LG Electronics: The Blue Ocean Strategy

Teaching Note Reference No.BOS0010A-**1**

This teaching note was written by Pinal Shah and Vara Vasanthi under the direction of Amy Sonpal, Icfai Business School Research Centre, Ahmedabad. It is only an illustrative orchestration of this case study. It is never meant to limit the learning outcomes.

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Teaching Note

Prerequisite Conceptual Understanding

- To understand the localisation strategies adopted by LG – Esfahani Elizabeth, "Thinking Locally, Succeeding Globally", http://money.cnn.com/magazines/business2/business2_archive/2005/12/01/8364622/index.htm, December 1st 2005
- To understand the concept of Blue Ocean Strategy – Kim Chan W. and Mauborgne Renee, "Blue Ocean Strategy", *Harvard Business Review*, October 2004 [Ref No. R0410D]
- To understand the limitations and sustainability of the Blue Ocean Strategy – Kim Chan W. and Mauborgne Renee, "Blue Ocean Strategy: How to Create Uncontested Market Space and Make the Competition Irrelevant", *Harvard Business School Press*, 2005
- To understand the strategies LG is trying to adopt to become a global electronics brand – Ihlwan Moon et al., "Korea's LG: The Next Samsung?", http://www.businessweek.com/technology/content/jan2005/tc20050113_3581_tc024.htm, January 13th 2005
- "Evolution of South Korean giants: Chaebols", http://www.venturerepublic.com/resources/Evolution_of_South_Koreas_giants_Chaebols.asp

Synopsis of Case study

The case is targeted at management students pursuing courses in strategic management and international business management. The case describes the concept of globalisation, innovation and localisation as tool for gaining competitive advantage. It also highlights the importance of the political factors for the growth of a business enterprise. This case talks about the strategies adopted by LGE for better performance and profitability. LGE, a leading consumer electronics company plans to reach its vision of becoming one of the top three global electronics players in the consumer electronics market by 2010. The company was promoting a new strategy, which focused on high tech innovations to tap the uncontested market and make competition irrelevant under its new strategy called Blue Ocean Strategy. The new strategy, which was announced in mid-2006, was implemented from January 1st 2007. The case highlights the concept and implementation of the Blue Ocean Strategy and how it can be used as a tool for creating new markets. The case facilitates the discussion on the challenges and sustainability of the Blue Ocean Strategy to achieve LGE's vision.

Teaching Objectives

- Growth of industrialisation in South Korea and growth of the Chaebols
- LG's diversification and expansion strategy
- Blue Ocean Strategy and its applicability for LGE
- Challenges of Blue Ocean Strategy

Assignment Questions

I. **List down all the parameters that you would be considering, if you were to start a business enterprise (manufacturing, distribution and selling) in any country?**
II. **"We will pursue a 'Blue Ocean Strategy', which is to move away from ordinary products to create genuine differentiation."[1] Why and in what way has LG put the Blue Ocean Management campaign into practice?**
III. **"Creating Blue Oceans is not a static achievement but a dynamic process."[2] Based on your understanding of the 3rd prerequisite conceptual understandings explain how companies can sustain the Blue Ocean that they have created? What are the challenges that companies might face in trying to sustain the Blue Ocean Strategy?**

Teaching Plan

Both the structured assignment and teaching note follow the same sequential order as presented in the teaching Plan **[Annexure (TN)-I]**.

Case Analysis

I. **List down all the parameters that you would be considering, if you were to start a business enterprise (manufacturing, distribution and selling) in any country?**

With the advent of globalisation, the business scenario has become more competitive. Any business enterprise, small or big is affected by internal and external parameters for its activities. For any business start up, following are the parameters, which need to be considered:

External factors

1) Political factors like, political stability, taxation policies, foreign trade regulations, social welfare policies, trade policies, government leadership, government support like subsidy and other benefits
2) Environmental factors like, environmental protection laws, ecological issues, customer value, waste disposal and energy disposal
3) Socio-cultural factors like, population demographics, income distribution, social mobility, lifestyle changes, buying trends, ethnic diversity, consumerism and education Level
4) Technological factors like, technological up-gradation and adoption, government spending on research, new discoveries and development, speed of technology transfer, technology legislation, licensing, patents, rates of obsolescence, technical know-how and expertise
5) Economic factors like, business cycle, Gross Domestic Product (GDP), Gross National Product (GNP), interest rates, supply and demand, inflation, Consumer Price Index (CPI), disposable income and unemployment
6) Legal factors like, monopolies, restrictive practices, legislation, employment law, regulatory bodies, consumer protection laws, health and safety, product safety
7) Other factors like, location of business, location of market, infrastructure, available resources, distribution network, and competition

Internal factors

1) Financial factors like, liquid money, cash flow, balance sheet, assets and liability, cost structure

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[1] "K.W. Kim President of LG Electronics", http://www.ameinfo.com/78605.html
[2] Kim Chan W. and Mauborgne Renee, "Conclusion: Sustainability and Renewal of Blue Ocean Strategy", (Book Chapter; excerpted from *Blue Ocean Strategy: How to Create Uncontested Market Space and Make the Competition Irrelevant* by Kim Chan W. and Mauborgne Renee) *Harvard Business School Press*, 2005

2) Stakeholders like employees, customers, shareholders, suppliers,
3) Other factors like, inventory, training and knowledge know-how of employees, etc.

Categorise the parameters that you have listed in the earlier response on the degree of their importance (mandatory, most important, preferable but not essential, can manage without it).

The importance of parameters affecting a business enterprise during its start up varies from industry to industry. **[Exhibit (TN)–I]** shows the importance of these parameters.

Exhibit (TN)–I
Categorising the Factors that Affect Business Start Ups

Factors	Mandatory	Most Important	Preferable but not essential	Can manage without it	Remarks
External Factors					
Political factors	✓				For most of the businesses in any industry, political factors will have the highest impact and are mandatory for a business to be successful
Environmental factors				✓	This factor may be important for chemical industry or textile industry.
Socio-cultural factors		✓			The socio-economic factors like consumer buying patterns, lifestyle changes, population shift and ethnic diversity are more important in the consumer oriented industries like retail, food, textiles, and dairy. This may not be essential for industries like engineering goods manufacturing. (socio-cultural factors have a significant impact for multinationals entering new markets.)
Technological factors			✓		For industries like food and beverage, this factor may not be the most important one but for other industries like software, engineering, automobiles, it is the most important factor. If the technology is not available it can be imported or outsourced.
Economic factors		✓			Economic factors specifically demand, supply and interest rate is the most important factor for any business in any country.
Legal factors	✓				As each business has to abide by the rules and regulations of the country, legal factors are very important for any business.
Internal Factors					
Financial factors	✓				For any business, either small or big, financial factors are mandatory
Stakeholders			✓		For initial startup of business when business has not grown, role of owner or proprietor is important rather than stakeholder.

