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STRATEGY FORMULATION: BUSINESS STRATEGY

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BUSINESS STRATEGY

- ***We are concentrated at Business strategy - which is focused on improving the competitive position of a company's or business unit's products or services*** within the specific industry or market segment that the company or business unit serves.

- Business strategy is ***extremely important*** because research shows that business unit **effects have double the impact on overall company performance** than do either corporate or industry effects.

BUSINESS STRATEGY

- Business strategy can be ***competitive*** (battling against all competitors for advantage) *and/or* ***cooperative*** (working with one or more companies to gain advantage against other competitors).

- Just as corporate strategy asks what industry(ies) the company should be in, ***business strategy asks how the company or its units should compete or cooperate*** in each industry.

BUSINESS STRATEGY

Porter s competitive strategy raises the following questions:

- *Should we compete on the basis of lower cost (and thus price), or should we differentiate our products or services on some basis other than cost, such as quality or service?*

- *Should we compete head to head with our major competitors for the biggest but most sought-after share of the market, or should we focus on a niche in which we can satisfy a less sought-after but also profitable segment of the market?*

- Michael Porter proposes two "***generic***" competitive strategies for outperforming other corporations in a particular industry: **lower cost** and **differentiation**.

GENERIC COMPETITIVE STRATEGIES

- These strategies are called **generic** because they ***can be pursued by any type or size of business firm***, even by notfor-profit organizations:
  - **Lower cost strategy** is the ability of a company or a business unit to design, produce, and market a comparable product more efficiently than its competitors.
  - **Differentiation strategy** is the ability of a company to provide unique and superior value to the buyer in terms of product quality, special features, or after-sale service.
- Porter further proposes that a firm's competitive advantage in an industry is determined by its **competitive scope**, that is, the breadth of the company's or business unit's target market.

GENERIC COMPETITIVE STRATEGIES

- ***Before using one of the two generic competitive strategies*** (lower cost or differentiation), the firm or unit ***must choose*** the ***range of product*** varieties it will produce, the ***distribution*** channels it will employ, the ***types of buyers*** it will serve, the ***geographic areas*** in which it will sell, and the ***array of related industries*** in which it will also compete.

- Acompany or business unit can choose a **broad target** (*that is, aim at the middle of the mass market*) or a **narrow target** (*that is, aim at a market niche*).

- Combining these two types of target markets with the ***two competitive strategies results in the four variations of generic strategies.***

GENERIC COMPETITIVE STRATEGIES

Porter's Generic Competitive Strategies

- When the lower-cost and ***differentiation strategies*** have a broad mass-market target, they are simply called cost leadership and differentiation.

- When they are focused on a ***market niche*** (narrow target), however, they are called cost focus and differentiation focus.

Competitive Scope \ Competitive Advantage	Lower Cost	Differentiation
Broad Target	**Cost Leadership**	**Differentiation**
Narrow Target	**Cost Focus**	**Differentiation Focus**

GENERIC COMPETITIVE STRATEGIES

- **Cost leadership** is a lower-cost competitive strategy that aims at the broad mass market and requires “aggressive construction of efficient-scale facilities, vigorous pursuit of cost reductions from experience, tight cost and overhead control, avoidance of marginal customer accounts, and cost minimization in areas like R&D, service, sales force, advertising, and so on.
  - Because of its lower costs, the **cost leader is able to charge a lower price for its products than its competitors** and still make a satisfactory profit. Although it may not necessarily have the lowest costs in the industry, it has lower costs than its competitors.
  - Some companies successfully following this strategy are Wal-Mart (discount retailing), McDonald’s (fast-food restaurants), Dell (computers), Alamo (rental cars), Aldi (grocery stores), Southwest Airlines, and Timex (watches).

GENERIC COMPETITIVE STRATEGIES

Cost leadership

- Having ***a lower-cost position*** also gives a company or business unit a ***defense against rivals***.
- Lower costs allow it to continue to earn profits during times of heavy competition. ***High market share means*** that it will have ***high bargaining power*** relative to its suppliers (because it buys in large quantities).
- Low price will also ***serve as a barrier to entry*** because few new entrants will be able to match the leader’s cost advantage. As a result, ***cost leaders are likely to earn above-average returns on investment***.

GENERIC COMPETITIVE STRATEGIES

- **Differentiation** is aimed at the ***broad mass market*** and involves the creation of a product or service that is perceived throughout its industry as unique.

