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STRATEGY

Blue Ocean vs. Five Forces

by Andrew Burke, André van Stel, and Roy Thurik

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Competition eventually erodes the profits from innovation. But that's a slow process, requiring 15 years or so.

Are you a five-forces disciple or a blue-ocean enthusiast? That is, do you try to dominate existing markets or look for opportunities to create new ones? Both approaches to strategy have their devotees, but to the best of our knowledge, no one before now has conducted an empirical study comparing the two camps.

So we did. For our research framework, we used a model that dates back to a seminal 1921 economics paper by Harold Hotelling. It posits that as long as there are profits to be had in a particular market, more and more vendors will arrive to serve that market until it reaches a saturation point, where everyone more or less breaks even.

Looking at entire industries in this way allows you to tell over time whether an innovation strategy or a competitive strategy is best. Of course, the blue-ocean approach to this model would call for creating a new market. If that attracted consumers over the long term, industry profits and the number of vendors would both steadily increase—and you could conclude that companies succeed by staking out new markets. If, however, firm profitability went down as the number of firms went up, you'd know that the scope of new opportunities was limited or that the barriers to following the trailblazer were very low. Either way in that scenario, companies focused on competition would outperform those setting their sights on blue oceans.

We tested the model on Dutch retailing. (Although one study doesn't constitute proof, this industry provides a good lab because it has shown signs of being both highly competitive and markedly innovative over the past two decades.) Its frequent new-brand introductions and widespread use of differentiation strategies have led to increased market segmentation, deeper and broader markets, and the rejuvenation of "tired" sectors such as hardware stores.

We looked at profits and numbers of vendors for 41 shop types over a 19-year period (1982–2000). In 2000 these shop types accounted for some 83% of all Dutch retail stores and about 90% of the industry's revenue and employment. We were surprised to find evidence that blue-ocean strategy is sustainable. In more than half the shop types, average firm profits and the number of firms were positively related. And more important, after controlling for extraneous factors such as business-cycle effects, we discovered across all types that average firm profitability and the number of vendors rose and fell together over the period.

Of course, it would be foolish to dismiss competitive strategy altogether. Our research shows that competition eventually erodes the profits from innovation. But that's a slow process, requiring 15 years or so, which suggests that it takes the better part of a generation for the blue-ocean approach to yield to competitive strategy.

All this indicates that businesses may want to consider a blend of the two approaches. For instance, by slowing down profit erosion with an effective competitive strategy for an existing market, they can increase the funds available for blue-ocean investments and thus their chances of finding an untapped market with plenty of consumers.

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