

Disruptive Innovation Ideas to Drive Market Growth

A case study of Maersk Line



SHAPING THE FUTURE
Global Growth Opportunities Reviews



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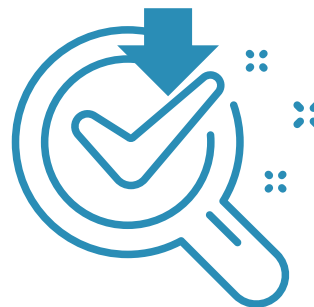
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ABOUT THIS REPORT

This is the Report of the Board of Directors which has been prepared in compliance with the activities of Maersk Line (company: A.P Møller-Maersk), the largest container shipping in the world and the global integrator of container logistics (together with its subsidiaries) during the 2018 financial year and first quarter of 2019. It presents the policies of the main player and innovator in global shipping, its strategy for growth and transformation as well as the innovation practice that drove the Maersk Line to its current position, with a fleet of about 715 container ships providing “point-to-point” services worldwide. Furthermore, the report identifies the financial risks and the risk management procedures set up by Maersk and provides accounting information for the funding performance of the Company. Lastly, the report covers Maersk’s low carbon strategy and its vision to slash carbon emissions to zero by 2050, as well as the financial risks arising from the effects of climate change.

For further information regarding the Company’s business, financial performance, risk management and corporate governance please refer to the Company’s website:



GENERAL OVERVIEW

With consolidated revenues of USD 39,019 million in 2018, Maersk is the largest shipping company in the world in terms of both fleet size and cargo capacity. In terms of market share, Maersk is a leading supplier of containers as it operates over 786 vessels and has a capacity of 4.0 million twenty-foot equivalent (TEU) and capacity market share 18.0%. Maersk is a leading player on market position on global capacity and on Reefer containers on Asia-Europe, Latin America, Africa and Oceania trades. Maersk Line serves 374 offices in 116 countries and it employs approximately 31,600 employees, 7000 of whom are shipping crew and 24,600 handling staff. Maersk organizes its business into the following four operating divisions: (1) Ocean, (2) Logistics & Services (3) Terminals & Towage and (4) Manufacturing & Others. In 2018, it generated approximately USD 28,366 million of its total revenues in the Ocean sector, USD 6,082 million in the Logistics & Services sector, USD 3,772 million in Terminals & Towage and finally USD 2,547 million of its total revenues in Manufacturing & Others.

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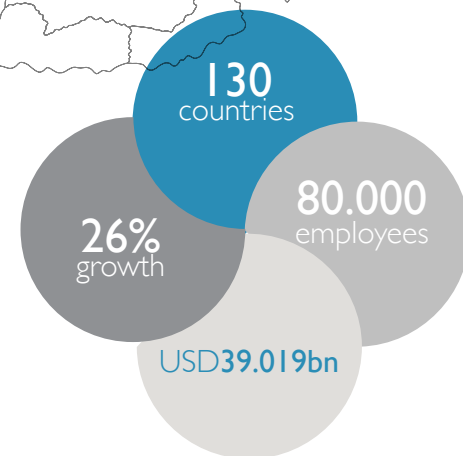
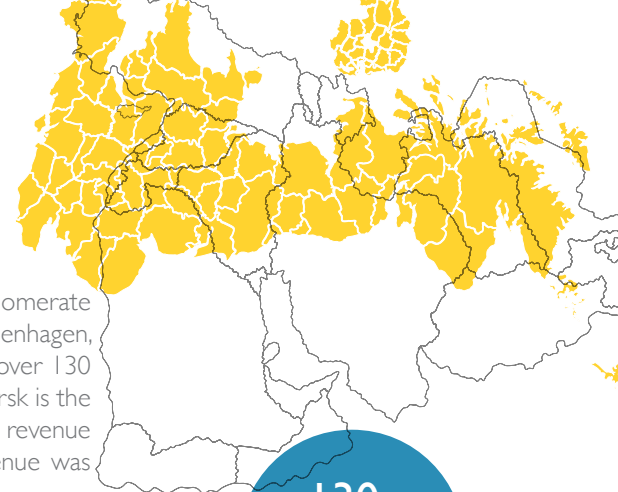
EXECUTIVE SUMMARY

A.P. Møller-Maersk Group, also known simply as Maersk, is a Danish conglomerate mainly engaged in shipping and terminal operations. Maersk is based in Copenhagen, Denmark, and operates with subsidiaries and offices across all continents in over 130 countries and has approximately 80,000 employees across all operations. Maersk is the largest container shipping and supply vessel operator in the world. In 2018, revenue grew by 26% from the previous year, and the company's 2018 annual revenue was estimated at USD 39,019 billion.

