptual distinction:
– **Order Qualifiers** are baseline performance features. Customers expect them; without them, a product won't even be considered.
– **Order Winners** are the decisive factors that make a customer choose one firm's offering over another.

For example, in luxury fashion, basic quality and craftsmanship might be qualifiers—prerequisites. But exceptional heritage storytelling, distinctive materials, or exclusive customization options may be the true order winners. In fast food, low prices and speed might be qualifiers, while consistent taste or extended operating hours may function as order winners.

An operations strategy must clearly identify which competitive priorities fall into each category and allocate resources accordingly.

**Final Synthesis**

This set of slides constructs a full conceptual architecture for understanding how operations create competitive advantage. Operations strategy aligns long-term decisions with the firm's positioning; operations management ensures that day-to-day execution embodies those choices; and operations performance expresses what customers actually value. Through competitive priorities—cost, quality, speed, dependability, flexibility, sustainability, customization—firms shape the capabilities that allow them to win orders and sustain differentiation over time.

The broader insight is that creative industries are not only creative in design or branding. Their creativity extends deeply into operations: the ability to industrialize craftsmanship, orchestrate complex supply networks, and convert intangible brand values into tangible performance is what ultimately determines success.

## SESSION 15 THE CALVISIUS CAVIAR CASE

In this session, through the case, we will apply the knowledge acquired in the previous session analyzing the operations strategy of Agroittica Lombarda, its strategic goals and its strategic success factors.


Classify the Calvisius caviar operations strategy (market driven vs. resource based) and explain the Reasons why

Their operations strategy is resource based: by definition in the market driven strategy the needs of the customers point out the possibility to create the product itself. The competitive priorities are defined analyzing the market needs, then operations are developed. This is not the case of Calvisius, since the company itself was founded after the discovery of an aquifer in Calvisano ( = the resource).

"*They discovered an aquifer in Calvisano, in the subsoil of the land chosen for the steel plant expansion and immediately had an idea for a new business*"

Focusing on quality, efficiency, and sustainability, please classify these three Calvisius Caviar operations competitive priorities as “order qualifier” and “order winner”, explaining the reasons why.

- Quality > order winner: quality is a competitive advantage for Calvisius, since the brand’s reputation is built on the production of premium caviar through traditional, labor-intensive processes. The company’s strict quality controls and artisanal methods help differentiate their company within the luxury market
- Efficiency > order qualifier: efficiency is indeed essential for the company, mainly to allow the company to remain competitive, it's not something that differentiates the company in the eyes of customers, that do not consider it as a driver for their purchasing decision.
- Sustainability > order winner: sustainability is crucial in attracting environmentally conscious consumers, especially in the luxury food market. It differentiates the company and its products in the eyes of customers.

As a typical example of luxury food product, explain how Calvisius Caviar embodies the Made in Italy success factors (premium quality and innovation, association with a country of origin, craftsmanship and know-how, sustainability, experience and lifestyle).

**QUALITY & INNOVATION**

- Sourcing premium raw materials
- Control over the entirety of the production process (more control over the quality without outsourcing)
- Each fish is microchipped to ensure quality

- Manual sieving to keep high quality
- Hand division of eggs during salting to reach quality standards
- Labeling process with QR that provides more information (to make consumers aware of quality)

**COUNTRY OF ORIGIN**

• Caviar known as "Black Gold of Calvisano" > strongly related to the specific city

**CRAFTMANSHIP & KNOWHOW**

- Sieving > manual delicacy not to break eggs
- Salting process
  - ○ Handdivisionofeggs
  - ○ Malossoltechnique
  - ○ Secrets handed down from generation to generation which are never revealed by the Master Salters

**SUSTAINABILITY**

- Ethical processes & sources > monitoring and doing ultrasounds on fished not to slaughter them before the time is right
- CITES certification

**EXPERIENCE & LIFESTYLE**

- Strong association with richness
- Association with 1st class airlines (like Lufthansa and Singapore Airlines)

## SESSION 16 COMMUNICATION PROCESS

The communication process in negotiation can be understood through five main styles that researchers typically distinguish by looking at how much value each negotiator places on the relationship and on the outcome they want to achieve. These styles reflect how negotiators balance their own interests with those of the other party, and how they navigate the tension between getting what they want and preserving long-term interactions.

The avoidant style emerges when a negotiator prefers to stay away from conflict. People rely on this approach when they need time to cool tensions, to avoid escalation, or because they recognize they are temporarily in a weak position. Even though avoidance can create space for reflection, it frequently backfires. By stepping back from necessary discussions, negotiators risk worsening the situation or letting key issues remain unresolved. The example of a negotiation shifting abruptly from “we want a lifelong contract” to “impossible, the market is growing too fast” and then jumping directly to “okay, let’s talk about sequels” captures how avoidance pushes parties to bypass the real conflict.

The competitive style is centered almost entirely on one’s own interests. This approach can be efficient when time is extremely limited, when there is no need to maintain long-term relationships, or when one party has significantly higher leverage. The focus is purely on maximizing outcomes for oneself. While this can create quick wins, it also blocks collaboration and prevents the development of trust. Because the relationship component is ignored, this style is not optimal when future interactions matter.

A more demanding but potentially more rewarding approach is the collaborative style. Here, the goal is to reach an agreement that satisfies the needs of all parties while simultaneously strengthening the relationship. Collaborative negotiators remain flexible, update their positions when new information emerges, and are willing to invest time and effort into reaching mutually beneficial solutions. This style works best when trust is already high and when the decision at stake is important enough to justify the extra time. Its main vulnerability appears when one party behaves opportunistically; collaboration requires mutual good faith, and without it, the more cooperative negotiator risks exploitation.

The accommodative style flips the focus almost entirely toward preserving the relationship. Negotiators use this style when the issue at hand matters little to them but is important to the other party, or when they want to build goodwill that can be leveraged later. By conceding today, they hope to gain influence tomorrow. The risk, however, is that excessive accommodation makes a negotiator look weak or uncommitted, reducing credibility and shifting the power dynamic unfavorably.

Finally, the compromising style sits somewhere in the middle, where both sides make concessions in order to reach an agreement that is acceptable, even if not ideal, for each. It is a pragmatic approach when time, resources, or trust are limited, and when the goal is simply to find a workable solution rather than a perfect one. Together these five styles illustrate how negotiation is not only about exchanging offers but about interpreting social cues, managing priorities, and choosing the appropriate balance between results and relationships. The art lies in recognizing which style fits the situation and being able to shift when the context demands it.

## SESSION 17 OPERATIONS PERFORMANCE

Operations performance can be understood through several dimensions that shape how a company produces, delivers, and adapts its offering. Speed is the first of these, referring to the capability to move from the beginning to the end of a process within a short lead time, allowing the firm to serve customers quickly. Companies usually try to shorten lead time by making each step of the value chain faster, although some firms rely on strategies like overstocking or over-resourcing. These shortcuts come with significant risks: holding inventory ties up capital that could be used elsewhere, and many products—whether because of expiration or changing fashion trends—lose value rapidly and may end up unsold. What counts as "fast," however, is always contextual. Operations must align with the business strategy and with the brand's identity. Prada, for instance, works on a long creative and production cycle that traditionally spans nine months from trend scouting to store delivery. Fast-fashion brands, on the other hand, operate with lead times of only a few weeks because their processes are built for rapid replication rather than original design. Even within the same industry, the importance attributed to speed varies. Brands with loyal customers can afford longer waits, while in markets where clients are driven by status—especially in emerging economies—slow delivery may simply push them toward competitors. Speed is therefore not an absolute measure but a reflection of the brand's values, positioning, and market expectations.

Dependability represents another essential dimension: the ability to meet customer expectations without disappointing them. This requires precise planning around delivery dates, from sourcing raw materials to scheduling production, packaging, and transportation. When a company fails to deliver reliably, customers lose trust, and may demand discounts or reconsider the relationship altogether. The consequences magnify in B2B environments: if a supplier is unreliable, the company depending on that supplier becomes unreliable in turn. Clients often respond by placing larger orders earlier than needed, attempting to compensate for expected delays. This behavior triggers the bullwhip effect, where small fluctuations in customer demand become amplified as one moves upstream in the supply chain, creating inefficiency and excess inventory. Dependability is typically assessed through both quantity and timing, and is measured using OTIF—on time and in full—which captures whether orders arrive exactly as promised.

Flexibility adds another layer to operational performance by describing how adaptable a company is to change. This adaptability can take different forms. Product flexibility reflects a firm's ability to introduce new products at a reasonable cost and within acceptable timing, with the balance between innovation and continuity shaped by brand identity. Mix flexibility refers to the firm's ability to produce a wide variety of items within the same product family; fashion brands illustrate this clearly, as each SKU is defined by attributes such as size, color, and material. A third type, volume flexibility, concerns the firm's ability to scale production up or down in response to fluctuating demand. While this capability helps avoid shortages or missed sales, it is costly when demand remains flat because underused operations generate inefficiency. Not every process can be adjusted easily—technology often imposes constraints—and any increase in flexibility requires setup costs. Firms are constantly navigating the tradeoff between flexibility and efficiency, choosing the balance that best fits their strategic priorities.

Sustainability has evolved into another core concern for operations. Traditionally, it was interpreted through the “triple bottom line”: people, planet, and profit. This meant ensuring safe and fair working conditions, minimizing environmental impact throughout the input and output stages, and maintaining the economic viability of operations. Over time, however, the profit dimension expanded into a broader concept of governance, which encompasses ethical decision-making, long-term strategic responsibility, and transparency. Some companies are born with sustainability embedded in their operational identity, while others move toward it gradually through product development or process innovation—such as Lavazza’s projects aimed at improving the environmental footprint of its Tierra coffee line.

Customization adds another layer of complexity. It represents how effectively operations can tailor a product to individual customer needs. From the company’s perspective, customization involves managing processes such as design, purchasing, manufacturing, assembly, and transportation across different lead times. From the customer’s perspective, the key factor is delivery time—how long they are willing to wait for the personalized product. Different production approaches reflect different positions along this spectrum. When customers expect immediate delivery, firms use the make-to-stock model, producing standardized products based on forecasts and storing them in inventory. If customers accept waiting only for final assembly, the firm operates on an assemble-to-order basis, relying on semi-finished goods held in a warehouse. When customers are willing to wait longer, production may shift to a make-to-order model, where raw materials are stored but manufacturing begins only after the order is placed. A step further is purchase-to-order, where even the procurement of materials responds to specific orders, extending delivery time but increasing personalization. At the extreme end lies design-to-order, where both product design and production begin after the order is placed, offering maximum personalization at the cost of the longest wait. The warehouses used in these systems act as decoupling points, marking where input switches from forecasts to actual orders and shaping the entire rhythm of production.

Across these dimensions—speed, dependability, flexibility, sustainability, and customization—operations strategy becomes a reflection of broader strategic choices. Each dimension shapes how a company competes, how it aligns with its brand identity, and how it positions itself within its industry’s competitive landscape.

## SESSIONS 18 THE GLOBAL SUPPLY CHAIN MANAGEMENT - SIMULATION

You'll be divided in groups and you'll be required to play a simulation being in the shoes of an operations manager in charge of designing, producing and selling two different lines of products. You will be asked to make some strategic decisions over four runs of simulation with the aim of improving your results and performances both from an economic point of view as well as a managerial stand point.

A useful way to understand how companies manage customization and delivery expectations is through the planning index, which compares lead time with delivery time. When the index equals one, lead time and delivery time perfectly overlap, meaning the customer is willing to wait exactly as long as the firm needs to produce and personalize the product. This is the ideal scenario because operational needs and customer expectations are perfectly aligned. When the planning index is greater than one, the company requires more time than customers are willing to tolerate. In this situation, personalization becomes impossible unless processes are sped up. Firms either remove customization entirely or invest in reducing lead times across one or more stages of production. When the planning index falls below one, the firm is capable not only of personalizing products but also of delivering them faster than customers expect. Speed becomes an additional service that can potentially be monetized. However, if customers are not willing to pay a premium for faster delivery, the operational model becomes inefficient because finished goods must remain in inventory, generating unnecessary costs.

These dynamics highlight the classic tradeoffs among competitive priorities. Improving one dimension, such as speed, may reduce performance in another, such as quality. Companies therefore need to define clear priorities based on the strategic goals of the business. This distinction is captured by separating order qualifiers from order winners. Order qualifiers are baseline performance attributes that allow a product to be considered at all—for instance, Patagonia's reputation for quality. Customers expect these attributes as minimum conditions. Order winners, by contrast, are the features that actually drive customers to choose one product over another. For Patagonia, sustainability functions as the decisive factor that converts interest into purchase. Understanding which attributes play each role helps firms allocate resources intelligently within their operations.

These ideas become especially relevant when examining how operations support creative industries, particularly those associated with Made in Italy. The Made in Italy label functions almost like a brand of its own—akin to Visa or Coca-Cola—and spans four major sectors: fashion, food, furniture, and automotive or automation. Across these industries, customers associate Italian production with creativity, aesthetic refinement, superior quality, sophistication, and a strong link to the cultural identity of Italy. These attributes shape how Italian companies design their sourcing, manufacturing, and delivery processes.