- The company or business unit may ***then charge a premium*** for its product. This specialty can be associated with *design or brand image, technology, features, a dealer network, or customer service.*

- ***Differentiation is a viable strategy for earning above-average returns*** in a specific business because the resulting ***brand loyalty lowers customers' sensitivity to price***. Increased costs can usually be passed on to the buyers.

GENERIC COMPETITIVE STRATEGIES

- Buyer loyalty also serves as an ***entry barrier***; new firms must develop their own distinctive competence to differentiate their products in some way in order to compete successfully.
  - Examples of companies that successfully use a differentiation strategy are Walt Disney Productions (entertainment), BMW (automobiles), Nike (athletic shoes), Apple Computer (computers and smart phones), and Pacar (trucks).
- Research does suggest that a ***differentiation strategy is more likely to generate higher profits than does a low-cost strategy*** because differentiation creates a better entry barrier.
- A low-cost strategy is more likely, however, to generate increases in market share.

GENERIC COMPETITIVE STRATEGIES

Cost focus is a ***low-cost competitive strategy*** that ***focuses on a particular buyer group or geographic market*** and attempts to serve only this niche, to the exclusion of others.

- In using cost focus, the company or business unit seeks a cost advantage in its target segment.

Differentiation focus, like cost focus, concentrates on a particular buyer group, product line segment, or geographic market.

- In using ***differentiation focus***, a company or business unit ***seeks differentiation in a targeted market segment***.

- This strategy is valued by those who *believe that a company or a unit that focuses its efforts is better able to serve the special needs* of a narrow strategic target *more effectively* than can its competition.

GENERIC COMPETITIVE STRATEGIES

Risks in Competitive Strategies

- Each of the generic strategies has risks.
  - For example, a company following a differentiation strategy must ensure that the higher price it charges for its higher quality is not too far above the price of the competition; otherwise customers will not see the extra quality as worth the extra cost. This is what is meant in by the term ***cost proximity***.

Risks of Cost Leadership	Risks of Differentiation	Risks of Focus
Cost leadership is not sustained: ■ Competitors imitate. ■ Technology changes. ■ Other bases for cost leadership erode.	Differentiation is not sustained: ■ Competitors imitate. ■ Bases for differentiation become less important to buyers.	The focus strategy is imitated. The target segment becomes structurally unattractive: ■ Structure erodes. ■ Demand disappears.
Proximity in differentiation is lost.	Cost proximity is lost.	Broadly targeted competitors overwhelm the segment: ■ The segment's differences from other segments narrow. ■ The advantages of a broad line increase.
Cost focusers achieve even lower cost in segments.	Differentiation focusers achieve even greater differentiation in segments.	New focusers subsegment the industry.

GENERIC COMPETITIVE STRATEGIES

Issues in Competitive Strategies

- Porter argues that to be successful, a company or business unit must achieve one of the previously mentioned generic competitive strategies.
- Otherwise, the company or business unit is **stuck in the middle of the competitive marketplace** with ***no competitive advantage and is doomed to below-average performance***.
  - The Toyota and Honda auto companies are often presented as examples of ***successful firms able to achieve both of these generic competitive strategies***. Thanks to advances in technology, a company may be able to design quality into a product or service in such a way that it can achieve both high quality and high market share - thus lowering costs.

GENERIC COMPETITIVE STRATEGIES

Issues in Competitive Strategies

- Although **there is generally room for only one company to successfully pursue the massmarket cost leadership strategy** (*because it is so dependent on achieving dominant market share*), **there is room for an almost unlimited number of differentiation and focus strategies** (*depending on the range of possible desirable features and the number of identifiable market niche*s).

- **Quality**, alone, has eight different dimensions each with the potential of providing a product with a competitive advantage.
  - Most entrepreneurial ventures follow ***focus strategies***. The successful ones differentiate their product from those of other competitors in the areas of quality and service, and they focus the product on customer needs in a segment of the market, thereby achieving a dominant share of that part of the market.

