CHAPTER 1

The Basics of Strategy

Chapter Guideline

Although many business strategy books deal with Michael Porter's strategy models, few successfully present Porter's key points and their true implications in an easily digestible manner. This chapter serves to this end. We will first explain the different units of strategy analysis, followed by Porter's strategy models for their appropriate levels of analyses. These strategy models will then be applied to Asian cases in order to demonstrate how they function in different business environments.

1.1 Competitiveness of Product, Firm, Industry and Nation[1]

Competitiveness is often confused with productivity. While productivity refers to the internal capability of an organization, competitiveness refers to the relative position of an organization against its competitors. These two important concepts are often confused and used interchangeably. In his seminal work, *The Competitive Advantage of Nations*, Porter (1990, p. 6) clearly states that the only meaningful concept of competitiveness at the national level is productivity.

For example, a firm may enhance its competitiveness by simply changing its strategies (e.g., new marketing strategy), while maintaining the same level of productivity. Likewise, a nation can enhance its

[1] This section is extended from Moon and Peery (1995).

competitiveness by changing national policies (e.g., currency devaluation, protectionism), without increasing its domestic productivity. Therefore, we need to distinguish competitiveness from productivity and highlight the relevant strategies at various levels of analyses. Some important strategy models can then be integrated and suggested for further development.

Competitiveness of a Product

A product is competitive if it has a lower price and/or superior differentiation than those of comparable products. Porter's generic strategies are thus relevant to the competitiveness of a product, but not always to that of a firm. This is why Porter's generic strategies are criticized when they are applied to a firm-level analysis. For example, critics state that the generic model focuses only on the last few hundred yards of what may be a skill-building marathon (Hamel 1991).

Another criticism is that the generic strategies of low cost and differentiation are useful for categorizing competitive strategies, but in themselves do not suggest where costs should be cut or how products should be differentiated (Kogut 1985). In addition, as the generic strategies model was primarily designed to explain domestic business strategies, it does not adequately describe the complexity of global business strategies. This is mainly because few firms pursue solely a cost or differentiation strategy in global competition; in fact, major competitors frequently adopt both cost and differentiation strategies (Moon 1993).

Competitiveness of a Firm

Another criticism regarding Porter's generic strategies is that it neglects the core competence in formulating firm-level strategies (Prahalad and Hamel 1990). The most important perspective in explaining the competitiveness of a firm is the resource-based view of the firm. This theory views the firm as a bundle of resources and capabilities that strategically focuses on (a) factor market imperfections,

(b) the heterogeneity of firms, (c) varying degrees of specialization, and (d) the limited transferability of corporate resources. According to this view, the competitiveness of a firm depends on the ability to identify and deploy its core competence. However, this concept is not entirely new as core competence, or unique resource, is closely related to ownership advantage and the capability to deploy the advantage, which is explained extensively by the internalization theory discussed in the foreign direct investment literature. Thus, theories related to foreign direct investment can provide important insights into firm-level global competitiveness that are not available in other approaches.

When going abroad, a firm has to choose between standardization and customization. In order to analyze these two international strategies, the integration-responsiveness (I-R) framework should be used. The two imperatives of this framework are pressures for global integration on the production side and pressures for local responsiveness on the marketing side. In reality, many businesses find it necessary to pursue multifocal strategies or transnational solutions, responding simultaneously to pressures for global integration and local responsiveness.

Competitiveness of an Industry

Most of the existing theories in strategic management are related to the competitiveness of a product or firm. On the other hand, Porter (1990, p. 18) raises an important question regarding the international competitiveness of a nation's industry by asking why firms based in particular nations achieve international success in distinct segments and industries. He defines international success of a nation's industry as "possessing advantage relative to the best worldwide competitors" (Porter 1990, p. 25). Porter then introduces the diamond model, an analytical model composed of four determinants — factor conditions, demand conditions, related and supporting industries, and business context. These four determinants are very similar to, yet more refined than, the variables included in his five-forces industry model (Porter 1980, 1985, 1990).

Despite the far-reaching explanatory power of Porter's diamond model, it is still quite limited when applied to global business. The original single-diamond model has thus been extended to the double-diamond model and other models to explain the multidimensional nature of global businesses.[2]

Competitiveness of a Nation

A nation's competitiveness is different from a firm's competitiveness. For example, competition between the USA and Japan is not like the zero-sum game between Coca-Cola and Pepsi. If you buy a can of Coke, it is Pepsi's loss; but the USA and Japan can both be winners through competition and cooperation, using different but often complementary sources of comparative advantages. However, when nations endowed with similar comparative advantages compete in a particular industry, the competition becomes largely a zero-sum situation.[3] Modeling competitiveness at the national level is thus not an easy task.

Popular models for national competitiveness are international trade theories and foreign exchange theories. More recent theories include the diamond model and its extended models. On the other hand, some scholars argue that if we hope to revitalize the competitive performance of a nation's economy, we must invest in people, not in nationally defined corporations. In the 21st century, the education and skills of the workforce may be the dominant competitive weapon.[4]

Where to Start?

We have briefly reviewed competitiveness at different levels of analyses and the relevant strategy models for each level. The conceptual clarity

[2] See Rugman and D'Cruz (1993); Moon, Rugman and Verbeke (1995, 1998); Cho (1994); Cho and Moon (2000); and Cho, Moon and Kim (2008, 2009) for the evolution of the diamond model.

[3] There is an interesting debate on this by Krugman, Prestowitz and Thurow. See Cho and Moon (2000).

[4] For example, see Reich (1990) and Thurow (1992).

will help portray the vivid institutional reality. Theories for each level are somewhat overlapping and sometimes misused. Among the four different levels of analyses, firm-level competitiveness is probably the most important unit in understanding our globalized economies because it is not nations, but firms, that compete in the real world. For the purpose of analyzing industry or product competitiveness, the basis of understanding must be at the firm level. We will thus start with the firm's competitive strategy and, when necessary, appropriately incorporate strategy models at other levels.

1.2 Porter's Competitive Strategy

Michael Porter is well known as the guru of strategic management, so we will first review Porter's key points (1980, 1985). We will then discuss some issues associated with Porter's model and suggest extensions in the later chapters.

