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The competitive advantage

Internal Analysis

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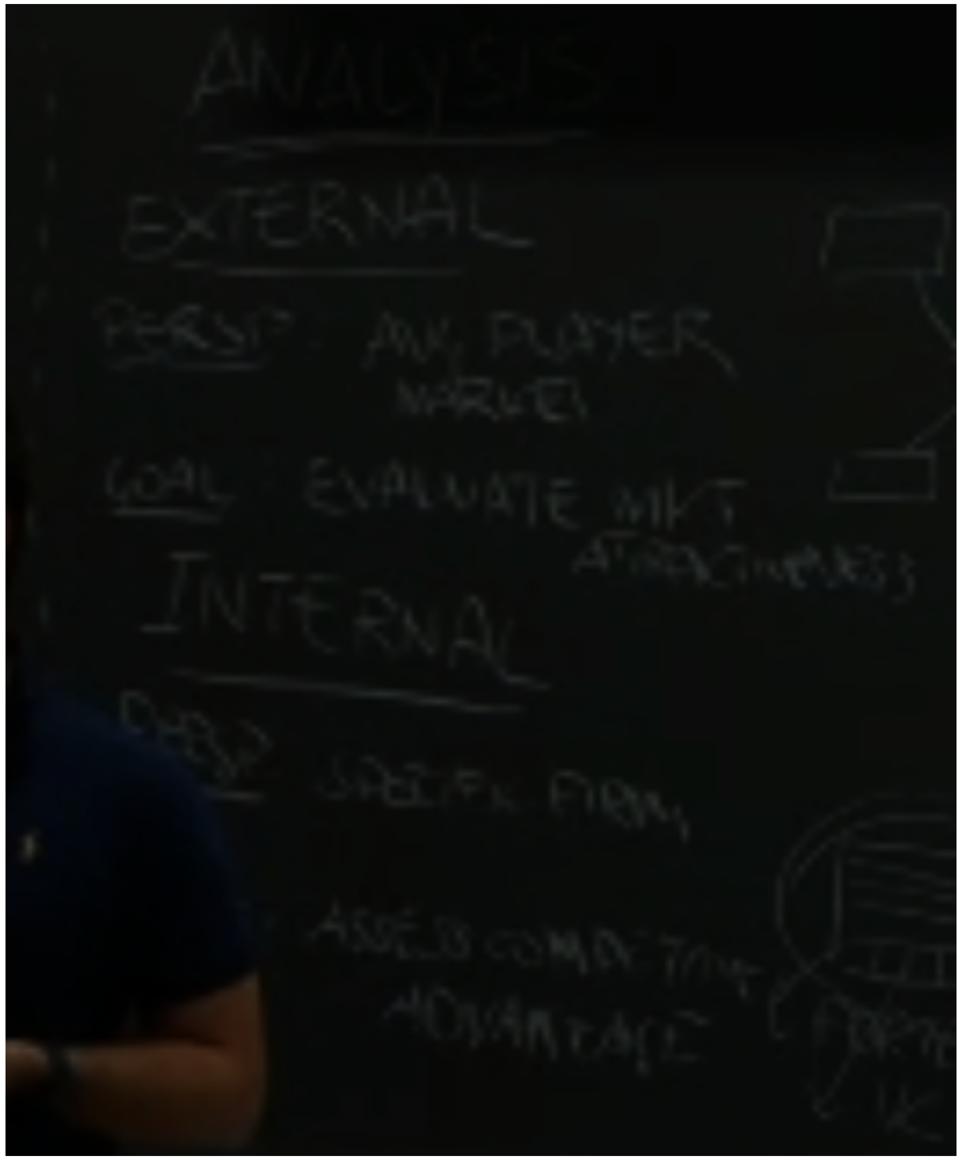
Agenda

