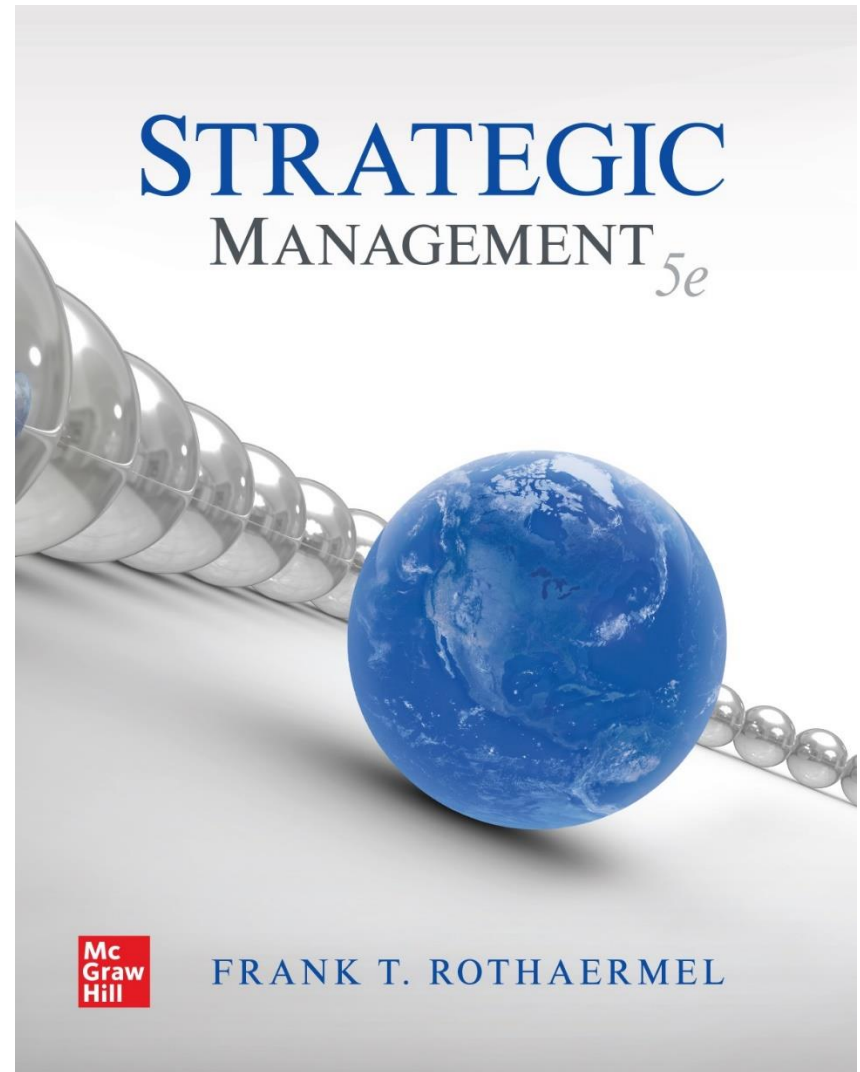


Chapter 6

Business Strategy:
Differentiation, Cost
Leadership and Blue
Oceans



Learning Objectives

1. Define business-level strategy and describe how it determines a firm's strategic position.
2. Examine the relationship between value drivers and differentiation strategy.
3. Examine the relationship between cost drivers and cost-leadership strategy.
4. Assess the benefits and risks of differentiation and cost-leadership strategies vis-vis the five forces that shape competition.
5. Evaluate value and cost drivers that may allow a firm to pursue a blue ocean strategy.
6. Assess the risks of a blue ocean strategy and explain why it is difficult to succeed at value innovation.

What Is Business Level Strategy?