Premium quality is one of the pillars of the Made in Italy reputation. Many Italian products rely on rare, innovative, or high-value raw materials that must be sourced with extreme precision. Examples range from Valentino couture garments to Poltrona Frau furniture to Parmigiano Reggiano. Their strength lies in deep craftsmanship and specialized know-how, which explains why Italy is structured around numerous industrial districts. These districts concentrate

expertise, techniques, and managerial approaches that allow them to excel in the production of specific goods. The challenge for many of these companies is balancing craftsmanship with the need for industrial-scale production. Markets demand increasing volume, and firms must find ways to maintain artisanal identity while meeting global demand.

Geographical specificity reinforces this relationship between territory and product excellence. For categories like food and beverage, origin is not just symbolic—it is formally regulated. Strict production protocols define what qualifies, for instance, as Parmigiano Reggiano, tying the product to a specific region and its raw materials. Geographic labels also become shorthand for product identity, as in the case of prosciutto di Parma. This shows how operations, supply chains, and regulation intersect to sustain credibility and authenticity.

The Made in Italy identity also extends into lifestyle and experience. Brands use operations not only to deliver products but also to cultivate a broader cultural aura. Prada's involvement with Pasticceria Marchesi demonstrates how a fashion house can enter a new category while preserving coherence with its aesthetic universe. The alignment between product design, service experience, and brand values strengthens the overall appeal and communicates a distinctive Italian sensibility.

Sustainability has become another channel through which Italian companies amplify their value. Venchi's decision to recycle Easter egg wrappings and reduce plastic is a response both to environmental concerns and to its own cheerful, high-quality brand identity. Muraglia, an olive oil producer from Puglia, offers another example: its cold-pressed process preserves the intensity of coratina olives, while the handcrafted ceramic packaging expresses artistry, locality, and environmental consciousness. The distribution strategy reinforces this positioning by placing the product only in high-end retailers such as Rinascente, Harrods, and Eataly. Associating the oil with top chefs and premium products further elevates its desirability.

Altogether, operations become a strategic lever for reinforcing the appeal of Made in Italy. By managing sourcing, production, delivery, design, and experience with precision, Italian brands translate cultural heritage into competitive advantage.

Forecasting within organizations often reflects group dynamics as much as analytical tools. Consensus forecasts, for example, tend to be heavily influenced by the individuals with the most authority or confidence, regardless of whether their assumptions are correct. Their personal traits—such as extroversion, expertise, or simply stronger persuasive skills—shape the group's final decision. Although consensus can simplify communication, it loses valuable information such as the variance and standard deviation of opinions, making the forecast less informative. The Delphi method attempts to solve this by allowing participants to express their views anonymously. Through iterative rounds of feedback, individuals refine their predictions without being pressured or influenced by stronger personalities, even though the process still relies on trial and error.

The lecture then moves into one of the most fundamental choices in operations: whether to make internally or buy from external suppliers. When a company decides to buy, it must design a supplier management strategy that reflects the strategic importance and risk profile of each purchase. The Kraljic matrix offers a structured approach to this decision by classifying materials

according to their profit impact and supply risk. Materials with low cost relevance and low supply risk are considered non-critical and should be purchased with minimal administrative effort to keep processing efficient. At the opposite extreme, strategic materials combine high profit impact with high supply risk; these require long-term partnerships built on collaboration and trust, since both parties depend heavily on the relationship.

Leverage materials are high in profit impact but low in supply risk. Because even a small reduction in price brings a significant improvement in profitability, companies usually create competition among suppliers to drive prices down. However, competition must be managed carefully: suppliers should be preselected based on alignment with operational needs before being asked to compete. Vendor rating systems help firms monitor suppliers' performance over time and maintain accountability. Bottleneck materials sit in the final quadrant—low in profit impact but high in supply risk. Even though they do not significantly affect costs, the absence of these inputs would halt operations entirely. Here, the priority is securing continuity through stockpiling, multiple sourcing, finding alternative products, or redesigning the product or process to eliminate the bottleneck. Because supply markets evolve, the matrix requires continuous updating.

On the "make" side of the decision, firms must choose how to configure their internal supply chain. The Ferdows model outlines different types of factories within a global production network, based on the primary reason for their location (low cost, access to knowledge, or proximity to markets) and the strategic scope of their activities. Offshore factories focus on efficiency and low-cost production, performing simple tasks based on instructions from elsewhere. Source factories also aim for efficiency but hold greater autonomy, including supplier contracting and process engineering. Server factories exist mainly to serve local markets quickly, especially when transportation costs or speed make centralized production inefficient. Contributor factories combine proximity to markets with strong capabilities in new product development, technology decisions, and procurement strategy. Outpost factories are located in strategically important regions, not for production volume but to monitor competitors, capture emerging trends, and integrate into crucial networks. Lead factories represent the highest level of capability, positioned in regions rich in skills and knowledge; they drive innovation, learning, and technological advancement for the entire production network.

The lecture concludes with the newsvendor model, which addresses how firms determine the optimal production quantity when demand is uncertain. Managers must balance the cost of producing too little—resulting in stockouts and lost sales—against the cost of producing too much, which leads to unsold inventory. If demand follows a distribution close to normal, the optimal quantity, Q*, minimizes total inventory costs while maximizing profits. Stockout costs equal the selling price minus the production cost, reflecting the opportunity lost when one extra unit could have been sold. Overstock costs include the difference between production cost and liquidation price, plus holding, obsolescence, and disposal costs. In practice, the model often simplifies this to production cost minus liquidation price. If overstock costs exceed stockout costs, the firm should produce less than its forecast; if the reverse is true, it should produce more. Overall, the lecture frames operations decisions—whether forecasting, sourcing, manufacturing, or inventory planning—as exercises in balancing risk, cost, and strategic priorities.

## SESSION 19 THE GLOBAL SUPPLY CHAIN MANAGEMENT – DEBRIEF

In this session we will debrief the simulation results analyzing the different managerial techniques and practices related to demand forecasting, operations planning, purchasing management and inventory management.

Effective supply chain management relies on the ability to connect product design choices, forecasting, sourcing strategy, and production planning into one coherent system. Every decision taken at the design stage influences margins, demand expectations, risk levels, and operational flexibility; for this reason, the supply chain must be understood as an integrated mechanism rather than a sequence of isolated tasks.

A starting point is the economic evaluation of product options. Each modification affects the unit margin through changes in price and direct cost, but the real impact emerges only when margin and demand are considered together. The relevant variable is therefore the **total margin**—unit margin multiplied by expected sales. A product option that looks attractive on a unit basis may become less appealing if it slightly increases margin but depresses demand or introduces substantial uncertainty. Profitability cannot be assessed without incorporating the expected quantity sold and the stability of that quantity.

Forecasting quality is essential in this process. Using the **mean of individual forecasts** preserves information about dispersion, which signals how uncertain demand actually is. Aggregated, discussion-based estimates tend to suppress this information and are vulnerable to social dynamics such as dominance, conformity, or reluctance to disagree. The average estimate is more analytically robust because it keeps the variance visible—something critical for risk-sensitive decisions.

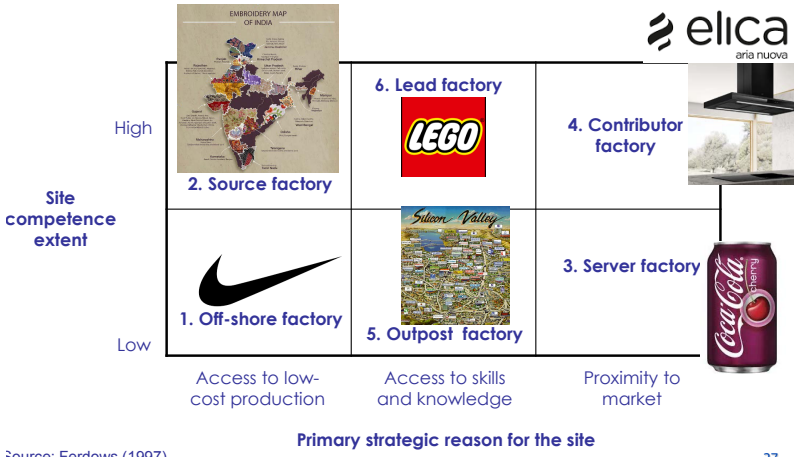
Variance or standard deviation across predictions acts as a proxy for demand uncertainty. High variance indicates disagreement among forecasters, suggesting that the true demand level is difficult to predict. In this context, even a small increase in expected sales rarely compensates for a disproportionate increase in risk. Decisions should therefore combine expected profitability with the volatility of demand: higher margins have value only when paired with a reasonable risk profile.

This logic extends to the selection of suppliers and the design of production capacity. Suppliers differ in lead time, setup costs, unit costs, and production capability, meaning that capacity is not interchangeable. A productive supply chain uses a **hybrid approach**, allocating slow, low-cost suppliers to the predictable portion of demand and fast, more expensive suppliers to the uncertain portion. This reduces indirect costs such as markdowns and stock-outs without inflating direct costs unnecessarily. Predictable demand belongs to long-lead-time production; volatile demand calls for reactive capacity.

Adjustment mechanisms such as **change orders** provide further flexibility. Adapting production based on early real demand makes sense when the change occurs early enough to influence final availability and when the gains outweigh the additional cost required to modify production. Flexibility is never free; it becomes valuable only when uncertainty is high and remaining production windows are wide enough to respond.

Strategic sourcing also requires structured supplier management. The **Kraljic purchasing portfolio model** classifies inputs along two dimensions—importance of purchase and supply risk—yielding four categories with distinct managerial implications:
• *strategic items* (high importance, high risk) require long-term partnerships;
• *leverage items* (high importance, low risk) call for negotiation and competitive sourcing;
• *bottleneck items* (low importance, high risk) require risk mitigation and assurance of supply;
• *non-critical items* (low importance, low risk) focus on process efficiency.
Treating all inputs identically would misallocate both attention and resources.

Beyond supplier categories, the spatial configuration of the production network shapes competitive advantage. The **Ferdows model** outlines six strategic roles that factories may play, from the cost-driven *off-shore* and *source* plants to market-proximate *server* plants, knowledge-oriented *outpost* units, and high-competence *contributor* or *lead* factories. Each site has a purpose defined by its capabilities and strategic value, and the overall supply chain becomes effective only when each plant is aligned with the role it is best suited to perform.



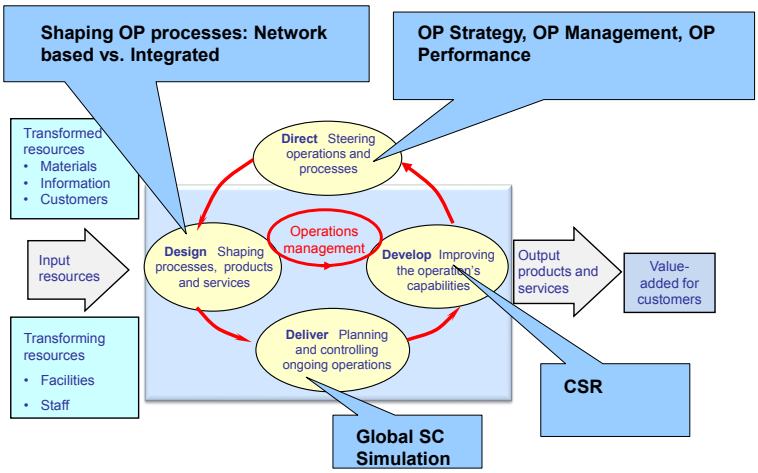

Production quantity decisions rely on the classic **Newsvendor model**, which balances two opposing risks: the cost of running out of stock and losing sales, and the cost of overproducing and absorbing markdown losses. The optimal quantity depends not only on average demand but also on the ratio between the two costs. When stock-out costs exceed over-stock costs, producing above the mean demand is justified; when the opposite is true, producing below the mean becomes optimal. This approach recognizes that demand uncertainty has asymmetric consequences and that the cost structure determines the right level of inventory.

Across all these elements runs a common principle: supply chain decisions must internalize uncertainty rather than ignore it. Forecast dispersion, variability in demand, heterogeneous supplier characteristics, and the economic consequences of misaligned capacity all shape the structure of choices. A well-designed supply chain transforms uncertainty into a manageable set of trade-offs, enabling the firm to preserve margins, avoid waste, and maintain responsiveness in industries defined by volatility and rapid product cycles.

# SESSION 20 NETWORK-BASED SUPPLY CHAIN VS INTEGRATED SUPPLY CHAIN

In this session we will compare two different operations models, namely the network- based and the integrated one, through the analysis of two fashion companies: BasicNet and Zara.

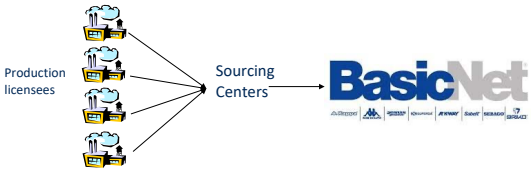
Operations shape how a company transforms resources into value and how it coordinates the flow of activities that connect design, production, logistics, and delivery. Within this system, the strategic challenge is understanding what to internalize and what to delegate to external partners. The structure of these choices determines the firm's speed, cost efficiency, flexibility, and ability to manage risk.