2016 was a challenging year for Maersk financially, as the company faced historically low freight rates, declines in oil prices and a slowdown in global trade. It delivered an underlying profit of USD 711 million and a return on invested capital of -2.7%, although the A.P. Møller-Maersk Group remained a leader in the industry. These challenges necessitated a renewal of the business strategy and identifying new sources of revenue growth. In December 2016, the Maersk Group announced their vision to become the global integrator of container logistics and took on a new strategy, focused on container shipping, ports and logistics. This new strategy provided the solution to the outstanding challenges and ensured longevity and growth in the long-term.

In January 2017, a diversified global conglomerate was formed as the new strategy reorganized and divided the company in two dimensions: Transport & Logistics and Energy. Setting a new direction in both dimensions resulted in 2017 being a year of significant and rapid change. The Transport & Logistics business, where Maersk has a clear competitive advantage, aims to become a global integrator of container logistics and to lead to higher growth and returns.

The Transport & Logistics division has access to unique opportunities in a market, which



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includes inland services, container shipping, freight forwarding, supply chain services and more, generating an annual revenue of approximately USD 1 trillion that is growing in line with global GDP. (1)

On 16 May 2019, APM Terminals Inland Services (APMT IS) joined Maersk Logistics & Services (L&S) and announced that all products and services will be sold under the Maersk brand in line with company's vision. The second dimension established through this new strategy, Energy, continues to be managed and operated as an individual entity, containing Maersk Oil, Maersk Drilling, Maersk Supply Service, and Maersk Tankers.

In 2018, Maersk accelerated this transformation and improved earnings despite lower-than-expected container volume growth. Generally speaking, 2018 was the year in which the foundation for the company's future was further developed, by attempting to find new solutions for energy businesses, incorporating transport and logistics businesses and strengthening governance. Since the implementation of the new strategy, Maersk has aimed to change its profile from being a diversified conglomerate with individual businesses units in different industries to an integrated company that leads the transformation of the transport industry.

Based on the foundational decisions set in 2018, Maersk will accelerate its transformation through 2019. This year, Maersk completed the separation of its energy businesses, continuing to be an integrated container shipping, ports and logistics provider and a key player in the whole supply chain. The core aims of Maersk are improving customer experience and adding value for the company's investors.

The technological landscape of Maersk is also transforming to help enhance customer experience and make operations more efficient. Furthermore, A.P. Møller-Maersk established a new company ambition to reduce carbon dioxide (CO2) emissions from

1. Maersk, 2017, Annual magazine, The 2016 financial highlights, markets and people of A.P. Møller-Maersk A/S, Charting a new direction, p. 6

their operations to zero by 2050, meeting current Climate Change goals. The sustainability of the global trading system is crucial to supporting continued viable development.

This report outlines the ways in which designing growth strategies, planning market-entries and using innovative technologies can drive growth and build a platform that mitigates risk.

We are going to discuss how a small company like Maersk succeeded in entering a market and becoming a key player as the largest container shipping company and a global integrator of container logistics. A.P. Møller-Maersk is a long-established company - it has been developing steadily over the past 110 years - yet it also demonstrates how disruptive ideas can drive to new perspectives. A.P. Møller-Maersk might not be a disruptive innovation in itself, but it has certainly caused disruption in the transport & logistics industry.

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KEY FINDINGS

- Maersk Line is the world-leading container shipping company, by both fleet size and cargo capacity. It represents a massive operation-encompassing 21,600 employees serving 374 offices in 116 countries. Maersk Line operates over 786 vessels and has a cargo capacity of 4.0 million TEU.
- By early 2017, the company transformed from a diverse conglomerate into a dedicated transport group with a growth strategy. This transformation is often described as historic but one of the most radical shifts took place in the early 1970s when Maersk segued into containerization.
- Maersk worked like innovator over a number of years and has launched many new initiatives. Maersk has perfected the art of reinventing oneself. A.P. Møller-Maersk reported an increase in revenue of 26% to USD 39.0 billion (from USD 30.9 billion), with growth seen across all segments.
- All companies need to implement an Innovation Strategy to achieve specific competitive goals. Achieving innovation remains a frustrating pursuit for many companies, but it should be seen as a huge investment opportunity driving growth. There is a strong connection between developing a business strategy and fostering innovation that can drive long-term innovation leadership.
- A company can create growth through innovative business models, as Maersk has managed to achieve. To succeed in innovation, the innovative business model should be linked to the creation of customer-value, and new processes must be mastered. Meeting, and preferably exceeding, customers' expectations is the is at the core of every business, so companies should motivate their workforce to find new ways of reaching higher standards.

