E-Commerce Strategies:
Achieving Sustainable Competitive Advantage and Avoiding Pitfalls

G.T. LUMPKIN  SCOTT B. DROEGE  GREGORY G. DESS

Is the Internet the 21st century breakthrough that will change business forever? Or is it simply a new technology that is quickly being absorbed and causing only incremental advances in business progress? Paradoxically, the answer is probably both. Consider the facts: few technologies have impacted society as quickly as the Internet. It took decades for radio, television and other popular 20th century technologies to be adopted, but the Internet reached 50 million users in less than 5 years. Forty-four percent of the U.S. population was on-line by the end of 2004, up from just 9% in 1995. The Internet's reach now extends well beyond the U.S. borders and includes over 200 million Internet users outside of North America.

The impact may have been even more dramatic in corporate boardrooms and small businesses around the globe. Companies have rapidly embraced Internet technology, with business-to-business (B2B) sales estimated to be $6.1 trillion by the end of 2004. This is remarkable considering that B2B sales generated less than $1 trillion in 2000. Business-to-consumer (B2C) sales are also still growing. In 2000 alone, despite the failure of many dot.com companies that same year, B2C sales grew 67%. In addition to sales, companies are capitalizing on cost-saving advantages. Giga Information Group projects that electronic transactions will save firms $1.25 trillion in 2002, contrasted with cost savings of $17 billion in 1998. Legendary General Electric Co. Chairman Jack Welch remarked that the Internet is the “single most important event in the U.S. economy since the Industrial Revolution.”

Despite this record of growth, there are many who view the Internet as little more than an enabling technology. It is not a new marketplace as some have claimed. It is a new channel, but distributes only knowledge and information in a digital form. Raw materials and hard goods still require physical distribution, and the Internet, at best, only supports production, logistics, and inventory management. Clearly, the Internet has speeded up processes and lowered some costs, but it is unclear how many productivity gains can be attributed to use of the Internet. Meanwhile, the contribution of Internet-generated revenues to the Gross Domestic Product (GDP) in the U.S. is relatively very small. Given these facts, can we say that the Internet has really changed things?

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For managers, perhaps the most important question is how to strategize in the era of the Internet. With rapid growth in global use of Internet technologies, increasing sales in both B2B and B2C markets, and the potential for large cost savings, many firms see the Internet as a source of revenue and profit growth. But how are these factors affecting strategy? Have the rules changed or can traditional models of competitive strategy be used to achieve sustainable advantages? Again, the answer is some of both. In this article, we investigate how the Internet is changing our view of strategy and suggest ways the new technology can enhance strategic initiatives. We also discuss the potential pitfalls associated with Internet-based strategies. Last, we suggest that combination strategies may be the key to sustainability of Internet-based competitive advantages.

THE INTERNET’S EFFECT ON FORMS OF COMPETITIVE ADVANTAGE

Internet technology is changing the way many firms do business. The most profound changes are not being seen at dot.com start-ups, but at incumbent firms that are being transformed into e-businesses. These changes are forcing them to craft new strategies and adopt new methods of implementation. Consider, for example, hardware giants Cisco Systems Inc. and Intel Corp. Their leadership in providing equipment for information technology is well known. But they have also transformed themselves internally by embracing the technologies they sell. Intel’s Chief Executive Officer (CEO) Craig Barrett says, “For Intel, being an Internet company meant turning ourselves into a 100% e-business from front to back—not just in terms of selling and buying, but also in terms of information transfer, education, and customer interaction.” A similar attitude permeates Cisco. As a result, both companies have adopted new strategic practices. Using the Internet, they have:
• created Internet-based knowledge management systems that make most employees only a few clicks away from vital information;
• turned customers into ad hoc research and development (R&D) teams by involving them throughout the development, testing, and launch of new products;
• become virtually paperless by relying exclusively on electronic purchase orders.

Many other new possibilities abound, including reducing the cost of inputs using on-line auction services, managing logistics and inventory in real time, and lowering distribution costs through e-commerce. But along with these advantages, easy access to Internet technology presents new challenges to competitive advantage. Because nearly all firms have access to this relatively inexpensive technology, companies who choose to compete in cyberspace must find ways to capture the potential while sustaining competitive advantage over rivals. This requires balancing a firm’s market position against forces—substitute products, new market entrants, supplier and buyer bargaining power, and inter-firm rivalry—that can rapidly erode a company’s competitiveness. Are these changes so profound that traditional approaches to strategy are outdated? We don’t think so. But there are important changes in how these strategies can best be deployed. This section clarifies these complex relationships.

