A STUDY ON COMPARATIVE ANALYSIS OF RED OCEAN OF MICROSOFT AND BLUE OCEAN OF GOOGLE PRODUCTS STRATEGY AND ITS RISK FACTORS: AN BLUE OCEAN VS RED OCEAN MODEL

Deepika[1] and Srinivasan J[2],
[1] & [2]Assistant Professor of Commerce,
Sri Krishna Arts and Science College,
Coimbatore.

ABSTRACT

Between the 1st and the 2nd calendar quarters of 2007 Google's (GOOG) sales increased from $3.664 to $3.872 billion. That's nearly 6%. In the same period Microsoft's (MSFT) sales decreased from $14.398 to $13.371 billion. That's a decline of over 7%. And it's the only time in the last ten quarters that MSFT experienced a March to June quarterly decline in revenues.

From March 30 to October 19, 2007 Google's market cap increased over 42% from $142.2 to $201.2 billion. In that same period Microsoft's market cap increased just a bit over 8% from $261.4 to $283.0 billion.

It's a common expectation that when one company's revenues increase at the same time as a rival's revenue declines, both stock prices will be affected. This is an expectation one could easily forget while tracking the valuation measures currently reported in popular financial services like Yahoo! (YHOO).

The Blue Ocean Strategy (BOS) framework promoted by them challenges and displays the ways in which an organisation can achieve the conventional trade-off amongst differentiation and low-cost. When it comes to building a blue ocean, what organisation wouldn't want to have an offering like Google's Search division? Its search engine is easy, fast, accurate – with an underlying algorithm that instantaneously sorts and ranks documents, images, and videos, making people more productive in finding information than most ever imagined. With nearly 65 percent of world market share, Google created a veritable blue ocean. Then there's Google Glass. Announced to the public in 2012, it was selected by Time Magazine as one of the "Best Inventions of the Year". With this revolutionary digital eyewear, Google intended to create a new mass market for wearable computers. However, the initial excitement soon gave way to disappointment.

This progress has resulted in intensified competition generating a need for organizations to distinguish themselves and create value for customers. The purpose of this paper, hence, is using Blue Ocean Strategy Framework for the analysis of the ways in which value innovation has been exercised by various players of the google product market to create a competitive advantage (CA) for themselves and be the front-runner.

Keywords: Blue Ocean, Red Ocean, Risk Factors, Google Products

INTRODUCTION

Blue Ocean Strategy can be applied across sectors or businesses. It is not limited to just one business. But, let's first understand what is Blue Ocean and how it is different from Red Ocean.

In today's environment most firms operate under intense competition and try to do everything to gain market share. When the product comes under pricing pressure there is always a possibility that a firm's operations could well come under threat. This situation usually comes when the business is operating in a saturated market, also known as 'Red Ocean'.

When there is limited room to grow, businesses try and look for verticals or avenues of finding new business where they can enjoy uncontested market share or 'Blue Ocean'. A blue ocean exists when there is potential for higher profits, as there is now competition or irrelevant competition.

The strategy aims to capture new demand, and to make competition irrelevant by introducing a product with superior features. It helps the company in make huge profits as the product can be priced a little steep because of its unique feature.

REVIEW OF LITERATURE

Value creation, according to Peteraf and Barney (2003), means the ability to create additional economic value in the product market as compared to its marginal competitor. Value creation is defined as having a fair accomplishment in the future by Porter (1985); Ghemawat, (1999); Barney and Hesterly, (2006). According to Payne et al., (2008), customers are proactive cocreators of value and companies are facilitators of value creation. Christensen (1997) and Hamel (2000) give the notion of customer value creation through fusion of capacity and business models, which also helps creation of wealth for investors. They perceive that competition is present between competing innovative regimes rather than amongst products or services.

Value innovation encircles all the activities of the company, bringing the entire system forward in terms of value for the customers and the company. As suggested by Kim and Mauborgne, (2005), Value innovation forms the base for Blue Ocean Strategy (BOS). It concurrently pursues low-cost and differentiation to enhance the value, create fresh demand and create an uncontested market space. Value innovation is the theme of Sustainable Competitive Edge (SCA); it goes beyond product or service innovation.