SUMMARY: 2018 FIRST HALF OF 2019

- **Three years almost into the execution of the new strategy**, customers have benefited from integrated offers, digital solutions and robust network improvements. Since 2016, the top-level figure has risen by 43% to USD 39 billion in 2018, an additional turnover of USD 12 billion.
- **Maersk's process of delivering end-to-end supply chain solutions to customers** included the integration of its transport and logistics companies and Hamburg Süd. Integration has progressed better than initially planned, with synergies of USD 420 million in 2018 in the first year following its acquisition of Hamburg Süd.
- **In the Q2 of 2019**, synergies of USD 1 billion were achieved earlier than expected.
- **Furthermore**, Maersk Oil and Maersk Tankers were successfully separated and Maersk Drilling's distinct listing announced in 2019.
- **Damco's Supply Chain Services** and Maersk Line's Ocean Product were integrated on 1 January 2019, and their various value-added services were coupled and sold as Maersk products and services.

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Highlights 2018 (2)

	2018	2017	Change
Revenue	USD 39,019	USD 30,945	26%
Profit before depreciation, amortisation and impairment losses, etc.	USD 3,806	USD 3,532	8%
Depreciation, amortisation and impairment losses	USD 3,325	USD 3,015	10%
Gain on sale of non-current assets, etc., net	USD 144	USD 154	-6%
Profit/loss before financial items	USD 627	USD 641	-2%
Profit/loss before tax	USD 238	USD 25	852%
Profit/loss from continuing operations	USD -148	USD -194	-24%
Profit/loss from discontinued operations	USD 3,369	USD -970	N/A
Profit/loss for the period	USD 3,221	USD -1,164	N/A
Underlying profit/loss - continuing operations	USD 220	USD 356	+38%
Cash flow from operating activities	USD 3,225	USD 3,113	4%
Gross capital expenditure, excl. acquisitions and divestments (capex)	USD -2,876	USD -3,599	-20%
Return on invested capital after tax (ROIC) from continuing operations	0,8%	1,6%*	

2. A.P Møller-Maersk accelerates transformation and grows revenue in 2018, 2019

SUMMARY: 2018
FIRST HALF OF 2019

- **Net interest-bearing debt** dropped considerably from USD 14.8 billion to USD 8.7 billion during 2018, and the business remains investment grade rated.
- **In February 2019**, Maersk acquired Vandegrift, a US customs brokerage and logistics business, in order to increase its customs house brokerage, which it said was a "main element" in its strategy of becoming an integrated container logistics business.
- **Maersk Group's Ocean Products** sector - including liner activities - saw revenue rise by 29% to USD 28.4 billion, with a 22% increase in volume (2.5% excluding Hamburg Süd).
- **The average freight rate** (excluding the impact of the Hamburg Süd rate) improved by 5.1% per FEU.
- **Maersk's east-west volumes** increased by 10% to reach 4.2 million FEU, while volumes on the north-south trade rose by 21.2% to reach

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INTRODUCTION

Innovation and the search for new business opportunities are vital to the continued development of established companies. Across the wider financial sphere, innovation provides the basis for an economy to attain new levels of technological prowess, productivity and eventually prosperity. In this report, the Maersk success story will provide a case study that highlights a number of the best practices firms can adapt to better structure themselves and become key players in their industries, while maintaining the innovations that are crucial for their growth.

Maersk Line is the leading container shipping company in the world today, operating a fleet of 584 vessels and holding a capacity of approximately 2.6 million TEU. Maersk Line is the largest business unit registered within the A.P. Møller-Maersk Group. Maersk did not base its success on technological innovation, but it has been an innovative player in the organization of its activities, and the ways in which value is created for customers across each business. The art of reinvention is crucial for an industry leader like Maersk, allowing it continue having a wide-reaching global impact across a number of different sectors.

It is helpful to outline the story of Maersk Line because it illustrates how a small company managed to be a key player in shipping and, even though it was a late mover in containerization, became the largest container liner company in the world. In order to meet the changing requirements of the company and remain ahead of the game, Maersk has introduced changes to the industry by incorporating new technologies into traditional procedures.

