

Erasmus University Rotterdam

**MSc in Maritime Economics and Logistics**

*2014/2015*

Implication of combining the differentiation strategy  
with the cost leadership strategy for container  
shipping lines

by

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## **Acknowledgements**

After a decade of working life, I joined the university to complete my master's degree at the age of 37 years. It was not an easy transition from professional routine life to get back into the classroom and study for a year. Personal aspiration and some turn in life events inspired me to take a chance, which I did and looking forward what it brings to me. Though it was not an easy year, in terms of intensity and demand of the course, uncertainties of the future; nevertheless it was very rewarding too. It helped me to recharge myself, think and encouraged to explore the career opportunities what I feel passionate about.

However this wouldn't have been possible without the support of my wife Koel and son Akash. They have accepted a lot of sacrifice and provided me strength in order to make my dream come true. My parent's blessings and moral support always encouraged me to pursue and stay focussed. I am extremely thankful and grateful for all the support they rendered to me.

I would like to thank my thesis supervisor Drs. Larissa van der Lugt for her time and guidance in writing the thesis. Her valuable input and feedback helped me to complete the thesis, which I found extremely challenging at the beginning. I would also like to thank all the professors, Mrs. Renee Slater and other MEL staffs for their help and support.

Last but not the least; I am thankful to all my friends and colleagues of the MEL class with whom I have shared some good time together. It's been cherish able and rewarding. This would have been an incomplete journey without all of you.

## **Abstract**

After a continuous growth for few decades, container shipping lines faced a new reality post 2008 economic crisis. There are significant challenges the industry is facing, which forced many companies to go bankrupt and the rest are struggling to survive and generate acceptable return on investment. Container liner industry is in a deflationary trend, and the companies are trying to cope up with the situation by reducing their cost base. However to gain sustainable competitive advantages container lines also need to create differentiation opportunities and attempt to increase the revenue. In this research, we have studied the implication of combining both the strategies for a container shipping line. We have done a qualitative study and case analysis of Maersk's three strategic initiatives, based on the analytical framework and conceptual model derived from the literature review. Our findings are cost leadership is the most dominant strategy for this industry, however to gain sustainable competitive advantages companies should try to create differentiation by implementing the combined strategies. Customer segmentation is extremely important in targeting the right market and implementing the combined strategy successfully, because the success depends on the customer's perceived value in the offered product or service, and their willingness to pay.

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## 1. Introduction

Shipping is an ocean transportation of cargo from one point to other. It's a derived demand, and is needed when there is a need for transporting goods or cargo from one place to other and so is dependent on the international trade. It is estimated that currently more than 60% of the global ocean transportation is done in container shipping (Container penetration in maritime transport worldwide in 2000 and 2011, 2015). It is revolutionary because the start of containerization was in the beginning of 1960s (Haralambides, 2007) which radically changed the way of ocean transportation. Since then, the container shipping industry saw a steady growth mainly fuelled by container penetration – a shift from transporting cargo in bulk to container, sustained economic and trade growth and increased globalisation with international sourcing and manufacturing. Globalisation has helped shipping to grow tremendously and also created new opportunities for the container lines in the transport chain (Notteboom & Winkelmanns, 2001). At the same time globalisation has also created intense competition and instability in the market. The continuous changing in the market structure and consequently the demand from the shippers has forced the shipping lines to change the way they operate and explore ways to adapt to the change. Container shipping industry is too international to be regulated by any governing body, and hence it created a self-regulation mechanism through the liner conference system where the ship owners used to meet and discuss of freight rates and capacity. However the abolition of the conference system in 2008 due to the EU competition laws led this highly capital intensive industry completely de-regulated and vulnerable.

The container shipping industries grew rapidly, and were profitable till the economic crisis hit on 2008. Since then most of the container shipping lines except very few are highly unprofitable and in poor health. The economy has still not recovered fully; the trades are not growing at the same level of the capacity in the market and the earnings and profitability have been extremely volatile. There is imbalance between supply and demand, and shipping companies' still continuing building capacities making the situation worse. Customers are also reducing their costs, and demanding better services at lower cost. The market is saturated, and the industry is in a race of gaining market share engaging in price wars and further dragging the freight rates down. Ultra large vessels deployed in the East-West trade to achieve economies of scale creating a cascading effect in the North-South trade, with vessels underutilised and raising concerns over the diseconomies of scale. The combination of poor financial performance, ruthless competition, and a less regulated industry with the abolish of conference system have put shipping industries under high pressure, and some companies are threatened by bankruptcy. Container lines are striving to reduce the cost and find opportunities to increase the revenue in order to survive and stay profitable. Most companies are taking extreme measures of cost cutting to stay in the game, whereas some are trying to create a differentiation in their product & service offerings or trying to capture a niche market. And some companies are trying both the strategies to sustain a competitive advantage.

In these challenges and changing market dynamics, container shipping companies need to reposition themselves and must have a clear strategy. Container shipping companies need to choose their position, business model and decide on what value proposition they want to deliver to their customers. Each type of business needs specific set of resources and capabilities and it is important for the container

shipping companies to understand and decide in which segment they want to play in and be able retain the cost leadership position within their segment.

Regardless the segment each container shipping line chooses to follow, however in order to be the winner they need to optimize their capabilities in

- Efficiency, quality and economy
  - Network profitability management
  - Customer relationship management
  - Advanced business intelligence
- (Naresh Hingorani, 2005)

There are many contingent factors that determine how firms strategize in shipping industry; it mainly depends on the company size and ownership. Bigger firms have different strategic approach than the medium or smaller firms, same as a group companies have different strategic approach than an individual firm (Panayides, 2011).

There can be different strategies for a firm to position themselves. A strategy which is good for one company may not be suitable for the other as it depends on the individual position and goal of the firms.

Here in this paper, we will analyse the implication of a firm if combine both the strategy of cost leadership and differentiation, and what are its advantages and limitations.

### **1.1. Relevance**

There are significant industry issues and beyond any individual company's scope to change all at a time. The situation is not expected to change any time sooner, with more capacities entering into the market. However the container shipping lines cannot sit with their hands tight and wait for the good times. Companies must act in transforming themselves and should try to turn the challenges into their competitive advantage. In this situation the companies who act first can step ahead in the game and can achieve profitability. Due to the sticky nature of this industry, when rest of the companies follow and achieve the same, it is likely the benefit will be passed to the customer and this no longer remains a competitive advantage for any company.

The shipping industry itself is commoditised, conservative, matured and non-innovative. On one hand these are the challenges and on the other hand this provides a lot of opportunities to improve efficiency and achieve competitive advantage, whether through cost leadership by reducing operational cost, optimizing network design, taking the advantage of crisis in procurement and make better contract with the suppliers like terminals, bunker etc.; or to create differentiation by offering value added services based on the customer's need and charge premium over the average freight.

Both the cost leadership and differentiation strategies are important for a company to secure competitive advantages, however one may or may not be complimentary with the other strategy. Here in this paper, we will look into the implications if both

the cost leadership and differentiation strategies are combined for a container shipping line.

## **1.2. Research Objectives**

Some strategic literature says that companies must choose one strategy, either cost leadership or differentiation, because one is incompatible with the other and cannot produce a sustainable competitive advantage if combined (Porter, 1985). However some other literature argues that both the cost leadership and differentiation strategies can be compatible with each other and can help in creating sustainable competitive advantage (Hill, 1988) (Miller, 1992) (Miller & Dess, 1993) (Kim, Nam, & Stimpert, 2004) (Wright, Kroll, Tu, & Helms, 1991) (Yasai-Ardekani & Nystrom, 1996).

The research aims to study; if it is profitable for the container lines to adopt both the cost leadership and differentiation strategies together, and whether it helps the firms to gain sustainable competitive advantages. Therefore, it aims to answer what are the issues for a container shipping line to adopt single strategy of either cost leadership or differentiation. In other words, what are the advantages and limitations if the combined strategy is adopted?

As such the main research question, which this thesis aims to answer, is

“What are the implications if both the cost leadership and differentiation strategies are combined, in a container shipping company?”

To sufficiently answer the research question, following sub research questions must be answered.

“What are the strategic issues for the container shipping line?”

“Why cost leadership and differentiation strategies are important for the container shipping line?”

“What positioning is logical for the container shipping lines?”

“What are the limitations for implementing differentiation strategy in a cost leadership company?”

## **1.3. Research Design and Methodology**

This research will employ qualitative method to find out the implications of combining both the cost leadership and differentiation strategies in container liner industry. We have done literature reviews on positioning strategies and container liner industry, based on which we have derived some strategic aspects and have created a conceptual model. Further we have conducted case analysis on Maersk Line which is currently the largest and most profitable container shipping line, and analysed three of its strategic initiatives to study the implications.

Two interviews are conducted with the Maersk middle-level managers to review the aspects of our findings and case analysis. There are other various sources used to gather the data and information. I myself have worked with Maersk since 2002 to 2014 and witnessed the transformation and change from growth strategy to 'Streamline', 'Back to Black' and partly 'Must win Battle' strategies. I was responsible in handling one of the global strategic accounts of Maersk the 'US Military' account, the experience and knowledge I gained is brought in this paper. I also gathered information of the 'Daily Maersk' product and 'Customer Care' project, through the Maersk internal meetings and training programs, which is also used here. The perspectives of five ex colleagues of Maersk are also taken and the information is used in the research. Further the information available through internet and intranet including news article, video interview of the Maersk executives and Maersk customers etc. are taken into account. Some more senior executives of Maersk were planned to be interviewed from both commercial and operational side, however due to summer holidays and busy timing it was not possible.

#### **1.4. Thesis Structure**

Chap 2 describes the current challenges and the general characteristics of the container shipping lines. Chap 3 illustrates relevant theoretical perspectives on positioning schools of strategy. Based on the literature review, Chap 4 is an analytical framework on different aspects of a container shipping line with a combined strategy, based on which a conceptual model is proposed. In Chap 5, we did three case analyses of Maersk and discussed those cases based on the proposed conceptual model. Finally Chap 6 concludes by summarizing the key findings of the implications.

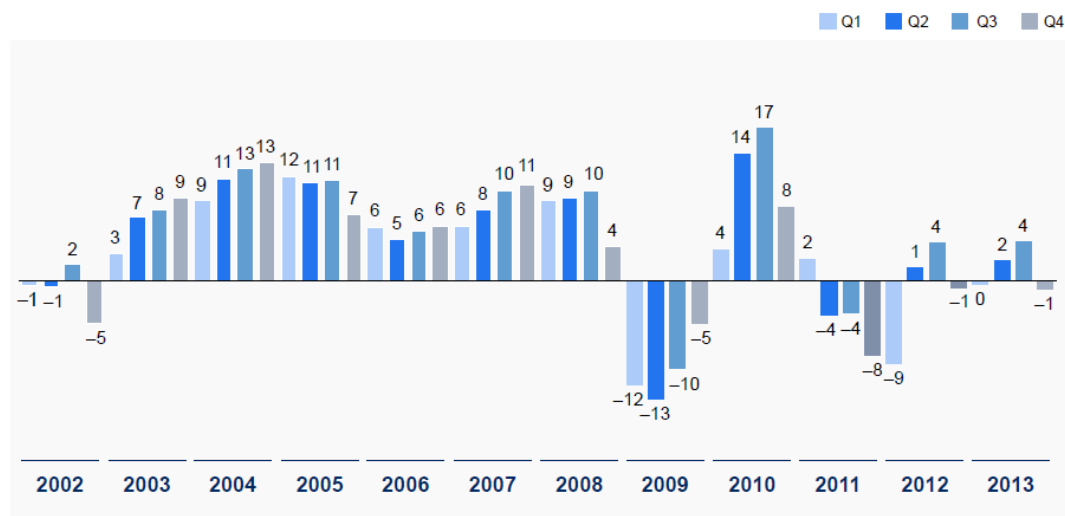


## 2. Container Shipping Industry

### 2.1. Current Challenges:

The container shipping industry is facing many challenges since the economic crisis 2009; overcapacity in the market, falling freight rates, infrastructural constraints, volatile earnings etc. which resulted in poor profitability and financial performance of the companies. This situation is constantly threatening its existence and forcing many shipping lines to consider how they will adapt and sustain in this scenario, and emerge as a winner.