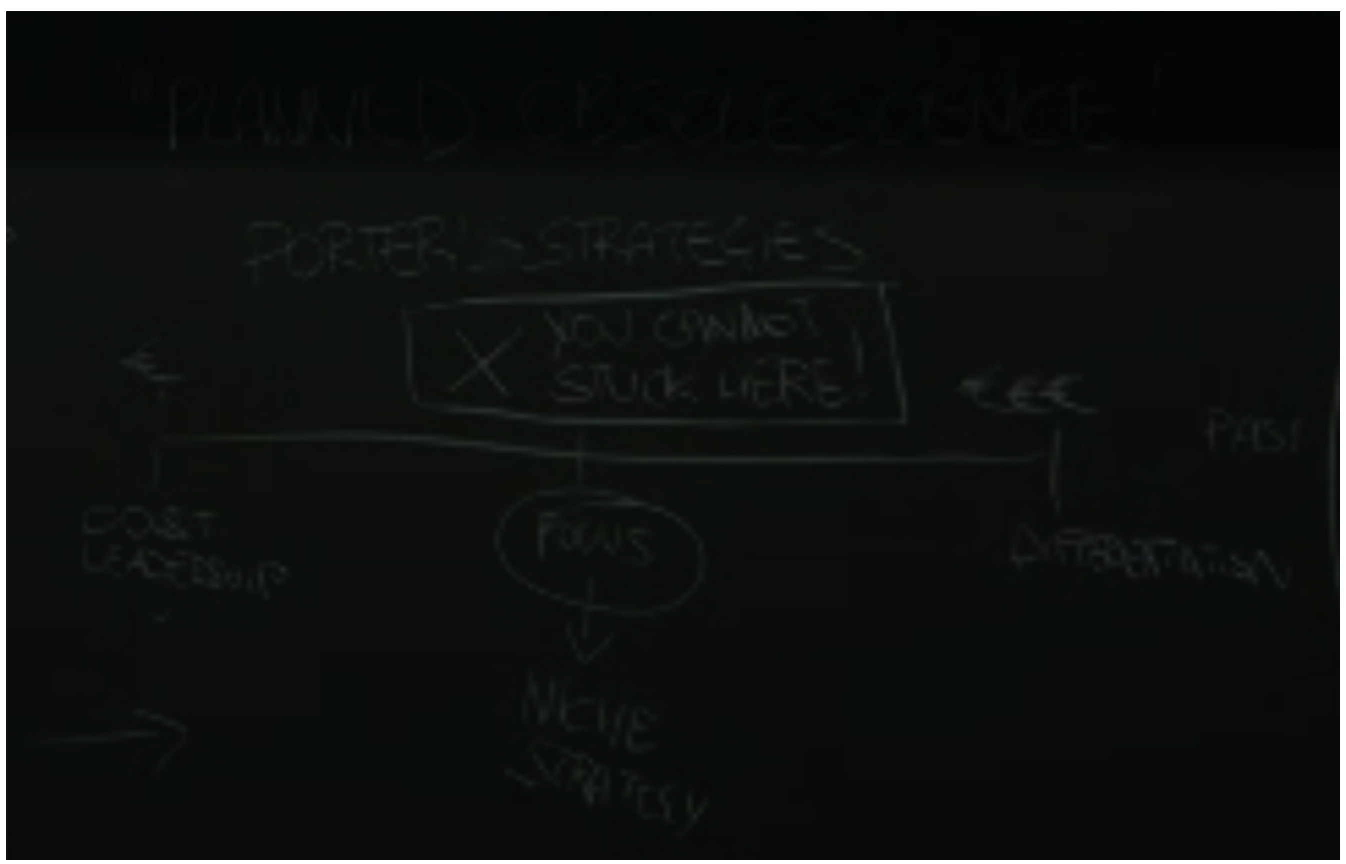
- The traditional approach: Porter's generic strategies
- The new strategic question
- From upstream competitive advantage to downstream
- The new mantra
- The big picture approach



The traditional approach: Porter's generic strategies

Porter's generic strategies

- **Cost Leadership:** low cost position achieved through aggressive cost reduction and high market share (e.g. Ryanair)
- **Differentiation:** differentiate the product or service in order to be perceived as unique (e.g. Mercedes)
- **Focus:** concentrate on a particular customer group, segment of product line or geographical market (e.g. Gore-Tex)



with digital inovation staying in the middle is possible!