Porter raises two central questions underlying competitive strategy. First is the attractiveness of industries for long-term profitability and the factors that determine it. Not all industries offer equal opportunities for success and it is important to choose an attractive industry. Second are the determinants of relative competitive positions within an industry. In most industries, some firms are much more profitable than others, regardless of what the average profitability of the industry may be. A firm can improve or erode its position within an industry through its choice of strategy.

The First Question: Industry Attractiveness (Five-Forces Model)

According to Porter, competition and profitability are driven by industry structure, not by whether an industry is emerging or mature, high- or low-tech, regulated or unregulated. The key determinant of industry profitability is its structure. Some industries such as postage meters and grain trading are extremely profitable, while some high-technology industries such as personal computers and cable television are not profitable for many participants.

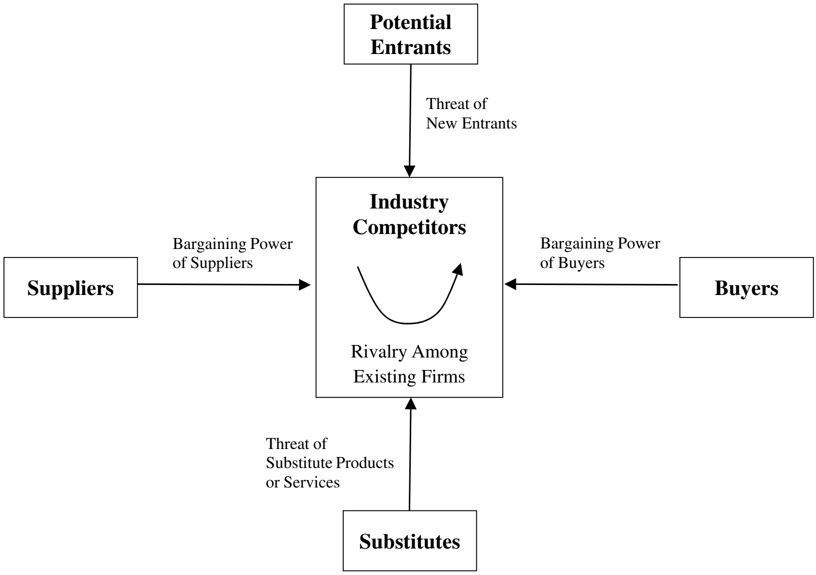

Fig. 1. The five competitive forces that determine industry profitability.[5]

In any industry, whether it is domestic or international or whether it produces a product or a service, the rules of competition are embodied in five competitive forces: the entry of new competitors, the threat of substitutes, the bargaining power of buyers, the bargaining power of suppliers, and the rivalry among existing competitors (see Fig. 1).

The collective strength of these five competitive forces determines the ability of firms in an industry to earn, on average, rates of return on investment in excess of the cost of capital. The strength of the five forces varies from industry to industry and can change as an industry evolves. Here, Porter forwards an important argument that a firm is not a prisoner of its industry's structure. Firms, through their strategic choices, are capable of influencing the five forces to their advantage. If a firm can shape the industry structure, it can fundamentally change an industry's attractiveness for better or worse.

[5] Porter (1980), p. 4.

Many successful strategies have shifted the rules of competition in this way. Contrary to the critics' assertions, Porter's conception of firm strategy is not that of a passive recipient of immutable industry forces, but a proactive entity which has the power to change the very business environment in which it operates.

In a recent update, Porter (2008) notes that understanding the five forces is important not only for individual firms, but also for investors. The five forces can be a powerful tool for investors to distinguish between structural changes and short-term "bubbles". Commonly used investment decision tools such as financial projections and trend extrapolations can be misleading, as they tend to overemphasize transient factors and industry profitability. From a macro perspective, this leads to misallocation of resources to unprofitable segments and unnecessary volatility. If managers and investors both focus on industry structure, the capital market would not exhibit such inefficiencies that we commonly witness.

The Second Question: Firm Competitiveness (Generic Strategies)

The second question in competitive strategy deals with a firm's relative position within its industry. There are two basic types of competitive advantage a firm can possess: cost advantage or differentiation advantage. Cost and differentiation advantages in turn stem from industry structure. They result from a firm's ability to cope with the five forces better than its rivals. Here, again, Porter argues that industry structure and firm strategy are not insulated, but are interconnected with each other.

The two basic types of competitive advantage combined with the scope of activities lead to three generic strategies for achieving above-average performance in an industry: cost leadership, differentiation, and focus. This is explained in Porter's early work (Porter 1980; Fig. 2) and later he divides the focus strategy further into two variants (Porter 1985; Fig. 3). In *cost focus*, a firm seeks a cost advantage; while in *differentiation focus*, a firm seeks differentiation in its target segment.

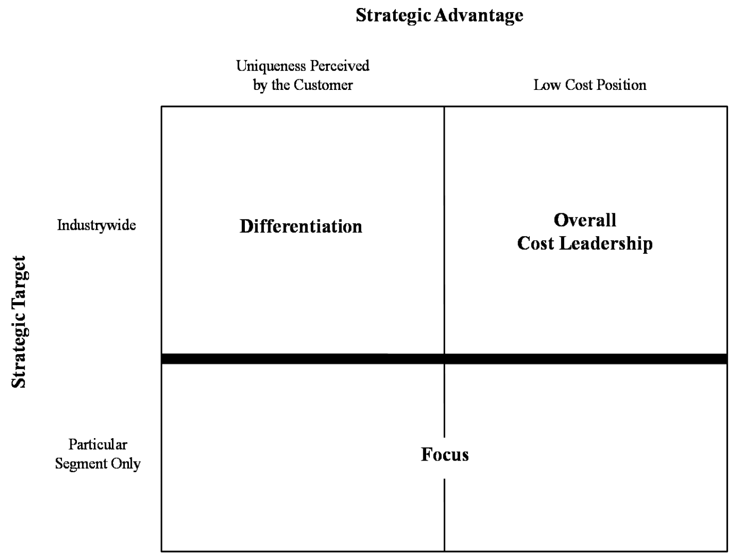

Fig. 2. Three generic strategies.[6]