Industry<sup>1</sup> earnings before interest and tax, 2004–13, %



<sup>1</sup> Includes 14 of the world's largest publicly traded container-shipping companies.  
Source: Bloomberg, company quarterly reports

#### *Economic slowdown:*

The economic crisis of 2008 has destroyed lot of the value that the shipping industry created over the past decades. The economy is yet to recover fully, and we see the low demand growth within the developed and high consumption regions like US, EU etc. As we know shipping is a derived demand, so unless the trade grows the demand for shipping also cannot grow.

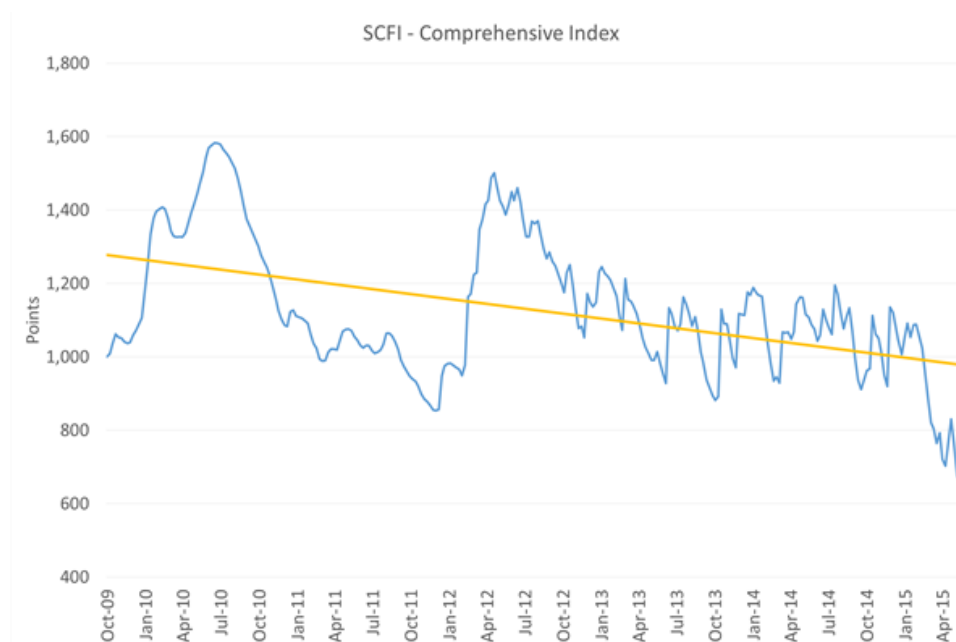
#### *Overcapacity:*

The ships ordered prior the crisis in 2008 entered into the market where the demand for cargo transportation didn't grow at the same rate. Further shipping companies are still building capacity and purchasing ultra large vessels to reduce per unit cost and gain economies of scale. The supply growth has consistently outpaced the demand, causing over capacity in the market.

#### *Falling Freight rates:*

The overcapacity in the market, combined with the competition to win over the same limited cargo has led to a situation of price war where the freight rates dropped

drastically in all trade lanes. The major impact being on the biggest trade lanes Asia-Europe and Trans-pacific, as there are not enough cargo to fill up the ships. As per the latest information in mid-2015, the container freight rates on the Asia-Europe trade has dropped below the fuel cost. Data from Shanghai Containerized Freight Index show that the cost of shipping a container from Shanghai to Rotterdam has dropped 15% from the previous week to 243\$ which is approximately 50\$ less than the average fuel cost for that sailing. (Paris, 2015)



*Infrastructure constraints:*

The industry is also suffering from the infrastructural challenges. The increase in the size of the vessels demands accessibility, faster cargo handling rate to ensure the reliability and to optimize the use of assets. However draft restrictions, poor productivity, organized labour restrictions, bottleneck and congestion at port and hinterland are some of the infrastructural challenges the shipping industry is facing.

*Imbalance trade flows:*

With the globalisation the manufacturing hubs are centralised around the low cost countries in Asia, and as a result there is trade imbalance in the major trade lanes Asia-Europe and Trans-Pacific. The cargoes are exported from Asia to EU and US, however for obvious reasons there are not enough exports cargoes from import oriented regions EU/US to their origin Asia. As a result there is a deficit of empties in Asia, whereas there is surplus in EU/US. The positioning of the empties is a major cost for the shipping lines which is approximately 25% of the operational cost as per the IBM Business Consulting Services estimate (Naresh Hingorani, 2005), since it not only occupies a slot in the vessel but also negatively affect the asset utilisation of the containers.

*Industry Practises:*

Shipping in a way is an old, traditional and dull industry. Though the business sounds simple about transporting cargo from one point to another, however the processes in practice are difficult, complicated and cumbersome. There are various parties involved in the chain process and so the information and communication flow

is a challenge and can halt the process costing time and money. From the booking stage to delivery there are still lot of documentation involved in every stage of shipping and the industry practise of creating dummy bookings, bad forecasting, multiple amendments etc. make the process less efficient and costly. There are many rules and regulations to comply with different authorities making it more difficult for shipping lines, safety and security risks are involved and last but not least industry developed a practise of doing business on credit. All these impact shipping line's efficiency and cost effectiveness.

#### *Competition:*

Though shipping is an asset based capital intensive industry with high entry barrier, however there is very high competition from the shipping lines operating within the industry and also externally from the freight forwarder companies, competing for the same cargo. It is very easy for shipping lines to compete with the other by deploying its capacity on the same trade lane or entering the market through vessel sharing agreement. Also due to the trend of shipping line's hub and spoke network the demand of the customers is shifting towards service orientation, and demanding integrated logistic solution than just point to point to shipping. As a result NVOCCs, freight forwarders, logistics service providers like Kuehne Nagel, Panalpina, DHL etc. who already are experts in end to end value proposition and inland logistics are taking advantages of building closer relationship with the customers and threatening the shipping lines position. This put the pressure to the shipping lines to be just the supplier for these freight forwarders and compete with its peers on the cost, whereas freight forwarders are positioning themselves to be a logistics solution provider and enjoy the margin from each part of the logistics chain without any investment on the assets.

#### *Customer demands:*

Customers are becoming more and more demanding, they want more reliability, flexibility, visibility and at lower cost. Customers are looking for additional value and reduce cost in their supply chain, and looking for end to end solution in order to reduce their overall cost in transportation, inventory and administration.

Going forward, customer value propositions in the container shipping line industry will demand for

- Most efficient and focussed operation: Being cost efficient
- Full service container shipping line: End to End transportation
- Integrated supply chain service provider: Value added services

(Naresh Hingorani, 2005)

## **2.2 General characteristics of the container shipping lines**

### *Organizational aspect*

Container shipping lines business is to provide regular services of ocean transportation of cargoes, stuffed inside container from one point to another, following the fixed time schedules and based on advertised, agreed price with the customers arranged in advance. The vessels need to leave the port on fixed time to maintain schedule reliability, irrespective of the fact whether there is enough cargo available, and if it is worth sailing for the next call. It may not be that difficult to

charter a vessel, however to run a container liner service it need to set up an extensive global network like sufficient number of vessels to maintain the time schedules and rotation, sufficient containers positioned at each port to serve the customers, port call agreements, IT and technological support, ICD arrangements etc. To run this kind of service it needs extensive infrastructure and assets, like ships, containers, terminals for cargo handling and agencies to run the operation. This is highly costly affair in terms of capital investment, time and management needed to set up that. Container shipping is not an easy business, its asset based; complex and capital intensive, it is costly to enter and run the business and also costly to exit the business as there are lot of sunk costs, the costs spend in building the network and market. It goes without saying, that lot of capital investment is needed to run this asset oriented industry. For example, to establish a weekly service network between Asia-Europe require more than a billion dollar investment. (Haralambides, 2007)

#### *Operational aspect*

In container liner service, once the network is set the liner is obliged to provide regular and reliable services meaning the ship need to leave the port regardless it is full or empty. It incurs fixed cost anyways, irrespective of sailing with or without cargo, which creates a pressure to the shipping companies to fill up their capacities by targeting volume, even if they have to shed their prices. Another big operational cost for the container shipping lines is to manage their equipment fleet. Due to trade imbalances, the number of exports and imports are not balanced which put the liner into a situation to position empty containers from surplus areas (import region) to deficit areas ( export region). Moving empty containers is costly; as it not only occupies a slot in a ship which is an opportunity cost but also incurs terminal handling cost. This situation also influences the liner shipping companies to secure any low paying cargo, and transport them just on Marginal Cost. These are opportunities for the shippers to transport their cargo at very low cost, however comes at a cost of the shipping liners who have set themselves in a position by accepting cargoes at a freight, below their total cost structure.

#### *Market Dynamics*

Transport is a derived demand; the need of transport arises when there is a demand to trade the cargo from one place to another. The demand for transport cannot be created itself and is dependent on the trade flows. So when there is trade, transport will be demanded to support the same, irrespective of its price. Demand for transport is inelastic to the freight rate; however the demand for individual operator's service is elastic. Shipping is commoditised, so though the transport freight cost is negligible compare to the shipment value, however still the customers have option to choose the low cost carrier. Now carriers are not is a position to influence the market after the abolishment of conference mechanism, they are engaged in the price competition to offer better prices to secure short run market share (Professor HE Haralambides, 2003). A perfect contestable market is a market where there are no barriers to entry or exit and both are costless, which brings the possibility to attract lot of competition in the same industry or in other words the industry where entry and exit barrier very high there is possibility to eliminate the competition. However for container shipping line though the entries of new carriers or companies are restricted due to its high entry and exit barrier, however the entry of new ships or

old ships from another route to the same trade route is not restricted. It's not the actual entry of a new competitor company in the market but the threat of competition which led the industry to destructive competition and intense concentration on cost. (Pearson, 1987) (Jankowski & Davies, 1989)

### *Strategic positioning*

The capital intensity of the business, high risk and low returns on investment are major concerns for the business. In order to improve the financial performance and profitability, there are two ways to do, either increase the revenue or decrease the cost. Container liners don't have much influence on the revenue side since they are price takers. They have more influence and control over the cost, which are internal focussed and perhaps easier to achieve a defensive mechanism. Container shipping line is a high fixed cost, asset based industry, and therefore vessel utilisation is important. If there are not enough volumes to fill up the ships, then the unit cost per container increases and benefits of the economies of scale are lost and turn negatively into diseconomies of scale. Therefore, the industry is in the trend of declining freight rate or price to secure the business volume, and in this situation the only option to make money is to save money from the cost. As (Panayides W. , 2011) states after the abolition of the Conferences system when there are no control of the shipping companies over pricing, then winners are those who can develop cost leadership. In container shipping, cost leadership is largely associated with economies of scale by operating larger fuel efficient vessels and thus by reducing unit cost per teu. Larger vessels produce economic benefits in building costs also since it is not proportional to the cargo capacity of the vessel. Cost leadership through economies of scale is just one thing; the same can be achieved also through strategic alliance by cooperating and sharing the operational costs with the competitor company, by sharing the terminal and maximising asset utilization. The alliances are done when two or more shipping companies mutually agree to cooperate with each other in order to achieve commercial and operational gains. Through alliances shipping companies can reach to new market, expand network and increase frequency which can add value to the customers. Further different companies coming together brings lot of knowledge which can be used in increasing vessel utilization, operational efficiency and buying power against the suppliers. Firms can pass these benefits to the customer through a better value proposition.

Deploying large vessels on a trade have a cascading effect on the other trade routes, where the overcapacity issue is also spread. Eventually when supply is more than the demand, the price falls and liners again fall in the loop of price wars where actually none of the shipping lines wins. Customers are the winners here who take away all the benefits of cost savings what the liners developed through investment and hard work. Due to these challenges the return on investment is poor, and not yielding acceptable return on the capital. The potential for cost saving is short term, so in order stay in the business and gain sustainable competitive advantages companies should seek opportunities somewhere else. Container liners must look at the opportunities to increase their revenue and profit. Shipping is the business of sea transportation of cargo from point A to B, which is homogenous and there is not much scope of building competitive advantage on just the transportation part. In order to demand premium over the market price, container liners need to differentiate from the competition and should create a unique value proposition. Container liners could go beyond just moving ocean freight and innovate how to

offer additional value to the customers in order to gain competitive advantage. The differentiation opportunities can be found in terminal operation, warehousing, network coverage or company's responsiveness towards the customers. (Juga, Pekkarinen, & Kilpala, 2008)(Gadhia, Kotzab, & Prockl, 2011) believes that there are opportunities in terms of frequency of sailing, direct sailing, door-door services, logistics services and IT. (Lorange, 2001) believes innovation and service are the key factors in shipping business. It is not necessary for the company to only use its own resources, they can also build a network organization to get the knowledge and utilize best services available. Differentiation is triggered by the customer's needs and innovation helps to provide solution for those needs. Lorange & Fjeldstad states that the successful firms are those who are not afraid of trying new and different things (Lorange & Fjeldstad, 2010). Firms need to look outside their boundaries for innovative ideas. According to (Doloreux & Melancon, 2008) shipping companies are more innovative when they engage with customers, suppliers and other stakeholders and learn from each other.

