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Finding a Blue Ocean
Creating Uncontested Market Space for Growth, Sustained Profitability

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"If the rate of change outside your organization is greater than the rate of change inside your organization, the end is in sight." -- Jack Welch

Translation: in today's world of accelerating change, more and more organizations will find themselves obsolete in the future. Perhaps today's challenging economy makes the need for change more obvious, but I think both in good times and in bad, organizations should constantly evaluate their business models, reflecting on how and where they choose to compete and on how they create innovative value for their customers. The reality is that many organizations are currently operating in shrinking and highly competitive "red ocean" markets, where instead they could enjoy increasing and sustainable growth in less competitive, more profitable "blue ocean" markets…

Last month, I outlined five traits common to successful enterprises of the future (visit here for more information on this year's IBM Global CEO study). One of those traits is being "disruptive by nature" – of radically challenging your business model, disrupting the basis of competition. The IBM research declares that the successful company "…shifts the value proposition, overturns traditional delivery approaches and, as soon as opportunities arise, reinvents itself and its entire industry."

Bill Mills, CEO of Minneapolis-based Executive Group, borrows the phrase "Blue Ocean Strategy" from the popular 2005 book by the same name to describe organizations that pursue business models which set them apart from their competition. In a talk he recently gave in Minnesota, Bill noted that successful companies today and in the future are successful because they have chosen to CREATE new markets rather than compete in highly competitive existing markets.

What does he mean exactly? In his talk, Bill claimed that "organizations are perfectly designed to get the results they are getting." I think that's a compelling thought. So if you're struggling right now, blame it not on the economy but on your business model – one that may not be appropriate for today's market conditions (or today's customers' needs, or your organization's core competencies, or your workforce's capabilities, and so forth). Bill's premise – and I completely agree – is that success is largely due to an organization's strategic positioning in the marketplace…of being at the right place at the right time to capitalize on a market need, to create value for a set of buyers, and to benefit from the flow of resources (money).

But Bill goes on to claim that strategic positioning may only be part of the equation: success is also based on an organization's ability to create a business model that fully capitalizes on that market need. In other words, just being at the right place at the right time doesn't ensure success (look at Texas Instruments and their attempt in the PC market: right idea, wrong execution).

So enter the notion of a "blue ocean strategy." In their book, W. Chan Kim and Renee Mauborgne ask readers to imagine a market universe composed of two sorts of oceans: red oceans and blue oceans. Red oceans represent all industries in existence today; it is the known market space where industry boundaries are defined and accepted, and competitive rules are generally known. "Here," they say, "organizations try to outperform their rivals to grab a greater market 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."

While their last comment is a bit graphic for me, the concept holds water (ok: I couldn't resist the pun). We've all seen it in many markets: as industries mature, more competition enters, differentiation diminishes (until innovations and new industries emerge), prices generally fall, and profits are divided over a larger number of players. In the 80s, Michael Porter called this a "highly concentrated market" – one with a high degree of "rivalry" – in his Five Forces strategic framework.

Contrast that to what Kim and Mauborgne call blue oceans, which denote all the industries NOT in existence today. Basically, this is the unknown – or at least untouched – market space. Blue oceans "…are defined by untapped market space, demand creation, and the opportunity for highly profitable growth. Although some blue oceans are created well beyond existing industry boundaries" – disruptive changes like Motorola's creation of cell technology, which completely changed how we communicate with telephony – "most are created from within red oceans by expanding existing industry boundaries" – like iPhone did.

"In blue oceans, competition is irrelevant because the rules of the game are waiting to be set." As a result, companies can set prices where the market will bear them, without having to consider competitive offerings (at least not at the outset). Hence, growth and profit are enhanced, according to Kim and Mauborgne, when organizations swim in blue oceans instead of red.

Think about the various examples of companies that have found – or created – their blue oceans over the years:

- Southwest Airlines, who has redefined customer focus in an industry that otherwise is not known for its service. They have also reinvented the airline operations model, moving from a "hub-and-spoke" strategy to a far quicker, more reliable (and more cost-effective) direct short-haul model. Finally, they eliminated seat assignments (at least at first), airline food (who wanted that anyway?!), and only use one type of aircraft (so that maintenance is cheaper and more efficient). As a result, they killed the market with their new model, and still today are one of the only airlines that consistently turns a profit.
- Cirque du Soleil, who redefined what it means to go to the circus (and what it costs). In just under 20 years, more than 40 million people in 90 cities have attended a Cirque show (it took Barnum & Bailey over a century to hit that number). They did it by changing the model: a circus directed toward adults and corporate clients willing to pay two or three times what traditional circuses (who cater mainly to kids and families) charged. Essentially, the integrated Broadway theater and circus performances under a tent with a cash bar. Different than cotton candy, smelly elephants, and jugglers.
- Apple, who redefined personal computing (remember Apple was first to market over Windows), then redefined the music industry (iTunes then iPod), and then redefined the personal communications industry (iPhone). Rather than competing with entrenched red ocean players like Columbia and Sony for music and Motorola and Nokia for cell phones, they just changed the game. And consequently captured pretty much 100% of new, emerging markets.