Blue Ocean Strategy (BOS) is defined, by Kim and Mauborgne (2005), as a creative strive where the competitors explore, create and procure novel markets, rather than competing with one another enduring in the same market, by catering to new demands through the effective use of value innovation. BOS provides an outline and tool-set for discovering new

markets within the traditional market by altering the nature of competition. This requires tools like Strategy Canvas, Value-curve, ERRC Grid (Eliminate-Reduce-Raise-Create).

RESEARCH GAP

Blue Ocean Strategy in B2B Sector which proves that Blue Ocean Strategy is viable in B2B. Apart from these, there are various other studies done, on similar lines and objectives, in emerging markets, implications on economic policy, in strategic management. But there are only a few studies done in area of Google Products and Microsoft Risk. A research done by Hee-Chan Song depicts the analysis of global Google Products market and it also studies the strategies of its main players. Another specific study has been done by Ian Brook on Apple's Blue Ocean Strategy. As stated in the literature review not many studies have been conducted in the Google Products market with respect to the BOS, hence in this study authors are using the BOS Framework in order to analyse how various players in the Google Products market have adopted the concept of value innovation to stand out in the marketplace.

BACKGROUND OF THE STUDY

This is the 4th in my series of posts on the competition between a blue-ocean superstar (Google) and its red-ocean rival (Microsoft). This one, like the earlier posts in the series, was inspired by *Blue Ocean Strategy*, the book by Professors Kim and Mauborgne of the <u>INSEAD</u> business school in Fontainebleau, France.

The 1st post in this series was "<u>Microsoft's $154 Billion Question: Optimizing Red Ocean Expenses</u>." In it I mapped enterprise marketing expenses onto the sources of intangible market value and introduced a simple measure of how shareholders know if they're are getting their money's worth from "red ocean" spending.

In the 2nd post on "<u>Microsoft vs. Google: The Battle for Your Network</u>" I argued that however appealing blue oceans may be, nearly every company ends up in a sea of red ocean expenses. At that point the most compelling question is how to manage expenses in this environment. Theoretically, the best way to do this is to "optimize" these costs. The 3rd post in the series was "<u>Google vs. Microsoft: Blue vs. Red Ocean Earnings Productivity</u>." That one addressed a larger question: are there significant differences between the earnings productivity of "Blue Ocean" compared with "Red Ocean" companies?

OBJECTIVE OF THE STUDY

$\Rightarrow$ To know the stakeholder of google products strategy in the market
$\Rightarrow$ To understand about the blue ocean and red ocean strategy of organization
$\Rightarrow$ To determine the risk adjust rate of Microsoft and google in BOS and ROS.

RESEARCH METHODOLOGY

The Study is fully based on Secondary data from various of magazines and website. However the researcher used expletory methodology to conduct the survey for collecting the data.

ANALYSIS AND INTERPRETATION

Here is a surprisingly simple transformation of commonplace financial accounting data into a metric that captures the competitive interactions between the separate, but equally important, markets for customers and capital. I call it the risk-adjusted (value-sales) differential: RAD (with a long "A") for short. It's what you need to cross the blue-ocean, red-ocean divide.

	1 SOV	2 SOR	3 VSD	4 RAD
Mar-05	14.0	11.6	2.4	0.5
Jun-05	21.7	12.0	9.7	2.0
Sep-05	26.0	13.9	12.1	2.5
Dec-05	31.4	14.0	17.4	3.6
Mar-06	29.6	17.1	12.5	2.6
Jun-06	31.8	17.2	14.6	3.0
Sep-06	30.5	19.9	10.6	2.2
Dec-06	37.8	20.4	17.4	3.6
Mar-07	35.2	20.3	14.9	3.1
Jun-07*	41.6	22.5	19.1	3.9
*SOV 10.19.07	Enterprise Risk		4.9	

Column 1 in this table shows Google's share of value [SOV] based on the closing price of its stock at the end of each quarter, from March 2005 through the close of trading on October 19, 2007. Column 2 shows the company's share of revenue [SOR] from March 2005 through June 2007. Quarterly value-sales differentials [VSD = SOV-SOR] appear in column 3. Enterprise Risk, the standard deviation in Google's VSDs, was 4.9. Risk-adjusted differentials in column 4 equal VSD/Risk. These ranged from a low of 0.5 in March 2005 to a high of 3.9 last Friday (using June 2007 revenue numbers for both companies). When Microsoft files its latest

quarterly report with the SEC on October 25 I'll update the revenue numbers for both companies.