The ability to differentiate in the physical product like in transit time, network, frequency etc., is very limited for the container shipping lines. Even when a company gains a competitive advantage through its physical product, often the market forces like growing customer experience and knowledge in the market with the differentiated product over the time, and competitor's indulgence in offering similar service destroys its long term sustainability and competitive advantage. Thus the container shipping market is perceived by the customers as a commodity, where the products and services are seen more or less the same and homogenous. Commoditization is not good for the business, since it erodes the competitive differentiation between the players, and eventually impacts the industry. Customers perceive the product and services are more or less same and their bargaining power increases. Customers demand for lower cost and increased global competition engages companies in price wars which reduce the margin. This is a key challenge for this capital intensive industry, as the industry strives to improve their financial performance and bottom-line. Due to the commoditization of the container shipping market, container shipping lines are more cost focussed and characterized by their cost leadership strategy.

There are many literature and theories on strategy, which addresses the concerns of commoditization and talks about strategic positioning of a firm in order to gain sustainable competitive advantages.

### 3. Relevant Theoretical Perspective

#### 3.1. Positioning Schools of Strategy

The word strategy originated from a Greek word called 'strategos' meaning 'general'. It is used to mean 'the act of a general' in a war. In a war the role of the general is to have a plan and act in a way against the enemy with the goal to win. So 'strategy' is all about the bigger picture, how to position yourself against the enemy in order to win. Around 400 BC the legendary Chinese general Sun Tzu mentioned strategy as 'the art of war' in his book (Horwath, 2006). There can be many complex tactics and actions needed to support the strategy in order to win or achieve the final goal. In this modern age, often businesses are seen in the same perspective of a commercial war and the role of the executives is similar to the general, to have a vision and orchestrate its resources against the challenges and rivals in order to achieve its goal. Strategy is the word used in broader terms to state how the organization is going to position itself in order to win, the choices the organization make to distinguish itself against the competition and deliver the unique value in the market (Porter M. E., 1996) . It is the core understanding of the organization's distinctive position it seeks to occupy in the market in order to achieve its goal. Strategy defines the road map to reach the final goal, and actions are about every step in your journey on the road map and stay within the course until the goal is reached.

Strategic thinking is not for competing head to head, but trying to be unique which will eventually help to win. To have a good business strategy organization must think strategic, and should be able to clearly answer some fundamental questions like:

- Where does the company compete, or in other words in which Market the company wants to be active or participate?
- What unique value does it bring to the customer, or in other words why the customers will chose the product/service of this company over the competition? Is it cost or differentiation in product and services?
- What resources does it utilize? Is it the technological advantage or market reputation, or exceptional network coverage etc.?
- How can it sustain to provide this unique value? In other words, what factors will determine that the company will win over time and will not be taken over by the competition?

(Kryscynski, 2015)

In this research paper, the positioning perspectives of the container shipping line are more relevant, and hence different positioning schools of strategy are discussed in this context. There are different multitudes of concepts in strategic management theory, and most notably are Mintzberg's schools of thought on strategy formulation, Porter's generic strategies and Resource Based View of a firm. Mintzberg explained about what are strategies, how it emerges and its development process. Porter took an outside-in approach where he focusses on external environment and views strategy is being industry driven, whereas Research based View is inside-out approach, where it focusses on the internal resources of the firm and views strategy is defined by the firm's unique resources and capabilities. Perhaps reviewing a firm from all perspectives will give a holistic view of the strategic positioning of a firm.

### **3.1.1. Mintzberg perspective**

Mintzberg's perspective could be of interest here, because he provides an overview of different perspectives on strategy of which the positioning school is one and relevant in this context. Mintzberg mentioned ten schools of thought about the strategy formulation, of which positioning school falls under the prescriptive models, that suggests how strategy should be formulated. The Positioning School concept suggests that the company should focus on the current position of the company in the industry, and develop strategies that could help them to change its position. Companies should focus and formulate its strategies in order to change its position within the industry, as well as in the customer's mind. His theory of strategy formulation mainly concentrates more on profit, and do not consider external factors like political, cultural, technology and social factors. Mintzberg also believes strategies do not come out of a formally planned process, it's a deductive process and not inductive, where strategies tend to emerge as people make mistakes and learn things. He explained strategy with his '5 P approach' where he defined Strategy is a Plan an intended form of action or guidelines developed consciously in advance and purposefully to deal with a situation. Strategy can be ploy too, a plan intended to confuse or discourage the competitors. As ploy, strategy engage with threats, deceit practises etc. to gain advantage against the direct competition. As pattern strategy focusses on action and intended behaviour, other than which strategy is useless. When a pattern is realized unintentionally it is called an emergent strategy. Therefore some strategies may not be conscious and purposeful. As position, strategy encourages the organization to look in the competitive environments and decide how they would like to position themselves against the competitors. Strategy is also about Perspective, how the organization perceives the changing world around them and raises questions about intention and behaviour of the organization in collective context.

### **3.1.2. Porter's competitive strategy framework:**

Porter's theory focusses on how to build sustainable competitive advantages of a firm through positioning. It is more of a prescriptive model, where he views the performance of a firm is a function of two factors – industry structure and its market positioning. The ability to make profit in a business depends on how strong is its position in the market. The external environment of the industry or the determinants of the industrial profitability can be analysed through his famous 'Five Forces' theory. Now whichever industry the company is in, the company need to position itself within the industry against the competitors. It is extremely important that in order to be profitable and be a winner, company need to understand it's strategic position and make some choices. There are two ways to increase profitability, either by increasing the revenue/price or by reducing the cost. So the key questions will be what the company is trying to achieve? It is going to be a low cost company or be a differentiator in the market? Does it want to serve all customers in the market or to serve selected customers in a niche market? The most important part of this decision process is the trade-offs – what the company is willing to sacrifice in order to focus on the other, the choices it is making to be distinctive and to position itself stronger against the competitors.

Therefore, according to Porter's theory there are three generic strategies for a firm to be in a strong position and outperform its competitors in a given industry. The first is cost leadership through operational effectiveness; the second is the differentiation



strategy through its strategic positioning and offering something different and unique in the industry. The third is the focus, where the firm choose and concentrate on particular group of customers, market and product /services with a cost focus or differentiation focus. The difference between the cost leadership & differentiation strategy and cost focus & differentiation focus strategy is the competitive scope. The cost leadership & differentiation strategy is targeted to a broad range of customer of a firm, whereas the cost focus and differentiation focus strategy is applied to a specific segment of a market with a narrow competitive scope.

Cost leadership strategy applies when a firm produces at the lowest cost in the industry and targets its customers in most or all segments by offering lowest price. Cost leadership strategy strives to supply, standard high volume product and services, with no extra features or benefits at the most competitive price to the customers, a price which the other competitors can't beat. In order to implement cost leadership strategy a firm need to focus on stringent cost control measures and have to discover and take cost advantages in all areas of operation. According to Porter, companies who can achieve cost leadership and will be able to sustain this position will outperform its competitors in the long run. There are two conditions which Porter identified as differentiation parity or proximity. Firstly cost leader firms, who set the price at the same level or lower to its competitors, can gain higher profit. Secondly cost leader firms need to offer comparable quality of products in the market; otherwise they have to set a very low price level in the market to be attractive which basically will take away the benefit of being a cost leader.

Differentiation strategy applies when a firm targets its customer in most or all segments based on the attributes like unique product, better quality service etc. compare to the competitors, in order to demand premium over the average market price or achieve higher sales and other benefits like customer loyalty. Differentiation strategy tries to create additional value to the customers by offering quality, innovative product, brand name and good services, a unique product which the competition can't beat Therefore a differentiator firm tries to find the attributes which the customers commonly perceive as important, and then tries to achieve unique position by offering those additional values in their product and services.

Focus strategy takes a narrow competitive scope and focus on a or a group of market segments instead of the total market, and uses cost focus strategy to gain cost advantage and differentiation focus strategy to create differentiation in the target segment. The focus strategy targets customers with special needs, and the opportunity arises when the industry fail to meet the special need of the customers. Further the cost that will additionally incur to serve the special need of this segment creates a barrier, which is also an opportunity for the firms who want to gain competitive advantages in that particular segment.

According to Porter (Porter, 1985), each of the three generic strategies is a completely different way of creating sustainable competitive advantage and is incompatible with each other. Cost leadership is more competitor oriented, and focus on the supply side of the market what competitors are doing and offering, in order to benchmark themselves and assess their relative cost position in the market. However differentiation is more customer oriented and focus on the demand side of the market, and tries to seek what additional value it can offer in its product and services based on market needs. Hence a firm must choose between cost

leadership and differentiation strategy, otherwise it will be 'stuck in the middle' and will experience low profitability. Porter meant that while trying to do both cost leadership and differentiation strategy, a firm can end up doing neither very well. Porter stated, "The firm stuck in the middle is almost guaranteed low profitability. It either loses the high-volume customers who demand low prices or must bid away its profits to get this business away from low-cost firms. Yet it also loses high-margin businesses — the cream — to the firms who are focused on high-margin targets or have achieved differentiation overall." (Porter, 1985)

Porter recognized that only under the following conditions a firm can have combination strategies and can still outperform its competitors, when all the competitors are stuck in the middle, when the cost structure of the firm is strongly affected by share or interrelationships and when the firm pioneers a major innovation. However still the firm will be vulnerable to the emergence of the competitors who will focus on either of the two strategies, become an active player in the interrelated industry or imitate the innovation. In other words, Porter stressed that the combination of cost leadership and differentiation strategies will unlikely produce a sustainable competitive advantage. (Porter, 1985)

### **3.1.3. Resource Based View:**

Resource based theory approach focuses on the micro perspective of the firm and relies on the resources and capabilities. It emphasizes that the firm's internal resources are the key determinants for the firm's sustainable competitive advantage. The resource based view suggests that core capabilities of a firm may be identified from the firm's capabilities and resources (Barney, 1991). The core capability concept is mentioned in many literatures and it is asserted that the corporate strategy should be built based on the strength of the firm's capabilities (Lu, 2007). (Ray, Barney, & Muhanna, 2004) found out a correlation between firm's performance and capabilities. (Wernerfelt, 1984) stated that a firm can gain sustainable competitive advantage by developing and deploying valuable resources and capabilities.

According to (Barney, 1991), there are four attributes of the potential for resources to generate sustained competitive advantage of a firm - Value, Rareness, Imperfect Imitability and Substitutability. Valuable resources mean the resources which improve effectiveness or efficiency, improve opportunities or minimize threats. If the resources are not only valuable but also rare it will bring competitive advantage. It should be something hard to imitate or copy, otherwise the competitive advantage achieved being valuable and rare resource will be soon gone once copied by the competitors. Last requirement for a firm resource to sustain competitive advantage is that the resource should not be substituted by similar or equivalent resource.

The difference between firm's performances arises due to the difference in valuable and rare resources which cannot be easily imitated or substituted by the other less performing firms (Barney, 1991).

Though RBV explains about the internal resources of the firm that are required to achieve sustainable competitive advantage, however it doesn't explain much about a firm's positioning strategy within a challenging external environment. A firm may have all the internal resources and capabilities to be successful, but what happens if the industry within which it operates is itself in poor health? Here in this paper about the container shipping lines, the industry structure is of much relevance because of

the nature of the industry which is commoditised and characterized by the cost focussed and differentiation strategies. Further our research is about the implication of combining the cost leadership and differentiation strategy, which is more relevant to review with the Porter's generic strategies.

### **3.2. Literature Review**

Based on the strategic literatures of Porter (1980, 1985), Barney (2002) and Mintzberg (1988), we can summarise that the following three value propositions can lead to competitive advantages and help in de-commoditization of the industry.

- Cost Leadership i.e. differentiation created through operational excellence and price value.
- Product leadership i.e. differentiation based on superior product quality.
- Customer linking i.e. differentiation based on superior service and customer relationship.