Two broad models dominate: **network-based operations** and **vertically integrated operations**. A network-based model relies on an extended ecosystem of suppliers and licensees. The firm orchestrates the system through digital platforms and standardized processes, while manufacturing and distribution are largely performed by external partners. A vertically integrated system, instead, builds competitive advantage by controlling most stages of the value chain directly, reducing dependence on external actors and tightening coordination inside the firm.

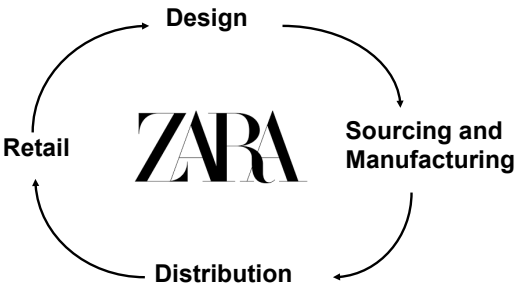
Sourcing decisions become more structured when viewed through the **Kraljic Matrix**, which classifies purchased materials by **profit impact** and **supply risk**. Non-critical items require streamlined, low-cost administrative processing; leverage items offer opportunities to reduce unit costs by creating competition among qualified suppliers; bottleneck items demand protection against disruptions through multiple sourcing, product redesign, or safety stock; strategic items require long-term partnerships because they combine high economic relevance with high vulnerability. The matrix must be continuously updated, since evolving products and market dynamics shift categories over time.

On the production side, the **Ferdows model** helps assign clear missions to factories in a global footprint.
Plants located primarily for cost advantages operate as **offshore** or **source factories**, focusing on efficiency, basic execution, and sometimes engineering tasks. Facilities close to core markets act as **server factories**, minimizing transport time and reacting faster to demand. **Contributor** factories take on more complex roles, including product development, process innovation, and sourcing strategies. **Outpost** factories provide access to strategic knowledge clusters or innovation ecosystems. At the highest level, **lead factories** influence the entire network, shaping technologies, processes, and product development thanks to deep capabilities and specialized skills.




A concrete illustration of a network-based system comes from the operational architecture of **BasicNet**.
All manufacturing is outsourced to a large pool of suppliers coordinated through proprietary IT platforms. The company focuses on brand management, product design, digital coordination, and network governance. Sourcing centers identify and supervise manufacturers that meet quality, sustainability, and cost standards. Commercial licensees handle market distribution across monobrand stores, brand outlets, and factory outlets. Every step—from design sketches to sourcing trims and fabrics, from purchase orders to logistics—is integrated digitally, creating a "virtual marketplace" where data flows substitute for physical integration. This model generates speed, efficiency, and flexibility while enabling global scale without owning factories. The digital backbone allows rapid updates to collections, synchronized processes, and last-minute corrections in response to market shifts.


However, a network-based architecture exposes the firm to governance challenges. When production is dispersed among independent suppliers, accountability becomes ambiguous. Questions arise about who guarantees consistent quality, who monitors compliance with labor and environmental standards, and how responsibility should be distributed across borders.
To reduce these vulnerabilities, companies may rely on frameworks such as **SA8000**, a global certification standard covering child labor, forced labor, health and safety, discrimination, working hours, remuneration, and managerial systems for social performance. Certifications provide structure and credibility in systems where production is decentralized and potentially opaque.




In contrast, companies built on **vertical integration**—such as major fast-fashion players—gain control by internalizing design, manufacturing, sourcing, logistics, and often distribution. Speed is achieved not through digital coordination of external partners, but through tight in-house communication loops and proximity between design teams, production lines, and retail data.
Both models can be fast, flexible, and cost-competitive, but they operate through opposite logics: network systems leverage external capacity and digital coordination, while integrated systems concentrate capability inside the firm.

Managing uncertainty in demand requires additional tools. The **Newsvendor Model** defines the optimal quantity to produce (Q*) when demand is unpredictable. The firm balances the cost of

**overstock**—unsold inventory discounted or written off—against the cost of **stockouts**, which reflects the margin lost when demand exceeds supply. Overstock cost derives from the gap between production cost and liquidation value, plus holding, obsolescence, and disposal costs. Stockout cost corresponds to the opportunity cost of losing a sale. When overstock cost is greater, the optimal quantity is below the forecast; when stockout cost dominates, the optimal quantity exceeds the forecast. This logic is fundamental for fashion and creative industries, where products have short life cycles and volatile demand.

Across sourcing structures, production footprints, inventory models, and digital platforms, competitive advantage depends on how coherently a company designs its operational architecture. The strongest firms align supplier relationships, factory roles, IT systems, ethical standards, and demand-planning tools into a single strategic logic that supports speed, adaptability, and responsible growth.

## SESSIONS 21 PLATFORMS AND NETWORKS (PAPER)

This session is designed as a thought-provoking module that introduces participants to the transformative role of platforms in reshaping industries and driving competitive advantage. We will define platforms and their role in the digital economy, identifying the characteristics that make such economic model unique. We will learn the strategic relevance of network effects and how they play a key role in platform governance and managerial challenges.

**Reference study material:** Shapiro, C. and Varian H.R. Networks and Positive Feedback, in "Information Rules: A Strategic Guide to the Network Economy", chapter 7 Harvard Business School Press

**The Strategic Logic of Differentiation**

Differentiation strategy rests on the idea that consumers are willing to pay a price premium when a product offers something meaningfully better than competing alternatives. This improvement can take many forms: superior technical performance, stronger brand associations, better aesthetics, or complementary services. What matters is not the firm's internal belief that the product is superior, but the consumer's perception of value. When the willingness to pay rises enough to exceed any additional cost required to deliver the enhanced feature, the firm captures a higher margin.

Differentiation is powerful because it shapes the competitive playing field. Firms that successfully increase consumer willingness to pay shift themselves upward on the value–cost plane. They escape purely cost-driven competition and reduce the risk of price wars. Over time, differentiation tends to separate winners from losers, creating a "battle zone" in the middle where firms with weak or inconsistent positioning struggle to survive.

**Sources of Willingness-to-Pay Gains**

Firms increase willingness to pay by improving the product's value proposition in ways that customers actually notice and care about. These sources fall broadly into three categories.

Performance Improvements: Performance-based differentiation occurs when a product delivers better functional results. This can come from engineering advances, higher durability, superior speed, or enhanced sensory qualities. Some categories depend heavily on performance improvements, such as electronics or sports equipment, where measurable differences strongly influence consumer choice.

Aesthetic and Emotional Value: Many industries rely less on measurable performance and more on identity, emotion, and symbolism. Fashion, cosmetics, and art-driven sectors illustrate how design, storytelling, and cultural meaning can increase willingness to pay even when technical performance differences are small. Brands serve as shortcuts for consumers who want products that express personality, lifestyle, or belonging.

Complementary Services and Customer Experience: A firm can also raise willingness to pay by offering superior complements: warranties, customer support, reliable delivery, or bundled digital services. Even if the core product is similar to competitors', the ecosystem surrounding it can create a distinctive advantage. This type of differentiation is often harder for rivals to imitate because it depends on organizational routines and long-term investments.

**Aggregated Value Creation**

When a firm differentiates effectively, it shifts the perceived value of the entire offering. The consumer sees the product as delivering more utility than the competition, which creates room for higher prices and improved margins. This aggregated value creation is what ultimately drives the divergence between leading and lagging firms. The stronger the differentiation, the more the firm controls its own pricing power rather than being forced to match industry averages.

**Dynamic Patterns: Competitive Cycles and Divergence**

Industries tend to evolve into patterns where differentiation advantages reinforce themselves over time. A firm that begins with a small edge in value creation can use higher margins to invest further in R&D, design, or brand equity. This initiates a virtuous cycle: more investment leads to greater differentiation, which leads to even more willingness to pay and larger financial resources.

The opposite dynamic also exists. Firms that fall behind may lack the resources to catch up, triggering a vicious cycle of declining margins and shrinking investment. The gap between leaders and laggards widens, not because of static differences but because of the feedback loops embedded in competitive strategy. These cumulative processes explain why industries often exhibit long-run winners and losers rather than stable parity.

**Means of Differentiation and Their Trade-Offs**

Differentiation arises from many strategic choices, each involving specific benefits and constraints.

Quality Enhancements: Improving product quality tends to raise willingness to pay but also increases production cost. The challenge is ensuring that the incremental willingness to pay is greater than the incremental cost. Markets where consumers value quality highly—such as luxury goods or technologically advanced products—offer more room for profitable quality-based differentiation.

Branding and Identity: Brand-based differentiation often depends on cultivating cultural associations or emotional resonance. This route requires sustained marketing investment and a coherent identity. Once established, brand equity becomes extremely valuable and difficult to replicate, but building it is costly and slow.

Service-Based Differentiation: Superior service, convenience, and reliability can shift consumer preferences significantly. These advantages typically depend on organizational capabilities, meaning they cannot be copied quickly. However, they require continuous investment to maintain.

**Strategic Positioning and the Battle Zone**

When plotting firms on a value–cost graph, clear leaders position themselves well above the competitive average. These are the firms that have succeeded in raising willingness to pay at a cost that remains manageable. Firms in the “battle zone” occupy the crowded middle, where differentiation is too weak to justify a premium and cost efficiency is not strong enough to compete as a low-cost player. They face constant pressure from both sides: premium players

capture high willingness-to-pay customers, while low-cost firms capture price-sensitive segments.

The lower region of the graph represents firms that consistently create less value than competitors. These firms are on the wrong side of competitive dynamics: they experience shrinking margins and face a high risk of exit. The divergence between winners and losers tends to grow over time: once firms drift downward, recovering becomes increasingly difficult.

**Industry-Level Divergence and Market Structure**

Differentiation influences not just individual firm performance but the structure of entire industries. Industries dominated by strong differentiation often display higher concentration, with a small group of powerful players controlling significant market share. Their superior ability to invest in branding, innovation, and customer relationships allows them to pull even further ahead.

At the same time, industries with weak or eroding differentiation become vulnerable to commoditization. Margins compress, competition intensifies, and the opportunities for sustained advantage shrink. The presence or absence of meaningful differentiation determines whether an industry evolves toward healthy margins and innovation or toward price-driven competition and stagnation.

**Cumulative Advantage: Virtuous and Vicious Cycles**

Differentiation naturally creates cumulative processes. A firm that successfully builds willingness to pay gains both higher margins and stronger brand loyalty. These advantages compound over time: higher profitability funds future improvements, while customer loyalty reduces price sensitivity. This self-reinforcing pattern forms a virtuous cycle.

Conversely, firms with weak differentiation fall into vicious cycles. Lower willingness to pay forces price cuts, shrinking margins. Reduced financial flexibility prevents investment in improvements, making it even harder to differentiate in the future. Over time, the gap between leaders and laggards becomes structural rather than situational.

These cycles illustrate why strategy is fundamentally dynamic. A firm's position today shapes the options available tomorrow, and early advantages or disadvantages can reshape the entire competitive landscape.

**What This Framework Implies for Managers**

Managers must think beyond isolated decisions and consider how differentiation choices interact with long-term dynamics. The goal is not only to raise willingness to pay but to do so in a way that competitors cannot easily imitate. Sustainable differentiation emerges from capabilities, design philosophy, culture, and ecosystems—not from one-off features.

To win, firms must invest where it creates enduring and compounding advantages. To survive, they must avoid drifting into the battle zone or ignoring the possibility of vicious cycles. Differentiation strategy is ultimately about shaping the trajectory of the firm, not just its current offering.

### How Differentiation Creates Competitive Advantage

Differentiation works when a firm raises customers' willingness to pay more than it raises its own cost. The entire logic rests on the wedge between value and cost: value refers to how much customers are willing to pay for the product, and cost reflects what the firm must spend to create it. A differentiated firm shifts the value side upward by offering something uniquely desirable. If that shift is large enough, the firm can charge a premium without sacrificing demand.

This approach is fundamentally different from cost leadership. Instead of trying to win by producing more cheaply, differentiation aims to win by offering more value. The power of this strategy depends on convincing customers that the product delivers something meaningfully distinct—better performance, superior design, emotional resonance, convenience, or a richer ecosystem. When the perception of value rises, customers become less sensitive to price, which gives the firm stronger pricing power and more stable margins.

### Differentiation Along a Stable Frontier

Every industry develops a technological and economic frontier that maps the feasible combinations of willingness-to-pay and cost. This frontier changes slowly, shaped by science, manufacturing capabilities, and industry norms. Firms compete within this landscape by making choices that position them somewhere on the frontier.

Some firms choose to move upward along the frontier by investing in higher quality. Others push leftward by reducing their cost structure. These movements require trade-offs because improving quality typically demands costlier inputs, better materials, and more complex processes. The strategy a firm chooses reflects a commitment about which part of the frontier it wants to occupy. The important insight is that competitors tend to be constrained by similar technologies, so differentiation comes from choices and capabilities rather than fundamental breakthroughs.

Firms that accumulate know-how, design capabilities, or brand equity can gradually move the frontier for themselves—expanding the feasible region through learning or innovation. Over time, this creates a private frontier that sits above the industry average, enabling sustained differentiation.

### The Economics of Moving on the Frontier

Shifting to a higher willingness-to-pay position requires spending more, whether on materials, research, design, or service. The key question is whether the firm captures more additional value than it spends. When willingness to pay increases more steeply than cost, the wedge expands, and profitability rises.