Primarily, there are three strategies firms use to create competitive advantage: overall cost leadership, differentiation, and focus. Each strategy is uniquely implemented to overcome forces affecting competitive strategy, including threats from substitute products and new market entrants, bargaining power of suppliers and buyers, and rivalry among existing competitors.

• An overall cost leadership strategy attempts to offer the lowest cost product or service to customers relative to a firm’s rivals. This low-cost position is contingent on the efficient management of the entire value chain. Thus, costs must be rigorously controlled from raw material purchases to distribution channel delivery.

Scott B. Droge received his M.B.A. from Mississippi State University. He is currently a Ph.D. student in strategic management at the University of Kentucky. His research interests include international business with an emphasis on organizational structures in transitional economies. He has several years of business experience in the financial services industry and holds the Certified Financial Planner™ designation. He can be reached at: scott-droge@msn.com
- A differentiation strategy positions a company to compete on the uniqueness and value of its products or services. Well-known brand image, a strong reputation, and quality products and services are the characteristics of a differentiation strategy. Gains in image, reputation, and quality come at a cost to consumers; they pay a premium compared to overall cost leadership products and services.

- A focus strategy is used by companies to position themselves in a market niche. They make no attempt to be all things to all consumers, but rather concentrate on a narrow market segment. Within their particular niche, they create competitive advantages over rivals through either cost leadership or differentiation tactics.

In the sub-sections below, we investigate how the Internet is affecting each of these approaches to competitive strategy.

**Overall Cost Leadership**

An overall cost leadership strategy concentrates attention on a company’s value chain resulting in low-cost products and services. Little attempt is made to differentiate products or services from those of competitors, and a wide net is cast over the entire potential market. By offering the lowest possible cost, these companies gain market share through price alone. The most successful companies are those that hammer down costs at each point in the value chain.

For example, Southwest Airlines slogan is, “The low cost airline.” No first-class seating, no in-flight meals, no movies—just low-cost transportation. Wal-Mart is well known for its cost leadership position. Brand is relatively unimportant, reputation for quality products is marginal at best, but consumers can find low-cost products with minimal effort. Both Southwest Airlines and Wal-Mart carefully control inputs throughout the value chain. Southwest cut costs by pioneering ticketless boarding. The airline uses only one type of aircraft to decrease maintenance costs. Wal-Mart carefully manages its inventory system to decrease storage.
costs. They offer little in the way of specialized customer services, driving down labor expenses.

Internet technology offers new ways for overall cost leaders to minimize costs. Indeed, at times the entire cost structure can be altered, affecting every firm in the industry. The Internet offers the potential for cost leaders to decrease prices through decreased transaction costs. And not just B2C costs; B2B transactions are affected also. This forces firms to re-examine transaction costs— from procurement to distribution and after sale service.

To compete successfully in the Internet economy, overall cost leaders must critically examine each input in the value chain. For example, dot.com companies such as Monster.com have given firms inexpensive access to a large, technically competent labor pool. Rather than manually sorting through a pile of paper résumés, human resource managers can screen potential applicants by entering sorting criteria that match the firm’s needs to an individual’s qualifications.

Jack Welch saw the potential for cost containment at General Electric at an early stage. He initiated Internet-based procurement activities in an effort to reduce costs. The first business unit to try this was GE Lighting. Engineers developed a Web site, Trading Process Network (TPN), which served as the primary source for all requests for quotes. In some ways, it was similar to the traditional way of doing business and prospective suppliers obtained specifications, prepared bids, and sent the bids to GE. The difference was that this was all done using the TPN interface. Just 1 year after TPN’s introduction, GE reduced procurement costs by more than $500,000, including a 30% reduction in labor expenses. Cycle time for the bid process was cut in half. Paperwork dropped 60%. Suppliers also benefited from TPN: the Internet-based approach streamlined the bidding process, shortened the selling cycle, and decreased suppliers’ cost of sales.

GE realized additional benefits that contributed to decreased costs. Disintermedia-
tion—removing intermediaries between the supplier and the purchases—resulted in GE’s procurement team dealing directly with their suppliers. There was no longer a need for their representatives to visit GE in person. By reducing suppliers’ cost of sales, disintermediation reduced the cost of products to GE while maintaining the suppliers’ normal margins.

The concept of the value chain provides important insights as to how Internet-based technologies have helped firms control costs. Value chain analysis (described by Michael Porter in his book Competitive Advantage) views the organization as a sequential process of value creating activities. Such an approach is useful for understanding the building blocks of competitive advantage. It is divided into two types of value-adding activities—primary and support. Primary activities contribute to the physical creation of the product or service, its sale and transfer to the buyer, and its service after the sale. Support activities (procurement, human resources management, technology development and firm infrastructure) add value through important relationships with both primary activities and other support activities.