SUMMARY: 2018
FIRST HALF OF 2019

6.5 million FEU. Intra-regional volumes jumped by 47.1% to hit 2.7 million FEU.

- **The transformation progressed** further with an improved cash return on invested capital at 6.9%
- **Asia-Europe routes saw less** development than Asia-US and intra-Asia routes, and intra-regional trade accounted for most of the global development.
- **In Q2 of 2019, EBITDA was up 17%** and cash flow improved 86% year-on-year, driven by continued recovery in Ocean Segment.
- **Quarterly earnings statistics** amounted to USD 9.6 billion (flat year-on-year), EBITDA was USD 1.4 billion, and fundamental earnings increased from USD 15 million in Q2 2018 to USD 34 million.

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A.P. Møller-Maersk aims to become a fully integrated transport and logistics company with digitalised and individualised customer solutions. Maersk's primary development focus will be to deliver the best in class transportation and logistics services. In 2016, the Board of Directors commissioned Maersk to conduct a review of Maersk Group's strategic and structural options with a view to generating growth, increasing agility and synergy, and unlocking and maximizing long-term shareholder value to help achieve these goals.

The shipping industry is particularly appropriate for business model innovation research because strategic changes often require huge investment in components such as new ships or port terminals. Containerization is a prime instance of a complicated business model innovation with transformative consequences far beyond just shipping cargo overseas.



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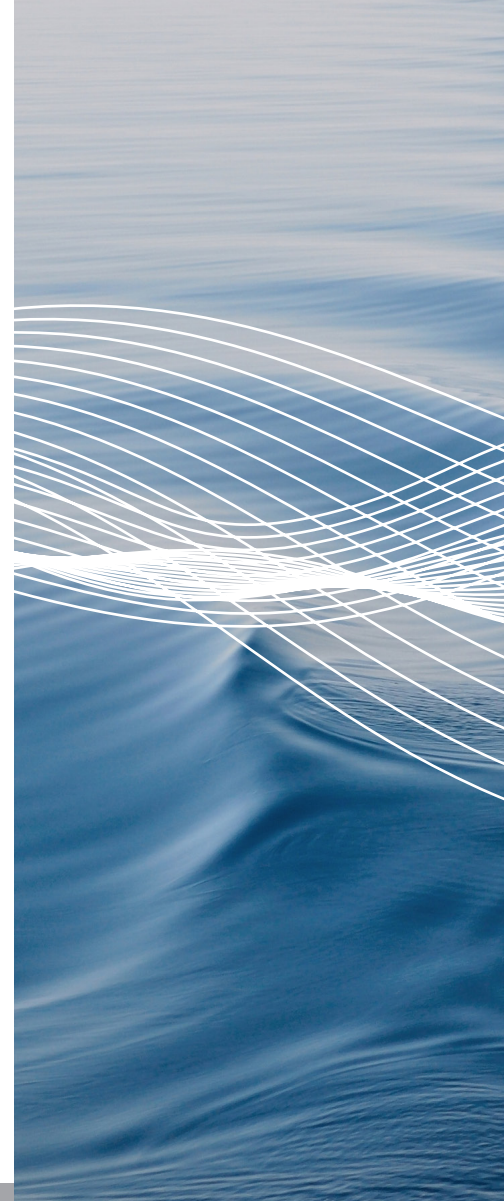
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I. INNOVATION AND BUSINESS GROWTH

There is a strong correlation between businesses' growth and their strategic activities, therefore an innovative mindset is needed to keep a business developing. The successful utilization of innovative concepts is essential in enabling a company to enhance its procedures, market new and improved products and services, boost effectiveness and, most significantly, strengthen its profitability.

This report describes how innovation can be transformed into a key business procedure and summarizes the different approaches that can be taken to achieve and foster this approach. Maersk is an example of a company that succeeded in creating the right business environment to develop its ideas. Companies like Maersk generate most of their revenue from the development a series of products, or by conducting marginal improvements to existing products and services rather than through a stream of radical developments. Companies can also innovate through their business model. Maersk has caused disruption in the transport and logistics industry with a series of small, progressive changes, revealing that a lot of innovative activity is incremental rather than radical.

These companies have, however, recognized innovative new methods of capturing value from their operations, with important consequences for the sectors in which they operate. There are various approaches to growing your business through innovation. The main approaches are business strategy, willingness, analysis and comprehension of the market, as well as the amount of funding you have.