Cost Leadership: sources of cost advantage

- Economies of Scale
- Economies of Learning
- Process Technology and Process Design
- Product Design modular, 60% of ikea is the same, mass production
- Input Cost
- Capacity Utilization ice cream & crossaint => summer and winter => optimizing
- Managerial Organisational Efficiency corporate strategies

Cost Leadership strategies and the five forces (1/3)

1. **Threat of New Entrants**
   Can frighten off new entrants due to their need to enter on a large scale in order to be cost competitive.
2. **Bargaining Power of Buyers**
   Can mitigate buyers' power by driving prices far below competitors, causing them to exit and shifting power with buyers back to the company.

3. Bargaining Power of Suppliers

Can mitigate suppliers' power by:

- being able to absorb cost increases due to low cost position
- being able to make very large purchases, reducing chance of supplier using power

4. Substitutes

Cost leader is well positioned to:

- make investments to be first to create substitutes
- buy patents developed by potential substitutes
- lower prices in order to maintain value position

5. Existing Competitors

Can use cost leadership strategy to advantage since competitors avoid price wars with cost leaders, creating higher profits for the entire industry

Risks of cost leadership

- Technological change that nullifies past investments or learning (e.g., smartphone vs satellite GPS).
- Low-cost learning by new players (or followers) through imitation (e.g., website design).
- Inability to see required products or marketing change because of attention placed on cost (e.g., low-end fast food chains vs high-end fast food chains).
- Inflation in cost that narrows the price differential.

Differentiation strategy

your sources

- Value provided by **unique features and value characteristics**
- Command premium price
- High customer service
- Superior quality
- Prestige or exclusivity
- Rapid innovation iphone

Tangible vs. intangible differentiation

- **Tangible differentiation** is concerned with the observable characteristics of a product or service that are relevant to the customers (i.e. size, shape, color, weight, design, material, technology, reliability, consistency, taste, speed, durability, safety…)
- Where a product or service is meeting complex customer needs (e.g. cosmetics, medical services and education) differentiation choices involve the overall image of the company's offering. **Intangible differentiation** concerns the social, emotional, psychological considerations that affect customers' choices (i.e. status, exclusivity, individuality, security…)

Factors that drive differentiation

- Unique product features
- Unique product performance
- Exceptional services
- New technologies
- Quality of inputs
- Exceptional skill or experience
- Detailed information
- Extensive personal relationships with buyers and suppliers

1. **Threat of New Entrants**

   Can defend against new entrants because:
   - new products must surpass proven products **or**,
   - new products must be at least equal to performance of proven products, but offered at lower prices.

2. **Bargaining Power of Buyers**

   Can mitigate buyer power because well differentiated products reduce customer sensitivity to price increases.

3. **Bargaining Power of Suppliers**

   Can mitigate suppliers' power by:
   - absorbing price increases due to higher margins

4. **Substitutes**

   Well positioned relative to substitutes because brand loyalty to a differentiated product tends to reduce customers' testing of new products or switching brands and technologies.

5. Existing Competitors

Can defend against competition because brand loyalty to differentiated product offsets price competition.

Risk of differentiation

- Cost differential with low-cost competitors becomes too great undermining brand loyalty (e.g., Bimby vs other kitchen robots).
- Customers become more sophisticated and their need for the differentiating factor falls (e.g., high-end smartphones).
- Imitation narrows perceived differentiation (e.g., SmartTV).
- Makers of counterfeit goods may attempt to replicate differentiated features of the company's products (e.g., football shirts, original vs non-original).

Focus strategy

- The focus strategy rests on the premise that the company is able to serve its narrow strategic target (customer segment, geographic market, "niche"), more effectively or efficiently than its competitors.
- The company achieves either **differentiation** from better meeting the needs of the particular target or **lower cost** in serving the target, or **both**.
- The focus strategy always involves a **trade-off** between profitability and sales volume.

Risks of focus

- The cost differential with broad-range competitors widens and…
  - … it eliminates the cost advantage of serving a narrow target; **or**
  - … it offsets the differentiation achieved by focus.
- The differences in desired products (or services) between the strategic target and the market as a whole narrows.
- Competitors find submarkets **within** the strategic target and outfocus the focuser.