Other factors				✓	Other factors like training and employees' know-how are necessary at the initial stage of growth of business.

(Note: these factors may differ from industry to industry, market to market, country to country)
Prepared by author/s

Based on the response to your earlier questions (Categorise the parameters that you have listed in the earlier response on the degree of their importance - mandatory, most important, preferable but not essential, can manage without it), analyse the influence of political environment on businesses.

Among all external factors, political factors are the most important for the effective operation of a business. In today's world multinational corporations are choosing their place of business by analysing closely, the political stability of the country. Some of the political factors like political stability, bureaucratic or democratic environment, developing or developed economy, association with other international bodies like G-7 group of countries, OECD countries, etc., affect the business operation.

For bureaucratic countries the policies and legal approaches are different. If, for example, only domestic companies are allowed to operate certain types of businesses, foreign companies will find it difficult to start businesses even though they have the capital to do so.

Political instability is another factor. A country is politically unstable if there is no rule of law against violence. In a country well established regulations can promote domestic industries and attract foreign companies. So through public policy, government can provide support to businesses. Therefore, developing and poor nations allow liberalisation in their countires to develop their industries and economy.

Apart from political factors, other factors also affect the business and its activity. Environmental factors like environmental protection laws affect the air conditioning and refrigeration industry, chemical industry, as well as casting, paint and automobile industries. Some of the laws like the clean air act, clean water act, the resource conservation and recovery act, the emergency planning and communist right-to-know act, the pollution prevention act, the toxic substance control act could affect business enterprises. The business has to follow the compliances given by governance bodies like Environmental Protection Agency which announces such laws and also monitors their implementation.

For food and drinks industry, the socio-cultural factors affect the most. For example, food preferences of one particular region may not be the same as in other regions. Further, companies eyeing to start their enterprise in India are more focused on vegetarian food as compared to other nations where non-vegetarian food is more in demand. Companies have to produce their products according to the income group of the country or region. In addition to this, lifestyle changes, ethnic diversity also change region wise and/or country wise.

Technological factors are most important for almost all industries. With digitisation and technological up-gradation taking place, old technology becomes obsolete and newer technology takes its place. So before leveraging resources on any new technology, a company should decide some of the parameters of new technologies. For example, the rate of obsolesce of new technologies and the frequent up gradation of the technology affect the productivity and efficiency of the organisation. It also increases training expenses for the company. The automobiles, electronics, and software industries are witnesses to such technological factors. In automobile industry, vehicles earlier ran on either petrol or diesel, but with development of technology, vehicles started running on gas and bio fuels.

In addition to these technological factors, economic factors are also important for business start-ups. For any industry player, loans and external borrowing rate is most important, which varies from one country to another. Other economic factors that affect the business are tax system, sophistication of financial market –

the ease with which capital can be moved or raised, price of the commodity like oil, energy, metals, monetary and fiscal policies like interest rates, tax regimes, government aid, internal regulation, bureaucratic or democratic government and exchange rates.

Legal factors like employment law and consumer protection law can also affect the start-up of a company. Employment laws, like how many people a business employs the number of employees in each location, the minimum number of employees specified in the employment law etc. Consumer protection law protects consumers from fraudulent or unethical business practices, misleading advertisements, and defective products. So, these are some of the laws that businesses must abide before starting a venture.

The scenario raises the following question,

Discuss the importance of favorable government policies to build industrial competitiveness in a country.

Depending on the nature and type of economy, governments of the countries play a major role in developing the competitiveness of the industries. In the free market economy, government does not play a major role compared to the developing economies.

Many factors are responsible for building industrial competitiveness like technological advancement, research and development (R&D), export policies, labor laws, infrastructure of the country, GDP, and employment rate. These factors are affected by the policies governing them, which are decided by the government. Thus, government plays a major role in building the industrial competitiveness of a country. For example, the R&D tax credits given by the government to the companies help in lowering the cost of capital and the risk of R&D investments.

Export oriented policies encourage companies to set up special organisations for export purpose. These organisations are made competitive with subsidies and support by the government. In China, software export enjoys credit support with preferential interest from Import and Export Bank of China.[3]

The discussion raises the following question,

"As financial institutions (especially banks) were under quasi-government control, the government was able to have these banks loan huge amounts of money to these chaebols. Such a favorable government policy resulted in many businessmen starting industries which later morphed into conglomerates or chaebols."[4] From your understanding of the 5th prerequisite conceptual understanding, analyse the role of the Korean government's policies in the creation of chaebols and their impact on the Korean economy.

South Korea, (the republic of Korea), got independence in 1945 from Japanese rule. In the initial years of its independence it was mainly dependent on agriculture. This situation changed under the leadership of the new president Park Chung Hee and the development of South Korea began. With the first five-year plan in 1961, the government created state capitalism[5] and free market economy under which government protected and supported large family businesses called Chaebols. Chaebols were large conglomerates and had strong tie ups with the South Korean government. Under the new rule, the government also created a policy to promote exports. This policy encouraged the inflow of foreign capital to fund export oriented

[3] Minghua Du, "China improves environment for the software export", http://english.people.com.cn/english/200103/27/eng20010327_66138.html, March 27th 2001

[4] "Evolution of South Korean giants: Chaebols", http://www.venturerepublic.com/resources/Evolution_of_South_Koreas_giants_Chaebols.asp

[5] The term "State Capitalism" is frequently used in two different ways: first, as an economic form in which the state performs the role of the capitalist employer, exploiting the workers in the interest of the state.

economic policies. To promote exports, it provided short-term export financing, allowed tariff rebates on materials, and simplified customs procedures. In 1970, with the focus on heavy and chemical industry the country developed successful undertakings in electronics, shipbuilding, and other fields with huge investments from chaebols. As a result, chaebols accumulated excessive debt in the process.