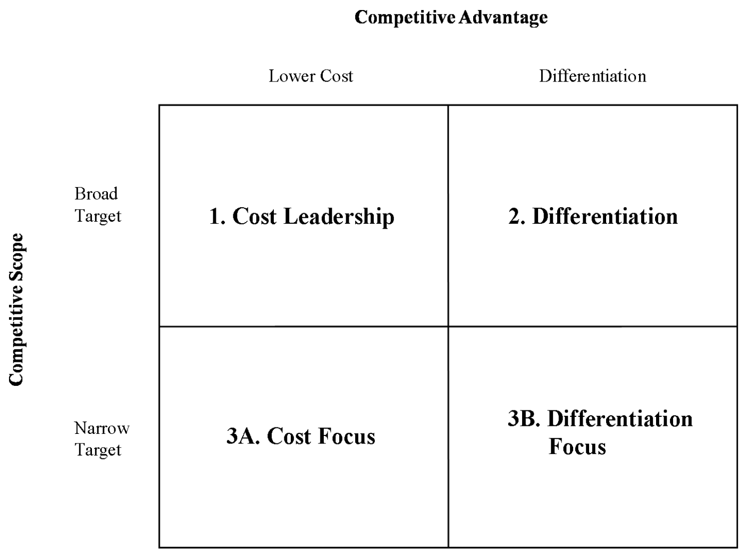

Fig. 3. Four generic strategies.[7]

[6] *Ibid.*, p. 39.
[7] Porter (1985), p. 12.

Stuck-in-the-Middle

Each generic strategy takes a fundamentally different approach to creating, sustaining and combining a firm's competitive advantage and deciding the scope of its strategic target. Usually, a firm must make a choice among the four strategies, or it will be "stuck-in-the-middle" which leads to a competitive disadvantage on all fronts. In most industries, quite a few competitors are stuck-in-the-middle. These firms will earn attractive profits only if the structure of its industry is highly favorable, or if the firms' competitors are also stuck-in-the-middle.

Stuck-in-the-middle is a very controversial concept that many scholars criticize.[8] However, Porter is more cautious than his critics may think. Porter asserts that a cost leader cannot ignore the basis of differentiation. If its product is not perceived as comparable or acceptable by buyers, a cost leader will be forced to discount prices well below competitors' to gain sales. Therefore, a cost leader must achieve parity or proximity in the basis of differentiation relative to its competitors to be an above-average performer, even though it relies on cost leadership for its competitive advantage. Similarly, a differentiator thus aims at cost *parity* or *proximity* relative to its competitors, by reducing cost in all areas that do not affect differentiation.

The Real Value of Porter's Generic Strategies

Porter's critics say that his generic strategies focus too much on competition and therefore his strategic vision is too narrow.[9] However, in many cases, this criticism is unfounded because Porter actually broadens the strategic options since generic strategies provide alternate routes to superior performance. While other strategic planning concepts have been narrowly based on only one route to competitive advantage (most notably, cost), generic strategies allow more leeway in selecting the appropriate generic strategy which allows firms to survive and prosper without being locked in a constant state of competition with each other.

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[8] Critics of stuck-in-the-middle will be analyzed further in Chap. 5.

[9] Various critics of Porter will be explored extensively throughout later chapters.

Evolution of Generic Strategies

The generic strategies remain useful to characterize strategic positions at the simplest and broadest level. In his later work, Porter (1996) introduces the three basics of positioning — varieties, needs and access — in order to enhance the understanding of generic strategies to a greater level of specificity (see Fig. 4). For example, according to Porter, Ikea and Southwest are both focused on cost, but Ikea's focus is based on all the home furnishing *needs* of its target customer group (e.g., a price-sensitive young family) while Southwest's is based on offering a particular service *variety*. This is an interesting extension to the original generic strategy, but there is room for debate and further development. This will be further discussed in a later chapter.

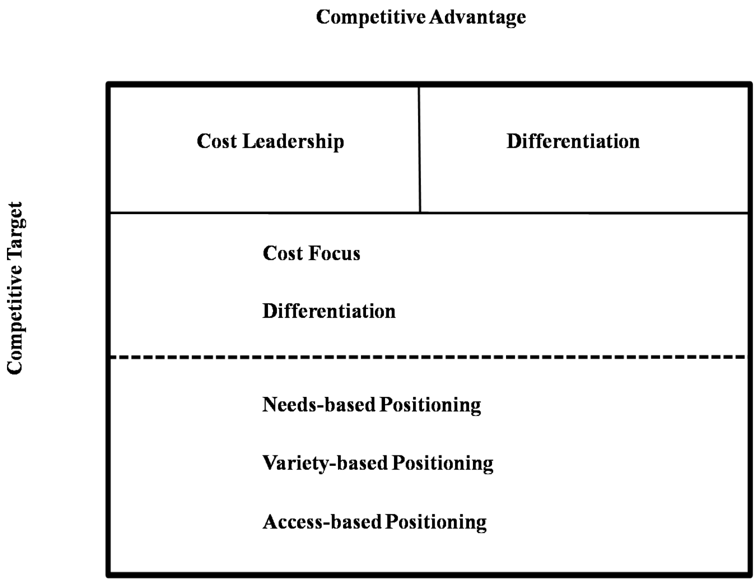

Fig. 4. Four plus three generic strategies.[10]

[10] This figure is a modified version of Porter (1996).

1.3 The Value Chain and Competitive Advantage

A firm's competitive advantage stems from the many discrete activities of designing, producing, marketing, delivering and supporting its product. Each of these activities can contribute to a firm's relative cost position or be the basis of differentiation. Competitive advantage (Porter 1985) is about how a firm actually puts the generic strategies (Porter 1980) into practice. How does a firm gain a sustainable cost advantage? How can it differentiate itself from competitors? Competitive advantage grows fundamentally out of the value a firm is able to create for its buyers. So, Porter introduces a very useful tool — the value chain — to disaggregate buyers, suppliers and a firm into the discrete but interrelated activities from which value stems. Potential sources of competitive advantage are everywhere in a firm. Every department, facility, branch office and other organizational units have a role that must be defined and understood.