CROSSING THE DIVIDE

From a technical point of view, applying the RAD metric to a company produces a standard normal variable (mean zero and standard deviation one). Practically speaking, RAD captures the competitive interactions between sales revenue and market value.

In the following chart, risk-adjusted differentials are on the vertical axis ranging from +5 to -5. The 95% confidence limits within this range are marked by the dotted lines at +2 and -2 RADs. Ten quarters, marked by their month's end, appear on the horizontal axis.

With only two companies, risk-adjusted differentials always will be mirror images of each other. Notice that with the exception of March 2005, all of Google's differentials are greater than +2.0, meaning they are statistically significant at a 95% confidence level. Besides the March quarter all of Microsoft's differentials are less than -2.0 at the same confidence level.
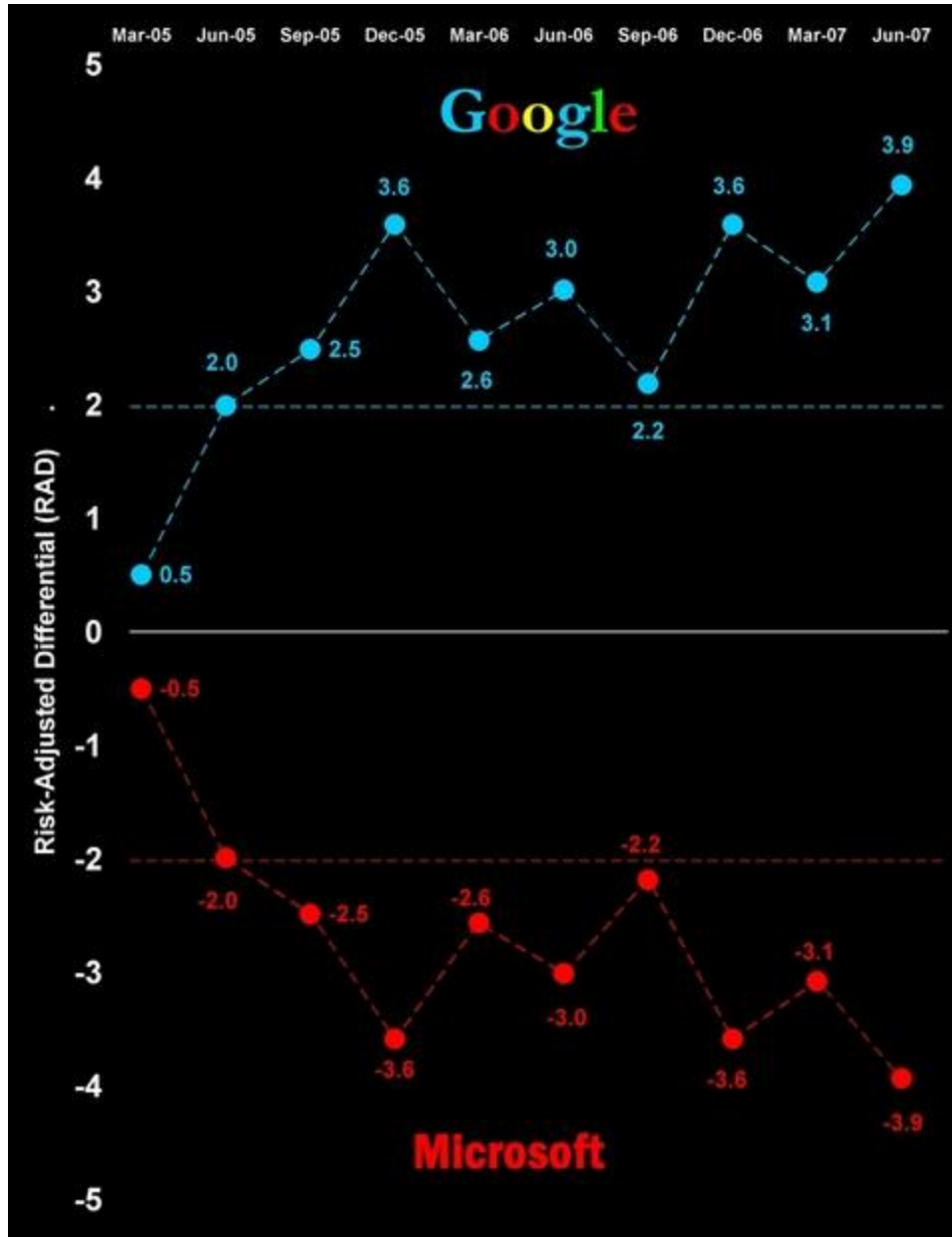
The meaning of this chart is simple, yet powerful. In the last nine of the ten quarters since Google went public, investors rewarded management with a significant value premium over and above its market power.The company captured only 22% of combined revenues, but created 42% of combined value. Of course, it follows that investors punished Microsoft by discounting its value relative to its market power. The company captured 78% of sales revenues, but created only 58% of shareholder value. In the long run, this is how free markets deal with monopolists.