To facilitate Chaebols, the financial institutions especially banks due to quasi-government control[6] were able to give huge amount of loans to these chaebols at low interest rate. The government favored these chaebols by a guaranteed repayment to their foreign creditors and additional funds were also available from domestic banks.[7] In addition to the financial help, government also promoted risk-taking initiatives, provided protection to its domestic markets by allowing limited foreign players. Such restructuring of the economy of South Korea had a major role in the growth of the Chaebols. In 1987, the top ten chaebols represented 40% of all bank credit in South Korea, 30% of value added in manufacturing and approximately 66% of the value of all South Korean exports. The five largest chaebols employed 8.5% of the manufacturing work force and produced 22.3% of all manufacturing shipments in 1987.[8] The success of the chaebols and the success of South Korea's industrialisation were intertwined. In the same period of 1980 to 1990, the Real GNP of South Korea was averaged to 10.5% annually.[9] The trade surplus began in 1986 and the amount of current account surplus reached to $14.2 billion in 1988.[10] In that period, the economy generated about 2.8 million new jobs[11], and the unemployment rate sank to an unprecedented level of 2.5% in 1988.[12]

The story of the remarkable growth of South Korea's economy is the story of the growth of its chaebols. Such growth can be observed by the fact that "in 1953, after the South Korean Civil war, South Korea was one of the ten poorest countries of the world. While in 2003, South Korea was a member of the rich countries' club of the OECD (Organisation of Economic co-operation and Development) and had become a significant industrial power of the world."[13]

The discussion leads to the next question,

"The Korean electronics industry with active support from the government in the 1970s showed promising growth. Goldstar established large plants and secured a nationwide production base." [page 4, para 2 of the case study]. How did the Korean government's policies help LG transform itself from a chemical company in 1947 to an electronics giant in 1970s?

Lucky Goldstar (LG), initially a chemical company was established in 1947 as Lucky Chemical Industrial Corporation (LCIC – Currently LG Chemicals) in South Korea, it started its electronics division in 1958. It was renamed as LG Electronics Incorporation in 1975. During the phase of industrial growth, Korean government was very supportive towards domestic industries, particularly chaebols. Most of the major chaebols diversified their businesses, including LG, which diversified into electronics.

During the journey from Lucky Goldstar to LG Electronics, the company received support from government through various policies like export-oriented policy, R&D policy, technology import policy, and restrictive FDI policy. The various supportive government policies are as follows,

- **Aid from export oriented policy**

[6] Quasi government is a hybrid organisation that has been assigned by law, or by general practice, some of the legal characteristics of both the governmental and private sectors.
[7] Nemani Frederick, "MSc in Development Studies: Industrialization Strategies", http://www.irvl.net/S-Korea-2.html, December 1999
[8] Ibid
[9] "Korea's Economy", http://www.asianinfo.org/asianinfo/korea/economy.htm
[10] Ibid.
[11] "Korea's Economy", op. cit.
[12] Ibid
[13] Walsh John, "Korea: Rags to Riches story", http://www.suite101.com/article.cfm/east_asian_history/110734, September 2nd 2004

By early 1960s, LG had established the foundation for its two major sectors, the chemical and electronics businesses. The various government policies had catalysed Lucky Goldstar's growth as an electronics giant. In the initial phase of its growth, the government shaped the development strategy and adopted export-oriented policies in mature industries, such as food, textiles (in the 1960s), metal, shipbuilding, chemicals, and electronics (in the 1970s).

- **Economies of scale and cost advantage policy**

To bring about economies of scale and competition on the basis of cost advantage in mature industries, the government intentionally supported large capacity plants of the chaebols. LG, after gaining confidence in the initial electronic products, expanded its business by establishing its first plant in Oncheong-dong area which was built to manufacture large quantity of radios, telephones, and fans, providing economies of scale to the company. With Kumi plant[14] as a start up in 1975, the company built large plants in Changwon and Kuro – and secured a nationwide production base. Such policies were focused towards investment driven growth rather than factory driven approach.[15]

- **Change in industrialisation policy**

South Korea witnessed a shift in its policies during 1980s when the focus of its industrial policy was on innovation driven industries. To build and develop comparative advantages in priority industries, technology acquisition was encouraged and domestic R&D was aggressively promoted by providing various tax incentives and preferential financing schemes (loans and subsidies) for R&D activities to entrepreneurs. With such encouragement LG had developed many products. The company was a pioneer in developing many products in South Korea, like electric fan, refrigerator, black and white and color television (TV), Video Cassette Recorder (VCR) etc.

- **FDI policy**

After the implementation of export oriented policy and R&D policy, FDI policy played a very important role in the growth of LG. FDI and foreign technology import policy was in contradiction in South Korea. Foreign technology imports were restricted in 1960s but later on restrictions were eased in 1970s to train their local engineers. While FDI, which was free in 1960s, tightened in 1970s. The government encouraged foreign loans but not FDI as it was cheaper compared to domestic loans.

Another reason for restricting FDI was that the government feared Japanese colonial rule. Due to these reasons, instead of encouraging FDI, the government promoted joint ventures of domestic companies with foreign players. In these joint ventures also various conditions were introduced. Competition with domestic companies, for example, was rarely allowed in domestic as well as international markets. Foreign participation was allowed with the restriction of equity partnership of below 50%. R&D initiatives helped all the major chaebols to maintain the flow of technology with leading foreign companies and to distribute R&D costs. With this aid, LG Electronics formed joint ventures with Alps Electronics of Japan, with Motorola to develop Application Specific Integrated Circuit Technology (ASIC), with Xerox for Power PC research, with Philips for video CDs and liquid display panels, and with Zenith for cable modem design and next-generation multimedia set-top box concepts.

LG being a chaebol was continuously supported by the government, which helped it survive and also grow into one of the major players in the industry. With such political help, LGE was able to establish itself as a

[14] The South Korean government had build Kumi National Industrial Complex as a collocation of electronics firms, where LG Electronics is one of the major hub companies.
[15] "Experience LG", http://ca.lge.com/en/experience/prfilm/prfilm.jsp

global electronics giant from a mere domestic chemical company within a span of three decades (from 1947 to 1977). Such diversification was only possible due to the Korean government's policies.

The discussion leads to the next question,
"Localization has been a key element of LG's successful global expansion, especially in non-U.S. markets."[16] From the 1st prerequisite conceptual understanding and from the facts given in the case, analyse the strategies adopted by LG to become a global electronics brand?

LG, the electronics giant is present in many foreign markets. It has faced many challenges in the foreign markets and used competitive strategies like localisation, building manufacturing facilities, branding and logistics to gain market share.