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First of all, an analysis of your industry's marketplace is needed. To keep your company moving forward, you have to study your marketplace and see how innovation can add value to your customers. Customer service remains at the heart of Maersk's transformation, and building a connection with customers (*by listening to their requirements and examining how the quality of goods and services can be improved*) is an important preliminary step towards enhanced innovation. Such considerations can allow you to deliver new solutions for improvement across the board. Continuous innovation generally requires thorough planning to help realize a strategic vision of how you want your company to develop.

By adjusting your product or service to the ways in which your marketplace is changing, you can further realize new innovation opportunities. Using digitalisation makes complex logistical operations simpler, more transparent and more effective. For example, Maersk is leading the Shipping Industry's transformation by using digitalization to render its extensive global supply chains easier to manage and more effective, making global trade access more available and less expensive. You can innovate not just by introducing an emerging technology, but also by incorporating new techniques or better procedures to deliver improved quality in goods and services that is consistent and effective.



It is also possible to develop further potential partnerships through business networking opportunities. Networking with others could have benefits such as sharing your experiences and ideas to improve your knowledge, allowing you to make the most of active involvement across many different networks.

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1.1 Innovation Policy

Innovation has been put on the policy agenda as a prevalent and strategic topic. By 'policy', we generally refer to the guidelines under which innovation is carried out. More specifically, this refers to the courses of action and financing priorities taken by supranational, national and regional government bodies which are worth considering further.

Policymakers have become increasingly concerned about the role of innovation in financial performance and, in recent years, in utilizing innovative ideas to address the problems that arise from continued industrial activity, such as climate change. Innovation policy is a fairly new item on the policymakers' agenda, referring to the courses of action and funding priorities adopted by supranational, national and regional government bodies, and these are also worth giving closer consideration. The view that policy can play a role in fostering innovation has become widespread and 'innovation policy' a familiar buzzword across various industries. Nonetheless, it is important to examine how innovation policies are implemented and controlled further.

Most significant innovations undergo dramatic long-lasting changes that can, and often do, completely transform their financial importance. At the diffusion stage, many of these changes occur through communication with multiple stakeholders, such as clients and vendors.

While strategies refer to policymakers' objectives, policy instruments can be described as tools designed to achieve those objectives. A typology created by Edler et al. (2016), based on knowledge of existing innovation policy tools, classifies such policy instruments, and a further 15 key innovation policy instruments are provided in (Figure 1.)

Technology innovation has been ranked the highest. Naturally, policymakers are concerned about the extent to which innovation policy instruments are expected to have an impact on their respective industries, and numerous efforts have been made to assess the impact of innovation policy measures.



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Figure 1. :Taxonomy of innovation policy instruments (3)

Source: Adapted from Edler; Gök, et al., 2016, p. 11

Chapter Title and Instruments	Overall orientation		Goals						
	Supply	Demand	Increase R&D	Skills	Access to expertise	Improve systemic capability, complementarity	Enhance demand for innovation	Improve framework	Improve discourse
1 Fiscal Incentives for R&D	●●●		●●●	●○○					
2 Direct Support to Firm R&D & Innovation	●●●		●●●						
3 Policies for Training and Skills	●●●			●●●					
4 Entrepreneurship Policy	●●●				●●●				
5 Technical Services and Advice	●●●				●●●				
6 Cluster Policy	●●●					●●●			
7 Policies to Support Collaboration	●●●		●○○		●○○	●●●			
8 Innovation Network Policies	●●●					●●●			
9 Private Demand for Innovation		●●●					●●●		
10 Public Procurement Policies		●●●	●●○				●●●		
11 Pre-Commercial Procurement	●○○	●●●	●●○				●●●		
12 Innovation Inducement Prizes	●●○	●●○	●●○				●●○		
13 Standards	●●○	●●○					●○○	●●●	
14 Regulation	●●○	●●○					●○○	●●●	

3. Edler Jakob, Fagerberg Jan, 2017, Innovation policy: What, why, and how

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1.2 Types of Innovation

There are three main types of innovation - product, process and strategy. A business must be able to handle innovation across all levels of its operations against these three separate arenas. Each one is critical and achieving innovation in any particular one does not guarantee company-wide changes.