In terms of competitive advantage, the Internet offers overall cost leaders new abilities to reduce costs in primary activities such as marketing (i.e., B2C e-commerce) and support activities such as purchasing (e.g., on-line auction procurement). Firms using an overall cost leadership strategy can use Internet-based technologies to reduce value chain costs in a variety of innovative ways including:

- web-based inventory control systems that reduce storage costs by providing real-time ordering and scheduling to manage demand more efficiently;
- direct access to status reports and the ability for customers to check work-in-progress to minimize rework;
- on-line bidding and order processing to eliminate the need for sales calls and decrease sales force expenses;
- on-line purchase orders for paperless transactions to decrease costs of both the supplier and purchaser;
• collaborative design efforts to reduce the cost, efficiency, and cycle time of new product development;
• on-line testing and evaluation of job applicants by human resource departments.

Another benefit of Internet technology is lower transaction costs at multiple levels in value chain activities. Such lower costs benefit first movers especially. However, the sustainability of competitive advantages may be problematic as rivals mimic successful strategies, first-movers lose their initial advantages. We address sustainability of advantages in a later section, but now turn our attention to the impact of Internet technology on firms employing a differentiation strategy.

Differentiation

Firms pursuing a differentiation strategy offer products or services that are viewed as unique and valued by customers. They achieve differentiation advantages when price premiums exceed the extra costs incurred in being unique. For example, both BMW and Harley Davidson increase consumer costs to offset added marketing expenses. A differentiator will seek ways to distinguish itself from similar competitors to justify price premiums greater than the costs incurred by differentiating.

Clearly, a differentiator cannot ignore costs. Its premium prices would be eroded by a markedly inferior cost position. Therefore, these firms must attain a level of cost parity or proximity relative to competitors. Differentiators do this by reducing costs in all areas that do not affect differentiation. Porsche, for example, invests heavily in engine design—an area in which their customers demand excellence—but they are less concerned and spend fewer resources, for instance, in the design of the instrument panel.

A striking trend that Internet technologies have fostered among differentiators is the way businesses interact with customers. For example, mass customization enhances how companies respond to consumer demand. Although not a new phenomenon, mass customization has been a growing trend with the advance of flexible manufacturing systems. These systems make manufacturing more adaptable to specialization and customization. The Internet has enhanced this process by facilitating direct communications between manufacturer and consumer.

The Internet has influenced this by bringing the customer closer to the manufacturer. Dell Computer Corporation has strengthened its leadership position by creating an on-line system allowing customers to configure computers to the customer’s specifications. Submitting the on-line order (another source of cost containment) results in mass customization of a computer exactly matching customer specifications with very short cycle times. Strategies such as on-line mass customization have enabled firms to decrease costs while enhancing product offerings, maintaining reputations for quality, and preserving brand image.

These tactics are challenging traditional approaches of differentiators. Traditional approaches included catalogs, showrooms, and personal sales rep calls. Products were marketed to make them appealing through prestige packaging, celebrity endorsements, and charity sponsorships. These venues remain available depending on the competitive environment, but technological innovation has forced companies to revisit such traditional approaches. Customers have changed the way they view quality. Rather than forming a relationship with a sales representative or connecting with brand image, customers now demand speed of response and delivery, accuracy in order processing, and customization capabilities of near-commodities such as computers.

As with overall cost leadership strategies, differentiators find that there are opportunities coupled with distinct challenges. Forward-thinking organizations anticipate situations where they can capitalize on Internet advantages throughout the value chain including:
• Internet-based knowledge management systems linking all parts of the organization to shorten customer response times;
• real-time access to manufacturing operations status such as scheduling and delivery information to empower sales forces and channel partners;
• personalized on-line access to provide customers (both upstream and downstream) with their own “site within a site” to track orders and process new orders;
• rapid on-line responses to service requests and fast feedback to customer surveys and product promotion to improve marketing efforts;
• access to real-time sales and service information to continually update research and development efforts;
• automated procurement and payment systems to provide suppliers and customers detailed status reports and purchasing histories.

The ability of Internet technologies to enable mass customization has provided many firms with tools that offer unique product offerings and exceptional service. But as competing companies adopt applications of these technologies, Internet-based differentiation will become more challenging. As with overall cost leadership, we will discuss the sustainability of competitive advantage in a later section.