However, increasing willingness to pay often triggers responses from customers and competitors. Customers may reward higher performance with brand loyalty or higher price tolerance. Competitors may attempt to imitate the new features, which slowly erodes the advantage. For this reason, durable differentiation tends to rely on capabilities that rivals cannot quickly match, such as specialized knowledge, integrated design systems, craftsmanship, or cultural legitimacy in the case of aesthetic industries.

**The Relationship Between Capabilities and Competitive Positioning**

Capabilities determine what a firm can do repeatedly and reliably. They shape which moves on the frontier are easy, difficult, or impossible. When firms possess capabilities suited to high-end differentiation, they naturally gravitate toward positions with higher willingness to pay. When their strengths lie in process efficiency, they gravitate toward lower-cost positions.

In differentiation strategies, capabilities often involve ambiguous, tacit knowledge—design sensibilities, aesthetic intuition, brand storytelling, or expertise in customer experience. These capabilities emerge through practice, culture, and cumulative experience, not simple investments. Because they are hard to imitate, they sustain competitive advantage by preventing rivals from replicating the firm's position.

This is why industries frequently show persistent performance differences. Capabilities accumulate slowly and unevenly across firms, shaping who becomes a premium leader and who remains a commodity producer.

**Why Hybrid Positions Fail**

The middle of the frontier tends to be strategically unstable. Firms attempting to deliver higher quality without developing the underlying capabilities often incur higher costs without achieving meaningful increases in willingness to pay. Conversely, firms trying to lower costs while keeping premium positioning compromise the features customers care about, reducing willingness to pay more than cost.

These "stuck in the middle" positions emerge when firms lack commitment and try to hedge between differentiation and cost leadership. Without a coherent direction, their cost base rises while demand weakens. Competitors on either side—premium differentiators and efficient cost leaders—outperform them. Strategic clarity, therefore, requires accepting the trade-offs inherent to differentiation: unique design choices, selective customer targeting, and operational investments that support high-value offerings.

**Dynamic Differentiation: Coevolution of Quality and Know-How**

When a firm keeps investing in quality improvements over time, it does not simply move upward along the frontier; it often reshapes the frontier itself through cumulative learning. This process creates a reinforcing loop: improvements generate higher margins, which fund further innovations, which push the firm further ahead. The firm becomes more skilled at creating high-value products, and customers increasingly associate the brand with superior offerings.

This coevolution explains why high-end firms rarely lose their status quickly. Their capabilities deepen as their market power strengthens, making imitation extremely difficult. High-end car manufacturers, luxury fashion houses, and premium electronics companies illustrate how quality trajectories become path-dependent: the longer the firm remains committed to excellence, the more its accumulated knowledge differentiates it from rivals.

At the same time, firms that do not invest in learning can fall behind. Their technologies stagnate, their designs become outdated, and their customers shift expectations based on the innovations

of market leaders. This creates an asymmetry: advantages compound, and disadvantages compound.

**Quality Upgrading and Its Economic Consequences**

Quality upgrading is rarely linear. Small improvements can lead to large increases in willingness to pay if customers value the attribute intensely. Conversely, large cost increases may generate small willingness-to-pay effects if the improvement is not meaningful.

Managers must therefore understand the elasticity of willingness to pay: how sensitive customers are to specific enhancements. In some industries, small performance gains—battery life, processing power, lens quality—generate disproportionately large willingness-to-pay increases. In others, quality improvements matter only when accompanied by design, brand meaning, or service enhancements.

The risk is overshooting: investing heavily in premium features that customers do not value enough. Successful differentiators avoid overshooting by studying customer preferences and identifying which elements truly drive willingness to pay.

**The Shape of the Advantage Curve**

As firms differentiate, the advantage curve—the relationship between investment in quality and resulting competitive advantage—tends to show diminishing returns over long time horizons. Early improvements generate substantial gains because competitors are far behind and the product lacks refinement. As the product approaches the upper frontier of what customers perceive as possible or necessary, additional improvements yield smaller willingness-to-pay increases.

This dynamic creates natural limits to purely performance-driven competition. Eventually, design, identity, and experience become more important sources of differentiation than engineering alone. This explains why mature industries often shift from technical rivalry to branding battles: once performance converges, the competition moves to softer but still powerful drivers of willingness to pay.

**Increasing Scarcity Through Competence Building**

Differentiation becomes more defensible as firms develop unique capabilities that others cannot easily copy. These capabilities create scarcity—an essential foundation of strategic advantage. Scarcity arises when a capability is rare, specialized, and difficult to transfer. Through continuous investment, firms deepen this scarcity, making their value proposition increasingly unique.

As scarcity grows, rivals find it harder to imitate the firm’s position even when they understand what makes the firm successful. They may see the quality, design philosophy, or service strategy, but they cannot replicate the underlying know-how, culture, or organizational coherence. This is the essence of sustainable differentiation: visible outcomes supported by invisible capabilities.

**Strategic Implications for Long-Term Differentiators**

Managers pursuing differentiation must think in terms of long-term capability building rather than isolated product features. The strategy works when the organization commits to delivering high value consistently and allocates resources toward the skills that enable it. The payoff is gradual but powerful: increased pricing power, customer loyalty, and cumulative advantage.

The cost of this strategy is rigidity. Differentiators cannot easily switch to cost leadership without dismantling the capabilities that made them distinctive. This trade-off is not a weakness but a structural characteristic of strategic positioning. Firms must choose where to excel, accept the path dependencies that follow, and build a trajectory that reinforces their chosen advantage.

Appropriating Value from Differentiation: Creating value through differentiation is not enough; firms must also capture a meaningful share of that value. The total value created by a differentiated product is divided among customers, competitors, and the firm itself. The challenge is ensuring that the wedge between willingness to pay and cost does not leak to rival firms or powerful buyers. Even when a company significantly increases industry value through innovation, it may capture only a small portion if competitors imitate quickly or if complements extract a disproportionate share of the surplus.

The ability to appropriate value depends on how unique, defensible, and hard to copy the differentiated feature is. If the firm develops a new design or service that competitors can easily replicate, the industry's overall value may rise, but the innovator's profits will be temporary. Sustainable value capture requires mechanisms that prevent imitation or reduce its payoff. This is why intellectual property, brand equity, network effects, and tacit knowledge become critical elements of differentiation strategy.

**The Relationship Between Broadcast Value and Private Gains**

Differentiation often produces both public and private benefits. Public benefits are improvements that competitors indirectly enjoy even if they did not contribute to them—like higher customer expectations or improved supplier capabilities. Private benefits are those the firm retains because they depend on proprietary knowledge or exclusive assets.

The firm's share of industry value depends on the balance between what it contributes and what it can protect. If a firm contributes heavily to industry value but does not secure exclusivity, much of that value becomes a shared resource. Conversely, if its contributions are tied to proprietary capabilities, the firm retains a larger share of the surplus. The strategic objective is not only to raise willingness to pay but to ensure that such gains cannot be easily redistributed to others.

**Imitability and the Erosion of Differentiation Advantages**

The major threat to differentiation is imitation. Competitors observe which attributes increase willingness to pay and try to adopt them. When imitation is easy, industries converge, and the spread between high-end and average offerings collapses. Prices fall, willingness to pay levels out, and differentiation erodes.

However, imitation is rarely frictionless. Barriers arise from tacit knowledge, complex organizational routines, integrated ecosystems, and long-term brand investments. These elements create a form of strategic friction that slows or prevents convergence. When imitation is slow or imperfect, early movers benefit from sustained competitive advantage. When imitation is rapid and precise, differentiation yields only transient profits.

Firms therefore seek not only to innovate but to innovate in ways that make imitation inherently difficult. This usually involves complexity, interdependence among activities, cultural embeddedness, or legal protection.

**Openness, Spillovers, and the Appropriability Trade-Off**

Differentiation strategies are shaped by how open or closed firms keep their innovations. Openness increases the flow of ideas, strengthens ecosystems, and accelerates industry growth, but also increases spillovers to competitors. Closed strategies protect intellectual property but may slow down adoption or complementary innovation.

There is a fundamental trade-off: contributing too much value openly reduces the firm's ability to appropriate returns, while being overly proprietary may weaken the complementary environment the product depends on. The optimal point lies somewhere between extreme openness and strict closure. Firms must ask not only "How can we create value?" but "How much of this value can we keep?" and "How does the industry environment support or erode our position?"

**Complementors and the Division of Value**

Products rarely create value in isolation. They depend on complements—software, accessories, infrastructure, distribution networks, or cultural assets. The strength of complements determines how much value the customer derives from the focal product. When complements improve, the willingness to pay for the focal product rises, regardless of whether the firm itself contributed.

However, complementors also compete with the focal firm for value capture. If a complementor becomes too powerful, it can appropriate a large share of the total value. Platforms, distributors, and key suppliers often hold bargaining power that allows them to shift profits away from the differentiator. This dynamic means that firms must think about industry structure and vertical relationships as part of their differentiation strategy.

Firms benefit when complementors are abundant, competitive, and innovative. They suffer when complementors are scarce or monopolistic. Managing the complement landscape—through partnerships, standards, incentives, or integration—is essential for protecting the value a differentiated firm creates.

**Finding the Optimal Degree of Openness**

The interaction between differentiation and complements leads to a strategic question: how open should a firm's technology or standards be? Openness encourages complementors to innovate, which increases customer willingness to pay for the entire system. But it also weakens appropriability by allowing others to ride on the firm's innovation.

A useful way to think about this is identifying the point where the firm captures the highest share of total industry value. Full closure restricts the ecosystem and slows value creation. Full openness increases spillovers and reduces the firm's share. The optimal point balances the need to stimulate complements with the need to avoid being commoditized within one's own ecosystem.

This is why firms such as Apple maintain a controlled but not completely closed environment, while others like Google opt for broader openness to fuel network effects. The trade-off is systematic, not arbitrary: firms design openness around where they expect to capture the most value.

**Why Appropriability Determines Long-Run Differentiation Success**

Differentiation produces advantage only when the firm retains enough of the created value to justify ongoing investment. If imitability is high and complementors extract large portions of the surplus, differentiation becomes costly and unprofitable. Firms then either abandon high-end positions or shift toward features that are easier to protect.

Long-run success comes from mastering the interplay between value creation and value capture. Firms that create private, proprietary sources of value—such as brands, distribution networks, tacit design knowledge, or exclusive complements—can reinvest their profits to stay ahead. Firms with weak appropriability see their advantages dissipate, even when they innovate aggressively.

This explains why some firms lead industries for decades while others experience short bursts of success. Sustained differentiation is not just about having better offerings but about locking in mechanisms that prevent value from leaking to rivals or partners.

**Strategic Implications for Managers**

Managers must consider differentiation not only as a question of offering superior products but also as a question of controlling the flow of value within the ecosystem. They must design strategies that ensure the firm captures a defensible share of the industry surplus. This requires identifying which aspects of value creation can become proprietary and which must be shared to stimulate complements.

Strategic decisions about investment, openness, partnerships, and intellectual property should be evaluated through the lens of appropriability. The overarching goal is to create advantages that endure because they are hard to imitate and structured in ways that maximize the firm's share of the value generated.

**How Imitation Shapes the Dynamics of Differentiation**

Differentiation advantages never exist in a vacuum; they evolve in a competitive environment where rivals constantly attempt to replicate what works. The speed, accuracy, and cost of imitation determine how long a differentiator can enjoy superior performance. When imitation is slow, costly, or incomplete, differentiated firms can maintain premium pricing and above-

average returns. When imitation becomes rapid and precise, the competitive edge erodes and what once was unique turns into an industry standard.

Imitation pressures push industries toward similarity, unless firms possess deep capabilities that resist copying. These capabilities operate as friction points: cultural routines, tacit know-how, embodied craftsmanship, or integrated systems that cannot be replicated by observing features alone. Sustainable differentiation emerges not from visible attributes, but from these hidden foundations that make the visible attributes possible.

**Frictions, Transferability, and the Limits of Learning**

Effective imitation depends on how transferable the underlying knowledge is. Explicit knowledge—like technical specifications—can be copied quickly. Tacit knowledge—like aesthetic sensibility, experiential expertise, or complex coordination—requires practice, time, and embedded organizational routines. Industries based heavily on tacit knowledge naturally support longer-lived differentiation, because rivals face steep adjustment costs.

Geographical, cultural, and institutional frictions also shape the pace of imitation. Some capabilities rely on ecosystems—artisan clusters, supplier networks, or creative communities—that cannot be easily reproduced elsewhere. When value creation depends on such ecosystems, differentiation remains durable because the capability is not portable. The firm's advantage becomes geographically anchored and culturally encoded.

But imitation attempts still accumulate pressure over time. Rivals observe, experiment, and gradually close the gap. Even imperfect imitation increases price competition and compresses margins. The differentiator must therefore innovate continuously—not only to stay ahead, but to move toward areas where imitation remains inherently difficult.

**Why Consumers Do Not Always Reward Higher Quality**

Quality improvements do not automatically translate into higher willingness to pay. Consumers vary widely in how much they value performance, aesthetics, or uniqueness. When quality upgrades exceed what customers perceive or care about, the additional cost does not generate a proportional value increase. This mismatch leads to overshooting—products exceed customer needs, become too complex, or feel unnecessarily premium.