GENERIC COMPETITIVE STRATEGIES

Issues in Competitive Strategies: Quality

The Eight Dimensions of Quality

1. Performance	Primary operating characteristics, such as a washing machine's cleaning ability.
2. Features	"Bells and whistles," such as cruise control in a car, that supplement the basic functions.
3. Reliability	Probability that the product will continue functioning without any significant maintenance.
4. Conformance	Degree to which a product meets standards. When a customer buys a product out of the warehouse, it should perform identically to that viewed on the showroom floor.
5. Durability	Number of years of service a consumer can expect from a product before it significantly deteriorates. Differs from reliability in that a product can be durable but still need a lot of maintenance.
6. Serviceability	Product's ease of repair.
7. Aesthetics	How a product looks, feels, sounds, tastes, or smells.
8. Perceived Quality	Product's overall reputation. Especially important if there are no objective, easily used measures of quality.

INDUSTRY STRUCTURE AND COMPETITIVE STRATEGY

Industry Structure and Competitive Strategy

- In a **fragmented industry**, for example, where many small- and medium-sized local companies compete for relatively small shares of the total market, focus strategies will likely predominate.
- **Fragmented industries** are typical for products in the early stages of their life cycles. If few economies are to be gained through size, no large firms will emerge and entry barriers will be low - allowing a stream of new entrants into the industry.
  - Chinese restaurants, veterinary care, used-car sales, ethnic grocery stores, and funeral homes are examples.
  - If a company is able to overcome the limitations of a fragmented market, however, it *can reap the benefits of a broadly targeted cost-leadership* or differentiation strategy.
  - Until *Pizza Hut* was able to use advertising to differentiate itself from local competitors, the pizza fastfood business was a fragmented industry composed primarily of locally owned pizza parlors, each with its own distinctive product and service offering.

INDUSTRY STRUCTURE AND COMPETITIVE STRATEGY

Industry Structure and Competitive Strategy

- ***As an industry matures, fragmentation is overcome***, and the industry tends to become a **consolidated industry** dominated by a few large companies.
- Although many industries start out being fragmented, battles for market share and creative attempts to overcome local or niche market boundaries often increase the market share of a few companies.
- After product standards become established for minimum quality and features, competition shifts to a greater emphasis on cost and service.
  - Slower growth, overcapacity, and knowledgeable buyers combine to put a premium on a firm's ability to achieve cost leadership or differentiation along the dimensions most desired by the market. R&D shifts from product to process improvements. Overall product quality improves, and costs are reduced significantly.

INDUSTRY STRUCTURE AND COMPETITIVE STRATEGY

Industry Structure and Competitive Strategy

- The ***strategic rollup*** was developed in the mid-1990s as an efficient way to quickly consolidate a fragmented industry.
  - With the aid of money from venture capitalists, an entrepreneur acquires hundreds of owner-operated small businesses.
  - The resulting large firm creates economies of scale by building regional or national brands, applies best practices across all aspects of marketing and operations, and hires more sophisticated managers than the small businesses could previously afford.

- ***Rollups*** differ from conventional mergers and acquisitions in three ways:
  1. they involve large numbers of firms,
  2. the acquired firms are typically owner operated,
  3. the objective is not to gain incremental advantage, but to reinvent an entire industry.

INDUSTRY STRUCTURE AND COMPETITIVE STRATEGY

Industry Structure and Competitive Strategy

- ***Once consolidated***, an *industry has become one in which cost leadership and differentiation tend to be combined to various degrees*, even though one competitive strategy may be primarily emphasized.

- A ***firm can no longer gain and keep high market share simply through low price***.

- The **buyers** are **more sophisticated** and demand a certain minimum level of quality for price paid.
  - Even Mc-Donald's, long the leader in low-cost fast-food restaurants, has been forced to add healthier and more upscale food items, such as Asian chicken salad, comfortable chairs, and Wi-Fi Internet access in order to keep its increasingly sophisticated customer base.

INDUSTRY STRUCTURE AND COMPETITIVE STRATEGY

Which Competitive Strategy Is Best?

- Before selecting one of Porter's generic competitive strategies for a company or business unit, management should assess its feasibility in ***terms of company or business unit resources and capabilities.***

- Porter lists some of the commonly required skills and resources, as well as organizational requirements,

INDUSTRY STRUCTURE AND COMPETITIVE STRATEGY

Which Competitive Strategy Is Best?