Focus

A focused strategy targets a narrow market segment with customized products or services. The Internet offers new avenues to compete by accessing markets less expensively (low cost) and providing specialized services and features (differentiation). This is especially important for small firms; the Internet has opened markets for small players that were previously inaccessible. Market researcher Keenan Vision, Inc. estimates that the number of small e-merchants in the U.S. has grown from 70,000 in 1999 to 525,000 in 2001. Keenan Vision anticipates growth will reach 2.6 million by 2004, fully one-third of all small companies in the U.S.

Even though the Internet offers possibilities to tap new markets, the same problems that face overall cost leaders and differentiators affect firms using a focus strategy. Achieving competitive advantage will depend on how effectively focusers use Internet technologies. SalvageSale, Inc. provides an intriguing example.

SalvageSale is the top choice of insurance and transportation companies needing to quickly liquidate commercial salvage goods. The Houston-based company has been successful by carefully watching costs, relying on word-of-mouth advertising, and staying focused on the narrow salvage goods market. Traditionally, when salvage goods become available, insurance adjusters and transportation agents seek bids from local brokers by phone and fax. But SalvageSale posts requisite information on-line where brokers can bid using an on-line auction. This decreases the commission SalvageSale must charge. The time savings and increased number of bidders has translated into higher prices for salvaged goods. The bottom line: SalvageSale increases revenues through higher prices and decreases costs through lower commissions, thus positioning the firm as the leader in the $50 billion salvage goods industry.

Another advantage the Internet provides focusers is technology driven. Scale economies have always created barriers to entry for smaller firms. But with the Internet, technology-based efficiencies are available to firms using focus strategies. These efficiencies reduce the importance of scale advantages. Focusers use Internet-based technologies to create:
• permission-marketing techniques that narrow sales efforts to specific customers who opt to receive advertising notices;
• chat rooms, discussion boards, and member functions for customers with common interests;
• niche portals targeting specific groups with specialized interests;
• streamlined browsing capabilities to focus customer search efforts within a specific domain;
• virtual organizing and on-line “officing” to minimize infrastructure requirements;
• procurement efforts using techniques to match buyers with sellers.

As in the previous strategies, firms employing a focus strategy must effectively deploy resources in analyzing value chain activities to compete successfully. Both primary and support activities can be improved through the single-mindedness characteristic of firms using a focus strategy. But as with overall low cost producers and differentiators, focusers can quickly see their market share eroded unless they find a way to sustain competitive advantages.

**ARE INTERNET-BASED COMPETITIVE ADVANTAGES SUSTAINABLE?**

Firms can generate above-average returns by integrating Internet technology, but the Internet’s widespread access threatens to erode any first-mover advantages. On one hand, the Internet makes possible new opportunities for strategic success. A few business models—those offering capabilities unique to the Internet such as eBay’s on-line auction system—seem to provide strong, sustainable advantages. Other applications have created opportunities for companies such as Cisco Systems and Sun Microsystems, Inc. that supply products needed to support Internet infrastructure. Companies such as Juniper Networks and SAP have found sustainable advantages by managing software applications and on-line order fulfillment.

On the other hand, the cycle of dot.com failures that began March 2000 suggests that the Internet boom was only temporary and that rapid growth of new firms and new opportunities for commerce is built on an unsustainable basis. Most observers agree that the downturn resulted largely from ignoring business fundamentals and basic financial requirements. **Boo.com** is a good example.

**Boo.com** tried to create a global fashion retailer offering services in seven languages and transactions in 18 currencies. The firm anticipated a technology allowing customers to view products from any angle using a virtual fitting room. Customers could virtually try clothes on in cyberspace. Unlike other e-commerce businesses, **Boo.com** planned to charge full retail price. But when the site was launched, only one in four purchases actually worked. Macintosh users could not log on to the site, and phone lines were backlogged with angry customers. The company lost $10 million of investment commitments within one week of its launch. Within 18 months, the company lost $185 million and sold off its remaining assets for a mere $2 million. The lesson to gain is that even though companies compete in cyberspace, business fundamentals remain as important as ever.

Another reason startups failed was that the service or capability they offered could easily be imitated. This was particularly damaging for young companies and “pure plays”—firms that exist only in cyberspace and have no true physical location—because larger firms can take a “wait and see” approach, conserving resources until they are confident about what works. In this way, firms with more resources could simply imitate successful startups without the risk involved of being first to market with a new technology.

Internet technologies can benefit firms that use them in ways that genuinely set the firms apart from rivals. But the extent to which the Internet can create advantages that are rare and inimitable remains questionable. With new opportunities come a host of pitfalls. And some of these pitfalls are intensified when firms use Internet technology.
Overall Cost Leadership: Advantages and Pitfalls

The Internet can strengthen a firm’s overall cost leadership position by reducing inventories, using real-time communications to make production schedules, warehouse management, and delivery systems more efficient. Low cost leaders can lower the costs associated with reaching end users or by threatening to more efficiently reach end users, thus strengthening their bargaining position over buyer channels.