In markets where customers are insensitive to quality, cost becomes the dominant driver of choice. Differentiators operating in such environments risk losing relevance unless they cultivate non-performance forms of value such as brand identity or experience. Firms must therefore align their quality trajectories with customer utility curves, not with internal technological ambitions.

**The Strategic Risks of Overshooting**

Overshooting occurs when firms raise quality faster than customers' willingness to pay increases. This creates a strategic trap: rising costs, shrinking margins, and increasingly niche demand. Competitors with more modest offerings can undercut prices while still satisfying mainstream needs.

Industries often experience cycles of overshooting. As firms compete for prestige or technical leadership, they escalate features beyond what customers require. This creates openings for low-end entrants offering simpler, cheaper alternatives—often triggering disruptions. Overshooting is therefore not just a pricing mistake but a strategic misalignment between firms' internal capabilities and market willingness to absorb higher value.

**Quality Plateaus and the Need for a New Differentiation Basis**

As markets mature, products converge around a point where additional performance yields minimal customer benefit. This creates a “quality plateau.” At this stage, firms can no longer differentiate meaningfully through incremental improvements. Competition shifts toward other dimensions—design, user experience, convenience, ecosystems, and emotional appeal.

When the industry reaches a plateau, capabilities that once created advantage lose their edge. Firms must redirect their innovation efforts toward areas with fresh headroom for differentiation, often outside pure engineering. Markets like smartphones, premium appliances, and consumer audio illustrate how performance-based competition gradually transforms into brand, ecosystem, and experience-based competition.

**When the Market Fails to Recognize Superior Quality**

Another challenge is perceptual. Customers sometimes fail to recognize genuine quality differences, either because they lack technical understanding or because the distinction is not visible or salient. If customers cannot perceive the benefit, willingness to pay does not rise even if objective quality improves.

Firms then face a choice: improve communication and education to make value more legible, or redesign features so the benefits become self-evident. Premium brands often excel at this. They turn subtle improvements into narratives that help customers understand why the product is worth more. The strategic lesson is that differentiation requires not only better features, but also framing mechanisms that shape customer perception.

**Cycles of Reversible and Irreversible Quality Investments**

Not all forms of quality investment are equal. Some are reversible—like adding decorative features or modifying packaging. These can be easily imitated, so the differentiation they create is fragile. Others are irreversible, emerging from accumulated know-how, technology pipelines, or long-term ecosystem development. These investments build deep capabilities that remain unique even when rivals try to copy them.

Firms that rely heavily on reversible quality changes are exposed to rapid imitation cycles. Their differentiation dissolves quickly, pushing them back into the competitive middle. Firms that build irreversible, path-dependent quality capabilities enjoy more durable advantages and can move further from the reach of rivals.

**When Each Firm Is Its Own Benchmark**

As capabilities deepen, firms begin benchmarking against themselves rather than the market. They create internal quality trajectories that reflect their own standards and traditions. These

trajectories often exceed the pace at which customers need improvements, which is why overshooting becomes a recurring risk among capability-rich firms.

Yet benchmarking against oneself also produces iconic differentiation. It explains why luxury houses, elite hardware manufacturers, and top-tier creative firms maintain consistent identity and excellence across generations. Their internal standards shape their competitive strategy, not short-term market pressures.

The strategic tension is balancing heritage with relevance: preserving unique capabilities without drifting too far above what the market values.

**The Strategic Logic of Reputation as a Capability**

Reputation functions as a cumulative, trust-based capability. It shapes customer expectations before they even experience the product. Strong reputations amplify willingness to pay and reduce customer search costs. They also lower the perceived risk of trying new products from the same firm.

Reputations, once established, become self-reinforcing assets. They attract talent, justify premium pricing, and build resilience during market shifts. However, reputations are fragile. A single misstep can rapidly destroy accumulated trust. This fragility requires firms to maintain consistent quality and uphold the behavioral norms that customers associate with the brand.

Reputation therefore operates both as a shield against imitation and as a constraint on strategic choices. Firms must act within the boundaries of the identity they have cultivated, or risk eroding the very asset that sustains their differentiation.

**Capabilities, Boundaries, and Strategic Identity**

Ultimately, differentiation strategy shapes not just what the firm offers, but who the firm becomes. Capabilities accumulate into a strategic identity: a set of expectations about what the firm does well and where it competes. This identity attracts certain customers, channels, and talent while excluding others.

The firm's boundaries evolve accordingly. It enters markets where its capabilities offer a natural advantage and avoids those where its capabilities create misfit or overshooting. Strategic identity is therefore both a guide and a constraint—it channels investment, shapes innovation, and determines how the firm responds to competitive threats.

A coherent identity also strengthens appropriability. The more a firm becomes known for a specific, difficult-to-imitate kind of value—craftsmanship, design, engineering mastery, cultural insight—the harder it is for competitors to displace it.

**The Strategic Logic of Cost Advantage**

Cost advantage emerges when a firm can produce at lower cost than competitors while offering similar value. In markets where products are relatively standardized and customers are price-sensitive, even small cost differences translate into significant competitive strength. A cost leader gains the ability to set lower prices, discipline rivals, and capture larger market share.

Once entrenched, the cost leader often becomes difficult to dislodge, because the very forces that lower its cost—scale, learning, efficiency, and systems—reinforce one another over time.

The power of cost advantage lies not in doing the same thing more cheaply, but in designing the entire activity system to deliver equivalent value at structurally lower cost. This typically requires organizational commitment, operational excellence, and a willingness to sacrifice certain forms of variety or customization. As with differentiation, the effectiveness of a cost strategy depends on coherence, trade-offs, and dynamic reinforcement.

**Sources of Cost Advantage: Scale and the Learning Curve**

The most fundamental driver of cost advantage is scale. When a firm produces at higher volume, fixed costs spread over more units, suppliers offer better terms, and workers become faster and more proficient. Scale allows firms to invest in automation, specialized equipment, and process optimization that smaller rivals cannot justify. Once scale advantages appear, they often reinforce themselves: lower prices attract more volume, which further reduces cost—a positive feedback loop.

Learning amplifies these effects. As cumulative output increases, the organization becomes more efficient through repetition, experimentation, and refinement. This phenomenon—captured by the learning curve—reduces unit cost independently of scale efficiency. Processes become smoother, waste declines, and tacit knowledge accumulates in teams, making each additional unit cheaper to produce. Because learning depends on cumulative experience rather than current volume, early movers gain a significant head start: rivals entering later must climb the same learning curve while competing against an already more efficient incumbent.

The combination of scale and learning makes cost leadership a dynamic advantage rather than a static condition. Firms that invest early and expand quickly can lock in persistent cost reductions that competitors find extremely hard to replicate.

**Diseconomies of Scale and the Limits of Growth**

Scale is not universally beneficial. Beyond a certain point, firms may experience diseconomies of scale—coordination failures, bureaucratic complexity, loss of flexibility, and declining managerial attention. These frictions increase overhead cost and slow decision-making. Once diseconomies arise, the benefits of additional volume diminish or turn negative.

Successful cost leaders design organizational systems to delay or mitigate diseconomies: decentralized structures, modular processes, strong standardization, and information systems that support fast decision-making. The challenge is balancing the efficiency of size with the agility of a smaller firm. Firms that expand too fast without building the supporting routines often lose control of cost and undermine the very advantage scale was meant to deliver.

**The Experience Curve and Cumulative Advantage**

The experience curve extends the learning concept beyond labor to include all organizational improvements—sourcing, engineering, purchasing, scheduling, quality control, and logistics. As cumulative output grows, the firm uncovers new efficiencies across the entire system. This

generates a steep cost decline that rivals must overcome before they can match the leader's performance.

Importantly, the experience curve depends on cumulative output, not just current production rate. A firm that entered earlier or scaled faster might have millions more units of accumulated experience, giving it an irreversible cost advantage. Rivals cannot replicate that history; they must go through the same learning calculations themselves. This path dependence explains why cost leaders often remain dominant even when competitors have better technology or more modern plants.

**Mechanization, Standardization, and Process Innovation**

Firms strengthen cost advantage by redesigning how work is performed. Mechanization replaces manual labor with machines, improving speed and consistency. Standardization eliminates variation, reducing waste and simplifying training. Process innovation—such as modular product design or lean production—further compresses cost by rethinking how inputs flow through the system.

These investments are expensive but pay off disproportionately at high scale. Only large firms can amortize the cost of robotics, specialized machinery, or complex IT systems. This reinforces the strategic loop: scale enables investment, which reduces cost, which increases volume, which expands scale further.

Process-driven cost leadership requires cultural discipline. Organizations must internalize routines, enforce best practices, and incentivize workers to continuously eliminate inefficiencies. The more ingrained these routines become, the harder they are for rivals to imitate.

**Input Cost Advantages and Bargaining Power**

Cost leaders rarely depend solely on internal efficiency; they also benefit from lower input prices. This can arise through economies of scale in procurement, long-term supplier relationships, vertical integration, or geographic advantages. Large buyers negotiate better terms, receive priority access, and often shape supplier development efforts to reduce upstream cost.

The key mechanism here is bargaining power. When a firm represents a significant share of supplier volume, suppliers depend on it economically. The firm can request lower prices, superior service, or exclusive deals. At the extreme, powerful buyers influence industry standards or impose production requirements that further reduce cost. Rivals who lack such leverage pay more for identical inputs, locking in their competitive disadvantage.

**Specialization and Narrower Product Scope**

Cost leaders frequently narrow their product range to increase efficiency. Specialization reduces complexity by limiting the number of variants, components, and tasks the organization must handle. This focus enables deeper experience, more refined processes, and faster learning. Each worker becomes more proficient, each machine more optimized, and each step more predictable.

Variety, in contrast, multiplies coordination costs and slows learning. Firms that chase too many customer segments simultaneously struggle to achieve the scale and simplicity necessary for cost leadership. The strategic trade-off is clear: cost advantage requires saying no to product features, designs, and segments that do not contribute to volume or efficiency.

**Geographic Clustering and Localized Efficiency**

Some cost advantages emerge from geography. Firms located in clusters—regions with dense supplier networks, specialized labor pools, and shared infrastructure—enjoy lower operating costs. These clusters reduce transportation needs, create labor market efficiencies, and facilitate knowledge spillovers. They also enable closer relationships with suppliers, faster delivery cycles, and smoother coordination across the value chain.

Geographic advantages compound over time. As clusters grow, they attract more suppliers, more talent, and higher investment, deepening the efficiencies available to incumbents. New entrants outside the cluster face higher cost structures and slower learning, reinforcing the incumbents' advantage.

**Volume–Cost Feedback Loops and Market Dominance**

The interaction of scale, learning, process innovation, and bargaining power creates feedback loops that drive market concentration. Lower cost enables lower prices, which attract more demand. Higher demand increases scale, which reduces cost further. The firm becomes increasingly efficient, forcing rivals into smaller niches or out of the market entirely.

This cumulative dynamic explains why many industries naturally evolve toward a small number of dominant cost leaders. Airlines, retail chains, discount stores, automotive manufacturing, and semiconductors all exhibit such patterns. In these markets, the cost leader often becomes the default choice, shaping pricing norms and disciplining the entire industry.

**Strategic Implications for Managers**

Managers pursuing cost leadership must design the entire operating model—product, process, organization, and supply chain—to reinforce efficiency. This requires sustained investment in scale, rigorous standardization, strict control of variety, and a culture oriented toward continuous improvement.

At the same time, they must avoid oversimplifying the strategy. Cost leadership is not about being cheap; it is about being structurally more efficient. Firms must understand where costs truly come from, which processes drive learning, which activities benefit from standardization, and how bargaining power evolves as scale grows.

Firms that commit to cost advantage early and consistently can build cumulative structures that are extremely difficult to imitate. Those that hesitate or pursue mixed strategies risk getting stuck between differentiation and cost leadership, unable to achieve either.

**When Cost Advantage Fails to Deliver Superior Performance**

Cost leadership is powerful, but not universally effective. Some industries simply do not reward scale-based efficiency because customer preferences, technology, and product characteristics do not allow for meaningful cost dispersion. In these markets, even massive investments in automation, standardization, or process optimization do not generate a defensible wedge between a cost leader and the rest of the market.

The core issue is **variance**: if products are inherently simple, require minimal labor, or use standardized inputs, cost structures across firms converge naturally. When variance is low, the opportunity to create meaningful cost advantage disappears. Firms then compete on differentiation, relationships, service, or brand rather than on cost structure.

**Scenarios Where Scale-Based Cost Leadership Is Impossible**

Not all markets exhibit economies of scale or learning-curve effects. Some markets are structurally resistant to scale advantages because:

1. Technology Does Not Favor Scale

If production relies on artisanal labor, manual processes, or micro-scale customization, doubling volume does not dramatically reduce unit cost. Efficient scale can be tiny, meaning small firms match the cost performance of large ones. In such industries—high-end craftsmanship, boutique creative services, specialized consulting—scale offers prestige and reach but not structural cost advantage.