Indeed, there have been many organizations who have "changed the game" to capitalize on a market need – they have moved from a competitive, red ocean to the high growth, high profit blue oceans.

All of these examples are compelling, but a bit anecdotal. So here's something that might grab your attention. The authors of Blue Ocean Strategy contends that there is economic evidence that companies that create Blue Oceans – that choose not to compete with others but rather invent or reinvent the marketplace – enjoy better returns in aggregate than their peers.

Specifically, Kim and Mauborgne studied business launches within 108 organizations. Of those, 86% were line extensions (incremental improvements within an existing red-ocean market space). Yet those launches accounted for 62% of total revenues and only 39% of total profits. On the other hand, the other 14% of business launches were in blue oceans (non-competing market spaces), and they generated 38% of total revenues and 61% of total profits. So 14% generating 61% of profits; that's compelling.

And that data were from 2005: think about how much more competitive markets are today, and how the proportion of revenues and profits may have shifted even further to those organizations who are in non-competing markets. Here's a sobering thought: Kim and Mauborgne believe that worldwide demand for many products is not keeping up to ever-increasing supply. As technologies continue to improve and global trade continues to increase, more and more companies are increasing productivity and output…but are chasing stable or declining dollars (not just because of the recession, but their research shows that worldwide consumption may have stabilized in general).

All of this is to say that organizations are finding themselves facing increasing levels of competition, which undoubtedly will impact revenues and profits. (And, by the way, that "competition" is now being felt by non-profits, governmental agencies, and other organizations traditionally immune to those market forces.)

So finding a way to differentiate your organization and create uncontested market space may be the only long-term way for sustained, profitable growth.

How do you do it? Kim and Mauborgne suggest a notion they've labeled Value Innovation. Their definition: "Value Innovation is created in the region where a company's actions favorably affect both its cost structure and its value proposition to buyers. Cost savings are made by eliminating and reducing the factors an industry competes on. Buyer value is lifted by raising and creating elements the industry has never offered. Over time, costs are reduced further as scale economies kick in due to high sales volumes that superior value generates."

That's simple enough: increase value for customers and drive costs down for the company. But the difference from traditional economics is in that the Blue Ocean Strategies require changing the business model rather than just the product or service. Think Southwest: they didn't just change the core product (your flight), but they changed virtually everything else in the business model that surrounded that product.

Kim and Mauborgne suggest six principles for creating Blue Ocean strategies:

- Reconstruct market boundaries: rethinking about how a market can be defined, in terms of alternative industries, customer segments, product/service offerings, and other domains. By redefining how you define "market," you open up potential blue oceans.
- Focus on the big picture, not the numbers: creating strategic plans that are less about numbers and jargon and more about a vision for future success.
- Reach beyond existing demand: creating the greatest potential market for your blue ocean. This principle is counter to a common perception that we need to segment markets into smaller niches to satisfy their needs; however, Kim and Mauborgne believe we need to "aggregate demand, not by focusing on differences that separate customers but by building on the powerful commonalities across non-customers to maximize the size of the blue ocean."

- Get the strategic sequence right: building a business model that allows you to capitalize on the market potential. Basically, this is following a process that allows you to move from buyer utility to pricing to cost structure to market adoption to implementation.
- Overcome key organizational hurdles: building leadership to manage the new business model.
- Build execution into strategy: integrating a blue ocean culture throughout the organization, for sustained performance and constant evolution.

Sounds pretty much like what Southwest Airlines repeatedly does…or Apple…or Google – those that have found a blue ocean, but also continue to explore and refine new opportunities and markets.

I opened with a quote, so I'll close with one from Jim Rohn: "We generally change…for one of two reasons: inspiration or desperation." With the challenges most of our organizations face today, I guess I'd rather choose the more proactive, controlled change that comes with constantly reinventing your marketplace ahead of your competitors. I wish you luck in finding your blue ocean…