Differentiation based on cost leadership is a price based value offer, whereas differentiation based on Product leadership and customers linking are non-price based value offer. Cutting cost and increased operational efficiency may provide temporary relief for the firm in the global competition, however in an industry which is cost focussed and all players are striving to operate at cost efficiency level, only cost leadership will not provide competitive strategy. The companies need to redefine the concept of customer value and offer non price based value propositions as a competitive strategy (Porter, 1996).

"Being 'all things to all people' is a recipe for strategic mediocrity and below-average performance, because it often means that a firm has no competitive advantage at all" (Porter, 1985) Porter further added, cost leadership, differentiation and focus all these represent different approaches towards sustainable competitive advantage and a firm must choose one path otherwise they will not be able to accomplish any of the strategies successfully and gain competitive advantage. As per Porter, cost leadership and differentiation are incompatible with each other, and the combination of both strategies will not produce a sustainable competitive advantage in the long run, because the competitors who will adopt one of the strategies will be better to serve any segment of the market. The companies who will combine both strategies or adopt the 'hybrid' strategy will be 'stuck in the middle' without a coherent strategy.

However many scholars argued that combination of both cost leadership and differentiation strategy is profitable, viable and can be a way to achieve sustainable competitive advantage (Miller & Dess, 1993) (Kim, Nam, & Stimpert, 2004) (Wright, Kroll, Tu, & Helms, 1991). Since the advantages created from cost based or differentiation based strategies are difficult to sustain, the firm who opts for both the strategies may achieve a superior performance than the firms who opts for single strategy. The low cost firms who also pursue differentiation strategy will be able to reduce their vulnerability against the dependency of low cost advantages only (Yasai-Ardekani & Nystrom, 1996).

Charles Hill argued that both the cost leadership and differentiation strategies can be compatible and can help in creating sustainable competitive advantage. Firstly differentiation can help a company in achieving its low cost position within the

industry, either by creating a brand loyalty which reduces the price elasticity of the product and increase the demand of the product, which in turn increases the volume and reduce per unit cost through economies of scale. Secondly there are no unique low cost positions in the industry, and soon the best practises will be copied by the competitors and have the same low cost structure. Hence both differentiation and cost leadership strategies together are needed to create sustainable competitive advantages and perform above industry average (Hill, 1988).

Danny Miller argued Porter's generic strategies from the managerial point of view. He stated specialization in one of the three generic strategies can cause inflexibility and can make the vision of the company narrow and vulnerable, by ignoring customer's need and tastes, by wrong product offerings and it makes easy for the competitors to copy or respond to. It is easier to copy single strategy than the mixed strategy because it doesn't focus on one component only. According to Miller, a strategy that cannot be easily imitated is the base for successfully competing company. He stated "most products must satisfy a significant market in numerous ways: with quality, reliability, style, novelty, convenience, service and price" and thus specializing in one strategy can affect a company negatively (Miller, 1992). In the same line of argument of Hill, Miller stated that the cost leadership and differentiation strategies can be complementary to each other. Differentiation can help in increasing the demand and produce economies of scale, which can reduce the cost of the company. It is also possible "Conversely, production cost savings may allow a company to spend more on marketing, service, or even attractive features, enhancing its ability to differentiate its products" (Miller, 1992)

(Acquaah & Yasai-Ardekani, 2008) stated that 'the stuck in the middle' firms are the ones who failed to pursue both the strategies successfully and should be distinguished from the firms who pursue a combination of strategy with high emphasis on both cost leadership and differentiation. The firms which are 'stuck in the middle' are the ones which neither offer features that are not unique enough to convince customers to buy that product, nor the prices are enough competitive in the market. These are the firms which fail to successfully pursue both the cost leadership and differentiation strategies.

There are many firms who are successful with the implementation of single strategy, and there are also firms who have been very successful with the implementation of hybrid or combined strategies.

For example, Airlines like Air Asia and Retail business like Walmart and Carrefour are very successful with the cost leadership strategy.

Following companies are very successful with their differentiation strategy who

Differentiated by Brand: Harley Davidson motor bikes

Differentiated by Design: Vertu, precious stones studded mobile phones

Differentiated by Positioning: Domino's Pizza '30 min delivery'

Differentiated by Technology: Apple Computers

Differentiated by innovation: 3M

## Examples of companies from different industries on their positioning status

	Differentiators	The Middle	Cost Leaders
Retailing	Nordstrom, Banana Republic, J. Crew	K-Mart, Woolworth	Sears, WalMart, Target
Beer	Microbrewers	Pabst, Blatz	SAB Miller, INBEV
Airlines	Singapore, Cathay Pacific	American	SouthWest, Express Peoples
Cellphones	Apple, Google	Nokia	Commodity Manufacturers
Autos	BMW, Mercedes	Chrysler, GM	Japanese Auto Manufacturers
Soft Drinks	Coke, PepsiCo	Dr. Pepper	Private labels
Orange Juice	Tropicana, Minute Maid	100 small brands	Private labels
White Goods	Sub-Zero, Viking	Maytag, Whirlpool	Korean Manufacturers
Motor Scooters	Aprilia	Piaggio	Honda, Yamaha

(Bruner, 2012)

IKEA is a successful company who uses hybrid strategy. IKEA offers low cost but differentiated furniture product that allows “people with limited means to furnish their houses like rich people”. It offers a compelling value proposition to its customer by offering low cost furniture but stylish, innovative and high quality, which is unbeatable. In order to do so, IKEA implement both cost leadership and differentiation strategy successfully, and so it is difficult to imitate for the competitors. The company realised its cost leadership strategy by, the make to stock concept and not on customer order, outsourcing production and delivery components of the value chain and scheduling set of suppliers to produce equipment parts at the lowest cost possible, arranging low cost logistics and setting large retail units in inexpensive suburban areas with not much emphasis on customer service. The large volume of transport in flat pack saves a lot of logistics cost. The products are cleverly designed can be unassembled and packaged in a compact way which is not only convenient but also can be transported economically adding more value and surplus to the customers. The success of hybrid strategy depends on the firm’s capability to provide better benefits to consumers at a low price, while attaining adequate margin to sustain and reinvest in low cost and differentiation initiatives (Johnson, 2008). IKEA’s success strategy can be analysed by the following factors:

Product Differentiation – IKEA is able to differentiate their product through their innovative and unique design. IKEA is able to merchandise the furniture business, from a traditional costly long term furniture use concept to low cost short term stylish

furniture usage concept. The product represents stylish, modern furniture at low cost.

Pricing – IKEA furniture are priced inexpensive but not cheap. The furniture is priced reasonably and affordable for the majority, however doesn't represent cheap quality.

Marketing – IKEA's marketing strategy is different than other furniture retail stores. IKEA have big stores in the suburban, outside the cities which not only is cost effective for IKEA, but also convenient to travel for the customers by car in terms of parking space, traffic etc. IKEA stores are huge and provide enhanced customer experience by combining the home-office decoration ideas, refreshment facilities like restaurants etc.

Sourcing - IKEA's sourcing strategy is based on volume and long term commitment with the suppliers which helps them to get the products at a very low cost. The whole supply chain process is vertically integrated from sourcing raw materials, manufacturing, product range to distribution to the stores, and IKEA's success lies in managing, controlling and coordinating the entire supply chain.

(Shoulberg, 2015)

## **4. Conceptual Framework**

To put this research in an analytical context, an extensive review of literatures on general strategic theories and container liner industry has been conducted. Based on the literature review, we can identify possible key drivers and barriers of the container lines that may arise towards implementing combined strategies of cost leadership and differentiation, as well as the probable success factors. Also the conditions for success have been discussed. Based on this literature review and findings from the Maersk cases and interviews, a conceptual model is proposed based on which three cases of Maersk are analysed in the next chapter.

### **4.1. Concept of Combined strategies**

We know the challenges of the container liner industry; the supply of capacity is more than the demand in the market which is influencing the freight rates to decline continuously. Due to the high exit barrier of this capital intensive industry and cut throat competition in order to survive in the business is leading to price wars, resulting in a situation for the container liners even to accept rates below the margin, and thus the profitability is poor and generating unacceptable return on investment. Just like any other commercial business, the objective of container shipping line is to increase its profitability or Return on Investment. We know  $\text{Profit} = \text{Revenue} - \text{Cost}$ ; so there are two options a company can increase its profit, either by increasing its revenue or lowering its cost. In order to increase the Revenue, there should be at least one of the two options – Increase in Demand or Increase in Price. In order to increase the demand, either the product needs to appeal to the customers with an added value at the same price, or offer the same product at a lower price. In order to increase price, the product must offer additional value to the customers which the customer recognises and accepts to pay.

This can be achieved through the implementation of cost leadership and differentiation strategies, which are the most common generic strategies discussed in the literatures. Cost leadership aims to achieve lowest cost position in the industry to be able to offer the lowest price. Cost leadership is achieved through standardization and overhead reduction by eliminating differentiation and exceptions in the process. Differentiation strategy aims to offer additional value or uniqueness, to be able to demand additional premium above the market price, which elevates the cost however aimed to recover through a premium price.

The objectives of both the strategies are different. Porter suggested that companies shouldn't adopt both the strategies together as they can get 'stuck in the middle' by not being able to appeal to customers in either way of offering lower price or product with added values. There are also other scholars (Hill, Miller) who argue against this view, and stated that combined strategies can be compatible to each other and if successfully implemented, can gain sustainable competitive advantages. It will be difficult for competitors to imitate, because implementing combined strategies successfully is not only difficult but also there are risks of being stuck in the middle.

#### **4.1.1. Main Drivers**

The main drivers for the combined strategy in a container shipping line are

##### *1. Reducing Cost*

Cost leadership strategy is aimed at reducing cost. The main costs for a container shipping line are Network cost, Operational cost and Organizational cost. The cost leadership in liner industry is mainly achieved through economies of scale and horizontal integration which can be characterized by the constant increase of vessel size, mergers & acquisition and alliances. Cost leadership strategy aims to standardize the product & service, eliminates flexibility and exceptional handling and offers the basic product with a lowest price. As (Gadhia, Kotzab, & Prockl, 2011) states that cost leadership strategy aims at developing low cost provider in the industry by reducing cost on all its value chain activities.

##### *2. Increase in Revenue*

Differentiation strategy is aimed at increasing the revenue. Differentiation strategy in shipping lines is mainly achieved through vertical integration where shipping lines engage in other activities outside just shipping like terminals, intermodal transport and logistics services in order to increase the scope and offer a better value proposition to the customer. According to Robinson, shipping companies can differentiate from competition by providing value that customers will accept (Robinson, 2005).

##### *3. Achieve sustainable competitive advantage*

Adopting only one strategy can gain competitive advantages so long the competition is not catching up. There is no unique cost leadership position for a company, so the company implementing only cost leadership position can be threatened by the competitor who can reduce their cost base further. This practise of competing on price and cost will erode the benefits and further weaken the industry. The company offering only differentiation strategy can also be challenged by the competitor the moment they find way to offer the same differentiated product or service and perhaps can also beat the pioneer company by offering lower price with the help of latest technology and already established know-how and experience from the market. Therefore, adopting the combined strategies of cost leadership and differentiation can help the firm to achieve sustainable competitive advantages like IKEA, because then it becomes difficult for competitors to imitate. There are risks for the competitors to 'stuck in the middle' if they fail to implement combined strategy successfully.

#### **4.1.2. Barriers**

The barriers for combining the differentiation strategy with cost leadership strategy are

##### *1. Risk of Conflict*

Cost leadership is achieved through standardization and overhead reduction by eliminating differentiation and exceptions in the process aimed to offer the lowest price, whereas differentiation is achieved by adding value or uniqueness which elevates the cost however aimed to recover through a premium price. So there is a fundamental difference in the objective, and the companies implementing both



policies together run the risk of failing to implement any strategies successfully; neither achieving the low cost position nor can offer a unique value proposition to the customer and can get 'stuck in the middle', as Porter said. The firm stuck in the middle also probably suffers from a blurred corporate culture and a conflicting set of organizational arrangements and motivation system." (Porter, 1985)

### *2. Commoditisation*

Shipping has been commoditised; customers perceive it is a homogenous product and hence price based offers have become the traditional and dominant marketing strategy for the container liner industry. It reduces customer's willingness to pay the additional price for the product, and thus creates a barrier for the container liner companies to invest in innovation and create additional value through differentiation.