Goal-directed actions:

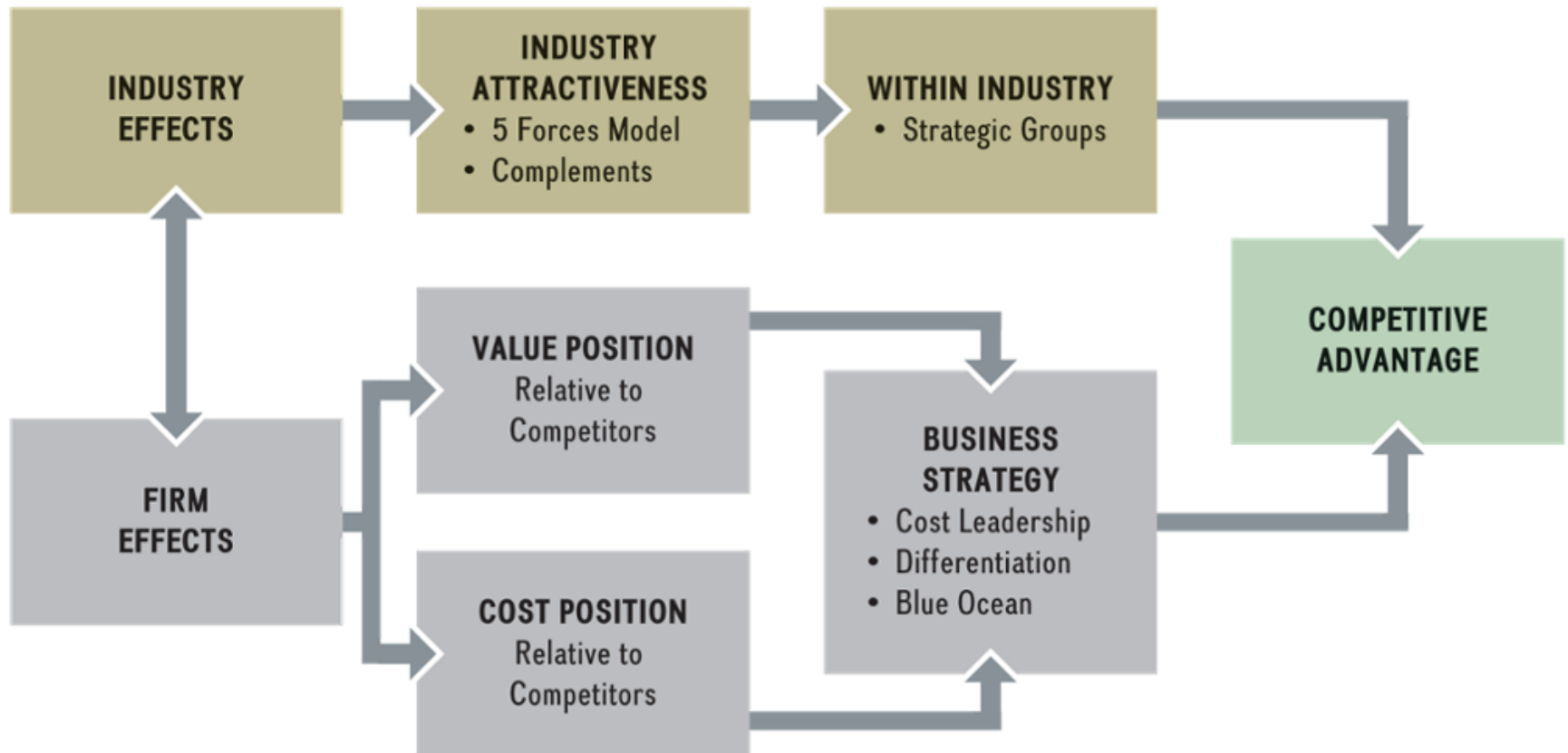
- To achieve competitive advantage in a single product market.

“How should we compete?”

- **Who**: which customer segments?
- **What**: customer needs will we satisfy?
- **Why**: do we want to satisfy them?
- **How**: will we satisfy our customers' needs?

Industry and Firm Effects Jointly Determine Competitive Advantage

Exhibit 6.1



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Strategic Position

A strategic profile based on value creation and cost in a specific product market.

A valuable and unique position, which:

- Meets customer needs.
- Maximizes product value.
- Lowest possible product cost.

Strategic Trade-Offs

Choices between a **cost** OR **value** position.

Tension between value creation and pressure to keep cost in check.

Purpose to maximize the firm's:

- Economic value creation.
- Profit margin.

Generic Business Strategies

Differentiation:

- Seeks to create higher value vs. competitors.
- Offers unique features.
- Charges higher prices.

Cost Leadership:

- Seeks to create similar value vs. competitors.
- Charges lower prices.

Focused Business Strategies

Narrower competitive scope.

Focused **Differentiation**:

- Example of Mont Blanc: exquisite pens at several hundred dollars.