But these advantages can be quickly eroded by imitation—one of the biggest threats to sustainability of Internet advantages—from rival firms if first-movers are careless in the deployment of new technology. With its easy access, the Internet magnifies the imitation problem. Most advantages of contacting customers directly, such as customized ordering systems and real-time access to work-in-process status, can be easily imitated by competitors.

Another pitfall for overall cost leaders is the availability of on-line information to consumers. Comparative shopping becomes easier—information asymmetry is decreased. As in Southwest Airlines’ slogan, companies must truly be the low cost leader.

Firms that become overly enamored with Internet-based business models can inadvertently focus so much on the new technology that they neglect their bricks-and-mortar operations. This may jeopardize customer relations or increase the risk of channel conflict. Further, companies may neglect other cost centers, thus increasing expenses and digging into their cost advantages.

Differentiation: Advantages and Pitfalls

Differentiators may gain distinct advantages through Internet strategies by providing highly tailored customer management systems to enhance sales efforts, provide rapid feedback to customers and suppliers, and give real-time solutions to service problems. The advantage of differentiation is that firms employing differentiators can create capabilities so specialized for a given customer that the chance of customers turning to other solution providers, whether imitations or substitutes, is greatly lessened.

However, as with bricks-and-mortar businesses, Internet-based businesses can see their advantages deteriorate if they do not position their products as unique and valuable to customers. This has been the case with some of the personalization and customization software that early dot.com companies added to their sites at great expense. Many users didn’t value these features, and the resources expended in the creation of the technology were wasted. Garden.com, for example, spent a large sum on gardening content and created customized feedback based on a customer’s unique profile. However, customers failed to find value in the content. Garden.com could not translate uniqueness into value—or sales—for the many visitors to its site.

Problems may also result from overpricing products and services and developing brand extensions that dilute a company’s image or reputation. Dow Jones & Company, Inc.’s efforts to develop an on-line version of The Wall Street Journal are a good example. The Journal had already been criticized for adding new color sections. Some readers thought this detracted from the high quality, reliable image that the traditional black-and-white print portrayed. With the on-line version, a new problem arose—Internet users were accustomed to getting on-line information for free. Companies such as TheStreet.com that tried selling the latest financial news on-line were unable to build a large enough base of paying subscribers to make on-line subscriptions profitable. Even with its highly devoted following, The Wall Street Journal has struggled to develop an on-line subscriber base. Print subscribers typically pay more than $100 for an annual subscription, but the Journal is having trouble selling on-line subscriptions for $59, despite the fact that the on-line version is more customizable, up-to-date, and complete. The lesson: customers, not companies,
determine which products and services have value.

Focus: Advantages and Pitfalls

Focusers can capitalize on many of the new Internet capabilities in attempting to capture a specialized market niche. A firm can use technological capabilities to satisfy the needs of particular markets and reduce the threat of new entrants by firmly establishing itself as the customer’s most valued provider. The limited size of specialized markets serves to discourage new entrants who would need to compete for limited market share.

However, these advantages can be challenged if focusers misread the scope and interests of their target markets. The result can be companies that lose their uniqueness by going after overly broad markets, making the firm vulnerable to firms offering imitation or substitution products. To illustrate:

Pets.com tried to “do it all” with their on-line pet store, spending millions on advertising, including pricey Super Bowl ads featuring its now-defunct sock puppet. All Pets.com’s efforts to build brand image were wasted, due to a faulty business model that included selling inexpensive pet food with skimpy 10% margins. In contrast, Waggin’ Tails is an on-line retailer specializing in high-end dog food and hard-to-find pet vitamins that command 30% margins. By remaining small, controlling costs, and sticking to their market niche, on-line e-tailers such as Waggin’ Tails are finding ways to profitably use Internet technology.

There are consequences when e-tailers overextend their market niche. Efforts to appeal to a broader audience through additional inventory, content, and services can cause firms to lose the cost advantages associated with limited scope. But when product offerings become overly narrow, firms have trouble generating enough customer demand and may find that even though Internet technology is inexpensive compared to bricks-and-mortar retailers, costs can quickly exceed revenues when the customer base is too narrow.

The message is clear. A focus firm’s market niche should be big enough to be profitable, but small enough to lessen the attractiveness to potential new entrants.

Table 1 summarizes the advantages and potential pitfalls of using Internet-based strategies for overall cost leaders, differentiators, and focusers.

