

## **Blue Ocean Strategy: The Magic and Science of New Value Innovation Blockbusters**

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### **Abstract**

Companies have long engaged in head-to-head competition in search of sustained, profitable growth. They have fought for competitive advantage, battled over market share, and struggled for differentiation. Blue Ocean Strategy provides a systematic approach to break out of the red ocean of bloody competition and make the competition irrelevant by reconstructing market boundaries to create a leap in value for both the company and its buyers. Instead of competing in existing industries, blue ocean strategy equips companies with frameworks and analytic tools to create their own blue ocean of uncontested human resource pool and market space. Thus, it is a challenge of how to create blue oceans, but also the equally important challenge of how to execute these ideas in action in any organization.

New products are engines of growth for many firms. Successful new products are often sources of long-term competitive advantage. Indeed, some firms survival depends on their ability to manage new product launches. In 2004, the average percent of firm's total sales attributable to new products developed within the last three years is about 33%. An extensive longitudinal study suggests that new product introductions increase a firm's long-term financial performance and market value. Thus, the importance of new product development cannot be over-emphasized.

**Keywords:** Value Innovations, Blue Oceans, New Product Blockbusters, Prediction Markets, Scientific Foundations, Wisdom of the Crowds.

### **1. Intellectual Basis of Blue Ocean Strategy and Prediction Markets**

Companies have long engaged in head-to-head competition in search of sustained, profitable growth. They have fought for competitive advantage, battled over market

share ,and struggled for differentiation .Yet in today's overcrowded industries , competing head-on results in nothing but bloody "red oceans" of rivals fighting over a shrinking profit pool. Based on a study of 150 strategic moves spanning more than a hundred years and thirty industries, tomorrow's leading companies will succeed not by battling competitors, but rather by creating "*blue oceans*" of uncontested market space ripe for growth .Such strategic moves-termed "*value innovations*"-create powerful leaps in value for both the firm and its customer, rendering rivals obsolete and capturing new demand. *Blue Ocean Strategy provides a systematic approach to making the competition irrelevant.* Examining a wide range of strategic moves across a host of industries, Blue Ocean Strategy highlights the six principles that every company can use to successfully formulate and execute blue ocean strategies. The six principles show how to reconstruct market boundaries , focus on the big picture , reach beyond existing demand , get the strategic sequence right , overcome organizational hurdles, and build execution into strategy .This game –changing strategy presents a proven analytical framework and the tools for successfully creating and capturing blue oceans. We used the terms red and blue oceans to denote the market universe. Red Oceans are all the industries in existence today the known market space. In the red oceans, industry boundaries are defined and accepted, the competitive rules of the game are known . Here companies try to outperform their rivals to grab a greater share of existing demand. As the market space gets crowded, prospects for profits and growth are reduced. Products become commodities, and cutthroat competition turns the red ocean bloody, hence, the term "red" oceans. Blue Oceans in contrast, denote all the industries not in existence today-the unknown market space untainted by competition. In blue oceans, demand is created rather than fought over. There is ample opportunity for growth that is both profitable and rapid. In blue oceans, competition is irrelevant because the rules of the game are waiting to be set. *Blue Ocean is an analogy to describe the wider, deeper potential of market space that is not yet explored. Like the "blue" ocean, it is untouched, vast and deep in term of profitable growth.*

Two powerful ways of improving the return of new products are to invest in only the most promising new product ideas and to improve supply planning before products launch. Most firms fail to correctly pick new product winners only one out of every five new product launches is successful. Also, firms frequently are unable to capitalize on the successes of a new product blockbuster because of poor demand forecasts. For example, Nintendo launched the new console Wii in November 2006 with huge product shortages and many frustrated fans. Similarly, Apple Computer had to push back their international launch date of iPod Mini because of supply constraints. Hence, it is important to discover and manage new product blockbusters.

## **2. Scientific Foundation of Prediction Markets**

**Incentive-** Prediction markets must provide strong incentives for good use of market information. They should neither reward status nor dominance, which are common in organizations. The principle of rewarding solely based on information use creates an

environment that is conducive for opinions to aggregate and emerge. Thus, Incentives provide a natural way to weigh opinions.