1.2.1 Product Innovation

Product / Service innovation is the results from identifying new methods to solving customer problems, benefitting both the customer and the sponsoring company. At this stage, all the offerings at a business has produced are classified as products in recent years. Product companies increasingly provide services alongside their products, such as vehicle manufacturers providing emergency roadside assistance. Despite the latest service trends, both firms and producers tend to use the word 'products' to define their products, offerings, services and service companies. Products and services have prevalent characteristics, particularly when it comes to innovation.

1.2.2 Process Innovation

To date, the innovation process has been short-lived in most companies. Process innovations improve bottom line profitability, reduce costs, increase productivity and increase employee satisfaction. Process innovations allow service companies to improve client service 'front office' and add fresh facilities, as well as new 'products' that are noticeable to the customer. By using a stronger, more coherent delivery of product or service value, the company ensures that customer also benefits from this form of innovation.

When Federal Express launched its distinctive monitoring scheme in 1986, customers only saw the small wand used by riders to scan packages. Yet while other activities within this advanced scheme remained invisible, customers could instantly 'see' that their packages were being tracked from sender to receiver at every stage, adding importance to their service experience and giving Federal Express a definite benefit. Process innovation will remain vital to business development for the simple reason that it is impossible to enforce innovation without process excellence, product or strategy.

1.2.3 Strategy Innovation

Strategy innovation, sometimes referred to as business model innovation, involves everything a company does in order to add value to the experience of its customers. Strategy Innovation is a major aspect of today's highly visible innovation practices. It involves new marketing or advertising approaches around goods and services, the introduction of new sales techniques, new customer service approaches and the placement of a brand.

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Strategy innovation also results when a company changes its target customer groups and the way it 'markets' towards them, meaning how it distributes its products to end customers.

In contrast to process innovations that are largely invisible to the customer, strategic innovations reach the customer directly and add tangible new value. A significant type of this innovation approach is when a company chooses to market its current goods, services or knowledge to new client organizations. Similarly, firms ranging from eBay to Amazon represent strategy innovations compared to the ways in which their respective industries traditionally did business. Southwest Airlines was a strategy innovator in the airline industry. Its business model is based on offering customers low fares in exchange for their giving up such amenities as preassigned seating, meals, nonstop flights, the ability to book using a travel agent and other value-added services - all aspects of Southwest's business model that differed from competitors.

Costco pioneered warehouse club retailing, another strategy innovation in this sector: "Category killers", retail stores that are so competitive that they dominate their product category, such as Office Depot, Home Depot, Staples, Borders, PetSmart, IKEA, and CompUSA, all pioneered new business models in their time. Wal-Mart pioneered a new business model that disrupted thousands of traditional merchants in the US and other countries. Walmart offered many of the same products as traditional merchants, but offered "everyday low prices" to lure in customers with the perception of greater value. As a result of their success, many traditional department stores and merchants were forced out of business.

Strategy innovations are those that don't directly involve your product, but that affect your customer. Your customer can see, feel and appreciate them. It would be worth considering some common types of strategy innovation along examples of their power to drive revenue growth:

1.3 Value-Added Services

Progressive - one of America's leading insurance companies - has grown at double digit rates by constantly pioneering new value-added services. Progressive's website claims its adjustment service settles accident claims with the client on the spot, twenty-four hours a day, seven days a week. And Progressive's website doesn't only provide quotes about its own rates, but those of its competitors as well, even when the competitors' rates are more advantageous.

1.4 New Distribution Methods

Dell Computer's strategy innovation was to rethink methods of distribution. Dell bypassed distributors and retailers to sell directly to corporations and consumers, giving the company a price advantage and adding value to customers.

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Wal-Mart introduced a new business model by offering Every-Day Low Cost (EDLC) to its customers, a strategy that offers low prices to customers throughout the year instead of only marking down prices for sales events. This innovative strategy increases both sales and customer loyalty.

1.5 New Market Channels

Innovation-adept companies constantly look for new market channels and territories through which to sell their

products, and new products to sell in existing markets.

1.6 Branding

Intel's strategy did not involve changing its products or processes, but branding its products to create greater consumer awareness.

1.7 Building New Markets

eBay didn't just enter a new market that previously existed; they built a new market from the ground up. Before

eBay, garage sales and swap meets were the commonly-used markets for buying and selling used items today eBay helps people buy and sell billions of dollars in merchandise online.

1.8 Innovation Must Be Customer-Centered

Customer-focused innovation should be one of the main goals of contemporary businesses. Customers with unprecedented decision-making and unparalleled pre-sale access to





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