In its home country, Korea, it adopted the localisation approach. Kimchi, a popular dish in Korea, is made from fermented cabbage seasoned with garlic and chili. It is served with most meals in Korea, but when it's stored inside a normal refrigerator, its pungent odor taints nearby foods. In 1985, LG introduced the kimchi refrigerator, a product specifically designed to address the odor problem. Featuring a dedicated compartment that isolates smelly kimchi from other foods, the fridge gradually became very popular in Korea. This even inspired rivals such as Samsung to offer similar models. Kimchi refrigerators became a norm and were present in almost 65% of Korean homes. After countering competition, LG became the country's top-selling manufacturer.

LG implemented the same localisation approach in other foreign markets as well by understanding the idiosyncrasies of key local markets by opening research, manufacturing, and marketing facilities in those countries.

LG entered India in 1997, two years later than its rival Samsung, but was still able to capture the leadership position by adopting aggressive competitive strategies. LG initially launched a line of products targeting health conscious consumers. For example, it launched a television that reduced eyestrain. Such product differentiation helped the company build its brand image and market share in the early years of its operation in India. By 1999, it had set up local research and design facilities, manufacturing plants, and a network of service centers. India, with a population of more than 1 billion functioned like dozens of smaller regional markets. To meet the needs of Indian consumers, LG rolled out refrigerators with larger vegetable- and water-storage compartments, surge-resistant power supplies, and brightly colored exteriors that reflected local preferences. For example, red color for south Indian market and green color for north India markets. Some of LG's Indian microwaves had dark-colored interiors to hide spices' stains. In 1999, LG introduced a television for cricket fans with a built-in cricket videogame. One of its televisions was offered with extra loud sound after research showed that many Indians use their TVs to listen to music as well. All these strategies helped LG gain market dominance in India.

The localisation strategy was most effective in emerging markets where people are not very brand loyal. For example, in Iran, LG offers a microwave oven with a preset button for reheating shish kebabs, again one of the favorite dishes in the country. As a result, LG commands roughly 40% of the Iranian microwave market. LG's one more product for the same market, Primian refrigerator includes a special compartment for storing dates, the fruit, which is a Middle Eastern staple and spoils easily. LG has adopted the same approach in the world's largest consumer market, China. Here it faces competition from major international brands such as Haier. It is replicating its strategy of India, by establishing manufacturing, research and development to marketing facilities in China.

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[16] Esfahani Elizabeth, "Thinking Locally, Succeeding Globally", http://money.cnn.com/magazines/business2/business2_archive/2005/12/01/8364622/index.htm, December 1st 2005

Thus, across the globe, LG has adopted localisation as the main strategy for growth. Understanding the market had provided dominance in many of the emerging foreign markets. The above discussion leads to the growth strategy followed by LGE of creating uncontested market space and making competition irrelevant.

II. "We will pursue a 'Blue Ocean Strategy', which is to move away from ordinary products to create genuine differentiation."[17] Why and in what way has LG put the Blue Ocean Management campaign into practice?

LG, a global electronics player is present in many markets. It faces challenges to sustain and grow at a faster pace against tough competition from local and global players. It adopted competitive strategies like localisation and was successful in gaining dominance in many markets. But with increasing competition, LG needed to sustain its position and increase its profits across markets. The Blue Ocean Strategy provides a systematic approach to creating uncontested market space and making the competition irrelevant. With an aggressive aptitude, LG naturally chose to adopt the strategy to make the competition irrelevant.

The reasons behind LG adopting Blue Ocean Strategy are,

- To create untapped market space and higher profitable growth
- The company wanted to be among the top three in the consumer electronics market by 2010
- LGE plans to double its sales volume and profit by 2010 with 30% of its sales volume and 50% of its profits coming from Blue Ocean products that is the differentiated products which earned higher profits
- To consolidate its market leadership in fast growing segments of consumer electronics and mobile handset markets
- To redefine industry boundaries by focusing more on high-end products and entering new segments of emerging markets like China, India and Middle East and Africa and thereby creating uncontested market space.

After discussing the reasons behind LG implementing Blue Ocean Strategy, the scenario leads to the question what is Blue Ocean Strategy and what are the benefits of the strategy.

"LGE planned to double its sales volume, profit and shareholder benefit with 30% of its sales volume and 50% of its profit derived from blue ocean products." [page 2, para 5 of the case study] Based on the 2nd prerequisite conceptual understanding, discuss the concept of the Blue Ocean Strategy and the difference between Blue Ocean and Red Ocean. How can companies benefit by adopting the Blue Ocean Strategy?

W. Chan Kim and Renee Mauborgne studied over 150 companies. A strategic thinking behind the creation of new markets and industries was observed and named by the authors as the Blue Ocean Strategy.

"Blue ocean donate all the industries not in existence today –the unknown market space, untainted by competition. In Blue Ocean, demand is created rather than fought over. There is ample opportunity for growth that is both profitable and rapid. There are two ways to create blue oceans. In a few cases, companies can give rise to completely new industries, as eBay did with the online auction industry. But in most cases, a Blue Ccean is created from within a red ocean when a company alters all the boundaries of an existing industry." [18]

Red Oceans consist of all the industries in existence in the known market where industry boundaries are defined and accepted and the rules are known. In Red Oceans, companies try to beat their competitors for a greater share of the existing demand. The prospects for generating profits and growth are reduced as the

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[17] "K.W. Kim President of LG Electronics", http://www.ameinfo.com/78605.html

[18] Kim Chan W. and Mauborgne Renee, "Blue Ocean Strategy", *Harvard Business Review*, October 2004 [Ref No. R0410D]

market is overcrowded. Red oceans are also characterised with cut throat competition where products are commoditised.

Red Ocean and Blue Ocean strategies will differ fundamentally as the imperatives for Red Ocean and Blue Ocean Strategy is starkly different **[Exhibit (TN)–IV]**.

Exhibit (TN)–IV
Difference between Red Ocean and Blue Ocean Strategy

Red Ocean Strategy	Blue Ocean Strategy
Compete in existing market space.	Create uncontested market space.
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 *or* low cost.	Align the whole system of a firm's activities in pursuit of differentiation *and* low cost.

Source: Kim Chan W. and Mauborgne Renee, "Blue Ocean Strategy", *Harvard Business Review*, October 2004

Benefits from Blue Oceans

1. Blue Ocean Strategy is not easily imitable by the competition immediately. The Blue Ocean creators enjoy and reap the benefits of creating Blue Oceans over a long period of time.
2. The Blue Ocean creator earns the advantage of building brand image in the minds of consumers.
3. Another advantage is of generating innovative value for customers and reducing cost by producing in mass quantities. This in turn restricts imitation.