### *3. Herd Mentality*

The container shipping industry is a very traditional and sticky industry. When one company takes a lead and tries to do something different, generally there is a trend other companies also follow the same. The huge overcapacity in the market following the crisis in 2008 is another example of the industries irrational and herd mentality behaviour. It is a discouragement for a company to be the first to invest in trying to innovate and do different, when the possibility of getting it copied is very high and likely the benefits from the knowledge & experience will be taken by the competitor, and when soon all companies follow the same path, it becomes an industry norm and the advantages are completely lost.

### **4.1.3. Success Factors**

The success factors of a container shipping line will depend on the following factors

#### *1. Better Product than competitor*

There can be many factors in ocean transportation like transit time, sailing ports, reliability, customer service, convenience, price etc. which determines customer perception, whether the product is better than the competitor or not. Due to homogeneity in most of the ocean transportation features, it is seen as a commodity. Therefore, the company which will be able to deliver one of the following will likely be successful.

- The similar featured product at a lower price than the competitors.
- The additional value in the product like faster transit time, better customer service or responsiveness, at a same price level of the competitors.
- A much differentiated product in the industry, which offers additional value to the customer's supply chain requirement like integrated logistics, enhanced visibility reporting etc. and hence can demand higher price.

#### *2. Customer's willingness to pay*

The success of the product depends on the customer's willingness to pay for that product. A product can be great in terms of its features, but the success depends whether the customers recognise the additional value in it and how much they are willing to pay for that product. The price which customers are willing to pay, does it generate sufficient margin to maintain profitability and reinvest in the differentiation strategy?

### *3. Compatibility*

The companies, who are successful by adopting the combined strategies, have found ways to implement the cost leadership and differentiation strategies in a way that they are complimentary to each other like in IKEA. The companies with low cost position can charge at the market price, and gain additional profit which they can invest in differentiation in marketing, service, product etc. On the other hand, differentiated product or service may increase the demand which eventually can reduce the cost base through the economies of scale.

### *4. Resources & Capabilities*

(Penrose, 1959) believes that the competitiveness of a firm depends on its ability to use its resources and organize its resources in a way which is not easy to imitate. The resources for a container shipping line are its physical assets like vessels, equipment's & network; capital and human resources. (Olavarrieta & Ellinger, 1997) believe that the strategies like cost leadership and differentiation to gain sustainable competitive advantages should be based on the firm's resources and capabilities. Therefore, firm's resources and capabilities are the determinants of the success of the firm's strategy on cost leadership, differentiation or combined.

### *5. Pricing*

Differentiation achieved through vertical integration like offering integrated logistics, not only an additional scope for the shipping companies to increase revenue & profit, but also an opportunity for the customers to reduce their total transportation cost in terms land side cost, administration and coordination with different suppliers. The seamless, less expensive end to end transportation is an additional value for the customers, which will make commercial sense so long it is cost saving for the customer, as well as it is profitable for the container shipping liner. Therefore, correct pricing is extremely important in implementing the strategies successfully.

### *6. Marketing*

In order to fight commoditisation successfully, companies should offer non price based customer value, and differentiate their product through service centred strategies using value concepts. It is important to engage with customers and understand their business challenges in their value chain, reduce internal organizational conflicts, build up team work & co-operation and prepare for change management. (Acquaah & Yasai-Ardekani, 2008)

### *7. Developing attributes, difficult to copy*

Due to the sticky mentality of the industry, there is a tendency to imitate the feature of the competitor. So the strategy or attribute which cannot be easily copied is the key to success in the container liner industry.

## **4.1.4. Conditions**

### *1. Revenue > Cost*

If the cost position is too low but there is not enough business or revenue due to the low quality of product and services it doesn't work. On the other hand due to the uniqueness of the product the business or revenue is higher, however the cost required to deliver the service is more than the earning, it is still not sustainable. Therefore, right balance need to be made and in order to be profitable, revenue must be higher than the cost.

## *2. Saturated market*

(Baroto, Abdullah, & Wan, 2012) study finds that the company implements combined strategy of cost leadership and differentiation strategy in saturated and stable market, whereas cost leadership strategy is used for emergent market.

## *3. Rules of Supplement*

(Acquaah & Yasai-Ardekani, 2008) study finds that the firms in transition economies that are implementing cost leadership strategy may achieve greater performance benefits by supplementing it with differentiation strategy. However it is not advisable to the firms that are implementing differentiation strategy to supplement with cost leadership strategy, then it can lose the attributes of product uniqueness and can get stuck in the middle.

## **4.2. Conceptual Model**

The literature review can be summarised in the following conceptual model. It presents all the aspects such as the main drivers, barriers, success factors and conditions, based on which a firm's positioning strategy can be analysed.

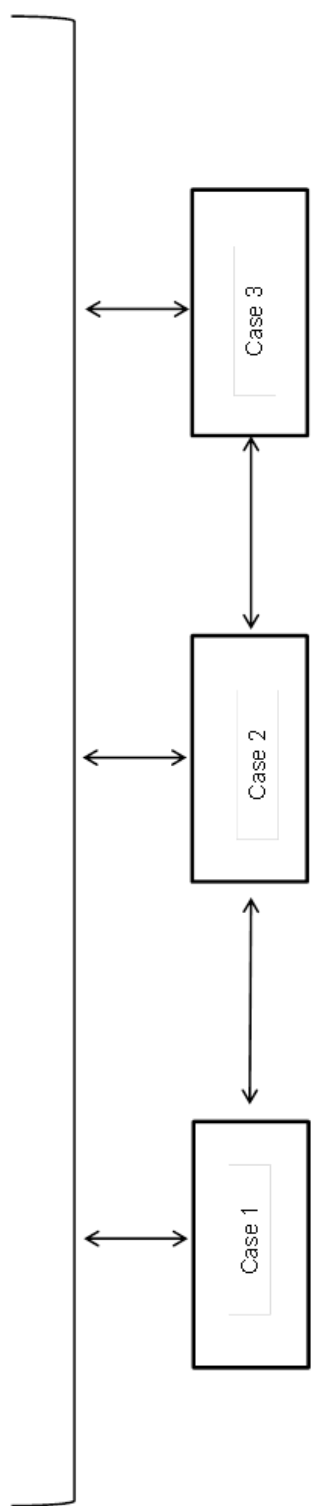
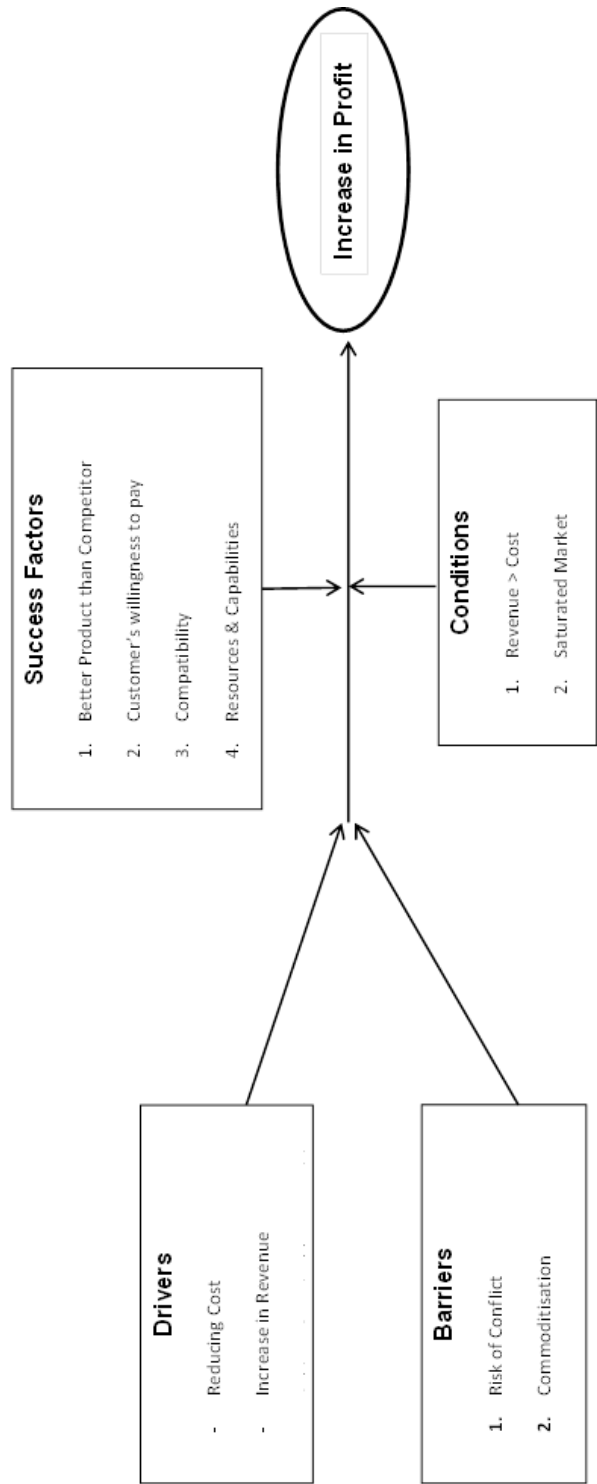


Fig: Conceptual Model

## 5. Case Study

### 5.1. General Information Maersk

The Maersk group is a global conglomerate operates in more than 130 countries, headquartered in Copenhagen, Denmark an annual revenue and profit of 47.6 and 5.2 billion USD respectively in 2014 (Annual Report 2014, 2015). The group is involved in various related and unrelated worldwide business with main focus in shipping and oil and gas. The five core businesses of the group include Maersk Line, APM Terminals, Maersk Oil, Maersk Drilling and APM Shipping Services which is comprised of Maersk Supply Service, Maersk Tankers, Damco and Svitser.

Maersk Line is the first company of the group founded in 1904, and now is the world's largest container shipping line with a fleet of over 600 ships and sail every major trade lane across the globe. The Maersk Liner business also include branded companies like Safmarine, Seago and MCC which specialises in Indian sub-continent & Africa, intra Europe and intra-Asia market respectively. APM terminal is one of the top global terminal operators who provide port and inland infrastructure, port management and operations to shipping companies in containers, bulk, liquid bulk and general cargo. Svitser provides towage and emergency response services for the safety and support to the vessels at sea. Damco is one of the world leading providers of freight forwarding and supply chain management services. Damco is a NVOCC focusses on providing logistics services and simplifying complex supply chain for their customers.

Maersk Oil is international oil and Gas Company produces oil from Danish and UK sections of North Sea, Qatar, Algeria and Kazakhstan. Maersk Drilling provides high efficiency drilling services to oil companies for the production of oil and gas. Maersk Tankers own and operates crude oil carriers and product tankers and Maersk Supply Service is a leading provider of offshore marine services.

Thus Maersk group have diversified their business, of which some are closely related and some less related. This diversification brings a sustainable advantage to the group as a whole, when one business is not doing well perhaps the other cover up the loss.

#### ***Maersk growth and challenge***

AP Moller group suffered its first annual loss in 2009 since its beginning. The group was negatively affected due to the economic crisis, and reported annual loss of 1.02 billion USD. The container shipping business was hit by the worst crisis since the container invention, and Maersk Line suffered huge loss of 2.1 billion USD. Though the other divisions of the group Maersk Oil & Gas, APMT, Maersk Drilling, Damco, Maersk Supply yielded positive result however due to the huge loss of Maersk Line the group financial result was negatively impacted.

2009 came as a very challenging year when the economic and financial crisis severely hit the world. The global economy contracted by 2.3%, the container shipping market contracted by 13% and at the same time capacity in the market increased by 6%, which reduced the freight rates drastically. The average freight rate including bunker surcharges were 2,370USD per FFE which is equivalent to 28% decline (AP Moller Maersk Annual Report 2009, 2010). Demand for transportation dropped whereas the supply tonnage increased, which lead to

reduced business volume on all main routes and a declined freight level which is highly unprofitable.

Since the invention of containers, container shipping lines enjoyed the stable growth in the industry and after some very good years 2001-2008 in the global economy when the container shipping was booming, 2009 brought a new reality in this industry. Since last 7 years, due to the unfavourable conditions low demand, overcapacity, increased competition and low freight rates the industry has been highly unprofitable, except for some big players. The return on investment is poor, and unsustainable, and the situation is not going to change in the near future as the global demand has decreased compare to the supply and the profitability will remain challenged. The container liners need to align themselves with the new reality in order to survive and emerge.