The Generic Value Chain

The value chain displays total value, and consists of *value activities* and *margin*. Value activities are the physically and technologically distinct activities of a firm. Margin is the difference between total value and the collective cost of performing the value activities. Value activities can be divided into two broad types: *primary* activities and *support* activities. Primary activities are those involved in the physical creation of the product, its sales, and its transfer to the buyer as well as after-sales assistance. In any firm, primary activities can be divided into the five generic categories shown in Fig. 5. Support activities assist the primary activities by providing purchased inputs, technology, human resources and firm-wide functions. The dotted lines in Fig. 5 reflect the fact that procurement, technology development and human resource management can be associated with specific primary activities as well as support the entire chain. Firm infrastructure is not associated with a particular primary activity, but supports the entire chain.

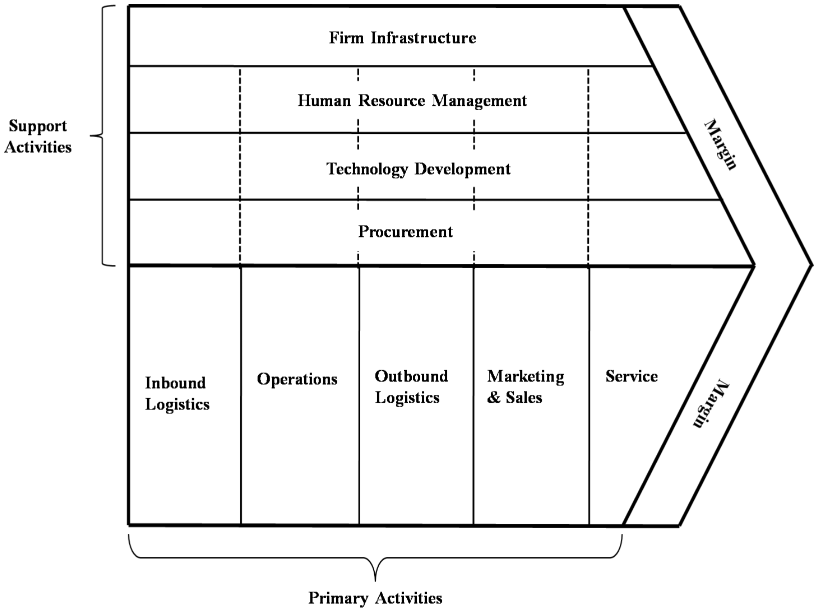

Fig. 5. The generic value chain.[11]

Primary Activities: Five Generic Categories

- *Inbound Logistics* — Activities associated with receiving, storing and disseminating inputs to the product, such as material handling, inventory controlling, vehicle scheduling and returns to suppliers.
- *Operations* — Activities associated with transforming inputs into the final product form, such as machining, packaging, assembly, equipment maintenance, testing, printing and facility operations.
- *Outbound Logistics* — Activities associated with collecting, storing and distributing the product to buyers, such as finished goods warehousing, order processing and scheduling.
- *Marketing and Sales* — Activities associated with providing a means by which buyers can purchase the product, such as

[11] Porter (1985), p. 37.

advertisement, promotion, sales force, channel selection, channel relations and pricing.

- *Service* — Activities associated with providing service to enhance or maintain the value of the product, such as installation, repair, training, parts supply and product adjustment.

The relative importance of each category depends on the industry. For a distributor, inbound and outbound logistics are the most critical. For a service firm such as a restaurant or retailer, outbound logistics may be largely nonexistent and operations is the vital category. For a bank, marketing and sales are critical to competitive advantage. For a high-speed copier manufacturer, service represents a key source of competitive advantage. In any firm, all five categories play some role in its competitive advantage.

Support Activities: Four Generic Categories

- *Procurement* — This is the *function* of purchased inputs used in the firm's value chain, not the purchased inputs themselves. Purchased inputs include raw materials, supplies, and other consumable items as well as assets such as machinery, laboratory equipment, office equipment and buildings. Improved purchasing practices can strongly affect the cost and quality of purchased inputs, and other activities associated with receiving and using the inputs and interacting with suppliers.
- *Technology Development* — This refers to how every value activity embodies technology, be it know-how, procedures or the technology embodied in the process equipment. Porter terms this category of activities as "technology development" instead of "research and development" (R&D) because R&D has too narrow a connotation to most managers. Technology development does not solely apply to technologies directly linked to the end product. It also takes many other forms, from basic research and product design to media research, process equipment design and servicing procedures.

- *Human Resource Management* — A firm performs myriads of activities related to recruiting, hiring, training, developing and compensating all types of personnel. Human resource management supports both primary and support activities (e.g., the hiring of engineers) and the entire value chain (e.g., labor negotiations). This management affects competitive advantage in any firm, through its role in determining the skills and motivation of employees and the cost of hiring and training.
- *Firm Infrastructure* — This refers to activities including general management, planning, finance, accounting, legal affairs, government affairs and quality management. Unlike other support activities, infrastructure usually supports the entire chain and not individual activities. In diversified firms, infrastructure activities are typically split between the business unit and corporate levels (e.g., financing is often done at the corporate level while quality management is done at the business unit level). However, many infrastructure activities occur at both the business unit and corporate levels.

Subdividing the Value Chain

Everything a firm does should be captured in a primary or support activity. Therefore, each generic category of the value chain can be further divided into discrete activities, as illustrated for one generic category in Fig. 6. The appropriate degree of disaggregation depends on the economics of the activities and the purposes for which the value chain is being analyzed. The basic principle is that activities that (a) have different economics, (b) have a high potential impact of differentiation, or (c) represent a significant or growing proportion of cost should be separated.