Thus, adopting the Blue Ocean Strategy gives the organisation evident advantages like brand recognition, economies of scale and the most important, capacity to earn higher profits through new markets.

Once the concepts of Blue Oceans and Red Oceans are clarified, the discussion can be steered towards the strategies adopted by LG in the Chinese and Indian markets.

"In China, there is no future competing in 'Red Ocean' markets, so we must focus on the 'Blue Ocean' segment and penetrate high-end sectors. As part of its (LGE's) new strategy, we had chosen China as one place where it (LGE) wants to create a "Blue Ocean" market." [page 10, para 4 of the case study]. With cut-throat competition in the Chinese market, would LG be able to create a Blue Ocean in China? Also discuss the strategies applied by LG under Blue Ocean management campaign to establish itself in the Indian market?

Since the open-door policy began in 1979, China had emerged as one of the fastest growing economies in the world. With a growth rate of nearly 20% annually[19], China is considered as the second largest

[19] "Chinese consumer electronics market ranks second worldwide", http://english.people.com.cn/200603/08/eng20060308_248972.html, March 8th 2006
[19] Ibid.

electronics market in the world after the US. Chinese electronics market was valued at $60 billion in 2004 and expected to reach $100 billion[20] by 2008. With cut-throat competition among many players in the market, the Chinese electronics market depicted all the characteristics of a Red Ocean.
LG aspired to be among the major players in the Chinese electronics market. Considering the prospects that China offered, LG entered China in 1997 and initially adopted a bipolar strategy.[21] But this strategy back-fired and it earned an image of a low cost appliance manufacturer. To improve its image, the company focused on high-end products, which were technically advanced. But with the Chinese electronics market becoming highly competitive, sustenance of market share itself was becoming difficult. It decided to implement the Blue Ocean Strategy in China.

Creating Blue Ocean in China

Looking at the low cost Chinese electronics market and after knowing the dynamics of the Chinese market, LG implemented the Blue Ocean Strategy through new product launches and focused on the high-end segment. With the vast potential of the mobile handset market, LG preferred to first launch its new GSM mobile phone, which was named as 'Chocolate'. The Chocolate series mobile phone was the first product of the Black Label Series mobile phones and was considered as the first Blue Ocean product. The mobile phones were equipped with all the latest features including a 1.3 mega pixel camera and an MP3 player. After its global launch in May 2006, 3.2 million units were sold in August 2006 and in January 2007; sales reached 8 million units with just a single model of Chocolate series mobile phone. The company later launched a new shine phone in the Black Label Series.

With the growth of 214% of LCD TV and shipment of 7.113 million[22] units' world wide in the first quarter of 2007, digital display division was second priority for LGE to focus on high-end products under Blue Ocean Strategy for Chinese market. In the LCD TV segment, the company developed a large screen TV to capture the high-end segment of the market. With localised production approach for the display market, LGE would be able to get economies of scale. With investment of KRW 1.4 trillion in 2006[23], LGE plans to increase research, development and design, which will drive the company's ambitions beyond its current Blue Ocean strategy.

Similarly in India, LG has become the dominant player in the electronics market.

After its first failed attempt in 1993, LGE re-entered the Indian market in 1997 as LG Electronics India Limited (LGEIL). When LGE re-entered it was perceived as one of the foreign giants trying to gain a small share of the Indian electronics Industry. LGE initially entered into a joint venture with some of the Indian companies as fully owned foreign subsidiaries were not allowed in the Indian market. Until complete foreign subsidiaries were allowed by the Indian government LGE operated as a trading company. Later, LGE adopted a localised approach and set up its manufacturing base in India.

Apart from localisation, marketing and advertising was also the company's priority to create brand awareness. Large distribution network and rural market penetration helped LGE gain higher market share. After exploring the Indian market it set up a production unit for its GSM mobile handsets to gain market share in mobile handsets' market. With the price sensitive Indian market, the company's next strategy was to concentrate on the high-end products under the Blue Ocean Strategy.

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[21] Under bipolar strategy, LG adopted two-sided strategy where it offered high products for the high-income people and low cost products for low-income people.
[22] "Quarterly Report of China LCD TV Market", http://www.researchinchina.com/report/ConsumerElectronics/5004.html, 2007
[23] Sangani Krish, "Big screen stars", http://www.iee.org/oncomms/sector/manufacturing/magazine.cfm?issueID=193&articleID=54389AA2-04BD-8511-C2524A615020C947

Creating Blue Ocean in India

For the Indian market, Blue Ocean Strategy was crafted to strengthen its capability and its competencies by improving its product portfolio and through innovative management processes. To improve its product portfolio, the company launched products targeting health conscious consumers under the brand name '*Intello*'[24]. The company was also looking forward to concentrating on high-end products like Whisen range of wall-mounted air-conditioners, TV Dios refrigerators and X-canvas plasma TVs.

To bring about an innovative management process in the company, entailed a complete realignment of the management to make the company more customer-centric as well as cost competitive. Under this strategy, the company has merged three categories of home appliances, namely, washing machine, vacuum cleaner and microwave, with its refrigerator business to form a new Kitchen Appliances Business Group. The company's intention was to focus on high-end products and retailing in the Indian market. The company also planned to leverage the success of its Chocolate series mobile phones in the Indian market. LGEIL planned to launch some of its innovative products like Qiblah phone[25], the TV refrigerator, the Swarovski Crystal refrigerator,[26] and the bag-less range of vacuum cleaners in India.

At the end of this discussion, the instructor could pose the following question,

To be among the top three players in consumer electronics industry by 2010, as a CEO of LGE, how would you achieve this vision by implementing the Blue Ocean Strategy?

The consumer electronics industry had witnessed a phenomenal growth over the past 10 years. This growth can be attributed to the confluence and merging of digital-based audio, video and information technology, and removing entry barriers across the markets. This has resulted in a greater demand for consumer electronic devices.

In this ever-changing electronics market, there is sufficient elbow space and window of opportunity for every company, which understands consumer needs and wants better and delivers the same through its products and services. This requires a new thought process to create a market for their products and services rather than competing in the over crowded and commoditised market. Such an unexplored market, which is also called as a Blue Ocean can be created with the help of the Blue Ocean Strategy.

For creating, Blue Ocean markets and products the following are the analytical tools:

Strategic Move
Strategic move refers to the various managerial actions and decisions involved in creating a market for a company. This is also the first requirement for implementing the Blue Ocean Strategy through strategic alliances, mergers and joint ventures. Through various strategic alliances LGE emerged as one of the leading consumer electronics companies with the most advanced technological know-how (refer to Exhibit V and VI of case study).