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Three key principles:

1. Strategy is the creation of a **unique and valuable position**, involving a different set of activities.

2. Strategy requires you to make **trade-offs** in competing - to choose what not to do.

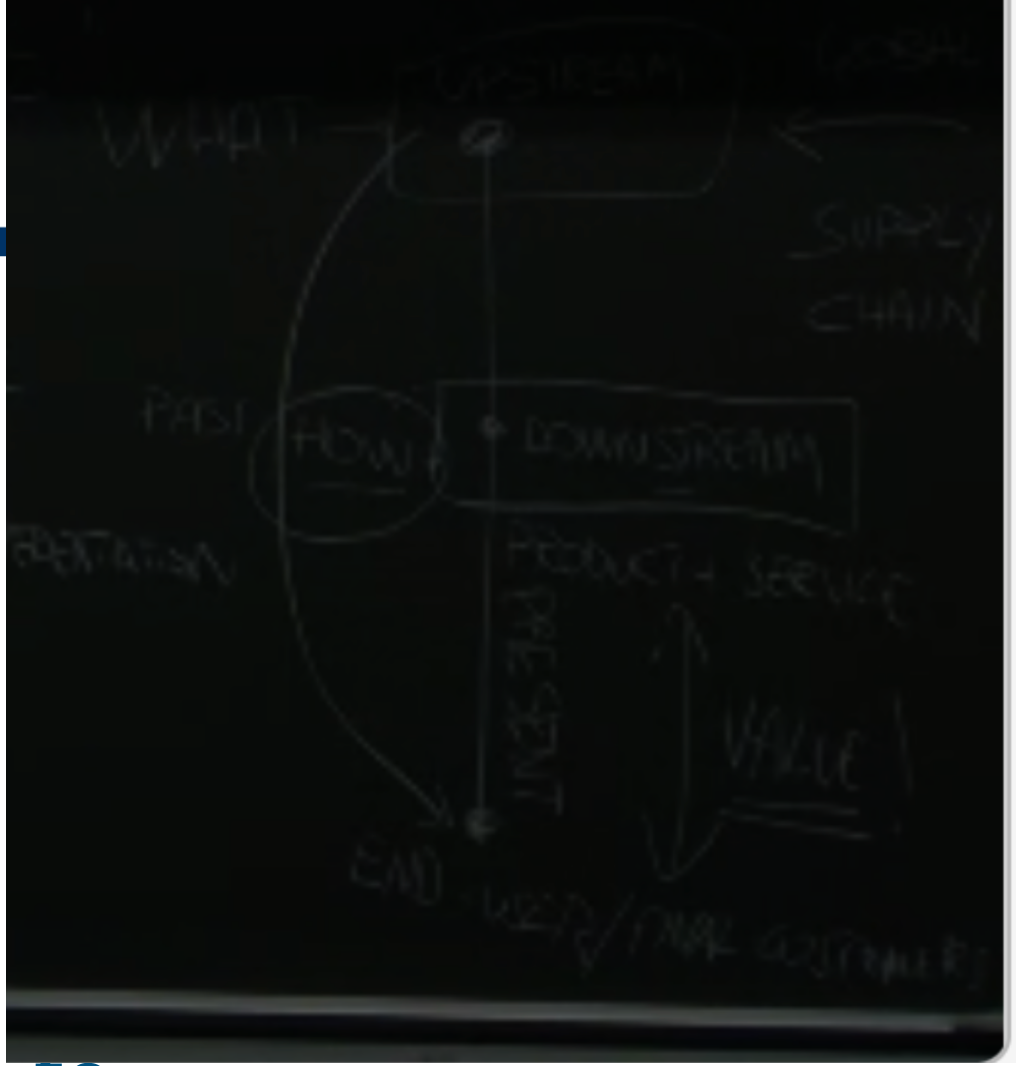
3. Strategy involves creating **fit** among a company's activities.