## **5.2. Maersk Strategies**

### ***Initial growth strategy***

Till the early 2000, Maersk was following an aggressive growth strategy where organization was decentralized; the management structure was entrepreneurial type and the company was looking for growth opportunities to expand their market through organic and inorganic growth. After the Sealand takeover in 1999, Maersk became the biggest container shipping line, and then with the P&O Nedlloyd takeover in 2005 Maersk became the undisputed leader in the container shipping industry controlling nearly 18% of the market share (Jason Singer, 2005). This merger came at a time when the container shipping industry is in the middle of huge growth supported by the China's expansion and dominance in the exports. The export from Asia to US was growing more than 10% a year (Jason Singer, 2005). All the container shipping lines were trying to add capacity to take the opportunity from this growth market, and the shipyards were full with order. It was a dream situation for any container shipping lines and the market was bullish. Maersk purchased P&O Nedlloyd in order to get the immediate access of the additional capacity and optimize the market opportunities.

### ***Streamlining of strategy***

However the integration between Maersk Sealand and P&O Nedlloyd didn't go as smooth and as expected. The service hampered due to system and IT integration issues, and many customers chose to switch to different carrier. In 2006, Maersk Line container business suffered loss of 568 million USD compare to 1.3 billion USD profit in 2005. Maersk CEO Eivind Kolding (2006-2012) said "We have lost focus. We are today 10 times the size we were 10 years ago, but we have lost the way we execute the business, and the way we operate today does not conform to our present size. With the growth we've had, the complexity has grown and so has the bureaucracy." (Leach, 2008). Something needed to be done to transform the Maersk container business, and Kolding implemented the 'Streamline' strategy. It's a reorganization plan, aimed in decentralizing the management and decision maker closer to the customers and cut costs by eliminating the layers of middle management. The overall objective of the Streamline strategy was to reduce cost and simplify the organization for a faster decision process with continuous focus on process excellence. This was a huge cultural shift for the organization and the way

business was done in the past, however a clear message was conveyed of not accepting unjustified cost a direction towards cost leadership. Though these initiatives yielded massive cost savings for the company, however still Maersk Line performed negatively reporting 2.1 billion USD losses in 2009 (Wright R. , 2010), due to the financial crisis than hit the global economy in late 2008. In the wake of worst year container shipping industry the group focussed on its cost leadership strategy in strengthening Maersk competitiveness. In 2010, the world economy grew by 4.1%, which helped the container market to develop positively and Maersk container business made a record profit of 2.6 billion USD a massive turnaround for the company. In 2010, Maersk shipped equivalent number of containers with the same average freight rate, however generated a profit of 2.2 billion USD higher than that of 2008 (A.P.Moller Maersk Annual Report 2010, 2011). This was mainly achieved due to the 'Streamline' strategy and cost savings measures. The group continued to focus on its cost leadership strategy to increase competitiveness, however the global economy still remained in crisis with uncertain outlook, high volatility and poor market conditions due to the overcapacity, declining freight rates and increased competition. .

### ***Three stage strategy***

In 2012, when Soren Skou joined Maersk as the CEO the company was losing 8-9 million USD a day, reaching a total loss of 600 million USD in the first quarter 2012. It was an unsustainable situation with unacceptable return to the shareholder's value. The challenge of the Maersk leadership team was to improve the profitability in the short term to an acceptable Return on Investment, and to deliver a sustainable shareholder value in the medium to long term. Soren Skou and his team rolled out a three-stage strategy that would have overlapping phases. The first phase is called 'Back to Black' to turn the loss around and restore profitability by cutting more cost and increase in revenues. There were many actions taken from slow steaming to super slow steaming and ensure assets are optimally utilised and laid down if necessary. However in order to create a sustainable performance and ensure the company continues to deliver acceptable return of investment, Maersk needed to do more than being cost efficient. Maersk grew 11% in 2011 whereas the market grew 7%, this is a problem created by itself because Maersk strategy was focussed at aggressive growth and volume (Chris Jephson, 2014). He changed the strategy from aggressive growth to grow with the market and the focus on profitability, instead of volume. The company will defend its market share around 15% and target individual trade based profitability and market outlook. The second stage of the strategy is 'Finish the Foundation', where the leadership team took more control of the internal organisation and direction is more top down approach in shaping the organisation by integrating the planning and operating systems, standardizing and making it coherent in order to make a strong organisational foundation for long term success. The third phase is 'Sustainable Profitable Growth' which is regarding the actions the company should take and prioritise to be the best performing container shipping company, and not only the largest (Malnight, 2014). It's about identifying the under-performance areas and lead the industry to a healthy path, than to beat the industry. Thus the Maersk strategy transformed from growth focussed to cost leadership, and striving to implement combined strategies of cost leadership and differentiation in order to achieve sustainable competitive advantage.

### ***Cost focus***

Maersk has taken various initiatives to cut down the cost and be the cost leader in the industry. The major part of the Maersk cost base is bunker, vessel and terminal cost which cover around 75% of the total cost (Reinhardt, Casadesus-Masanell, & Nellemann, 2015). Maersk reduced its cost base significantly majorly from the bunker cost savings. The drop in bunker price in the global market, combined with the tight control of the slow & super slow steaming, upgradation of fuel efficient technologies in the vessels and replacing older inefficient vessels with the modern larger fuel efficient fleet helped Maersk to achieve significant bunker savings. Maersk also optimized their network by closing some services and replaced those with some other extended or upgraded services, thus reducing the overall capacity, improving the utilization and reducing the slot cost. Maersk put lot of focus on the data analysis of the vessel performance through regular reports and benchmarking, and continuously strived on improving the performance. Also the other initiatives like auto-tuning, cut out turbo charger, investing in vessel retrofits like bulbous bow, optimising the propeller, upgrading the paints and driving the behaviour change yielded positive results. Further cost savings are being aimed to achieve through the economies of scale by deploying ultra large container vessels like Triple E, idling & blank sailings where it doesn't make commercial sense, expiry of the expensive charter contracts and building strategic alliances.

### ***Differentiation activities***

Though cost leadership has helped Maersk to regain a competitive position, but something more needs to be done to differentiate themselves from the competitors and regain sustainable competitive advantage. Maersk wants to lead the change and turn this asset based industry to service based industry. Maersk identified reliability, extensive global network and superior customer experience are its commercial success drivers, and customer service and sales key to differentiate and maintain share. Maersk took different initiatives to improve its sales and customer service function. All sales staffs are trained through the 'Value Selling' program, which is aimed to take the sales discussion and negotiation away from the traditional price war, and to get into more structural discussion of what additional value it delivers to the customer. 'Salesforce' system is introduced to make the sales process more structural, which provides more sales visibility and control through the management tools. On the Customer Service side, there are also many initiatives taken to increase more customer loyalty and satisfaction, by offering 'Customer Care' and 'Customer Charter' programs. 'Customer Care' program is meant to offer more care and attention to the important customers through customized service and proactive issue resolution. There are different levels of standardised customer service and special care program, the premium customers gets addition proactive service while the less important customers will be offered basic service and self-service facilities. 'Customer Charter' program promises a timeline and sets an internal performance target to deliver different shipping activities like Booking needs to be processed within 2 hrs, Dispute Resolution turn time shouldn't be more than 7 days etc. These targets are aimed to achieve the best industry standards. (Maersk Line – Performing In Rough Seas, 2013).

We will study three case illustrations of Maersk positioning strategies, and will analyse based on the conceptual model and compare between each cases.



### **5.3. Case Illustrations**

#### **5.3.1. Competitive Advantage by Product Differentiation: Daily Maersk**

In 2011, Maersk introduced a new product called Daily Maersk, which is completely unmatched within the industry, a differentiated product to change the mind-set of the industry in the way it operates and gain competitive advantage. Daily Maersk is a daily cut offs of the Maersk vessels in the Asia – Europe trade, from the four major ports of Asia Ningbo, Shanghai, Yantian and Tanjung Pelapas to three major ports in North Europe-Felixstowe, Rotterdam and Bremerhaven and offers absolute reliability in shipping. In a commoditized industry, it is one of the Maersk efforts to position itself different to its competitors and offer a great value proposition to the customers.

##### ***Benefits for customers:***

Shipping is an integrated part of the customer's supply chain, and thus reliability is extremely important in efficient planning and performance for the customers. However the industry statistics of reliability is as low as 50-60% which is extremely poor compared to any other transportation industry (Abraham Zhang, 2014). The unpredictability and uncertainty about, when the container will be available has forced the customers to maintain additional inventory into their supply chain which is a substantial cost. Maersk found reliability is the most important factor for the customer's supply chain through interviews. In reaction to the customer's transportation need, Maersk developed 'Daily Maersk' as a unique value proposition which aimed to achieve 95% reliability.

Daily Maersk offers its customer, commitment over fixed transportation time i.e. the time from the port gate in cut-off date at origin till the container available date at destination, and there are daily sailings from each of the four ports in Asia. Customers do not need to worry about the vessel departure time, transit time, waiting time etc. and once the container is gated in it will be available at the destination within the agreed transportation time. If the shipment has missed the cut off, it doesn't need to wait for a week to load on the next available vessel and it can go the next day, due to the daily sailing. Maersk offered specified compensation to the customers, if the containers do not arrive on time as agreed. It is a real good value deal for the customers who don't have to customize their production schedule based on the shipping cut off, and can ship immediately what they have produced avoiding any storage at origin. Due to the high frequency of the service combined with absolute reliability, customers don't need to maintain inventory at the receiving end also and the cargo can go directly into the clients production or sales schedule without any delay. It is believed that this product can significantly reduce customer's inventory up to 500 USD per container (New Daily Maersk service launches next month to provide "Absolute Reliability", 2011), by reducing working capital cost, storage cost, and administrative cost. Further due to unreliability and delay caused by the shipping lines, customers had to pay additional cost in faster intermodal transportation to make up the delay at the receiving end, which can be avoided with reliability of 'Daily Maersk'. Customers have to work with multiple carriers and based on their shipping cut off dates to match up their production capacity, however now with the availability of daily sailing this can be avoided and can work with less

number of carriers. This means less complexity and time spend in coordination and administration which eventually means time and cost savings. Customers can plan their supply chain more efficiently and effectively.

### ***Impact for Maersk:***

This is a great value addition to the customer by reducing their total supply chain cost; however it comes with lot of additional cost and investment for Maersk. In order to run this service and offer absolute reliability, Maersk had to invest heavily and redesign the operational network like a virtual conveyer belt in the Asia-Europe route. Maersk had to put 70 post panamax vessels including the Triple E vessels into the network, which is 25% of Maersk's total tonnage capacity (New Daily Maersk service launches next month to provide "Absolute Reliability", 2011). However due to the overcapacity and price wars the freight rates are declining continuously on the Asia-Europe trade, and there are not enough paying cargoes on the backhaul to Asia to fill up the ships. Further, in order to deliver the promised standard of reliability Maersk had to speed up in the sea burning more fuel, in contradiction with the cost leadership strategy of slow and super slow steaming. Therefore, on one hand it is a huge investment and high operational cost to run 'Daily Maersk' service, however on the other hand it is unable to generate adequate revenue to justify the cost.

### ***Drivers:***

The main drivers of 'Daily Maersk' are, '*Increase in revenue*' and '*achieve sustainable competitive advantages*'. The idea was to shift away from the traditional price wars, and sell reliability to the customer and thus demand an additional premium from the customers for the added value it offered through its reliable service, for increasing its revenue and profitability. This unique product was expected to build company's brand recognition on reliability, and thus attract and retain customers to buy this service. It is a highly complicated, capital intensive network so it is also difficult for competitors to copy. Therefore, 'Daily Maersk' aimed to be a differentiator in the industry through its unique product, in order to increase revenue and gain sustainable competitive advantages.

### ***Barriers:***

The main barriers of 'Daily Maersk' are *commoditisation* of ocean transportation in Asia-Europe trade, and the *conflict it created with its cost leadership strategy*. Though customers see value in reliability, however due to the commoditization of shipping in the Asia-Europe trade, customers perceive the 'Daily Maersk' product as homogenous and indifferent than any other available ocean transport solution available in the market. There are other carriers who have weekly services from Asia to Europe, with different departure days distributed throughout the week. So for customers, there are possibilities to sail any day of the week by using different carriers. In a competitive market, when the freight rate is declining continuously, customers do not see the reason to restrict themselves with 'Daily Maersk' only, and pay higher premium. It is easy to switch carriers for shippers, and end of the day customers perceive ocean transportation as homogenous product with no difference between one another, so it makes commercial sense for customers to encourage more competition, by using different shipping companies and demanding the best

freight rate. Further 'Daily Maersk' itself is a product, which can only give the benefit to the customers by reducing their inventory cost, provided the customers adjust their supply chain planning accordingly. The added value from the inventory cost savings and less coordination with multiple carriers, may justify the additional premium in the freight rate otherwise not. In a commoditised market with declining freight rate, 'Daily Maersk' product failed to justify the additional premium.