2. Customer Demand Is Fragmented

When customers value variety, customization, or uniqueness, offering a standardized product at scale becomes a liability. Large-scale firms face pressure to broaden their offering, which reintroduces complexity and raises cost. Meanwhile, small specialized firms maintain low overhead and tailor products efficiently. The market rewards fit rather than scale, making cost leadership unattractive.

3. Input Costs Are Uniform Across Firms

If raw materials, labor, and distribution resources are priced the same for everyone, then bargaining power does not produce meaningful savings. Firms pay similar rates regardless of size, making it difficult for a cost leader to widen the cost gap. Commoditized supply industries—like agriculture or basic commodities—often display this pattern.

**Why Efficiency Does Not Always Translate Into Advantage**

Some industries are simply too efficient already. If all competitors have optimized their processes, adopted best-in-class automation, and refined their workflows, then the efficiency frontier is flat: no firm can move meaningfully below the average. In these situations, investment in further efficiency does not produce an advantage—everyone captures it simultaneously.

This creates a strategic paradox. Even though the industry benefits from high productivity, individual firms cannot convert those efficiencies into relative competitive advantage. They become necessary but insufficient conditions for success.

**When Cost Leadership Is Not the Best Strategic Choice**

Given these constraints, firms must resist the temptation to pursue cost leadership automatically. A market may reward **distinctiveness** far more than efficiency. Attempting to compete on cost in a market that does not structurally support cost dispersion pushes firms toward margins so thin they cannot sustain innovation or brand strength.

The strategic lesson is that **advantage depends on context, not on effort**. Cost strategies succeed only when industry economics allow firms to drive meaningful gaps in unit cost. When that is impossible, differentiation—or niche specialization—becomes the more defensible path.

**The Central Question Managers Must Answer**

The final slide asks a deceptively simple but strategically essential question:

**Why are technical progress and falling costs in an industry not always identical to competitive advantages for individual firms?**

Technical progress often reduces cost for *everyone*—through cheaper automation, improved software, or more efficient supply chains. These improvements shift the entire industry cost curve downward. But because rivals can adopt the same technology, no firm captures a relative advantage. The industry becomes more productive, but competitiveness remains unchanged.

In other words, **an absolute cost reduction is not the same as a relative cost advantage**. Strategy is always about relative position. If technology is widely available, easily diffused, and simple to implement, then it raises the average performance level without altering competitive hierarchy.

This means cost advantage must come from sources that are **difficult to access, difficult to imitate, or cumulative over time**—scale, learning, proprietary systems, bargaining power, or organizational routines—not from technological progress alone.

**Strategic Implications for Firms Operating in Such Environments**

Managers must carefully evaluate the structural conditions of their industry before committing to a cost strategy. When scale-driven advantages are weak, the winning moves lie elsewhere: mastering branding, cultivating customer relationships, offering tailored services, or innovating on dimensions customers actually value.

Attempting to lead on cost in structurally flat industries is a race to the bottom. The firms that win in these markets understand that: efficiency matters, but does not differentiate; technology levels the field rather than tilting it; value must be created and captured through non-cost mechanisms.

Advantage emerges not from being efficient, but from being uniquely valuable or uniquely hard to imitate.

## SESSIONS 22 PLATFORMS AND NETWORKS (LECTURE)

**From Pipeline Logic to Platform Logic**

For most of the course, the analytical focus has been on how firms create value through the activities they directly control. This reflects the traditional pipeline logic: a company organizes a linear sequence of operations—sourcing, transforming, assembling, distributing—to convert inputs into outputs that have higher value. Competitive advantage, in this model, emerges from owning and managing resources and capabilities that allow the firm to operate this chain more efficiently or more distinctively than rivals. Industries like record labels clearly illustrate this structure: value creation depends on controlling assets, coordinating steps in the chain, and optimizing internal processes to deliver a finished product.

However, this logic reaches its limits when applied to businesses that do not produce value through linear transformation but through interaction. Google's search engine is a clear example: its value does not depend on a sequential chain of activities, but on connecting millions of users and content producers in real time. A pipeline framework is not suited to explain why such firms scale so fast, why they enjoy winner-take-most dynamics, or why their competitive advantage is rooted in participation rather than production. This gap between pipeline reasoning and platform behavior is the reason strategy must shift its unit of analysis when discussing digital ecosystems.

A platform business creates value by enabling interactions between external parties. Instead of transforming inputs into outputs, it orchestrates exchanges—of information, content, services, goods, or experiences—among participants who do not belong to the firm. The platform provides the infrastructure, the rules, and the incentives that allow these exchanges to happen efficiently. In this model, the key strategic assets are no longer internal resources but the communities and networks that gather around the platform. Value is not produced inside the firm but emerges from the interactions it facilitates.

The evolution of the smartphone market illustrates this shift vividly. Before the rise of platforms, the industry was dominated by hardware manufacturers competing on device design, functionality, and incremental product performance. Market share fluctuated as firms introduced new models, but value was tied to the physical product. The launch of the iPhone in 2007 did not immediately overturn this logic; at the time, the device offered only a handful of basic apps and was significantly more expensive than competitors like BlackBerry and Nokia.

The turning point came when Apple understood that the true source of value was not the device itself but the ecosystem of applications that could run on it. Market research in 2008 showed that users spent almost 60% of their time on apps—revealing that the phone's value was being generated outside the boundaries of the firm, by third-party developers. Apple responded with a platform move: it launched the App Store, lowered the device price to accelerate adoption, and

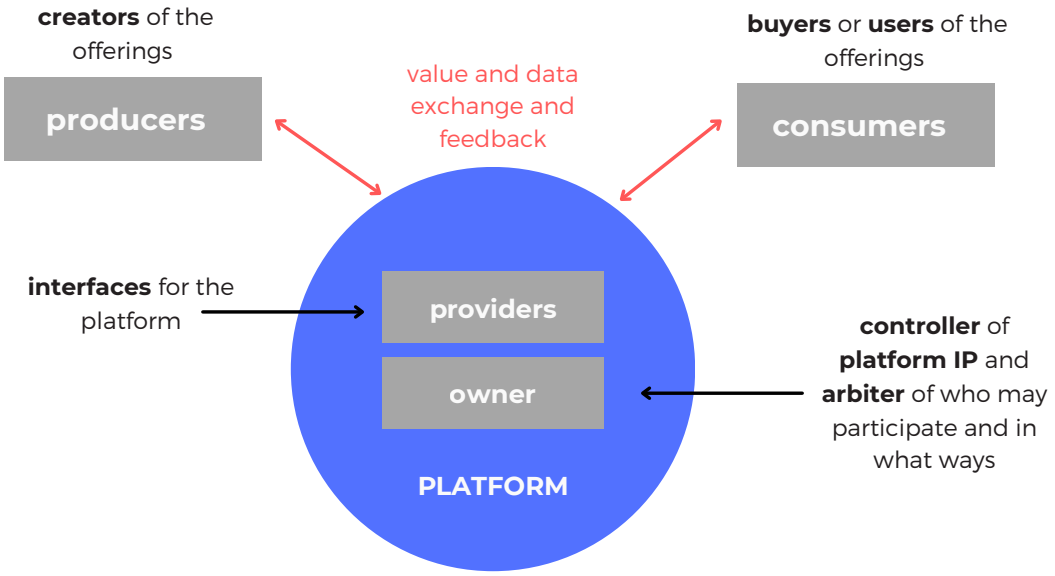
opened development to anyone while granting developers 70% of the revenue from their apps. Within days, millions of apps had been downloaded; within two years, tens of thousands of independent developers had created over 100,000 apps. Apple effectively transformed the iPhone from a premium hardware product into a multi-sided platform that orchestrated interactions between developers and users.

This move also triggered a competitive response. Google recognized the same opportunity and launched Android as an open software platform available to any hardware manufacturer. With the Android ecosystem and Google Play, the smartphone industry shifted decisively from product competition to platform competition: success depended less on the capabilities of the device-maker and more on the strength of the ecosystem surrounding it.

This logic generalizes across platform companies. Whether considering Airbnb, YouTube, PlayStation, or Uber, platforms operate by connecting producers and consumers in multi-sided markets. They reduce the cost of interaction, overcome barriers like search frictions and trust, and often subsidize one side of the market—usually the side that is harder to attract—to stimulate participation and strengthen network effects. One side is typically charged (the monetized side), while another receives free or discounted access to build scale. The platform becomes an “information factory,” providing the infrastructure and governance rules that make these exchanges possible and efficient.

The strategic shift from pipelines to platforms involves two major transformations. First, the focus moves from resource control to resource orchestration: competitive advantage arises from attracting, governing, and scaling the contributions of external participants. Second, the locus of value creation moves from internal optimization to external interaction: what matters is not how efficiently the firm produces but how effectively it facilitates exchanges. Platform firms therefore rely on ecosystem governance rather than traditional operational control, and their success depends on persuasion, incentive design, and rule-setting rather than on owning assets.

In summary, the move from pipeline to platform logic reframes how value is created, captured, and defended. It expands the unit of analysis from the firm to the ecosystem and highlights the strategic importance of interactions, participation, and network effects. The lesson is that in digital and creative industries, advantage increasingly comes not from what a firm makes, but from what it makes possible for others.




**Network Effects and the Competitive Logic of Platform Markets**

Once a platform succeeds in orchestrating interactions between producers and consumers, its competitive trajectory becomes governed by network effects. Network effects capture how the value of a platform changes as more users join. Unlike traditional products—where the value perceived by one buyer is independent of others—platforms become more or less valuable depending on the size and composition of their user base. This dynamic explains why some platforms grow explosively while others stagnate or collapse.

Network effects can be absent, negative, or positive. Some goods, like a plain T-shirt, are unaffected by how many other people own them. Others, like a wedding dress at a ceremony, lose value when too many people share the same choice. Digital platforms instead benefit from positive network effects: the more users participate, the more valuable the service becomes for everyone involved. This is particularly evident in communication tools like Zoom or messaging apps, where each additional user directly increases the usefulness of the service to others. These are direct (same-side) network effects. Platforms also rely on indirect (cross-side) network effects, where one group's participation increases value for another group—developers creating apps for iPhone users, hosts listing homes for Airbnb travelers, or drivers joining Uber to meet growing rider demand.

The presence of network effects fundamentally alters competitive dynamics. When value increases with adoption, markets no longer evolve gradually. Instead, they display tipping behavior: small early advantages snowball into large, persistent differences in market share. Historical data on social media adoption, illustrated by the divergence between Facebook and MySpace, shows how one platform can accelerate sharply once it crosses a certain participation threshold. The same pattern appears in search engines, where Google's early performance advantage was magnified through user growth, reinforcing its relevance and making entry extremely difficult for rivals.

Economic theory describes these environments as DSIR (demand-side increasing returns) markets. In DSIR markets, more users attract even more users, triggering self-reinforcing loops. These loops produce virtuous cycles for the leader and vicious cycles for the laggard. As a result, markets that once appeared balanced—such as a 60–40 split between competitors—tend to evolve toward highly uneven outcomes, often 90–10 or even more extreme. The winner grows stronger because its installed base increases the value of joining, while the smaller rival appears increasingly unattractive, accelerating its decline.

For firms attempting to compete in DSIR markets, the first strategic imperative is to achieve a critical mass of users before competitors do. Future adoption is heavily influenced by expectations about which platform will become the standard, meaning that platform competition hinges on shaping beliefs as much as on offering superior features. The tipping point—where positive feedback loops take over—is a decisive moment in the life of a platform. Failing to reach it early can render even well-designed technologies commercially irrelevant.

When platforms mediate interactions among multiple user groups, the complexity heightens. Multi-sided markets require the platform to scale each side of the ecosystem in proportion, because mismatches generate negative network effects. If Uber attracts riders faster than drivers, waiting times increase and the service degrades. If Android attracts users but not enough developers, the value of the ecosystem drops. Moreover, cross-side effects are often asymmetric: a single high-quality driver on Uber influences customer adoption more than a single rider influences driver participation; similarly, one strong app can attract far more users than a single user can attract developers. Effective platform strategy therefore requires not only growing the user base but managing its composition, density, and balance across market sides.

Beyond solving the growth problem, platforms must eventually confront monetization. Making money in multi-sided markets depends on identifying which user groups generate the most value from participating and which groups require subsidies to join. Some users—creators, influencers, developers, or other “stars”—may need to be subsidized because their presence increases value for everyone else. Others can be charged according to the value the platform unlocks for them. Monetization can also reflect differences in willingness to pay among segments: price-sensitive groups may remain free, while premium users pay for additional features. The platform’s pricing architecture must therefore reflect its ecosystem logic, not just its cost structure.

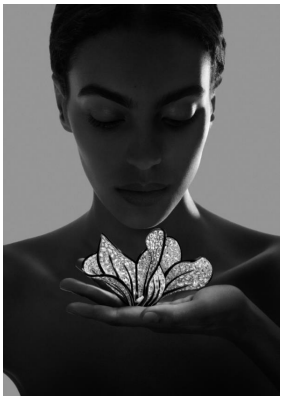
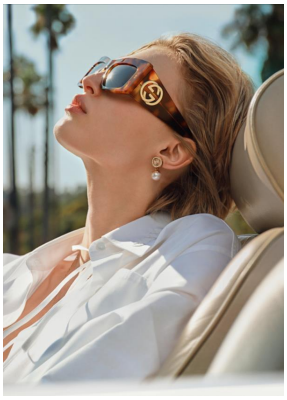
Ultimately, network effects reshape the foundations of competitive advantage. In pipeline businesses, firms win by optimizing internal operations. In platform businesses, firms win by managing participation, expectations, and the strength of cross-side interactions. The race is not to build the best product, but to become the market’s de facto standard—because in DSIR markets, being the standard is the advantage. The key skill becomes governing the ecosystem: guiding behaviors, balancing incentives, and orchestrating interactions in ways that amplify positive network effects and dampen negative ones. Platforms that master this logic gain positions that are extraordinarily difficult for competitors to challenge.