Linkages within the Value Chain

Although value activities are the building blocks of competitive advantage, the value chain is not a collection of independent activities, but a system of interdependent activities. Value activities are related through linkages within the value chain. Linkages are relationships

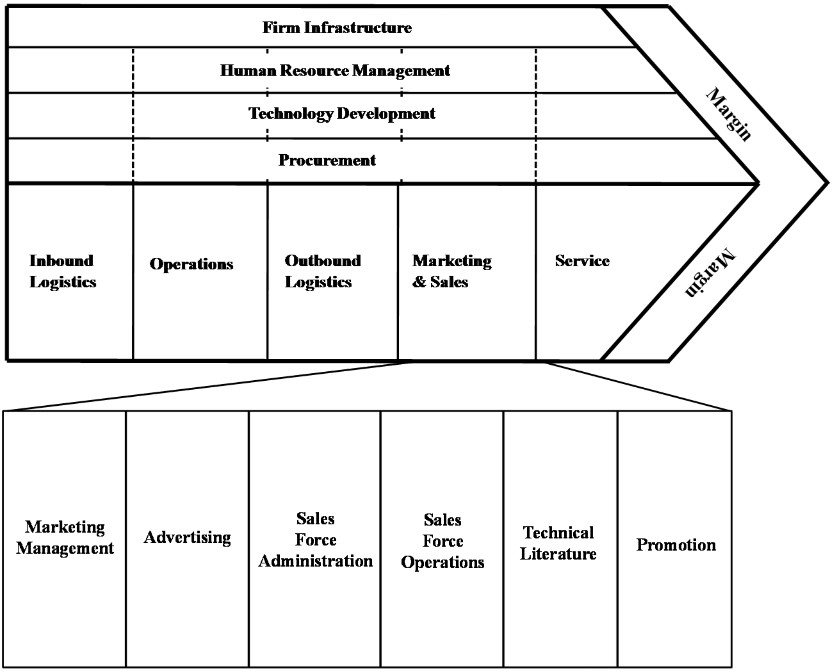

Fig. 6. Subdividing a generic value chain.[12]

between the performance of one value activity and that of another. Linkages can lead to competitive advantage in two ways: optimization and coordination. Examples of optimization include a more costly product design, more stringent materials specifications and greater in-process inspection, which may reduce service costs. A firm must optimize such linkages in order to achieve a competitive advantage. Linkages may also reflect the need to coordinate activities. The ability to coordinate linkages often reduces cost or enhances differentiation. Better coordination, for example, can reduce inventory throughout the firm. Linkages imply that a firm's cost or differentiation is not merely the result of efforts to reduce costs or improve performance in each value activity individually. Much of the achievement is the result of linkages.

[12] *Ibid.*, p. 46.

Case Study 1: Wal-Mart's Challenge in Asia[13]

"The secret of successful retailing is to give your customers what they want," Sam Walton, the founder of the world's largest retailer, wrote in his autobiography (Walton 1992). He also noted that one must think about one's business from the customer's point of view. Wal-Mart has continued to thrive in many countries outside of the United States, particularly in Mexico, Canada, Brazil and Britain. However, Wal-Mart failed in Japan, Korea and India because the company did not understand its Asian customers and, just like its French rival, Carrefour, ended up withdrawing from these countries. Wal-Mart's failure in these three countries provides important lessons for Western multinationals that aspire to garner success in these markets.

On the contrary, British retailer Tesco has achieved remarkable success in the Korean market. The British retail giant owns 89% of Samsung Tesco, but has relied heavily on local managers from Samsung. Tesco reported that its overseas growth has been driven by Asia, where profits grew by 30% in 2006. Consequently, this was the same year it became the second-largest retailer in South Korea, making South Korea one of Tesco's biggest overseas success stories (Center for Management Research 2006). If one overseas retailer prospered in Korea, why couldn't Wal-Mart do the same? What went wrong with Wal-Mart? The following illustrate the reasons behind Wal-Mart's failure in Korea, Japan and India:

- *Cheap Real Estate* — Large stores, vast parking lots and huge distribution centers have been an integral part of Wal-Mart's success. So, it is understandable how Wal-Mart could easily expand to places with cheap real estate (Latin America), but have a hard time expanding to places where real estate is expensive (South Korea and Japan).

[13] Information for this case study is abstracted from *The New York Times* (2006a, 2006b), the Wal-Mart website (www.walmart.com) and *The Economist* (2008a).

- *Price* — Wal-Mart's focus has always been on low prices. It provides merchandise in bulk for prices below its competitors'. However, Koreans prefer high quality over price and often equate low price with low quality. Wal-Mart focused on maintaining low prices and selling in bulk, while its local competitors, E-Mart and Lotte Mart, focused on selling the product's quality by building eye-catching displays and hiring employees who hawked their goods with megaphones.
- *Frequent Visits* — Wal-Mart is an ideal store for consumers to visit once a week. Most American consumers visit Wal-Mart once a week and buy in bulk because American shoppers rarely shop without their automobiles. However, in Japan, most consumers visit stores almost every day, by bicycle, and do not purchase in bulk. With such a stark difference in consumer behavior between Japanese and American consumers, Wal-Mart was unable to succeed in Japan.
- *Government Protection* — Wal-Mart was unsuccessful in entering India, where the government is adamant about protecting the country's retail sector. Over 90% of Indian retailers are very small, traditional and unorganized, and there was fear that Wal-Mart could eventually undermine the small retailers dominating the Indian market.

Wal-Mart's experience in India implies that the company should have planned to buy more local goods, which could help Indian farmers and small manufacturers. More importantly, Wal-Mart should have changed its cost leadership strategy when entering certain Asian countries. The company's "Everyday Low Price" approach backfired in Korea and Japan, where consumers tend to equate low prices with low quality. The one-size-fits-all approach should have been changed from standardization to localization and from a cost to a differentiation strategy.