ON THE OTHER SIDE OF THE DIVIDE

The best part of this story is what you see on the other side of the blue-ocean, red-ocean divide ... when both capital and customer markets are firing on all twelve cylinders.

The two axes on the following chart combine Google's earnings productivity (from my last post) with its risk-adjusted differentials. Risk-adjusted differentials [RAD] are calibrated on the left-hand blue axis from 0.0 to +4.5. Relative earnings productivity [REP with a short "E"] is calibrated on the right-hand green axis from 0% to -35%. REP is the ratio of actual to maximum potential earnings scaled to equal zero when they are equal.
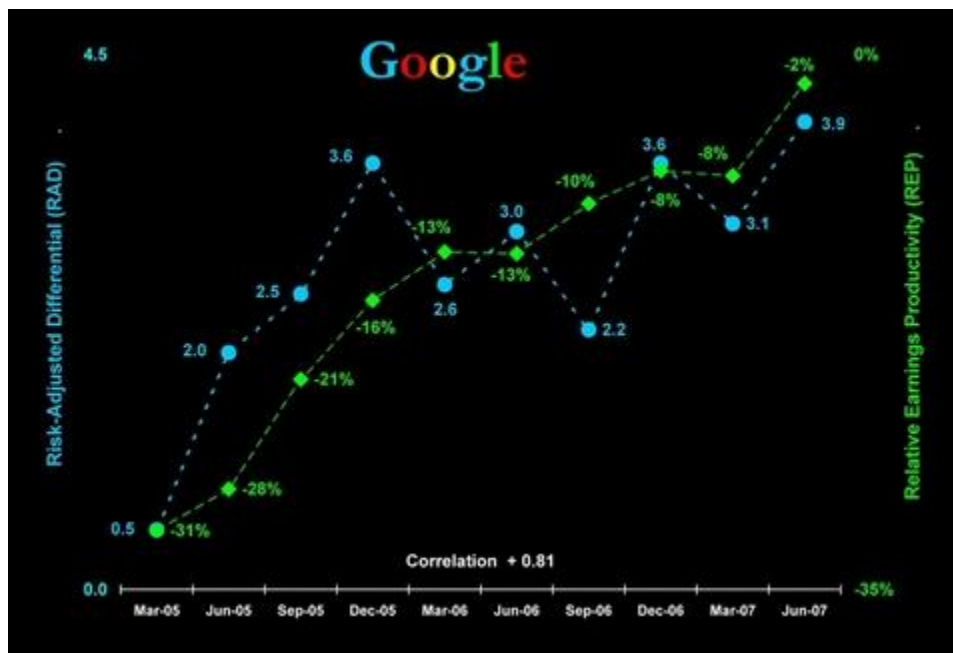
In the 1st quarter of 2005 Google's actual earnings [EBITDA] fell short of its theoretical maximum by 31%. Theoretical maximum earnings are the point at which outgoing costs equal incoming profits, at the margin. Over the next nine quarters Google management guided the company systematically in the direction of greater relative earnings productivity. By June of 2007 the difference between actual and maximum earnings was just 2%. Over the same period, Google's risk-adjusted differential increased more or less systematically from +0.5 to +3.9 points. The correlation between the two is +0.81.