Requirements for Generic Competitive Strategies

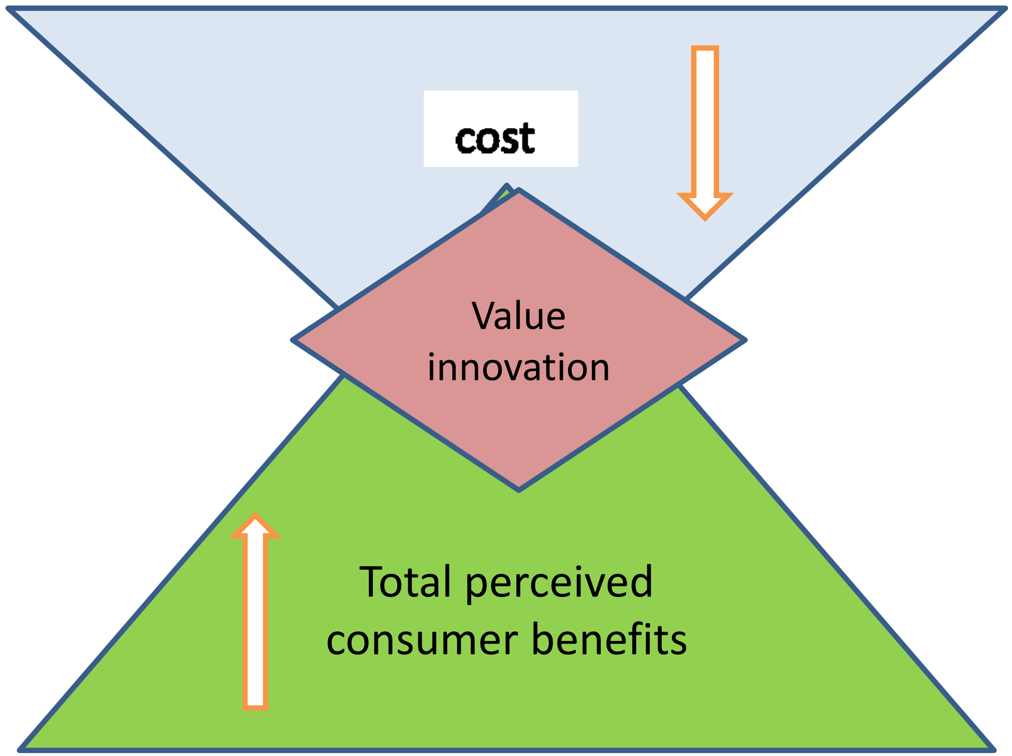
Generic Strategy	Commonly Required Skills and Resources	Common Organizational Requirements
Overall Cost Leadership	■ Sustained capital investment and access to capital ■ Process engineering skills ■ Intense supervision of labor ■ Products designed for ease of manufacture ■ Low-cost distribution system	■ Tight cost control ■ Frequent, detailed control reports ■ Structured organization and responsibilities ■ Incentives based on meeting strict quantitative targets
Differentiation	■ Strong marketing abilities ■ Product engineering ■ Creative flair ■ Strong capability in basic research ■ Corporate reputation for quality or technological leadership ■ Long tradition in the industry or unique combination of skills drawn from other businesses ■ Strong cooperation from channels	■ Strong coordination among functions in R&D, product development, and marketing ■ Subjective measurement and incentives instead of quantitative measures ■ Amenities to attract highly skilled labor, scientists, or creative people
Focus	■ Combination of the above policies directed at the particular strategic target	■ Combination of the above policies directed at the particular strategic target

Blue Ocean Strategy

Competitive Scope		Strategic Position	
		Cost	Differentiation
	Broad	Cost leadership	Differentiation
	Narrow	Focused Cost Leadership	Focused Differentiation

Blue Ocean Strategy

Blue Ocean Strategy



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COMPETITIVE TACTICS

Competitive Tactics

- A **tactic** is a *specific operating plan that details how a strategy is to be implemented* in terms of when and where it is to be put into action. By their nature, ***tactics are narrower in scope and shorter in time horizon*** than are strategies.

- Some of the tactics available to implement competitive strategies are **timing tactics** and **market location tactics**.

COMPETITIVE TACTICS

Timing Tactics: When to Compete

- A **timing tactic** deals with when a company implements a strategy.
- The first company to manufacture and sell a new product or service is called the **first mover** (**or pioneer**).
- Some of the advantages of being a first mover are that the company is able to establish a reputation as an industry leader, move down the learning curve to assume the cost-leader position, and **earn temporarily high profits** from buyers who value the product or service very highly.
- Asuccessful first mover can also set the standard for all subsequent products in the industry. Acompany that sets the standard "**locks in" customers** and is then able to offer further products based on that standard.