## SESSION 23 ESG: GUEST LECTURE

This session will be the opportunity to link all the areas of inquiry we have been working along the entire course: business, corporate and operations strategy. Through the lens of ESG (environmental, social and governance) factors that qualify a company as sustainable, we appraise how decision-making at corporate, business and operational levels interweaves with and informs on practices on various sustainability and ethical issues.


Kering represents a distinctive model within the global luxury industry, shaped by the long-term evolution of a family business that gradually transformed into an international group operating across fashion, leather goods, jewelry, eyewear and home-related creative categories. Its trajectory reflects a shift from traditional industrial activities toward a vision centered on cultural

production, aesthetic innovation and responsible value creation. Over time, the group consolidated a portfolio of Houses, each with its own creative universe, historical legacy and craftsmanship traditions, while establishing a shared strategic backbone that supports growth and strengthens the resilience of the entire ecosystem. The corporate identity emphasizes the idea of a home, a collective environment where different creative entities can flourish without losing the individuality that makes them desirable.

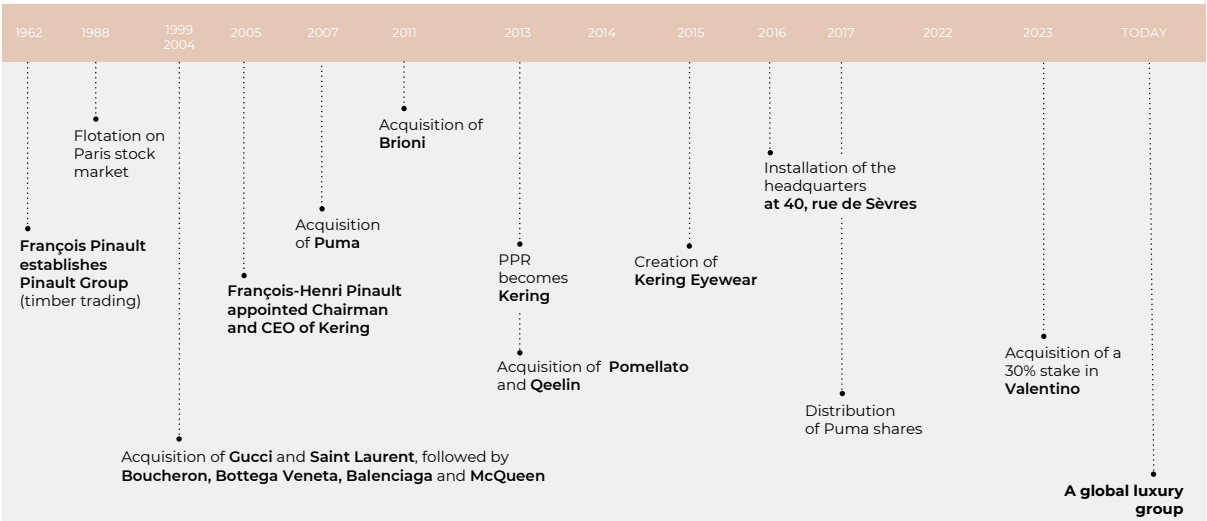
**A Hybrid Organizational Model: Autonomy and Integration**

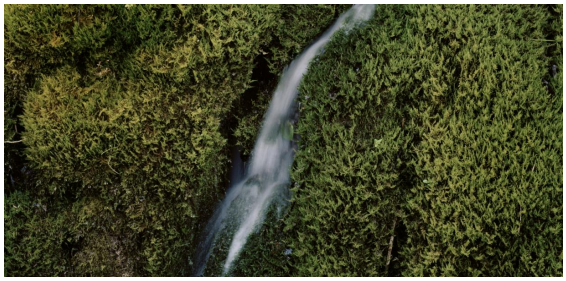
The group's approach relies on a careful balance between autonomy and integration. Each House preserves its cultural codes, aesthetic language and creative direction, which are essential for maintaining authenticity and emotional relevance in the luxury market. At the same time, central functions provide expertise, coordination and long-term guidance on areas such as innovation, sustainability, talent development, supply chain transformation and strategic planning. This hybrid model avoids the homogenization that could arise from excessive central control, while also preventing fragmentation or inefficiency that would appear if each brand operated entirely independently. Creativity is treated as a strategic resource rather than a branding accessory. It becomes the engine of desirability, a source of differentiation and a driver of economic performance, since luxury depends on scarcity, symbolic meaning and exceptional craftsmanship.

## 2024 KEY FIGURES

| | |
|---|---|
| €17,194 M | Group revenue |
| €2,554 M | Recurring operating income |
| 1,813 | Directly operated stores |
| 47,000 | Employees |
| 63% | Proportion of women in the total workforce |
| 1st | According to the Corporate Knights' 2025 Global 100 rankings, Kering occupies the top spot in the "Textile, Clothing and Luxury Product" category for the eighth consecutive year. |

## HISTORY



**Care, Collaborate, Create**

To reduce our environmental footprint and protect natural resources, we set high policy standards, develop pioneering measuring tools and innovative practices, as well as preservation programs established in collaboration with local stakeholders and NGOs.


**A source of inspiration and innovation**

Sustainability is at the core of our Houses' creative processes. Our brands adopt innovative materials and groundbreaking techniques to design new products while our innovation platforms play a crucial role in introducing innovation to our Houses' creative teams.

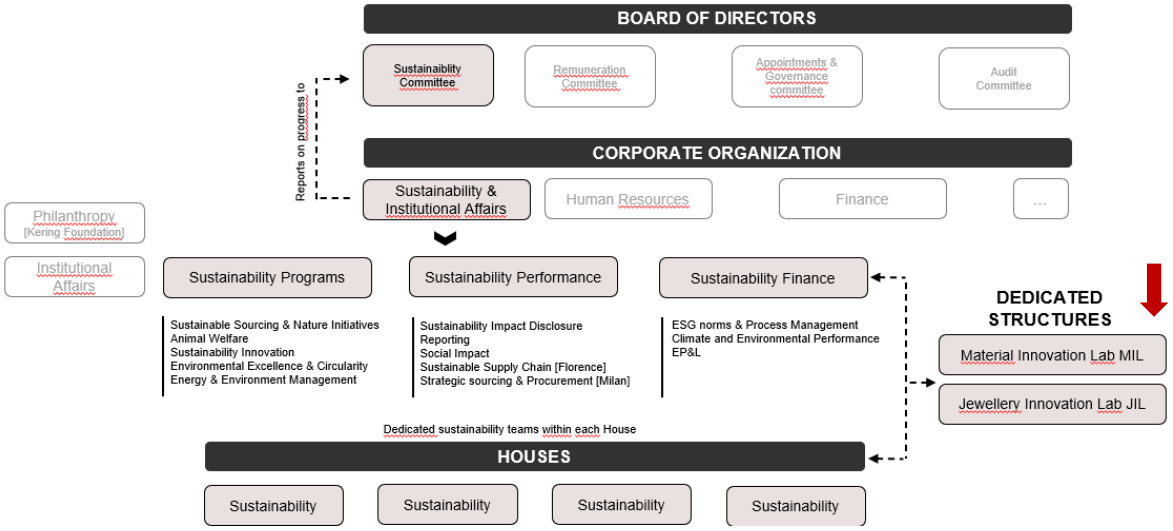
**The Portfolio of Houses and Their Distinct Creative Universes**

Within this framework, the group manages a diverse set of Houses with unique identities. Gucci stands as one of the most influential and historically significant Italian fashion brands, merging craftsmanship with a constantly renewed aesthetic that oscillates between heritage and experimentation. Saint Laurent transformed modern fashion by redefining ready-to-wear for the luxury segment, establishing an attitude of freedom, sharp modernity and stylistic sophistication. Bottega Veneta is characterized by its mastery of leatherwork and its philosophy of discreet elegance, while Balenciaga draws from a couture heritage marked by innovative construction now expressed through contemporary cultural commentary.

McQueen embodies an expressive and narrative interpretation of fashion rooted in British cultural history. Brioni represents the pinnacle of Roman sartorial tradition, where generations of artisans specialize in complex tailoring processes. The jewelry Houses contribute a diversified spectrum of aesthetics: Boucheron values artistic freedom and imaginative form; Pomellato embraces color and Milanese design culture; DoDo introduces a modular, personal approach; Qeelin merges Chinese symbolism with modern design. Ginori 1735 extends the group's cultural footprint into homeware, porcelain artistry and decorative craftsmanship. Kering Eyewear ensures control over a strategic product category by integrating design, development and distribution, enhancing creative coherence and economic performance.

**Strategic Orientation and the Primacy of Organic Growth**

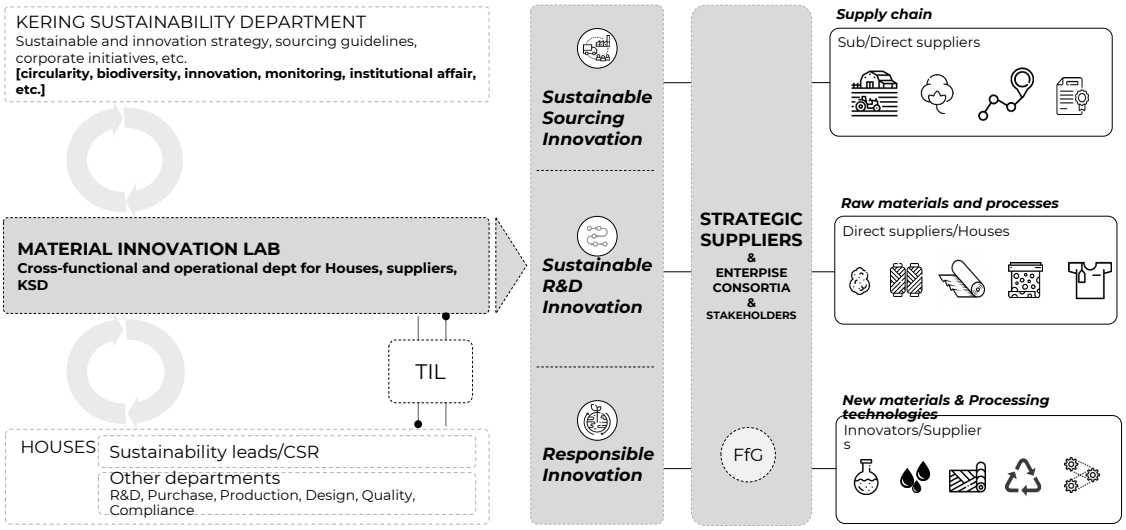
The group's strategic orientation places strong emphasis on organic growth, interpreting it as the most effective path to preserving each House's identity, creative strength and long-term equity.




Acquisitions may support this vision when aligned with the group's creative and cultural philosophy, but the central idea is that sustained desirability arises from innovation and coherence rather than expansion alone. Luxury's competitive advantage lies in cultural influence, emotional attachment and differentiation; therefore, the capacity of each House to evolve while remaining true to its essence is considered more important than rapid scaling or excessive diversification.

### Sustainability as a Core Strategic Dimension

A defining pillar of the group's positioning is sustainability, treated as both an ethical obligation and a source of competitive advantage. The luxury industry depends on high-quality natural materials, long product lifecycles and heritage craftsmanship, which naturally align with principles of durability and ecological respect. For the group, sustainability shapes not only operational decisions but also creative possibilities and risk management. Reducing environmental impact becomes a structural necessity as climate change and resource scarcity threaten both supply-chain stability and product integrity.




### Extending Responsibility Upstream in the Supply Chain

Most of the environmental footprint associated with fashion and luxury originates upstream, during raw material production and processing. The group therefore extends its strategic involvement beyond traditional supplier relationships, collaborating with farmers, herders, processors, certifiers, research institutions and NGOs. This upstream engagement aims to reshape systems that historically lacked transparency and consistent environmental standards. The goal is to secure long-term access to high-quality materials, reduce ecological pressure and embed responsibility into the earliest phases of value creation.

### Material Innovation and Regenerative Practices

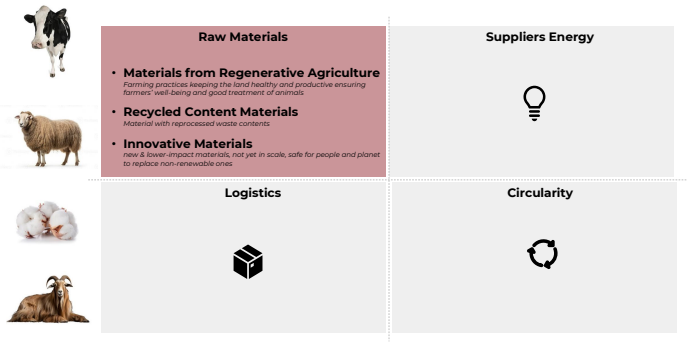
Material innovation becomes a central field of action. Investments are directed toward discovering or scaling sustainable fibers, developing recycled or regenerated inputs, redesigning processes to reduce emissions and fostering collaborations that bring scientific and technical breakthroughs into the creative workflow. Regenerative agriculture plays an essential role in this transformation. By enhancing soil health, preserving biodiversity and improving water retention, regenerative systems increase resilience against droughts, floods and temperature variability. These practices not only mitigate environmental risks but also strengthen the economic stability of rural communities, ensuring continuity in material availability.