Combining Strategies: Key to E-Business Success

Because of the dynamic changes presented by the Internet and Internet-based technologies, new strategic combinations that make the best use of overall cost leadership, differentiation, and focus may hold the greatest promise. Several things are clear. First, the Internet, in general, is eroding opportunities for sustainable advantage. The Internet offers fewer rather than more opportunities for sustainable advantages. Therefore, strategic thinking is even more important in the Internet age.

More specifically, the Internet has provided new tools for managing costs. It may be that cost management and control will increase in importance as a management tool. This may be good if it leads to an economy that makes more efficient use of scarce resources. However, for individual companies, this may shave critical percentage points off profit margins and create a climate that makes it impossible to survive, much less achieve sustainable, above-average profits.

The Internet also diminishes differentiation advantages. The ability for consumers to more easily comparison shop is depriving some companies of unique advantages that have been previously hallmarks of success. Differentiating is still an important strategy, but how firms achieve differentiation has changed.

Given the competitive environment presented by the Internet, the best approach may
be to combine a differentiation strategy with other types of competitive strategies. Perhaps the primary benefit to be enjoyed by firms that successfully integrate low-cost and differentiation strategies is that it is generally harder for competitors to duplicate or imitate such strategies. An integrated strategy enables a firm to provide two types of value to customers: differentiated attributes (such as high quality, brand identification, reputation) and lower prices (because of the firm’s lower costs in value creating activities). The goal becomes one of providing unique value to customers in an efficient manner. Some firms are able to attain both types of advantages simultaneously. For example, superior quality can lead to lower costs because there is less need for rework in manufacturing, fewer warranty claims, a reduced need for customer service personnel to resolve customer complaints, and so forth. Thus, the benefit of combining advantages can be additive instead of merely involving tradeoffs. Let’s look at how an Internet firm, NextCard, illustrates this strategic approach:

NextCard enjoyed early success by being the first to allow consumers to apply for credit cards over the Internet and the first to provide instant approvals. Its signature product is a customizable Visa card available exclusively on-line. NextCard is the only credit card company to solicit customers entirely over the Web. Although the firm suffered during the year 2000 downturn, it has maintained quality customers and low delinquency levels and charge-offs. It has done so in a cost efficient way, spending only $65 per account to solicit new customers compared with $90 to $110 that its off-line competitors spend.

The greatest beneficiaries are likely to be focusers who use the Internet to capture a previously inaccessible market niche or develop highly specialized capabilities. Yet even this is not assured; the same factors that make it possible for a small niche player to be a contender may make that same niche attractive to a larger company. An incumbent firm that thought a niche market was not worth the effort in the past may now use Internet technologies to enter that segment at lower cost. If larger companies find it worthwhile to enter, they will bring their market

### Table 1: Advantages and Pitfalls of Internet-Based Strategies

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<td>Inventory reduction</td>
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<td>Increased buyer power</td>
<td>Ability for customers to customize—products and services</td>
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<td>Improved warehouse management</td>
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<td>Pitfalls</td>
<td>Channel conflict</td>
<td>Customers may find little value in customizable products and services</td>
<td>Overextension of market niche encourages substitution and imitation</td>
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<td>Higher threats from substitution and imitation</td>
<td>Dilution of brand image or company reputation</td>
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power and resources to bear in a way that a smaller competitor cannot keep up with.

This was the situation faced by Loudcloud Inc. when it went public. Founded by Marc Andreessen, co-founder of Netscape Communications Corp., Loudcloud Inc. provides reliable Web sites for high-demand users from media outfits to e-tailers using a proprietary capability called Opsware that quickly integrates different types of software programs. However, technology giants such as Electronic Data Systems (EDS) Corp. and IBM Corp. have recently entered this market offering customers another kind of reliability—trusted brand names—at competitive prices.

Firms using combination strategies may also fall short if they underestimate the demands of combining approaches and get “stuck in the middle.” This can lead to inaccurately assessing the costs and benefits of a strategy that combines differentiating and low cost features: firms may believe they can keep prices and costs low, but still try to offer high-end services that are expensive to provide. Many dot.com startups fell into this trap. Consider Kozmo.com:

Kozmo.com sought to develop a rapid-response delivery service using bicycles, one of the cheapest forms of delivery. It believed urban Internet users would grow accustomed to receiving everything delivered to their door on short notice, from a cup of coffee to a video to show tickets, and that their bicycle delivery “army” could provide it. But the products they focused on tended to be low price, and there were too few users. They tried to broaden their service by delivering higher margin products and forming an alliance with Starbucks, but this failed to produce much additional revenue. In the end, they were unable to generate enough business to keep their cyclists employed and their company in operation.