Although Wal-Mart is successful in the United States, the same competitive advantage may not translate into success in foreign markets. Asian consumers shop at large retailers, not for cheap

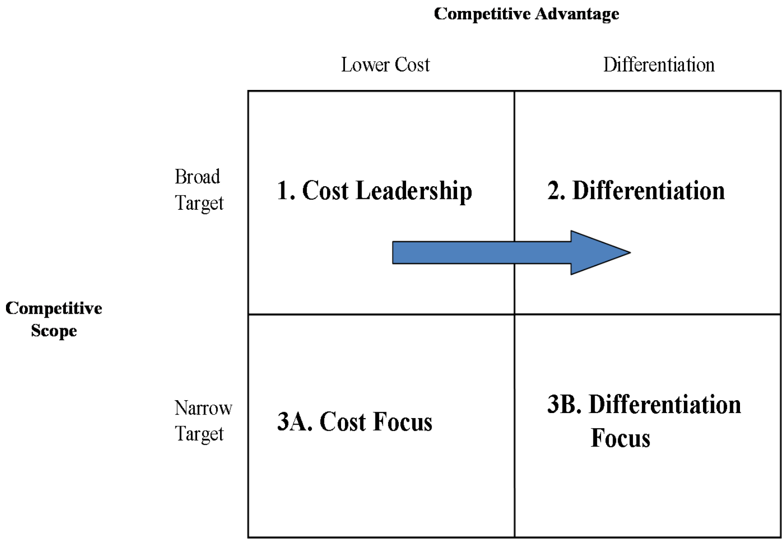

Fig. 7. Wal-Mart's international strategy.

and bulky items, but for the convenience of a variety of smaller-sized quality products. Using the generic strategies model, Wal-Mart's cost leadership strategy in the United States should have been changed to a differentiation strategy in Asia. The optimal strategic prescriptions are outlined in Fig. 7.

Case Study 2: *Sogo Shosha*'s Changing Competence[14]

A *sogo shosha* is a form of industrial organization and a kind of vertically integrated trading company that originated from Japan. The term *sogo shosha* is Japanese for "general trading company", but is often confused with *zaibatzu* or *keiretsu*. The *zaibatsu* commonly consists of a primary enterprise — usually a *sogo shosha* — surrounded by subsidiaries engaged in a wide range of operations such as

[14] Information for this case study is abstracted from the Mitsubishi Corporation website (www.mitsubishicorp.com), Mitsubishi's INNOVATION 2007 management plan (www.mitsubishicorp.com) and others.

banking, insurance, shipping, mining, real estate, food processing and manufacturing.

The seven largest *sogo shosha* in Japan are Mitsubishi Corporation, Mitsui & Co., Itochu, Sumitomo Corporation, Marubeni, Toyota Tsusho and Sojitz. These *sogo shosha* supply large volumes of raw materials and distribute goods from large manufacturers to smaller distributors and to numerous retailers. What make them unique are their size, scope, information-gathering capabilities as well as their functional diversity. They are the Japanese traders that operate at the center of Japan's global economic foray, and serve as intermediaries for half of their country's exports and two-thirds of their country's imports.

Other nations have tried to emulate this system to promote a similar kind of economic success. South Korea's large conglomerates (e.g., LG, Samsung and Hyundai) all have their version of the *sogo shosha* (*jonghap sangsa* in Korean), while Chinese firms have started to implement the *sogo shosha*-type companies with assistance from Japanese firms. The United States tried to replicate the *sogo shosha* in the early 1980s with the signing of the Export Trading Company Act of 1982. Such export companies, however, never developed as the American tendency to reject government-sponsored programs and the lack of publicity derailed this effort.

In the 1990s and 2000s, the *sogo shosha* found itself at a crossroads, adapting to new market conditions and opportunities. These opportunities included new business fields of high technology, such as biotechnology, computer technology, information technology and telecommunications. The *sogo shosha* also had to prepare for the increasing globalization of the world. There are both new opportunities as well as threats with this new environment.

Facing these new challenges, the *sogo shosha* is now changing its business models as follows:

- The activities of *sogo shosha* encompass not just trading, but also investments and other activities. The essence of *sogo shosha* is to provide any needed service to propel the businesses forward.

- The *sogo shosha* is engaged in business with customers around the world in virtually every industry, including energy, metals, machinery, chemicals, food and general merchandise.
- The *sogo shosha* actively studies market trends and takes initiatives to develop new business. Finding a new growing industry and industry segments is critically important for *sogo shosha*'s sustainable growth.
- The uniqueness of *sogo shosha* is the ability to *link and coordinate* functions such as logistics, financing and marketing. The *sogo shosha* thus shares risk with business partners and adds value to the business.

Therefore, the real value or core competence of *sogo shosha* is to find a problem or *imbalance* within the value chain and fix it. The *sogo shosha* can thus make the value chain more efficient and enhance its productivity. As shown in Fig. 8, this will contribute to the enrichment of society as well as its business partners in the linking activities of the value chain. As the industry structure becomes more sophisticated and as new industries emerge, *sogo shosha*'s role and scope of business will become greater. When the *sogo shosha* leverages its organizational strengths and networks of its affiliated companies, its power and thus potential benefits to its business partners will become even greater, as depicted in Fig. 9. Leveraging these organizational strengths and linking them to other activities of the industry value chain are unique advantages of *sogo shosha* that are clearly differentiated from other organizations.

Case Study 3: Playing into Asia[15]

In a recent article titled "Asian invasion," *The Economist* (2008b) reported that "for millions of East Asians, online gaming is not so

[15] Information for this case study is abstracted from *The Economist* (2008b), *The New York Times* (2006c), Runckel (2005) and the Blizzard Entertainment website (www.blizzard.com).

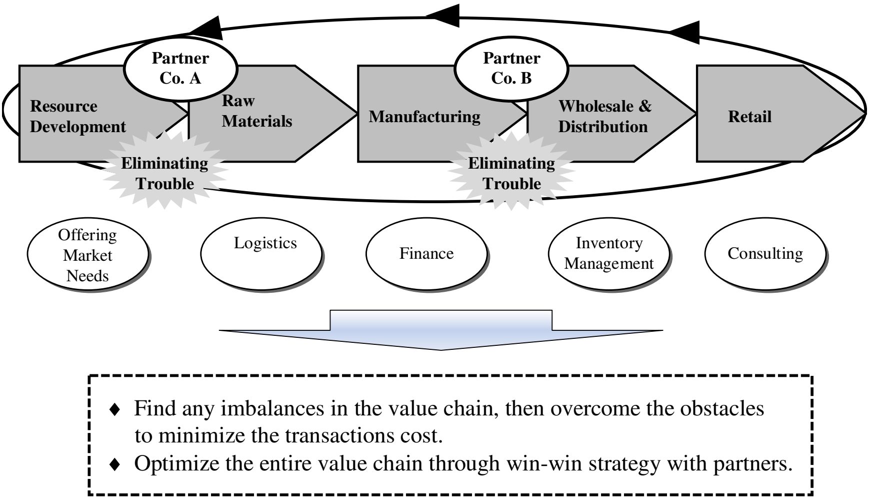

Fig. 8. Industry value chain and the *sogo shosha*.