(Michael Porter, **HBR**, 2000)

The new strategic question

The new strategic question

- For too long the business world has been obsessed with the notion of building a sustainable competitive advantage.
- The dominant idea in the field of strategy has been always to establish a unique competitive position, sustained for long periods of time
- The most common strategies coming from a product, or production facilities-centric approach
- Firms continue to spend inordinate amounts of time, effort and resources on their products
- **but is this center of gravity still sustainable?**



From upstream competitive advantage to downstream’s

Upstream value: a successful strategy in the past

- **Businesses have traditionally sought competitive advantage in the upstream**- the value creation activities related to production and products

- The upstream has been **historically very profitable**:
  - **Ford** built such a huge and streamlined factory that it drove per-unit cost of production for the Ford Model T far below that of competitor's cars
  - **Walmart** built an unbeatable network for moving inventory between its global supply chain and its stores, allowing the company to underprice competitors due to efficiency savings
  - **De Beers** pulverized its competitors as regard diamond market by gaining control of much of the world's supply of diamonds….
  - …

Value shifts downstream

- But **now the business world is suffering from the erosion of upstream competitive advantage**
- Why?
  - Rapid **commoditization** of products and production
  - **Outsourcing** of the upstream activities
  - **Short product life-cycle**
  - …
- In this **new scenario, value is created in the interactions with customers**, competitive advantage is built and sustained in the marketplace, and the primary costs reside in acquiring, satisfying and retaining customers

Many ways of buying a can of Coca-Cola

1)A consumer goes to a supermarket and buys a twenty-four-pack of Coca-Cola. The pack might be priced at $5.99 (0.25$ per can)

2)The same customer, the next day, finds herself in a park on a blazingly hot summer day and pays $2 for a chilled single-serve can of Coke sold at the point of thirst through a vending machine

The premium price is due to a perceived added value in the eyes of the consumer. The product (What) is the same, but the purchase and consumption is different (how)

VALUE = WHAT + HOW

so

VALUE shifts from Product to Experience

Neglecting the change: the case of the music industry

- **The music business has always been “ok”**
  - Each of the major record labels had a **unique stable of artists who gave the label its cachet**
  - **The label were not in direct competition with each other**: they appealed to different segments of the market with different musical tastes
  - Upstream assets: a **lock on the supply of the music and no direct competitors**

- Nevertheless the music industry was unprepared for what happened when the digital and the Internet revolutions hit

Neglecting the change: the case of the music industry

- Suddenly music could be downloaded easily (Napster), shared as easily as sending an e-mail and potentially be shared by millions of people
- The music industry panicked
- Record labels sued to reclaim copyright in a world of global file-sharing: they sued the keepers of music download websites, Internet service providers whose customers shared music online, the developers of file-sharing software, and the freeloading downloaders
- **Between 2003 and 2007, the Recording Industry Association of America launched twenty thousand lawsuits. During the same period, the number of people sharing files online tripled**

Neglecting the change: the case of the music industry

- Before the industry burst, Steve Jobs stepped in; even he came from outside the music sector
- Apple was not wedded to the **upstream assets** the music industry had accumulated (the recording contracts with artists, the decades of music libraries), but Jobs understood that the music industry had lost control over the mode of music distribution and consumption, its downstream activities
- Apple set out to build an organized marketplace that would create downstream value for customer of music and give producers the incentive to continue to produce:
  - value for consumers through searchability, recommendations, playlists, customization, ease of use, ease of storage, legacy, “my music everywhere”…
  - value for the offer side, $ 0.99 for each song
- **The brilliance of this approach was the recognition that the value consumers would pay for was no longer in the what, but in the how!**

The new mantra

Competitive advantage is created by uncovering **the costs and risks** the customer incurs in the buying process and finding ways to eliminate or reduce them before competitors!

Customer's costs and risks

- Customer's costs and risks can be explicit, or hidden:
- EXPLICIT
  - Monetary costs and monetary risks
- HIDDEN
  - COSTS: defined in terms of "effort"
    - time spent to buy the product
    - difficulty in processing the product characteristics
    - difficulty in understanding what are the most relevant information in the buying process
    - …
  - RISKS: defined in terms of "poor choice"
    - what if my girlfriend doesn't like my gift
    - what if this product is not the best solution for me
    - what if next year I won't use this product anymore
    - …

Customer’s costs and risks

EXPLICIT COSTS AND RISKS

EACH COMPETITOR SEE THEM!

PRICE WAR

CONTRIBUTION MARGIN CONTRACTION

HIDDEN COSTS AND RISKS

NO ONE SEE THEM!