Strategic Canvas
Once the requirement of strategic move has been fulfilled, the second logical step is creating the strategic canvas. The strategic canvas could be best prepared by managers and executives of LGE for different divisions and markets. The parameters for drawing LGE's strategic canvas can be quality, pricing,

[24] Intello, signifying intelligent and futuristic technology
[25] Qiblah phone comes with embedded compass, direction indication and prayer time alarm, indicates the direction of Mecca to the users when they input their location in about 500 cities worldwide with Arabic-based user interface.
[26] Swarovski refrigerator featured a floral pattern embedded with Swarovski crystals. Swarovski is the brand name for precision cut lead crystal glass products produced by companies owned by Swarovski AG of Switzerland.

availability (location), spending on advertising, service provided, availability of products (waiting time), distribution, other product related services, other advanced product features (washing machine with features of drying), maintenance service and warranty period etc.

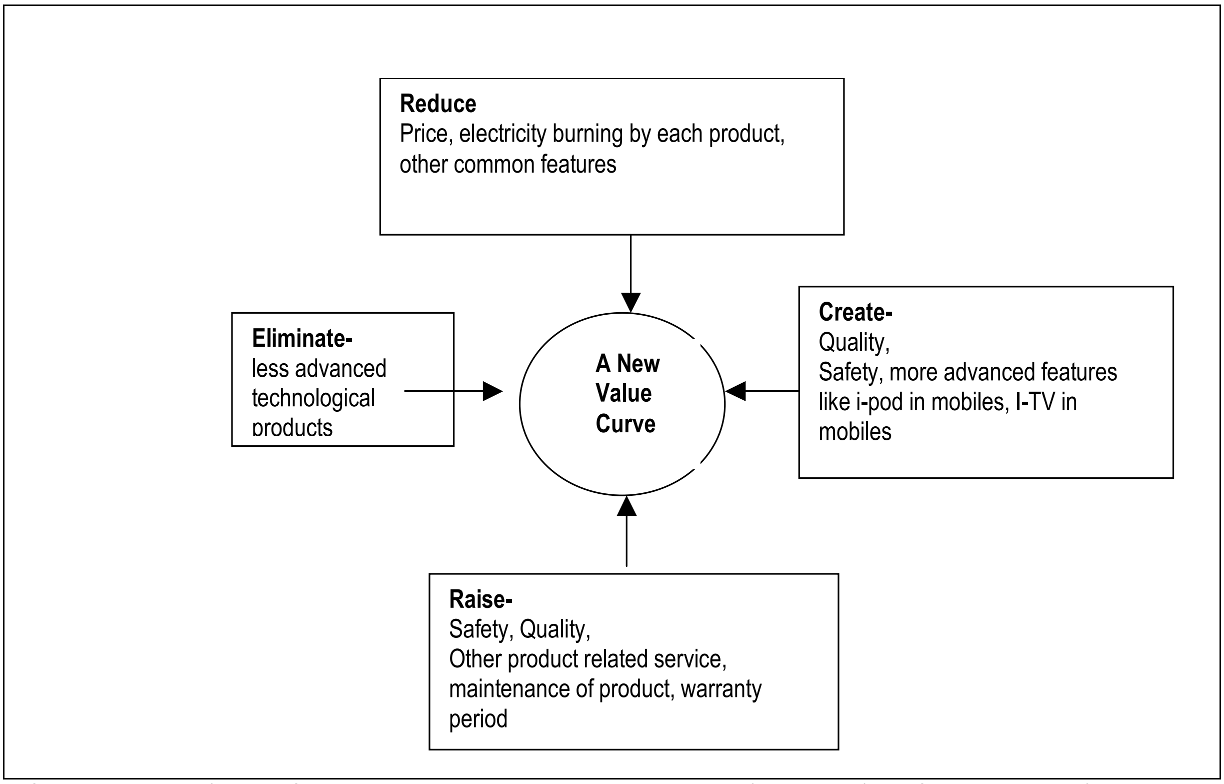
By rating these parameters on a scale of low, average and high, the managers can determine the parameters in which the company is weak and its competitors are ahead of it and so as to improve upon them.

After the strategic canvas is created, the next logical tool is to develop the following framework.

Four Action Frame work - Eliminate, Reduce, Raise and Create Grid

Four action framework is also called ERRC (eliminate, reduce, raise and create). By drawing this grid for LGE, executives and managers realise where to invest, which features of their products and services should be avoided or enhanced to capture greater market share. For LGE, the grid is presented in **[Exhibit (TN)-VI]**.

Exhibit (TN)–VI
Four Action Frame Work – ERRC Grid for LGE



Compiled by authors from Kim Chan W. and Mauborgne Renee, "Analytical tools and framework ", (Book Chapter; excerpted from *Blue Ocean Strategy: How to Create Uncontested Market Space and Make the Competition Irrelevant* by Kim Chan W. and Mauborgne Renee) Harvard Business School Press, 2005

After analysing the tools and framework for Blue Ocean Strategy, following formulating principles can be used for effective implementation.

1. Re-Construct Market Boundaries

The first principle of Blue Ocean Strategy is to reconstruct market boundaries to break competition. The challenge to it is to find Blue Ocean opportunities. Managers cannot afford random gambling or personal intuition in finding Blue Ocean areas. In order to reconstruct market boundaries Blue Ocean Strategy defines six path way frame work which is generally applicable to all industries.

Path 1: Look across Alternative Industries
LGE started with electronic products like TVs, fans, washing machines, and microwave ovens etc. But the company's affiliation with Phillips and joint ventures with other companies provided a path towards establishing high-end products like big screen LCD and Plasma TVs. The company expanded its product portfolio by adding vacuum cleaners, MP3 Players, DVD players, DVD recorders, home theater systems. In addition to this, the company also focused on the car audio equipment, portable audio equipment to expand its customer base.

Path 2: Look across the strategic group within the industry
Strategic group refers to a group of companies within an industry that pursue a similar strategy. For LGE this strategic group can be different for different products and for different markets. For example, the groups of the consumer electronics companies like Samsung, Sony, were also pursuing digitisation and innovation strategy for gaining market share in each of the regions that they operated in.

Path 3: Look across the Chain of Buyers
LGE focused on the different segments of buyers like housewives for home appliance products, young people for mobile phones and music players, higher income groups for its LCD TVs and Plasma TVs. By concentrating on each segment of buyers the company would be able to widen the scope of its products.