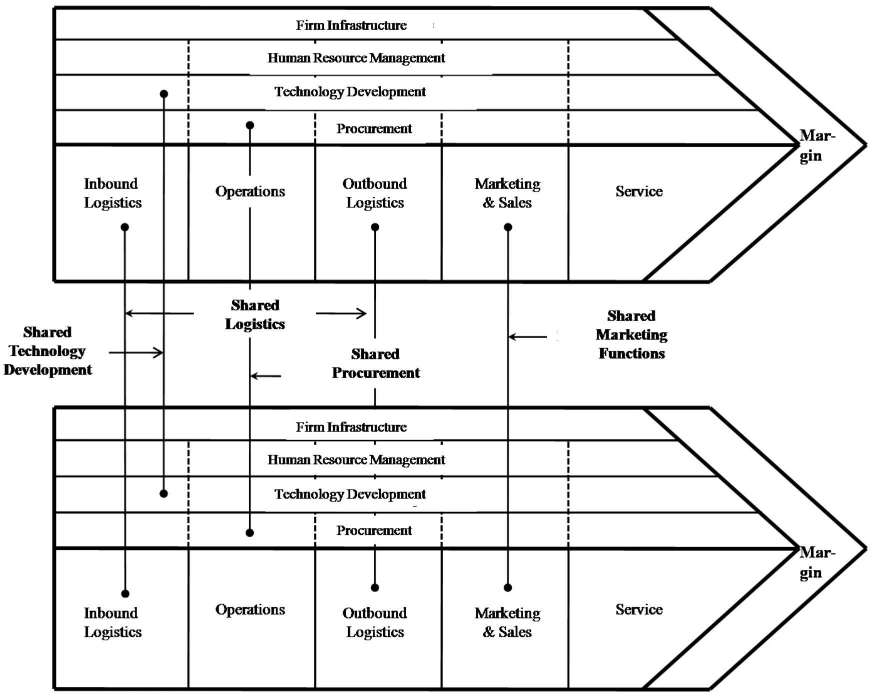

Fig. 9. Leveraging *sogo shosha's* strengths.

much a hobby as a way of life." In Korea, China and Japan, Internet cafés can be found on virtually every street corner, where legions of devoted gaming fans spend a considerable amount of time and money. Online gaming is big business, particularly in East Asia, and the Western gaming companies want a piece of the action.

However, the gaming industry in East Asia uses a decidedly unique business model compared to more traditional methods utilized by Western companies. In the West, games or software are sold off the shelf as packaged goods which can be installed and played on PCs or game consoles. In Asia, games or software are usually given away for free as a download and users can play for nothing. Revenue is generated by small payments made by avid customers to buy add-ons for their in-game characters.

Western gaming companies also face a number of barriers in entering the Asian market:

- *Language Barrier* — Games require language translation in addition to software rewrites to accommodate different alphabets and characters.
- *Piracy* — Most Asian countries do not have stringent enforcement of copyright protection. Asian programmers are adept at replicating and disbursing software, which compounds the problem for Western companies.
- *Gamer Culture* — Online game rooms and Internet gaming cafés provide a major social venue for most East Asian teens and young adults. Therefore, the online components of games are more important in Asia than the stunning graphics that entertain Western audiences.

The Asian model has benefits that are lacking in the Western model or can help overcome the barriers faced by Western firms:

- *Lowering the Entry Barrier* — This can be achieved by allowing new users to play for free. This will ultimately lead to a wider customer base, since more people are likely to try the product.

- *Overcoming Piracy* — Ironically, making the games free of charge will automatically mitigate this problem. If the games are free, firms need not worry about piracy. The company can then generate profit through advertisements or extra services (e.g., special weapons, new characters, extra events) to the gamer.

One Western company which altered its business strategy and became successful in Asia is Blizzard Entertainment, based in Irvine, California, USA. With its "World of Warcraft" online game, which has over 10 million subscribers worldwide, it seems to have found a strong foothold in Asia.

Blizzard has customized its servers for six different languages, thus overcoming the language barrier that many companies face when selling a product abroad. Blizzard has also circumvented the piracy problem by giving away World of Warcraft software for free and then charging for the game service, either hourly or monthly. Furthermore, Blizzard has expanded and opened subsidiaries around Asia in order to overcome cultural differences.

This model is becoming so successful that it is now being applied outside of Asia. Electronic Arts (EA) is preparing to release "Battlefield Heroes," which will be free to download but will hopefully generate revenue from in-game advertising and the sale of character upgrades. Thus, what began as a distinctively Asian model may now be developing into a global standard.

If the larger and more powerful Western gaming firms wish to enter the Asian market, they should follow Blizzard's lead and move away from spending money on highly sophisticated graphics and fancy packaging aimed only at young teenage males. Games in Asia need to be free to download and easily accessible by a wide range of people. Applying the generic strategies model, we see that although a differentiation focus strategy is effective in Western markets, a cost leadership strategy may be more effective in Asian markets (Fig. 10).