EVEN IF THEY ARE INVISIBLE, THEY'RE STILL A PAIN FOR CUSTOMERS

COSTS AND RISKS FIRMS IMPOSE ON CUSTOMERS ARE INDUSTRY WIDE PRACTICES, AND BECAUSE EVERYONE IMPOSEs THEM, THEY ARE WIDELY ACCEPTED AND INVISIBLE

REDUCING THEM I CAN CREATE VALUE FOR THE CUSTOMERS WHERE NO ONE MORE CREATES VALUE

COMPETITIVE ADVANTAGE

The big picture approach

digital world

Seeing customers' hidden costs and risks

Firms have access to the **big picture** and can see different things in the marketplace than what customers can. Firms can see problems that are likely to arise, because the have arisen elsewhere, or they can see solutions to problems that plague a particular customer or subgroup of customers, because they have seen solution successfully implemented elsewhere

How to see customers' hidden costs and risks

- Each customer holds a piece of hundreds-piece jigsaw puzzle
- While each piece is unique, when assembled the pieces reveal a larger meaning
- In most instances, that piece of the puzzle remains forgotten in a drawer, in a database, untouched, and unused because customers fail to realize its possible role in the larger context
- Being able to bring together all the pieces of information that lie dispersed with customers, firms can see patterns they've never seen before
- These patterns can help the customers make different and better choices that add valued to themselves and to the company

The big picture as Business Model

- In twenty-first century information businesses, the “big picture” (the puzzle assembled) is rapidly becoming an indispensable tool
- **Some businesses go farther: the big picture is their business**
- **Bluefin Labs**, for example, is a recent Cambridge Massachussets start-up launched by an MIT professor. The company aims to **understand how the “Twitter-sphere” responds to television programming advertising.** By analyzing patterns in the tweets that appear in reaction to TV commercials, Bluefin is able to tell advertisers which if their ads had the greatest **social media impact and whether that impact was positive or negative**
- Bluefin Labs’ social media analysis and technology was deemed so valuable that the company was acquired by Twitter in February 2013 and Twitter declared Bluefin’s products would not be sold to any new clients

- There are three main ways in which marketplace information can create value for your customer:

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  - **relaying and connecting**
  - **benchmarking and mirroring**
  - **predicting**

Relaying and connecting

- The main idea is to take information from one location and apply it in another, to **learn from one customer and use the learning to help another**
- The company therefore sees ideas and solutions that have been implemented or tried, and knows those that worked and those that did not
- The **Amazon**'s huge success is due to this value proposition: not only does Amazon allow the customer to shop online at any time he or she chooses, in any time zone, but **the customers also gets extensive information and advice unavailable in a traditional store**, for instance browsing through what other readers think of the book

Benchmarking and mirroring

- Benchmarking provides customers with the all-important “you are here” location on dimensions that are relevant to them. This **information allows them to pinpoint their own position relative to the peers on crucial metrics**
- Benchmarking is a special case of a more general use of the big picture: **mirroring** (to aggregate and feed back to individuals information about groups of customers)
- The value and availability of benchmarking data has increased with the growth of the third-party benchmarking industry, as well as in social comparisons on social networking sites such as Facebook and Linkedin
- **Nike +**, for instance, allows runners to measure running performance and upload their running data to Facebook. **Benchmarking against other runners and their own past performances motivates Nike’s customers to maintain a training regimen**

- **The most sophisticated use of marketplace data lies in discerning patterns that can help predict future trends**
- In this perspective, **Google Flu Trends** is a relevant business case
- A rapidly spreading worldwide flu-like epidemic is considered one of the greatest dangers facing humanity. It's not surprising that doctors and researchers know a lot about influenza viruses and health authorities devote considerable effort tracking and preventing outbreakes
- They know when influenza will strike, what strain of influenza will strike in a given year, how the disease progresses and who will likely develop complications, however, they do not know where flu outbreaks will occur
- This is where Google Flu Trends comes in: Google reasoned that when people feel ill, they tend to turn to the Internet for information before heading to the doctor. Thus Google extracts the value by aggregating the searches and plotting the data over geographical locations