Daily Maersk is an extremely costly network, which failed to generate adequate revenue in order to invest and run the service. Due to the commoditization of shipping, when customer's decisive criteria are mainly dependent on cost then 'Daily Maersk' was neither complimenting the company's cost leadership strategy nor differentiation strategy. It was highly expensive to maintain the 'Daily Maersk' network for the company, and was not making any commercial sense to the customer because the market freight rate is deflationary. There was a *conflict* between the cost leadership strategies of Maersk on one hand, and differentiation strategy with 'Daily Maersk' on the other hand which incurs additional cost to run the service, however failed to generate adequate revenue. As a result, 'Daily Maersk' is not a commercial success and the service was withdrawn in March, 2015 (Porter J. , 2015).

#### **Success Factors:**

There were many success factors for the 'Daily Maersk' product. It is launched as a unique product which will change the rules of the game in the traditional shipping industry. It promised absolute reliability, daily cut offs and fixed transportation time, which was unmatched in the industry. So it was a *better product than competitor*, in terms of its uniqueness and additional value it offers. To successfully launch a network like 'Daily Maersk' it needs lot of assets, capital, human *resources and capabilities* which Maersk has and deployed successfully. The complex network structure created like a virtual belt, using its resources and capabilities is *difficult to be copied* by the competitors.

However *customer's willingness to pay* additional price for this product was negative, perhaps the only reason 'Daily Maersk' failed to succeed in spite of having many success factors.

#### **Conditions:**

In order to be commercially successful and profitable, the *revenue must be greater than cost*, however 'Daily Maersk' as a product couldn't satisfy the condition. Daily Maersk was introduced in 2011, in the middle of global economic crisis when all the customers were trying to cut cost in order to sustain. The demand of transportation reduced sharply, and the oversupply of capacity flooded the Asia-Europe trade lane. Perhaps it was not the right time to introduce a product like 'Daily Maersk' which is expensive to maintain and demands additional price, when the whole market was and still is extremely cost focussed with freight rates constantly declining. Also the target of achieving 95% reliability was over ambitious and redundant, when the average industry standard was 50-60%. If Maersk would have targeted an above industry average reliability, which is still better but not necessarily excellent and able to keep the cost base competitive with no increase in fuel or operational cost then perhaps it would have been a success.

### **5.3.2. Competitive Advantage in a niche market segment: U.S. Military Contract**

Though there was a close relation of Maersk with the United States since World War II, and the Maersk US subsidiary called Maersk Line Limited was involved in the ship management and operations of the US Navy's fleet since then, however after the acquisition of Sealand, Maersk liner business inherited the US Government & Defence cargo transportation business, to support military, government and humanitarian missions in containers, tankers and multi-purpose ships. It is a different segment of business, and demands more than just port to port ocean transportation. It demands ocean transportation in US flag vessels, end to end transportation including value added service like custom clearance, enhanced in-transit visibility solutions, cargo protection, consolidation, washing services, warehousing etc. Maersk participates in the Maritime Security Program (MSP) and Voluntary Intermodal Sealift Agreement (VISA) in order to be eligible for the US Military and Defence cargoes protected under this program and receive subsidies (U.S. Flag Transportation Services, 2015).

#### ***Benefits for customers:***

Carriers and vessels under the Maritime Security Program, agree that the ships must be made available to the US Government Department of Defence in times of war or national crisis and in return MSP program provides subsidies to the ocean carriers for the additional cost it requires to maintain US flag vessels and crews. VISA program is partnership between US Government and carriers, a voluntary cooperative agreement from carriers to provide access to additional transportation and intermodal capacity to support the deployment and sustainment of DOD in case of emergency and national crisis (Lewis & Coulter, 2000). There is a mutual benefit in this partnership; US Government can save huge cost of maintaining the self-owned government ships and crews for the time of crisis, and through these partnership programs can attain the commercial capabilities and expertise at much lesser cost through subsidies and the attractive contractual rates.

#### ***Impact for Maersk:***

Maersk participating in this program can offset their additional cost of maintaining US flag vessels through the subsidies received, and at the same time eligible for the attractive US Military and Department of Defence cargo contract, protected from the external competition. The cargo transportation requirement of Department of Defence is managed by United States Transportation Command (USTRANSCOM) under the Universal service Contract (USC) and is more than a billion dollar contract value. In FY12 the USTRANCOM procurement value was 7.8 billion \$, in FY 13 it was 5.5 billion \$ and FY14 it was 4.1 billion \$ (US Transcom Acquisition Procurement Forecast, 2015). Though with the US defence budget cut there is a decline in the military cargo transportation requirement, however still it is one of the high value contracts globally.

**Drivers:**

The main driver for Maersk to focus on the specialised US flag business is to *increase its revenue* and profitability. Surface Deployment and Distribution Command (US Military) is the top global account of Maersk Line in terms of revenue and yield (Maersk, 2012). This business is influenced by geo political reasons and not directly impacted by the economic cycle. After the economic crisis hit in 2008, when the freight rates declined drastically and the carriers struggling to make any margin out of the freight rate, US Government & Defence business delivered steady revenue flow and contributed high margin to the company. There was surge in the cargo volume during 2010-2012, which helped the company to compensate some of the losses which Maersk was making from other businesses. Therefore, this account is considered strategic and very important for Maersk.

**Barriers:**

Maersk's US flag business is more than just ocean transportation, where carriers are an integral part of the US Military supply chain and expected to provide integrated transport solution, an end to end transportation and logistics including sea, air, land and value added services like custom clearance, storage at warehouses or ICD, providing security convoy or providing enhanced in transit visibility report etc. Customer is extremely demanding, it involves complicated operations and expects high reliability and flexibility. The US Military contract requirements are often outside the Maersk standard process and special care is needed to ensure right level of service delivery. Though there are specialised small teams to oversee the account and assist in bridging the gap, however rest all the operation process is executed together with the commercial shipments by the same teams and through the same systems and process. This can create conflict within the internal organization, as the objective or Key Performance Indicators of the departments are set based on the Maersk standard commercial process and not aligned with the contractual requirement of this customer. In other words, the US Military business negatively impacts the objective, performance and efficiency of some other internal departments.

Also there are financial and legal risks involved in failing to perform as per the contractual obligations. Maersk is responsible for end to end transportation, and as such if any Maersk sub-contractors fail to perform contractual obligations in the transport chain, its still Maersk who is responsible. The process is fragmented because Maersk is usually not in the business of end to end transportation and had to depend on sub-contractors and information from various parties in the chain and hence vulnerable. As we have seen in 2012, Maersk had to pay back US Government 31.9 million USD to resolve the allegations against false submissions of invoices for transporting US Military cargo in Afghanistan and Iraq (Justice News, 2012). These allegations of wrong invoices are the result of the wrong information, disconnection in the information flow through the various parties in the chain and information falling through the cracks in the fragmented process flow. It not only impacts financially, but also there are legal implications and affects the brand name. The exceptional operational handling cost more; executing complicated end to end booking takes more time which means additional resources are needed to support the business. This *conflicts* and contradicts with the Maersk cost leadership strategy, which is more of a standardized, systematic approach and offers less flexibility.

### **Success Factors:**

Maersk being a conglomerate, with extensive global network and investment in different related business in terminal (APMT), logistics (DAMCO) have the required asset, capital, human *resources and capabilities* to be successful in this business. It gives more flexibility to the contract holder company to be more competitive against their rivals, as often the internal companies work in a partnership relation instead of typical supplier-customer relationship. It is possible one company sacrifice their margin in order to win the business for the other group company or allow the major share of the margin going to the other group company, because end of the day it helps to secure the business which benefits all and the profit remains in the same pocket. Maersk has the most 18 US flag container ships under the MSP program, followed by other competitors like APL with 9 ships and Hapag –Lloyd with 5 ships only (Maritime Security Program Fleet as of May 1, 2015, 2015).

The contractual requirements, terms and conditions of US Military business are different than the Maersk's standard process and systems, and hence Maersk has developed different regional support team to bridge the gap between the special requirements of the customer and make it *compatible* into the Maersk standardised process

US Military (SDDC) is the top global account of Maersk Line in terms of revenue and yield (Maersk, 2012). *Customer's willingness to pay* the additional premium on the price for the required value added services is the key reason for the success of this business.

### **Conditions:**

US Military is a very important strategic customer for Maersk, not only for being the biggest revenue and profit earner, but also helps to maintain strategic relationship with the US Government. It helps Maersk to develop and gain specialised knowledge and experience to handle integrated logistics solution, which can be used in creating differentiation strategies for other businesses. Hence this customer deserves more attention and resources in order to ensure exception handlings are done properly, and in compliance with the contractual requirement. In order to avoid internal conflicts and contradictions regarding US Military business, perhaps it can be structured as a complete separate function within the Maersk organization, and it should be exempted from the measurement of KPI's of rest of the commercial organization. US Military tops the Maersk list of top global account in terms of profitability, therefore we can conclude it well satisfies the condition of *Revenue > Cost*.

### **5.3.3. Competitive Advantage by Service Differentiation: Customer Care Program**

The basic steps in the shipping process from booking, documentation to invoicing can be extremely frustrating and can turn costly for the customers. The customer satisfaction surveys have repeatedly revealed that the customer services are poor and customers expect more to be done in that area. The poor standard of customer service is typical feature of this cost focussed shipping industry, where not much

focus has been given to offer more attention and flexibility to the customer's requirement, because that demands more resources and cost. On the other hand with no better options customers also have accepted the additional costs incurring in the whole transportation due to the low level of service, and thus limit themselves into freight rate negotiations only. This is a lose-lose situation. Maersk Line sees an opportunity here, through which it can differentiate itself from the other container lines and demand extra premium for the service it offers, through 'Customer Care & Charter' program.

"We talked to a couple of hundred customers to get their definition of what good customer service is," Maersk Line Chief Commercial Officer Stephen Schueler said. "That's how we came up with the eight goals. We have made progress on these goals." (Leach, 2014)

### ***Benefits for customers:***

The 'Customer Care & Charter' program is intended to address some basic concerns of the customers in terms of service expectation in the shipping industry. Customer Charter is a promise to customer by setting customer expectation on the eight fundamental service areas in terms of accuracy and turn around time. These are the basic service areas like Booking Confirmation, Documentation, Pre-Arrival Notification, Dispute Resolution, Invoice Quality, Phone accessibility, etc. which Maersk researched are the most critical areas to focus for elevating the service level. The faster turnaround time in the shipping processes and care services, will help the customers to reduce their overall transportation cost, by eliminating the cost associated with delays, inaccuracy and poor services.

### ***Impact for Maersk:***

Maersk intends to turn its identity from just ocean transportation to a brand that stands for global transport services, and 'Customer Care & Charter' program is a step towards that. It is a program where Maersk Line intends to roll out the care packages to its different segment of customers. Customer Premium package will provide Single Point of Contact, Proactive service and ETA notifications on top of standard service offerings. Customer Care package will include single point of contact, reactive notifications along with standard service offerings. Under the Essential services it will be mainly self-service facilities through the E-Channels, Live-Help and local phone contacts along with the standard service offerings (Maersk Line – Performing In Rough Seas, 2013). Maersk Line introduced the Customer Charter and Care Program as its differentiation strategy and to build customer loyalty. The goal is to offer this enhanced customer experience based on the importance of the customers in order to add value in their supply chain and retain them, and the same is not sold as a separate commodity to increase the revenue.

### ***Drivers:***

The main drivers of this service oriented strategy are to gain *competitive advantages* by differentiating itself with the rest of the carriers in the industry, and to build *customer loyalty*. Maersk Line Chief Commercial Officer Stephen Schueler states that "In an environment where we will share more of our vessels with our

competitors, the need to differentiate on commercial services is stronger than ever before” (Churchill, 2014).

**Barriers:**

Maersk is traditionally known as arrogant in the industry (Berrill, 2014), and the customer’s continuous feedback is, that they expect to see improvement in the customer service. Customers expect to see a change in the way of servicing, a shift from reactive to proactive approach. Thus this program is focussed for the client facing roles within Maersk mainly for Customer Service and Sales employees in order to change their way of working, behaviour and professionalism. It is about changing people’s way of thinking, working and behaviour, and hence *resistance to change* is a barrier in this case.