By now you may be wondering what Microsoft looks like on the other side of the divide. The next chart tells its story using the same language. And it's not a pretty picture.
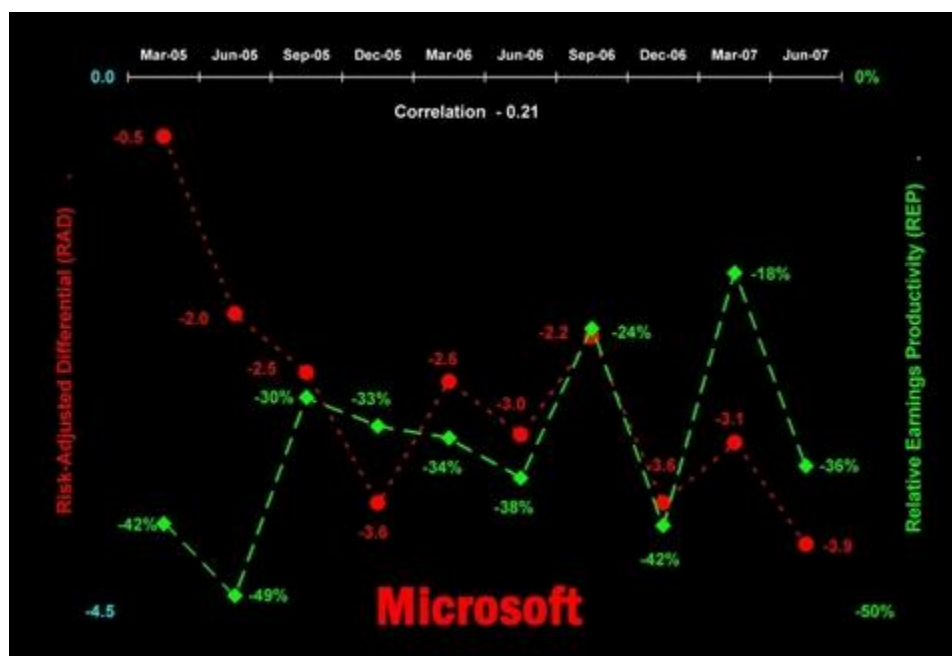
Microsoft's risk-adjusted differentials are the mirror image of Google's. But the company's relative earnings productivity is dramatically different. In March 2005 Microsoft's actual earnings after all expenses fell 42% short of its theoretical maximum. And the pattern didn't improve much over the next nine quarters. Microsoft's relative earnings productivity followed a zigzag path reaching a high of -18% in March 2007 and closing the last quarter at -36%. The correlation between Microsoft's risk-adjusted differentials and relative earnings productivity is -0.21. Beginning in March 2006 the two more or less move in step.

WHY DO THESE METRICS MOVE TOGETHER?

My RAD and REP metrics are not currently used by investors to value a company's stock. So why do they move together? Can it be that these metrics capture underlying, but otherwise unobservable and mysterious, market behavior? Or is it simply that Google, on the blue-ocean side of the divide in this market, is in the driver's seat? Motivating investors' performance expectations on revenues, earnings and market value to follow its lead in the competition with Microsoft, on the red-ocean side of the divide?

Whatever the reasons, I believe these metrics pull back the curtain on market mysteries enough to consult them in forecasting stock prices. To find out how to do just that, stay tuned to this station. Next week, after Microsoft releases its September quarterly report (providing a full deck of fresh, concurrent information on both companies) I'll forecast their closing stock prices on Monday December 31, 2008.

DISCUSSION AND SUGGESTIONS

Red Ocean Strategy Focus on current customers	Blue Ocean Strategy Focus on noncustomers
• Compete in existing markets	• Create uncontested markets to serve
• Beat the competition	• Make the competition irrelevant
• Exploit existing demand	• Create and capture new demand
• Make the value-cost trade-off	• Break the value-cost trade-off
• Align the whole system of a firm's activities with its strategic choice of differentiation <u>OR</u> low cost	• Align the whole system of a firm's activities in pursuit of differentiation <u>AND</u> low cost

Focus on current customers vs. focus on noncustomers. In most industries there is little effort to attract new buyers to the industry, thus the focus on the customers currently purchasing in that industry. In the Blue Ocean, there is a focus on trying to increase the size of the industry by attracting people who have never purchased in that industry.