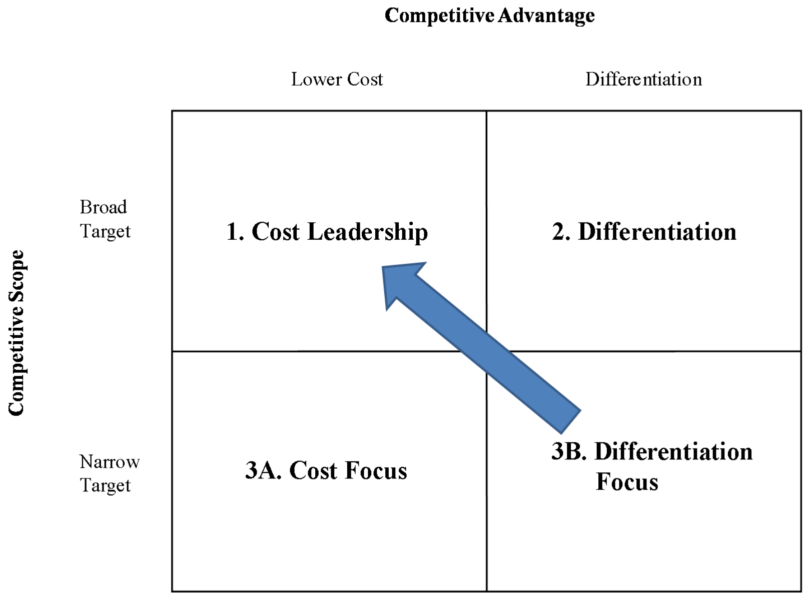

Fig. 10. Asian gaming strategy.

Case Study 4: Starbucks in China[16]

Starbucks, perhaps one of the most successful global companies in the world, has had its fair share of problems in China. The company views China as a must-have market, and is making it a clear priority for growth outside of the United States. Starbucks is well known for the standardization of its stores and whether one enters a store in New York in the United States, London in the United Kingdom or Paris in France, it is almost impossible to tell which city's Starbucks one may be in. However, the company's formula has not been as well received in China and other Asian countries as it has been in the West.

There are a number of cultural differences that have played a strong role in redefining Starbucks' Asian strategy: (a) Asia is traditionally a continent known for having a tea-drinking culture rather than a

[16] Information for this case study is abstracted from *The New York Times* (2005a), *Seattle Post-Intelligencer* (2005) and *The Economist* (2007a).

coffee-drinking culture; (b) Asians tend to view coffee or tea shops as a place to socialize; and (c) Asians tend to eat while drinking.

Starbucks is a coffee shop and, for the most part, keeps its tea menu to a minimum. However, after entering the Chinese market, the company discovered that many customers, while enjoying the Starbucks atmosphere, preferred a cup of tea to a cup of coffee. The company, therefore, was forced to expand its standardized menu to include a wider variety of tea.

In the West, Starbucks' revenue is driven by the speed and frequency of its transactions. Customers tend to grab their coffee and a quick pastry before scurrying out the door to their next appointment. However, coffee or tea is more of a social event than a daily necessity in the East. Customers come to meet and chat with their friends and thus Asian customers spend more time in the stores, on average, than their Western counterparts. Starbucks has had to increase the size of its stores to an average of 2,000 square feet (185.806 m^2) to accommodate all of the dalliers.

Another change came due to the company's realization that Asians tend to eat and drink simultaneously. Starbucks was forced to expand its menu once again to include more food. For example, Starbucks catered to local tastes by providing snacks such as mooncakes. Although Starbucks has made numerous efforts to adjust its formula to suit the Chinese market, the efforts may not be enough.

On July 13, 2007, Starbucks was forced to close the doors of its branch in the Forbidden City in Beijing, China. It was argued that the image of the coffee shop "trampled over Chinese culture" and the outlet was described as "a symbol of low-end US food culture." As a result, Starbucks may have to rethink its branding and marketing strategy if it wishes to be fully accepted by China. Traditionally, Starbucks has relied upon a differentiation focus strategy. However, with its problems in China, the company may have to move to a broad differentiation strategy in order to please Chinese customers — for instance, by including more Chinese menus and so enlarging its competitive scope — as shown in Fig. 11.

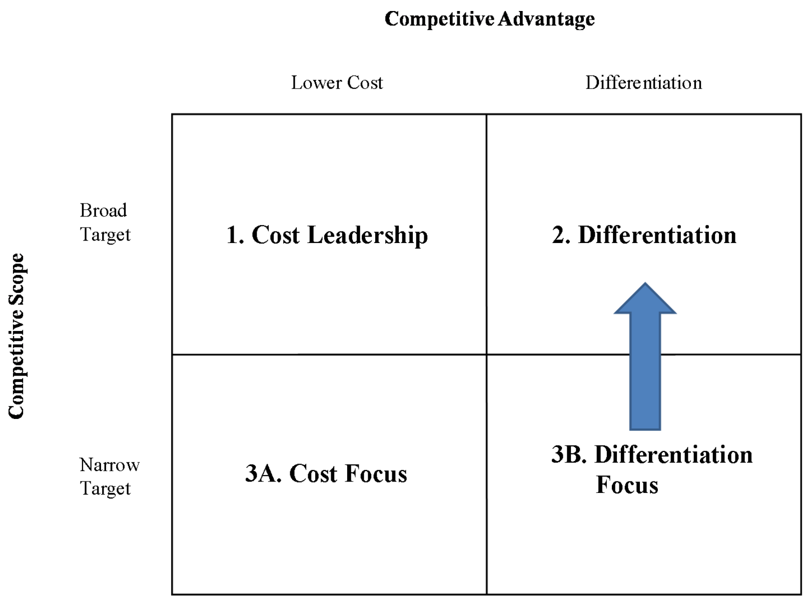

Fig. 11. Starbucks' strategy shift.

Discussion Questions

1. Why are the ideas of competitiveness and productivity so often confused? What do competitiveness and productivity mean to you? Are they entirely different or interchangeable?
2. Do you agree that there is a need to differentiate among product, firm, industry and nation when applying frameworks or models of competitiveness?
3. Are there any weaknesses in the five-forces model? Would you add, subtract or alter it in any way in order to improve it?
4. What do you think of the terminology used in the three generic strategies? Is it clear? How would you improve the three generic strategies?
5. Do you agree that being "stuck-in-the-middle" is always disadvantageous? Can you think of any examples where this is not so?

6. What do you think of the extension to the three generic strategies? Is the extension effective?
7. Do you agree with the division of the value chain into primary and support activities? Can you think of any other activities that are omitted?