Another potential pitfall for companies using combination strategies relates to the difficulty of managing complex strategies. Managers tend to develop a bias in favor of the functional areas they are most familiar with. Some companies fall into the trap of believing in “one best way” to accomplish organizational goals. A combination strategy, by definition, challenges a company to carefully blend alternative strategic approaches, remaining mindful of the impact different decisions have on the firm’s value-creating processes and its extended value chain activities. Strong leadership is needed to maintain a birds-eye perspective on the integrated, overall approach and coordinate the multiple dimensions of a combination strategy.

Even with the potential pitfalls, combination strategies that are attuned to market opportunities and make the best use of Internet technologies have the strongest chance of success in the era of the Internet. Thus, strategic managers need to consider how to reconfigure traditional strategies to make them effective in the new economy.

**IMPLICATIONS FOR DEVELOPING STRATEGIES**

The Internet is changing the way business is conducted. This has enormous implications that today’s managers need to take into account when formulating and implementing strategies. Two factors are especially important. First, Internet-based technologies are creating new capabilities that are altering the rules of competition. These technologies are allowing businesses to interact with each other and customers in new, faster, smarter, and cheaper ways that are forever changing the competitive landscape. Second, even though these new capabilities are fundamentally altering the way business is conducted, the technologies themselves do not create the new conditions. It is the use of these technologies by suppliers, buyers, intermediaries, alliance partners, and others that will ultimately determine how the Internet affects a firm’s operations. As Internet-based capabil-
ities and related information technologies become more widespread, strategic managers must increasingly integrate the Internet into their strategic plans.

The way that existing firms are responding to these changes is instructive. Let’s consider some examples of how companies are crafting and deploying strategies in the Internet economy.

Overall low-cost strategies may be more important as some firms use Internet technologies to lower transaction costs and increase their operating efficiency. K-Mart Corp. has chosen an unusual approach to keeping its e-commerce costs low:

K-Mart Corp. is one of several major corporations that generated entirely new ventures rather than attempt to combine their e-commerce activities with their existing bricks-and-mortar operations. The cost of integrating legacy systems with new Internet-based information systems was very high and did not add value. Thus, K-Mart’s strategy was to spin off Bluelight.com, a separate e-commerce venture. Named for the “blue light specials” that are part of K-Mart’s in-store strategy, Bluelight.com (which is operating normally during K-Mart’s restructuring) is K-Mart’s on-line store. “K-Mart and Bluelight are doing things right,” says Paul Gosselin, executive vice president of Zone28, an applications provider for on-line retailers. “The separation (of on-line and retail operations) can keep K-Mart more focused on brick-and-mortar issues.” So far it’s working. Bluelight.com attracted 8.2 million visitors in December 2000, making it one of the top 10 most visited Web sites.

Differentiation strategies may be harder to implement for many firms because the Internet is eroding some of their most unique features. Even so, several major corporations have found that the Internet can successfully showcase their brand name products. Sears, Roebuck Co. is using the Internet to promote its popular Kenmore line of appliances. But Sears isn’t worried that visitors to its Web site don’t always click on the buy button. The Web site itself is a valuable information resource and, compared to print advertising, viewing products digitally on the Web is relatively inexpensive. In fact, Sears reported that $500 million worth of recent in-store appliance sales were influenced by customers researching on-line first.

Note that in the previous two examples, even though the companies had a dominant strategy, they combined it with other strategic approaches. In the case of K-Mart, a major objective with the Bluelight.com initiative was to operate more efficiently. But the strategy also made it possible for K-Mart to stay focused on its brick-and-mortar stores. In the case of Sears, its Web site offers a rich source of consumer information and a venue where it can strengthen the reputation of its best brands. But it also provides a lower cost way to market its products than its traditional print advertising approach. Thus, in the case of these two companies, combination strategies are helping sustain a competitive advantage.

Focus strategies may increase in importance as use of the Internet expands. For one thing, the Internet provides highly targeted and lower cost access to narrow or specialized markets. But beyond the Internet’s new technological capabilities, the strategic advantages of focusing on a core competence enhance the potential to earn above average profits. FreeMarkets, Inc. provides a good example of how one Internet startup leveraged its initial core competence into a successful Web-based business.