Compete in existing markets vs. Create uncontested markets to serve. Sounds good, right? But how do you do that? Existing markets are all the customers doing business in the industry right now, whether they are doing business with you or your competitors. If someone wins a customer, then it is assumed, someone will lose a customer. For someone to win, someone must lose.

In uncontested markets, there is only a winner, you. No one else is fighting for the business because either they don't know about it, or they don't know how. They will try, of course, but if you have done things the Blue Ocean Strategy way, they will not be successful for a very long time. Take Cirque du Soleil, for example. I read where there have been about 150 companies trying to compete with them, everyone went out of business. And after [yellowtail] wine came out, many wineries tried putting an animal on their label. None of them had the same success.

Beat the competition vs. Make the competition irrelevant. The competition becomes irrelevant because they cannot duplicate the ideas in a way that is a commercial success. Remember, the whole idea of Blue Ocean Strategy is to have high value at low cost. If you are doing that, how can anyone compete with you? All the would-be competitors fall by the wayside.

Exploit existing demand vs. create and capture new demand. You will be creating value so high that you will be attracting customers that never before would have considered

entering the market. Nintendo's Wii appeals to families and seniors. [yellowtail] attracted beer drinkers, Southwest Airlines appealed to auto travelers.

Make the value-cost tradeoff vs. break the value cost tradeoff. If you cut your strategy teeth on Michael Porter's Competitive Strategy concepts, as I did, you understand that there were only two strategies to chose from, value or low cost. It was understood that you could not have both value and low cost. Kim and Mauborgne have broken that concept and said that you can have high value and low cost and developed the tools to do it. In fact, if you don't break the value cost tradeoff, competitors will easily duplicate what you are doing and the ocean will once again be very red.

Align the organization with differentiation OR low cost vs. aligning the organization with differentiation AND low cost. You can't just say you are going to have differentiation and low cost. You must search every nook and cranny of your processes and organization to strip away unnecessary cost. The entire organization must be aligned this way…anything that doesn't create or contribute to value, gets eliminated or reduced. It is just the most efficient way to run an organization whether in a blue or red ocean.

CONCLUSION

In conclusion, this paper has dealt with definitions and characteristics of Red Oceans of Microsoft and Blue Oceans of Google Strategy. Moreover, the impacts of the shift from Red Oceans to Blue Oceans have been clarified. In fact, Blue Ocean strategy cannot be avoided in modern business. When Red Ocean becomes too crowded, the need of creating a Blue Ocean strategy will increase. Blue Ocean is a dynamic process that helps companies to create, and capture their own business. Moreover, Blue Ocean supports companies to generate new Blue Ocean when new competitors come into their Blue Ocean. This strategy on one hand minimizes and eliminates old value offerings while on the other hand creates and increases new value innovation. Once a company has succeeded in creating a Blue Ocean, it needs to keeps a distance as far as possible from competitors. However, if their field is invaded, they should find other Blue Ocean to invest in. Blue Ocean maintains a company's competitive advantage, helps it gain substantial market share and customers, and accounts for a disproportion contribution to future profit.

REFERENCES

❖ Wubben, E. F., Düsseldorf, S., & Batterink, M. H. (2012). Finding uncontested markets for European fruit and vegetables through applying the Blue Ocean Strategy. *British Food Journal*, *114*(2), 248-271.

❖ Kim, C., Yang, K. H., & Kim, J. (2008). A strategy for third-party logistics systems: A case analysis using the blue ocean strategy. *Omega*, *36*(4), 522-534.

❖ Leavy, B. (2005). Value pioneering–how to discover your own "blue ocean": interview with W. Chan Kim and Renee Mauborgne. *Strategy & Leadership*, *33*(6), 13-20.

❖ TN, S. K. (2008). Blue ocean strategy: how to create uncontested market space and make the competition irrelevant. *South Asian Journal of Management*, *15*(2), 121.

❖ Fabricius, K. K., & Alderslade, P. P. (2001). *Soft corals and sea fans: a comprehensive guide to the tropical shallow water genera of the central-west Pacific, the Indian Ocean and the Red Sea*. Australian Institute of Marine Science (AIMS).