**Indicator-** Prediction markets employ a clear information indicator. In particular, price is used to convey aggregation information to all participants. This solves two fundamental problems of information pooling of information pooling and dissemination (for learning). First, individuals have different mental models of demand. The use of price forces participants to express their thinking in a precise and common metric, which is paramount to the market's ability to merge information. For example, *there is no scientific method to combine a news story about a trend in the market and an expert opinion about a new product into one single demand forecast. Prediction markets fill this gap.*

Secondly, different participants have different levels of accuracy of information. The use of price allows the market to give more weight to more informed individuals. These individuals are more likely to trade and hence influence the market. This is so because the individuals can increase their profit by trading with their personal information. Thus, *they have huge incentives to quickly "pump" information into the market before others do. As a consequence, the market forecast of demand becomes more accurate.*

**Improvement-** Prediction markets encourage individuals to improve their knowledge. As noted, prices capture the latest information about the demand. The price discovery process, in effect, allows the uninformed individuals to learn from the informed ones. Hence, all participants will become knowledgeable of the demand through trading.

This adaptation process allows individuals to piggyback their personal learning on other's information. This is analogous to the common scientific discovery process of riding on the shoulders of giants. Put differently, this process equalizes the information bases of all individuals, because prices are common knowledge. Consequently, the markets become smarter through this continuous process of learning by traders.

**Independence-** Prediction markets benefit from independent information sources. For example, Hewlett thinks that demand for the same printer is either medium or high. Prediction markets can pool Hewlett and Packard's information together to yield a demand forecast of medium.

In most organizations, there are rigid hierarchies. These layers of structures impede free flow of independent information. For example, a manager may filter off opinions incompatible with their own thinking, thereby stopping the organization from employing all useful information. Prediction markets are designed to remove these barriers.

**Crowd-** Prediction markets work best in a large crowd. The surprising fact that groups consistently outperform individuals is well documented. This observation is grounded on the statistical principle of the Law of Large Number. This principle further states that a large group of laymen can even beat a small number of experts.

### 3. Application Sweet Spots

**Barnes & Noble**-Barnes & Noble and Borders superstores in the United States redefined the scope of the services bookstores offer. Instead of focusing solely on the moment a customer purchases a book – as the hundreds of bookstores were doing – they asked, what do customers do before, during, and after purchasing a book? B&N and Borders observed that before purchasing books, buyers often want to sit and leaf through several selections before making a choice. However, traditional bookstores did not offer a place to do so – in fact they discouraged the practice. Also, after purchasing books or magazines, many customers went to a coffee shop to spend some time alone reading. With these insights they added lounges, knowledgeable staff, and coffee bars to create an environment that celebrates reading, expanding the product offering from the book itself into the *pleasure of reading and intellectual exploration*. In less than six years, B&N and Borders emerged as the two largest bookstore chains in the United States, with more than one thousand three hundred superstores between them.

**Movie Industry**- The Hollywood Stock Exchange (HSX, [www.hsx.com](http://www.hsx.com)) is an online prediction market that has been used to forecast box-office receipts of movies. The HSX has 1.7 million registered users. New users are provided with two million “Hollywood dollars” (fake money) and can increase the value of their portfolio by trading. HSX has been highly accurate in the results.

### 4. Potential Pitfalls

While the Blue Oceans of Prediction Markets can be a powerful tool, it is not a panacea for all forecasting situations. They only aggregate information well if the *number of participants is a large pool*. It demands *high market liquidity*. Moreover, principles of crowd and independence imply that only those people who have relevant information and the “*wisdom*”, should be included in the market. It is impossible to find that wisdom in the crowd for all times, hence results are inaccurate forecasting.

### 5. Conclusions

*Blue Oceans of Prediction Markets are “smart” Oceans* that are capable of accurately predicting outcomes of uncertain future events they work well if the underlying scientific principles (incentive, indicator, improvement, independence, and crowd) are adhered to the most current “*wisdom of the crowds*”.

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