### Shared Investment and Cost Coverage Mechanisms

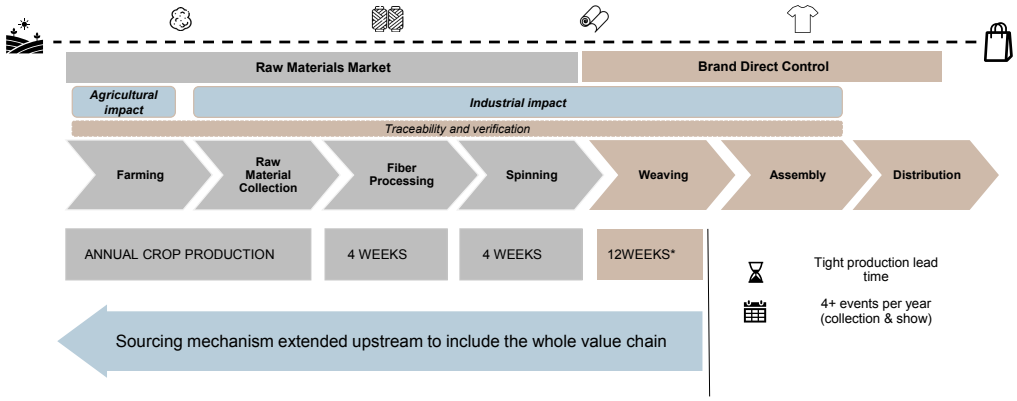
Recognizing that transitions to sustainable systems often come with higher initial costs, the group adopts cost-sharing mechanisms to support suppliers. By covering or contributing to these additional expenses, it reduces the financial burden on upstream actors who might otherwise be unable to adopt regenerative practices or innovative technologies. This strategic choice distributes responsibility more equitably across the supply chain and accelerates the pace of transformation. It also reflects an understanding that the long-term risks of inaction would exceed the short-term costs of investment.

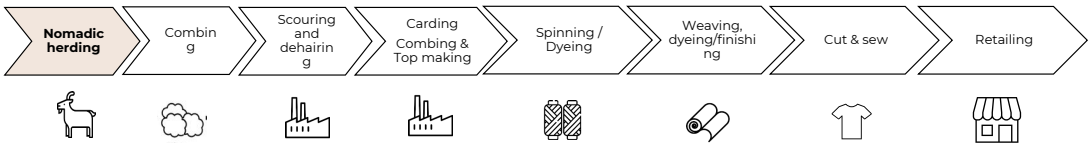
**The Cashmere Case: A Model of Ecosystem-Based Intervention**

The cashmere supply chain provides a concrete example of this strategic philosophy. Cashmere production in Mongolia is highly sensitive to ecological degradation, overgrazing and climate instability. Through partnerships with conservation organizations, academic researchers and local herding communities, the group contributes to reshaping production practices, preserving biodiversity and improving land management. The complexity of the cashmere lifecycle, which involves numerous steps from herding to combing, carding, spinning, weaving and finishing, demonstrates the necessity of intervention across multiple layers of the supply chain. By supporting sustainable practices at the earliest stages, the group protects both product quality and ecosystem resilience.




Multi-stakeholders sourcing mechanism between:
**GROUP: MANAGE RAW MATERIAL PRODUCERS + NGOs**
**BRANDS: MANAGE SUPPLIERS (DIRECT and/or SUBs)**






**Sustainable cashmere project: a "steppe" in the right direction**

Led by **Kering** along with the **Wildlife Conservation Society** and with collaboration from **Standford University** and **NASA**, the South Gobi Cashmere Project is redefining high quality cashmere production in the Mongolian steppe.

### Embedding Sustainability into Creative Practice

The group ultimately aims to integrate sustainability directly into the creative and design processes. Instead of treating ecological responsibility as a technical constraint, designers are encouraged to explore new aesthetic possibilities enabled by innovative materials and processes. Cross-functional collaboration between creative teams, sourcing departments, production experts and scientific partners ensures that environmental considerations influence design decisions and that technological innovations stimulate new forms of creativity. This integrated approach positions sustainability not as a limitation but as a space for exploration and differentiation.

### Long-Term Vision and Industry Influence

The broader ambition extends beyond reducing environmental impact to influencing the overall transformation of the luxury sector. By aligning creativity with responsibility, economic value with ecological regeneration and brand identity with resilient supply-chain structures, the group positions itself as a catalyst for systemic change. The vision is to build a model of luxury capable of enduring in a future shaped by environmental volatility, evolving cultural expectations and increasing scrutiny of industrial practices. In this framework, creativity, sustainability and long-term strategy become inseparable elements of competitiveness.

**SESSION 24 FINAL WRAP UP**
Well, we stitch the thread of our journey together and say Arrivederci!

# knowledge

**Key questions**
What are the leading topics of each session ?

**Tools and frameworks**
Which theoretical instruments back the topic up or complement its analysis?

**Case studies**
How did we empirically try to build such knowledge?
Through which real decision-making episode?

## Market attractiveness

| Key questions | Tools and frameworks | Case studies |
|---|---|---|
| • What is **business strategy**?<br>• What is "competitive analysis"?<br>• How to assess the **attractiveness of an industry**? | • Industry analysis<br>• SWOT analysis | • SoundCloud<br>*Audio Streaming industry* |
| • What is the role of **complements** in influencing industry average profitability? | • Complements' 6th force<br>• PIE model | • iPod and music<br>*HW, SW, content industries* |

## Competitive advantage

| Key questions | Tools and frameworks | Case studies |
|---|---|---|
| • What is competitive advantage?<br>• **How** can a firm **reach competitive advantage**? | • Value chain activities analysis<br>• cost drivers analysis | • Blumhouse productions<br>*Movie industry* |
| • How to escape head-to-head competition and carve a **new market space**?<br>• How to complement industry and internal resources analyses with **demand perspectives**? | • Value innovation logics<br>• Value proposition curves<br>• Reduce/Raise/Eliminate/Create | • Cirque du Soleil<br>*Performing arts* |
| • How **new sources of competitive advantage** redefine the rules of competition?<br>• How can a company leverage on **strategic resources to react to increasing competition**? | • Distribution-financing deals logics<br>• Strategic grouping<br>• Analysis of drivers of competitive advantage | • MRC and Netflix<br>*TV and SVOD industry* |

## Corporate strategy

| Key questions | Tools and frameworks | Case studies |
|---|---|---|
| • What is corporate advantage?<br>• What is a **business portfolio**?<br>• When **synergies** occur and how can we spot them? | • synergies operators<br>• corporate portfolio assessment | • AT&T<br>*Telco, advertising and media* |
| • How can a company **expand in a new business**? | • Growth strategies<br>• Organic growth assessment | |
| • How can two businesses best **structure their relationship** to unlock synergies? | • Governance costs<br>• Inorganic alternatives<br>• Governance structure assessment | • Pacific Review<br>*Audiovisual industry* |
| • What is a **negotiation** ? How to best prepare for it? | • The structure of a negotiation<br>• ZOPA | |
| • Which communication style is better in a negotiation?<br>• When is **ownership** preferred? | • Negotiation styles<br>• Market vs hierarchy assessment | |

| | Key questions | Tools and frameworks | Case studies |
|---|---|---|---|
| **Operations strategy** | • What is **operations** strategy and management?<br>• What are the competitive priorities of ops?<br>• How to **steering** operations and **processes**? | • OP strategy, OP Management, OP competitive priorities, OP strategic fit | • Bulgari, CocaCola, etc.<br>• *diverse industries* |
| | • What is the **consensus forecast**?<br>• How to properly **manage suppliers** according to what materials' cluster they supply? How to optimize **inventory management**?<br>• How to **design manufacturing network** for different product lines? | • Delphi method<br>• Purchasing portfolio model (Kraljic matrix)<br>• The newsvendor model<br>• Ferdows model | • Global Supply chain Management simulation *FastMovingConsumerGoods* |
| | • How to shape **processes**, product and services? And how to improve sustainability? | • Virtual / Network based OP<br>• Integrated OP<br>• Corporate Social Responsibility (CSR) | • BasicNet and Zara *Fashion* |

| | Key questions | Tools and frameworks | Case studies |
|---|---|---|---|
| **Selected issues** | • What is a **platform** business?<br>• What are the key underlying logics of platform competition? | • Pipeline v. Platform businesses<br>• Network effects<br>• Demand-side economies of scale | • several examples *diverse industries* |
| | • What is the **relationship between corporate, business and operations** strategy?<br>• How can **sustainability** be a lens for strategic and operations decision-making? | • disclosed internal methods by guest speaker | • Kering Group *Luxury industry* |

# along our journey

we put ourselves in the shoes of **executives**...
and tried to take **decisions**.

basically, we have enjoyed **class as a management board**
and we all have been **colleagues** trying to handle puzzling decisions...

# what to do?

| Decision to be made | Case studies |
|---|---|
| • Should we **pivot to a different industry** in order to look for future economic sustainability? | • SoundCloud |
| • How can we **ensure higher than industry average returns** by working on supplier's willingness to sell? | • Blumhouse productions |
| • How can we **carve a new market space** where it is possible to enjoy higher than average profitability of the original industry of operation?<br>• How can we work on both WTP and WTS to **reach competitive advantage**? | • Cirque du Soleil |

| Decision to be made | Case studies |
|---|---|
| • **Should we accept an offer?**<br>• How can we assess the desirability of an offer, analytically?<br>• How can we **consider the rationale of the counterpart** behind a proposal? | • MRC and Netflix |
| • Does it make sense to **build *such* a corporate business portfolio?**<br>• How can we **make sense** of it, **business** and **financial market**-wise? | • AT&T |
| • **What does it take to enter a new business?**<br>• Which **alternatives** do we have?<br>• How can we **come to a favourable agreement with a partner**? | • Pacific Review |

MOCK QUESTIONS

### Multiple choice

**Which of the following statements correctly compares/contrasts economies of scale and economies of scope?**

**a.** Economies of scale result from the decline in the average cost of production as volume increases, whereas economies of scope result from the decline in the average cost of production due to the outsourcing of resources across products and services.

**b.** Economies of scope result from the decline in the average cost of production per unit as volume increases, whereas economies of scale result from the decline in the average cost of production due to the sharing of resources across products and services.

**c.** Economies of scale result from the decline in the average cost of production per unit as volume increases, whereas economies of scope result from the decline in the average cost of production due to the sharing of resources across products and services.

**d.** Economies of scope result from the decline in the aggregate cost of production as volume increases, whereas economies of scale result from the decline in the aggregate cost of production due to the outsourcing of resources across products and services.

### True or False

**Value propositions can be used to search for appealing, new mixes of attributes.**

**a.** True

**b.** False

### Open-ended, short answer

**Why could we state that the erosion of industry profits is a barrier to entry?**

**Which of the following statements correctly compares/contrasts economies of scale and economies of scope?**

**a.** Economies of scale result from the decline in the average cost of production as volume increases, whereas economies of scope result from the decline in the average cost of production due to the outsourcing of resources across products and services.

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**c.** Economies of scale result from the decline in the average cost of production per unit as volume increases, whereas economies of scope result from the decline in the average cost of production due to the sharing of resources across products and services.

**d.** Economies of scope result from the decline in the aggregate cost of production as volume increases, whereas economies of scale result from the decline in the aggregate cost of production due to the outsourcing of resources across products and services.

**Reference in the readings** → Introduction to Strategy
**2.2 The Integrated Set of Choices: Achieving Internal Consistency**

## True or False

**Value propositions can be used to search for appealing, new mixes of attributes.**

**a.** True

**b.** False

**Rationale**

Value proposition diagrams can be used to search for new mixes of attributes to develop a blue ocean strategy to "create uncontested market space" by assessing which attributes should be eliminated, reduced, raised, and created.

**Reference in the readings** → Strategy reading: Competitive Advantage
**3.1 Analyzing value propositions**

**Open-ended, short answer**

**Why could we state that the erosion of industry profits is a barrier to entry?**

**Answers may vary.**

**Rationale**: Answers should note at least one of two points.

First, other things equal, the erosion of profits in an industry makes that industry less attractive to new entrants and should have them think twice about entering, particularly if they have other profitable options for entry. Second, they should note that the erosion of profitability will typically increase intra-industry rivalry as firms attempt to capture their share of declining profits.

**Reference in the readings** ⟶ Industry Analysis
**2.2 The Methodology of Five Forces Analysis**

# FOR DOUBTS OR SUGGESTIONS ON THE HANDOUTS


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TEACHING DIVISION

# OUR PARTNERS

TEGAMINO'S

LA PIADINERIA

LA PIADINERIA dal 1994