Path 4: Look across the complementary products and service offerings
LGE could provide complementary services with its products. To cater to house wives who are the end-users of home appliances, the company could bundle products which encourage them to use the primary products. For their home appliance products, the company can provide any household item as a free gift to increase its revenue. For their digital display division, it can provide other complementary products like CD or DVDs of popular movies, or TV shows. For its microwave products the company could start cookery classes, which can teach customers how to use the oven to make different items. Better features in its Chocolate series mobile phones like inbuilt MP3 players could also be provided. The company could also increase its service contracts with buyers compared to other competitors.

Path 5: Look across the functional or emotional appeal to buyers
LG believed that they are not just in the business of selling products or services but enriching life. With this attitude LGE is able to attract customers with emotional advertisements. For its home appliance division it used the punch line, "A Richer, Happier life wherever you are". For its HD DVR (High definition digital video recording) built-in plasma TV, the company used the "Thrilling moments with HD DVR built-in Plasma TV" advertisement that focused on football fans that missed live football matches. With LGE's HD DVR and built in Plasma TV, the person can enjoy the same thrilling moments of football match as if they are watching a live match. For its air conditioners, LGE's Neo Plasma Plus, had the theme of "LG, caring your health in every way", to protect family members from minute and invisible dust and germs.[27] With such innovative print and TV advertisements, which had an emotional appeal LGE was able to attract customers.

Path 6: Look across the time
To reconstruct the market boundaries another path is to look across time and adopt new and latest technology to capture the market. Looking at the various new trends, companies can create Blue Oceans for

[27] "2006 print advertising", http://www.lge.com/experience/advertising/ad_print_2006_1.jsp

their products. With the latest digital technology and other new features, LGE can also create Blue Oceans for its products.

2. Focus on the Big Picture, Not the Numbers

After knowing the path for creating Blue Oceans the next question is about aligning the strategic planning process to focus on the big picture of tapping uncontested market space and applying these ideas to draw the company's strategic canvas to arrive at the Blue Ocean Strategy. After selecting the parameters for the strategic canvas the managers could focus their attention on the big picture rather than focusing on the numbers.

For LGE, the implementation of Blue Ocean Strategy was to focus on the high-end products and enter into the areas which they had not focused on previously and where the market boundaries have still not been drawn. Instead of looking only for market share in the US and other European regions, the company focused on markets like India, China, Middle East and Africa. The company wanted to gain market share in the mobile segment instead of becoming a niche player in CDMA or GSM segments. In the digital display division too the company focused on all kinds of display products like LCD, PDP (Plasma display Panel) with big screens.

3. Reach beyond Existing Demand

This principle describes the conventional strategy of retaining existing customers and converting non-customers into customers. Non-customers can be divided into three tiers. The first tiers of customers are those who are not using company's products but using the same product of another company. For LGE these were the customers who were using the competitors' products. LGE could convert them into customers by making them aware about the features of its products and services. Second tier customers are those who refuse to use industry's offerings. These are the customers who can use the industry's product but due to improper knowledge and information they had voted against it. For example, the customers of regular TV could be converted into users of LCD and Plasma TVs with the right advertising and marketing campaigns. While the third tier of non-customers, are generally very poor people who use very limited electronic products.

4. Get the strategic sequence right

To make Blue Ocean Strategy viable companies need to set their strategic sequences right. Such sequence follows four strategies, which include buyer utility strategy, price strategy, cost strategy and adoption strategy. Under buyer utility strategy, companies should consider that their product should provide exceptional utility to the buyers. To provide exceptional buyer utility companies have to enhance features of their products. After deciding buyer utility companies should review whether, the price is affordable to the buyers for the given extra feature or not. They should also consider whether the price is reasonable or too high for a buyer. After following the price and buyer utility strategy, cost strategy is the next strategic sequence. Under the cost strategy, cost of the products should be lower than the price to earn profit. The company should check whether expenses like production, marketing, distribution and advertising are higher than the price of the product. Carefully drawn ERRC grid can help a company in providing higher buyer utility together with low cost to the company. While adopting this strategy the company should consider any potential hurdles that might exist in adopting Blue Ocean Strategy for its markets and products. At each phase a company should rethink and make the necessary changes for perfect viability of the Blue Ocean Strategy.

5. Overcome key organisational hurdles

This principle stipulates that for Blue Ocean Strategy to be successful, the manager will have to overcome the hurdle of resistance to change. In such a case its top management should provide leadership role by motivating employees, refocusing attention, shifting resources from ineffective to effective areas and giving credibility to managers and executives. The company should motivate employees by comparing Red Ocean and Blue Ocean market and profits.

6. Build execution into strategy

For any company, adoption and implementation of a new strategy is not easy. Under Blue Ocean Strategy, managers and executives need to change their mindset of traditional Red Ocean market. This becomes difficult, as their comfort level with the existing processes, needs to be changed. To avoid managerial risk, it is necessary to build people's trust, commitment and their co-operation to implement the Blue Ocean Strategy from the start. This can be achieved by considering suggestion of employees of the organisation, which may lead to voluntary cooperation. Further, fair practices at management level and clarifying issues regarding execution of Blue Ocean Strategy would help in successful implementation. LGE pursues the philosophy of 'great people, great company' which motivates employees.

The scenario leads us to the broader debate on whether Blue Ocean Strategy is sustainable and the challenges involved, raising the next question,

III. "Creating Blue Oceans is not a static achievement but a dynamic process."[28] Based on your understanding of the 3rd prerequisite conceptual understanding, explain how companies can sustain the Blue Oceans that they have created? What are the challenges that companies might face in trying to sustain the Blue Ocean Strategy?

The term Blue Ocean is new but its existence is not new. Ford's model T and Apple's i-Pod are some of the products based on Blue Ocean Strategy. Creation of Blue Oceans is a dynamic process in which companies need to constantly innovate to sustain their market position. The main challenge for sustaining a Blue Ocean is imitation by competitors of the industry. The other challenge is to develop innovative products for customers every time.

Blue Ocean is only beneficial if it is not imitated by competitors. Once the competitor knows your secret for Blue Ocean Strategy, (Like ERRC grid, value innovation, and strategic canvas) the Blue Ocean will be difficult to sustain. To counter competition, companies may adopt competitive strategies (like selling at too low price, offering heavy discounts etc.) to protect their market share, which would eventually lead them into the Red Ocean market. For example, in Ford's case, the Model T was very famous and Ford got first mover advantage, which led to increased sales and revenue. But Ford could not sustain this advantage after General Motors started using the same concept and manufactured the same quality of cars. To sustain benefits from the Blue Ocean, companies have to constantly innovate and upgrade their products and services.