COMPETITIVE TACTICS

Timing Tactics: When to Compete

- **Late movers** may be able to imitate the technological advances of others (and thus keep R&D costs low), ***keep risks down by waiting until a new technological standard or market is established***, and take advantage of the first mover's natural inclination to ignore market segments.

COMPETITIVE TACTICS

Market Location Tactics: Where to Compete

- A market location tactic deals with where a company implements a strategy.
- A company or business unit can implement ***a competitive strategy*** either **offensively or defensively**.
- An **offensive tactic** usually takes place in an established competitor's market location.
- A **defensive tactic** usually takes place in the firm's own current market position as a defense against possible attack by a rival.

COMPETITIVE TACTICS

Offensive Tactics

- **Frontal assault**: The attacking firm goes head to head with its competitor. It matches the competitor in every category from price to promotion to distribution channel. To be successful, the attacker must have not only superior resources, but also the willingness to persevere.

- **Flanking maneuver**: Rather than going straight for a competitor's position of strength with a frontal assault, a firm may attack a part of the market where the competitor is weak.

- **Bypass attack**: Rather than directly attacking the established competitor frontally or on its flanks, a company or business unit may choose to change the rules of the game. This tactic attempts to cut the market out from under the established defender by offering a new type of product that makes the competitor's product unnecessary.

- **Encirclement**: Usually evolving out of a frontal assault or flanking maneuver, encirclement occurs as an attacking company or unit encircles the competitor's position in terms of products or markets or both. The encircler has greater product variety (e.g., a complete product line, ranging from low to high price) and/or serves more markets (e.g., it dominates every secondary market).

COMPETITIVE TACTICS

Offensive Tactics

– **Encirclement:** Usually evolving out of a frontal assault or flanking maneuver, encirclement occurs as an attacking company or unit encircles the competitor's position in terms of products or markets or both. The encircler has greater product variety (e.g., a complete product line, ranging from low to high price) and/or serves more markets (e.g., it dominates every secondary market).

Defensive Tactics

- aim to lower the probability of attack, divert attacks to less threatening avenues, or lessen the intensity of an attack.
- Instead of increasing competitive advantage per se, they make a company's or business unit's competitive advantage more sustainable by causing a challenger to conclude that an attack is unattractive.

COMPETITIVE TACTICS

Defensive Tacticsde

- ***Raise structural barriers*** - entry barriers act to block a challenger's logical avenues of attack. Some of the most important, according to Porter, are to:
    1. Offer a full line of products in every profitable market segment to close off any entry points;
        - (for example, Coca Cola offers unprofitable noncarbonated beverages to keep competitors off store shelves);
    2. Block channel access by signing exclusive agreements with distributors;
    3. Raise buyer switching costs by offering low-cost training to users;
    4. Raise the cost of gaining trial users by keeping prices low on items new users are most likely to purchase;
    5. Increase scale economies to reduce unit costs;
    6. Foreclose alternative technologies through patenting or licensing;
    7. Limit outside access to facilities and personnel;
    8. Tie up suppliers by obtaining exclusive contracts or purchasing key locations;
    9. Avoid suppliers that also serve competitors; and
    10. Encourage the government to raise barriers, such as safety and pollution standards or favorable trade policies.

COMPETITIVE TACTICS

Defensive Tacticsde

- ***Increase expected retaliation -*** tactic is any *action that increases the perceived threat of retaliation for an attack*.
  - For example, management may strongly defend any erosion of market share by drastically cutting prices or matching a challenger's promotion through a policy of accepting any price-reduction coupons for a competitor's product.

- ***Lower the inducement for attack*** – a third type of defensive tactic is to *reduce a challenger's expectations* of future profits in the industry.

BUSINESS STRATEGIES – COOPERATIVE STRATEGIES

Collusion

- Collusion is the active ***cooperation of firms within an industry*** to reduce output and raise prices in order to get around the normal economic law of supply and demand.

- Collusion may be **explicit**, in which case firms cooperate through direct communication and negotiation, or **tacit**, in which case firms cooperate indirectly through an informal system of signals.