Due to the *herd mentality* of the industry, perhaps this could be the next standard of the industry and the competitive advantage may get lost in the short term.

**Success Factors:**

It is too early to say whether this program is successful or not, since it is still on the implementation stage. However it is recognised as a better customer service than the competitors can presently offer, which could be a success factor in the short term.

Maersk is investing in its human resources to develop service oriented skills and capabilities, which can help them to build a brand name, a shift from asset based to transportation service oriented company. Once this skill and culture is imbedded in the company, it will be an inherent quality which can be difficult to imitate easily.

**Conditions:**

There are mainly three levels of Customer Service packages – Care Premium, Care and Essential Services which will be offered to the different segment of customers. Maersk Line analysed their customer base into three tiers, the global key clients and the key clients with strategic importance fall into the first tier are typically less in numbers 6% of the customers who offers the most business 50% of the volume will be offered the Care Premium package. The second tier of customers around 9% who offer around 15-20% of the volume will be offered Care service package, and the balance 85% of the customers who offer around 30-35% of the business will be offered Essential Services (Maersk Line – Performing In Rough Seas, 2013). It is not a transactional product by itself. It’s an enhanced service, offered based on the importance of the customer and validated only when the potential of overall revenue is greater than the Cost.



## **5.4. Discussion on Case Analysis**

### **Reflection on the Conceptual Model**

There are some additional aspects those were not mentioned in the conceptual framework, but are derived from the case analysis:

*Loyalty* and *Brand name* can be important drivers for differentiation and creating competitive advantages. As Charles Hill stated, if differentiation can be created based on firm specific skills, something unique for the firm it can create brand loyalty for the customers and once established can take on the characteristics of a durable asset (Hill, 1988). Branding is an identity creation by which the company can be distinguished within the industry, and can be recognised through its quality, creditability and satisfaction in the targeted customer's mind and thus can help in retaining customer's loyalty. Due to its recognised position in customer's mind, it will be hard to imitate by the competitors.

Maersk taking similar initiative to develop customer relationship skills through the 'Customer Care' program, where they are investing on intense and extensive two years training programs for the customer service and sales employees. It is a skill of a company which is developed through its employees by hiring the right talent, training and retaining. Though the concept can be easily copied by the competitors, however it will not be easy to develop the skills quickly. A firm can also create its uniqueness, through innovation in its marketing approaches, enhanced customer relation services, information & processing systems or through sustainability programs etc. Innovation can be technical, commercial or environmental.

*Legal risks* and *Resistance to Change* can be strong barriers in the differentiation strategies. During 2012 Maersk had an allegation from the US Government about false and overcharged invoices for US Military business, which had serious financial and legal consequences due to the contractual compliance issues. There are legal risks if the contractor fails to perform the contractual obligations, which is a big barrier while trying to do something different than the usual standard business.

If the implementation of differentiation strategy is related to change in people's behaviour, way of working and mind set, *resistance to change* can be a strong barrier. Humans are naturally resistant to change, hence the biggest challenge in Maersk's 'Customer Care program', is the Change Management.

*Protectionism* or *less competition* can be a strong success factor for being profitable. Maersk being one of the few participants of the MSP and VISA program enjoys protectionism of the high paying US Military cargo from the external competition. It is one of the key reasons that Maersk able to secure this business with much higher rate and profitability than the commercial cargo, and over the years the rates relatively didn't erode compare to the commercial shipments.

### **Pros & Cons of Combined Strategy**

Combined strategies can result in gaining high profitability and sustainable competitive advantages like in IKEA and the 'US Military business'. It can be a double win situation for the company, if the differentiation strategy can create the additional business opportunities, develop customer loyalty or demand extra premium over the average freight rate, and on the other hand cost leadership

ensure the low cost position in the industry. The yield per unit from the US Military business is much higher than the other customers in the Maersk portfolio, because of the combined effect of earning additional premium on the price against the low cost position of the company. The attributes of the combined strategies are difficult to imitate, and hence the threat of the competition on the same features are limited. It helps the organization to remain flexible by avoiding over specialization in either of cost leadership or differentiation, and thus allows the organization to remain close to the customer and adapt as per the customer's requirement.

However on the other side, combined strategies are difficult to implement successfully and there is a risk of getting 'stuck in the middle', without being able to offer anything appealing to the customer, neither unique value nor low price. Even if the product is able to create unique value, it is important to understand how many customers would be willing to buy the product with additional price, otherwise it can turn into a failure like 'Daily Maersk'. Though most of the customers recognised 'Daily Maersk' as a great product which can change the rule of the game in the container shipping industry, however actually other than very few customers none were interested to pay the additional premium price for the added value it offered. Deep understanding and careful analysis of the customer's requirement, thorough understanding of the organization's own position in terms of resource & capabilities, legal implications, long term vision, and targeting the right customer & market segmentation are absolutely necessary to implement the combined strategy. Further the organization should be able to manage, control and coordinate the internal conflict and contradictions successfully which may arise during implementation of combined strategy.

### ***Success conditions***

The combined strategy can be successful under the following conditions:

- A combination or hybrid strategy seeks to achieve both differentiation and a low price relative to the competitors. The success depends whether the firm is able to deliver the additional value at a price what customer is willing to pay, and make sufficient margin in order to reinvest to maintain and develop differentiation initiatives.

- The differentiation strategy is only successful, if the customer is willing to pay the additional price for the added value, required to justify the additional expenses or investment for offering the differentiated product or services. Therefore the added value in the customer's perception must be greater, than the additional price charged.

- The combined strategy is said to successful when the differentiation strategy can produce unique value proposition, and cost leadership strategy can help to achieve competitive price at the same time. This is possible, if both the strategies are implemented successfully on its own, and at the same time organization is able to avoid internal conflicts & contradictions through efficient management, control and coordination.

- Differentiation approaches of container shipping lines through integrated logistics services can reduce the overall transportation cost of the customers by offering a seamless integrated transport solution at a better price. Therefore differentiation

strategy not only creates an added value proposition for the customers, but also can complement the cost focussed strategy of customers.

-In a commoditised market, if the service oriented differentiation is created and offered to the customer with no additional cost, it can be easily acceptable and may create sustainable competitive advantages through brand name and customer loyalty.

### ***Lessons learnt***

As (Acquaah & Yasai-Ardekani, 2008) stated in his paper that the companies fighting the commoditization should try to add non price based customer value, through different product and service-centred strategies. We have seen Maersk adopting similar initiatives in the 'Must Win Battle' strategy. The 'Value Selling' initiative at Maersk is to understand customer's challenges and pain, so in fact to understand the core issue and requirements of customer's customer and the whole chain. Maersk 'Teamwork' strategy is focussed to blend the organization and ensure they cooperate with each other to explore all opportunities. In order to break the industry standards and redefine the same Maersk took initiatives like 'Customer Charter' and offered absolute reliability through 'Daily Maersk product'. Last but not the least, Maersk 'Cultural amplifier' initiative is to overcome the cultural barrier and ensure whole organization is focussed and work in team to execute the strategy. The idea of 'Value Selling & Customer Charter' is that the carrier move from the rate discussion to a conversation with the customer, where both parties can mutually discuss about business solutions and find opportunities in each other's offering. However many are sceptical that whether it is possible to shift the customer's position from cost focus to a value based high priced offer, in a commoditised industry.

We saw 'Daily Maersk' was a great differentiated product which had many attributes to be successful, however failed to break the commoditization because most of the customers are highly focussed on reducing transportation cost and not willing to pay the additional price required to run this network. However on the other hand, Maersk is successful with its differentiated service to US Military business because customer is willing to pay the additional price for the required services. So it can be concluded that, the success with a differentiated product or services largely depends on the customer's willingness to pay.

The customers are willing to pay more, when they have a requirement for which either they don't have a cheaper solution available or if there is a risk associated with the cheaper solution which can turn highly costly for them. For example customers would be willing to pay more to a reliable container line for achieving on time delivery, like garments during the Christmas peak season, or transporting turkey meat to American customers before 'thanksgiving' day, or to deliver machineries to a production line without which the whole production can stop. Customers would be willing to pay premium price for the quality service, when there is sensitivity and a high risk associated with delivering the special cargoes like refrigerated and hazmat cargoes. Some cargoes need special equipment such as flat racks and expertise to handle the oversized cargoes, which may not be widely available in the market, and in this situation container liners can charge premium price for the service. Maersk 'magnum reefers' which can maintain temperature up

to – 60 degrees Centigrade specially needed for transporting highly expensive tuna fishes to Japan is a highly differentiated product and can demand premium price. Container lines can also gain competitive advantage and demand additional premium by positioning their equipment fleet in the market where there are demand of transportation but equipment deficits.

In a commoditised market, customers are extremely price sensitive and perhaps segment based service oriented differentiation have more chances to be successful than general differentiation. In the 'Customer Care & Charter program', Maersk trying to create service oriented differentiation for three different segment of customers based on their commercial importance, in order to gain loyalty and retain the business. Maersk not targeting to offer the additional service level as a commodity, and sell to increase the revenue. Perhaps that would help in easy acceptance of the offered services, and if successful would raise the customer's service expectation level from the shipping industry. Competitors failing to perform at the same level would be an added advantage for Maersk.

Maersk should asses its customers carefully and segment them, based on their requirement and price elasticity. Customers are different, and so are there requirements and the way they value the additional service levels. The required service levels of US Military neither would be necessary for a smaller client nor would they like to pay at the same level. It is important to assess how much the customer's value the differentiated product or services, and how much they are willing to change internally to make the most benefit out of it. 'Daily Maersk' would have helped customers to save cost on inventory and administration for handling different carriers, provided they would have changed the supply chain planning accordingly. We have seen most of the customers neither acted accordingly, nor did they value the same way as Maersk expected. On the other hand, extensive analysis on customer's requirement and customized product and services for each segment of customers, would not be operationally cost efficient for the company. Maersk need to find a right balance between its low cost position and its differentiation strategy by targeting the right customers. The core part of the strategical success will lie in understanding the customer's need, evaluating its own position in terms of resources and capabilities to be able to deliver to the customer's requirement, and then accordingly plan the strategy based on customer & market segmentation; otherwise number of unwilling customers can be a barrier in the process.

## 6. Conclusions

The container shipping industry is struggling through many fundamental challenges like economic crisis, over capacity, ruthless competition, declining freight rates etc., which has significantly reduced the profitability of the shipping lines, and fetching unsustainable return on capital investment.

Shipping has been commoditised, that triggered price wars among the container lines and led industry to follow a deflationary trend. In order to offset the negative impact of the declining revenue and profit margin, and with not much control on the price side due to commoditisation, the shipping lines are left with no choice other than to focus in reducing their internal costs. Cost leadership strategy is the dominant strategy for this industry and the company which can achieve lowest cost position will emerge as a winner in this deflated market. However to achieve sustainable competitive advantage, container lines also need to differentiate themselves from its competitors. Otherwise once the competitors reach the same cost level and engage into price wars, all the cost advantages will be lost, handing over all the benefits that were achieved through cost leadership to the customers. Further differentiation strategy aims to create opportunities for additional revenue and increase profitability.

Therefore, a combined strategy of both cost leadership and differentiation can be a logical positioning strategy for a container shipping line, to increase profit and achieve superior performance. Cost leadership would still remain the most relevant and dominant strategy to remain cost competitive, whereas differentiation strategy can be implemented in targeted market and customer segments in order to increase revenue.

Cost leadership is achieved through standardization and eliminating flexibility and exception handling to reduce cost, whereas differentiation is achieved by adding value and uniqueness to the standard product or services, which incurs additional cost. These are two different ways to achieve competitive advantages, and hence both strategies can contradict with each other and can create conflict within the organization. It is not easy to implement the combined strategies successfully, and the risk is that the organization can get 'stuck in the middle' situation, neither being able to appeal to the customers through its uniqueness nor by its low price. On the other hand it means the combined strategy is difficult to imitate, which can give the firm a sustainable competitive advantage. The success of a combined strategy depends on different factors, like the firm's ability to implement the strategy successfully through its resources & capabilities, the targeted customer and market, and customer's perceived value and willingness to pay for the product and services. Neither all customers have the same requirements, nor do they value the uniqueness in the same way. Hence careful consideration about the target market should be done while implementing combined strategy through customer segmentation. 'One size fits all' is not the right approach for implementing the combined strategy.



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