A prime example of sustaining a Blue Ocean is Apple, which constantly innovated and came up with a range of products. Apple first created i-Pod and created a Blue Ocean market in the music industry. But competitors soon imitated the i-Pod and produced the same quality of products at a lower or the same price. When the market for i-Pod saturated, Apple developed i-Pod nano, i-Phone, etc.

Thus, to sustain Blue Ocean, value innovation on a continuous basis is essential. The scenario leads to the next logical question,

How has LG benefited by adopting the Blue Ocean management strategy? Will LG be able to achieve its target of being among the top three companies in the electronics industry by adopting this strategy?

[28] "Creating a blue ocean", op. cit.

Blue Ocean management campaign was the paradigm strategic shift at LG, a means to achieve the target of being amongst the top three players in the industry. The company started implementing this strategy from January 1st 2007. With the focus on high-end products, the company implemented Blue Ocean Strategy for its mobile communication and digital display divisions.

With the adoption of Blue Ocean Strategy, the company would be able to convert promising markets of China and India into Blue Ocean markets by 2010 and would be able to position itself among the top 3 by 2010 by adopting this strategy.
In this regard Mr. K. W. Kim, president of middle east and Africa region, LGE announced, "The growth associated with the 'Blue Ocean' initiative will not be accomplished in just one or two years, but is a multi-pronged effort that will firmly reinforce our position among the top three in the electronics industry."[29]

With the positive statistics for the first quarter of 2007, especially for its mobile communication and digital display division, LGE is confident about its Blue Ocean Strategy. The mobile communication division grew by 14.7%, with the value of KRW 2.51 trillion[30]. This performance increased the revenue by 17.8% with sales of 15.8 million of Chocolate series phones. Sales for the Digital Display division including plasma display panels and flat panel TVs and monitors increased by 1.5% to KRW 2.75 trillion from the year 2006.[31]

Final Thoughts

After analysing LG's Blue Ocean Strategy, the discussion will lead to the concluding question, which could be thrown open to the class,

What are the challenges that LG might face in trying to implement the Blue Ocean Management Campaign? Will the company be able to sustain the benefits that it has accrued from the campaign?

There are many challenges that LG will face in trying to implement the Blue Ocean Campaign, like

- The first challenge was commitment and co-operation from its employees towards the new strategy. Blue Ocean Strategy is built on the assumption of letting-go of its traditional market. So the stumbling block is changing the traditional Red Ocean mindset and competition benchmarking attitudes of executives and managers.
- To adopt Blue Ocean campaign globally is the other biggest challenge for the company. As a multinational company, it must have some unique products with competitive pricing for each market where it operates.
- After implementation of the Blue Ocean Strategy, LG needs to continuously re-invent their products and services with some unique features to sustain the Blue Ocean.

Though there are many challenges, given the company's historic accomplishment in successfully implementing competitive strategies like localisation and gaining dominance in various foreign markets, LG should be able to sustain the Blue Oceans and the benefits derived thereof.

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[29] **"LG H1 sales turnover in Mid-East and Africa touch $1.36 billion", http://business.maktoob.com/News-20060806124521-LG_H1_sales_turnover_in_Mid_East_and_Africa_touch_1_36_billion.aspx.aspx, August 7th 2006**

[30] **"LG Electronics reports first quarter 2007 earnings results", http://www.lge.com/ir/news_ir/detail/PRE%7CMENU%5EPRER%7CMENU_20390_PRER%7CMENU.jhtml, April 19th 2007**

[31] **"LG Electronics reports first quarter 2007 earnings results", op. cit.**

Additional Readings

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Annexure (TN)-I

Teaching Plan

Prerequisite Conceptual Understanding

- To understand the localisation strategies adopted by LG - Esfahani Elizabeth, "Thinking Locally, Succeeding Globally", http://money.cnn.com/magazines/business2/business2_archive/2005/12/01/8364622/index.htm, December 1st 2005
- To understand the concept of Blue Ocean Strategy – Kim Chan W. and Mauborgne Renee, "Blue Ocean Strategy", *Harvard Business Review*, October 2004 [Ref No. R0410D]
- To understand the limitations and sustainability of the Blue Ocean Strategy – Kim Chan W. and Mauborgne Renee, "Conclusion: Sustainability and Renewal of Blue Ocean Strategy", (Book Chapter; excerpted from *Blue Ocean Strategy: How to Create Uncontested Market Space and Make the Competition Irrelevant* by Kim Chan W. and Mauborgne Renee) Harvard Business School Press, 2005
- To understand the strategies LG is trying to adopt to become a global electronics brand - Ihlwan Moon et al, "Korea's LG: The Next Samsung?", http://www.businessweek.com/technology/content/jan2005/tc20050113_3581_tc024.htm, January 13th 2005

Big Picture: Expected Learning Objectives
▪ Blue Ocean Strategy – A tool for creating new markets

Teaching Plan Flow

S.No	Analysis Section	Expected Learning Objectives	Forward Linkage	Ideal Duration (mins)
1	LG – The Emerging Global Brand	▪ LG's growth strategies ▪ Creation of a global brand	Facilitates discussion on the logic behind LG's decision to adopt the Blue Ocean Campaign	20 mins
2	LG's Blue Ocean Management Campaign	▪ The concept Blue Ocean Strategy ▪ Why LG adopted the Blue Ocean Management Campaign ▪ How and to what extent company has put Blue Ocean Strategy to practice	Helps understand the value addition offered by the Blue Ocean campaign to LG	40 mins
3	Sustainability of the Blue Ocean Strategy	▪ What has LG gained by adopting this campaign ▪ Constraints of the Blue Ocean Strategy ▪ Can LG sustain its competitive edge by leveraging on the Blue Ocean Campaign?		40 mins

Detailed Teaching Plan

LG – The Emerging Global Brand

- Journey from Lucky Goldstar to LG – the company's inception and growth
- Growing beyond the domestic market
- Creating a global brand

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LG's Blue Ocean Management Campaign

- Blue Ocean Strategy – The concept
- Rationale behind LG's adopting the Blue Ocean Management Campaign
- Putting the Blue Ocean strategy into practice
- Benefits accrued

↓

LG: Can it sustain the campaign?

- Limitations of the Blue Ocean Strategy
- Challenges that LG might face in trying to sustain its Blue Ocean campaign

Prepared by the author(s)