FreeMarkets, Inc. began in 1995 with a simple proposition: use the Internet to facilitate purchasing. It developed proprietary software that was used to conduct a specialized kind of transaction, the reverse auction, in which buyers name the price they would like to pay for products or
services, and suppliers bid competitively to get the buyer’s business. In traditional auctions, many buyers bid for the products of a few suppliers; in reverse auctions, by contrast, many suppliers provide bids to just a few buyers. What FreeMarkets recognized was that the Web could be used as a platform where many suppliers could participate in real time, a capability that was impractical before the Internet. Since many suppliers were needed to make it work, their original business model involved seeking out and pre-qualifying suppliers. Although FreeMarkets, like many Internet startups, is still struggling toward profitability, its strategy is working and its customer base is growing.

Carrier Corp., the world’s largest manufacturer of air conditioners, turned to FreeMarkets after its own on-line auction resulted in only 20 suppliers and 5% in savings. According to president Jonathan Ayers, Carrier, which buys over 100 million motors each year, turned to FreeMarkets. “Right off the bat, we expanded the number of qualified vendors from 20 to 68. Then, over a two-day period, we ran a series of competitive-bidding events. By using the Net, we were able to have lots of suppliers bidding in real time from several countries, including China, Korea, Malaysia, and Thailand. We simply couldn’t consider that kind of thing before we started using the Web. And this time around, we saved 16% on the cost of components.”

Today, FreeMarkets has expanded its horizons to include information and support services that complement its e-sourcing software. Its customers include Deere & Company (John Deere), GlaxoSmithKline, and United Technologies Corp. But it still specializes in B2B auctions that focus on vertical supply chains.

This focus may be important as other forms of e-marketplaces emerge that compete with the services FreeMarkets provides. Here’s why:

Many industry groups are working to establish e-marketplaces, that is, Web-based virtual trading floors where participants can reduce transaction costs and reach new customers. FreeMarket’s auction is just one approach. There are also exchanges that operate like the stock exchange (such as Altra Energy for natural gas) and virtual communities that provide services, information, and trading opportunities to specialized industry groups (such as VerticalNet). Because buyers and sellers want to be where the action is, only one or two big e-marketplaces is likely to survive in each industry. Unless FreeMarkets can establish itself as a leading provider of sourcing services, there is a danger that its control over some of its supply chain verticals will erode. To remain competitive, FreeMarkets has to specialize in those industries where its reputations and brand identity are strong, and where auctions are the preferred way of doing business. Thus, it is combining support services and other differentiating features to complement the advantages it already enjoys in on-line auctions. FreeMarkets is also expanding by offering services to smaller businesses and providing a wider array of sourcing services for its big customers such as Carrier and John Deere.

Clearly, FreeMarkets has benefited from pursuing a focus strategy. But it is also striving to provide cost advantages to its customers by creating substantial operating efficiencies from using its services and attempting to differentiate itself by expanding its customer services and support. By recognizing the Internet’s potential and combining strategies, FreeMarkets has created a new strategic position aimed at achieving a competitive advantage that is sustainable.

As these examples suggest, the Internet is a dynamic and rapidly evolving business environment where new competitors and improved capabilities are continually
changing the competitive landscape. In the case of FreeMarkets, it is the evolving nature of e-marketplaces that may influence its strategic positioning and future success. The changing nature of the Internet provides both exciting challenges for strategic managers and also important reminders of the need to carefully monitor trends and understand the dangers as well as the potential benefits of Internet-based approaches.

Thus, the Internet, while promising to provide new opportunities for creating value and fostering firm growth, may make the competitive landscape more challenging for many firms. We have addressed both the pitfalls and the possibilities provided by the rapidly expanding presence of the Internet. Companies that seize these possibilities may achieve competitive advantages and, in some cases, these advantages may be sustainable. But the Internet has also created the very factors that are contributing to the erosion of competitive advantages. FreeMarkets provides an illustration: during the economic downturn in 2001, suppliers participating in on-line auctions were willing to accept lower prices because they needed the business. As a result, FreeMarket’s customers’ savings increased substantially. But because FreeMarkets makes money by charging a percentage of what its customers spend, it lost revenue. The service that made FreeMarkets successful continued to benefit its customers, but caused FreeMarket’s profitability to suffer.

Such stories emphasize why strategic managers must stay at least one step ahead of the changes and closely monitor potential rivals to successfully sustain Internet-based advantages. Further, we believe that by combining strategies in ways that capture market opportunities and make the best use of the new technology, competitive advantages can be sustained. Indeed, the key to effectively implementing all e-business strategies is for the leaders of today’s firms to recognize that the Internet is forever changing the way business is conducted. They must adopt practices that make use of advantages offered by the Internet such as tapping new markets, lowering costs, and managing inventory. Perhaps most importantly, strategic managers need to accept that the Internet is here to stay. As Intel chairman Andy Grove expressed it, “The world now runs on Internet time.”
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