- Explicit collusion is illegal in most countries and in a number of regional trade associations, such as the European Union.

BUSINESS STRATEGIES – COOPERATIVE STRATEGIES

Strategic Alliances

- A strategic alliance is a ***long-term cooperative arrangement*** between two or more ***independent firms or business units*** that engage in business activities for mutual economic gain.

- Alliances between companies or business units have become a fact of life in modern business.

- Some alliances are very short term, only lasting long enough for one partner to establish a beachhead in a new market.

- Many alliances do increase profitability of the members and have a positive effect on firm value.

BUSINESS STRATEGIES – COOPERATIVE STRATEGIES

Strategic Alliances

- Companies or business units may form a strategic alliance for a number of reasons, including:
  - **To obtain or learn new capabilities**: Alliances are especially useful if the desired knowledge or capability is based on taci knowledge or on new poorly-understood technology.
  - **To obtain access to specific markets**: Rather than buy a foreign company or build brewerie of its own in other countries, Anheuser-Busch chose to license the right to brew and market Budweiser to other brewers.
  - **To reduce financial risk**: Alliances take less financial resources than do acquisitions or going it alone and are easier to exit if necessary.
  - **To reduce political risk**: Forming alliances with local partners is a good way to overcome deficiencies in resources and capabilities when expanding into international markets.

BUSINESS STRATEGIES – COOPERATIVE STRATEGIES

Mutual Service Consortia

- A mutual service consortium is a ***partnership of similar companies in similar industries that pool their resources to gain a benefit*** that is too expensive to develop alone, such as access to advanced technology.

- The mutual service consortia is a f***airly weak and distant alliance*** - appropriate for partners that wish to work together but not share their core competencies. There is very little interaction or communication among the partners.

BUSINESS STRATEGIES – COOPERATIVE STRATEGIES

Joint Venture

- A joint venture is a ***cooperative business activity, formed by two or more separate organizations for strategic purposes***, that creates an independent business entity and allocates ownership, operational responsibilities, and financial risks and rewards to each member, while preserving their separate identity/autonomy.

- Joint ventures are the *most popular form of strategic alliance*. They often occur because the companies involved do not want to or cannot legally merge permanently.

- ***Joint ventures provide a way to temporarily combine the different strengths of partners to achieve an outcome*** of value to all.

BUSINESS STRATEGIES – COOPERATIVE STRATEGIES

Joint Venture

- Extremely popular in ***international undertakings because*** of financial and political–legal constraints, forming joint ventures is a convenient way for corporations to work together without losing their independence.

- ***Disadvantages*** of joint ventures include ***loss of control, lower profits, probability of conflicts with partners***, and the likely transfer of technological advantage to the partner.

- Joint ventures are often *meant to be temporary*, especially by some companies that may view them as a way to rectify a competitive weakness until they can achieve long-term dominance in the partnership.

BUSINESS STRATEGIES – COOPERATIVE STRATEGIES

Licensing Arrangements

- A licensing arrangement is an ***agreement in which the licensing firm grants rights to another firm in another country or market to produce and/or sell a product***.

- The licensee pays compensation to the licensing firm in return for technical expertise.

- **Licensing is an especially useful strategy if the trademark or brand name is well known** but the MNC does not have sufficient funds to finance its entering the country directly.

BUSINESS STRATEGIES – COOPERATIVE STRATEGIES

Value-Chain Partnerships

- A value-chain partnership is a ***strong and close alliance*** in which one ***company or unit forms a long-term arrangement*** with a key supplier or distributor for mutual advantage.
  - To improve the quality of parts it purchases, companies in the U.S. auto industry, for example, have decided to work more closely with fewer suppliers and to involve them more in product design decisions.
  - Activities that had previously been done internally by an automaker are being outsourced to suppliers specializing in those activities.

STRATEGIC CHOICE: SELECTING THE BEST STRATEGY

- After the pros and cons of the potential strategic alternatives have been identified and evaluated, one must be selected for implementation. By now, it is likely that many feasible alternatives will have emerged.
  - *How is the best strategy determined?*

- The most important criterion is the capability of the proposed strategy to deal with the specific strategic factors developed earlier, in the SWOT analysis.

- If the alternative doesn't take advantage of environmental opportunities and corporate strengths/competencies, and lead away from environmental threats and corporate weaknesses, it will probably fail.