Focused **Cost Leadership**:

- Example of BIC: disposable pens and lighters at low cost.

Strategic Position and Competitive Scope: Generic Business Strategies

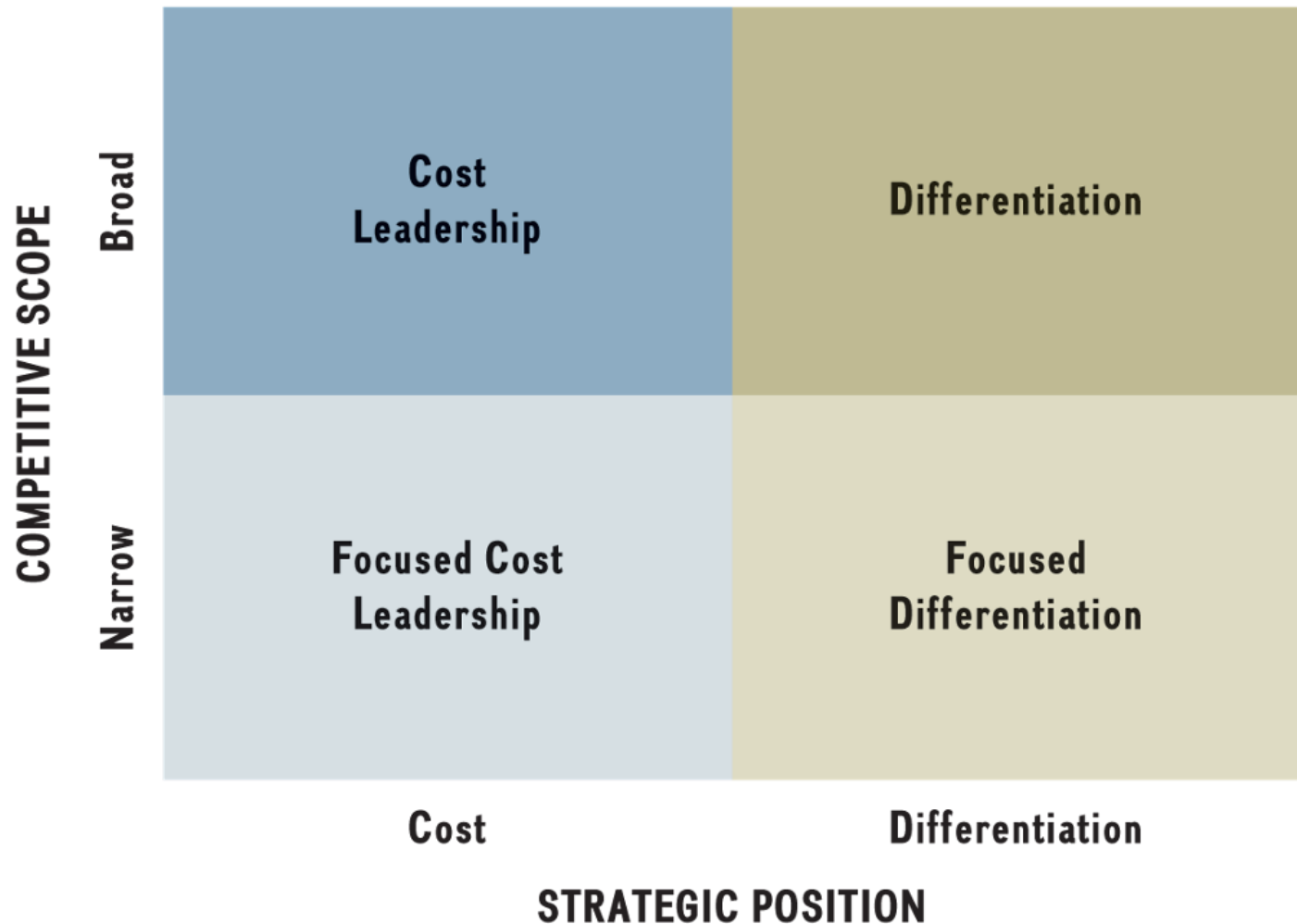


Exhibit 6.2

Source: Adapted from M.E. Porter (1980), *Competitive Strategy. Techniques for Analyzing Industries and Competitors* (New York: Free Press).

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Differentiation Strategy

Unique features that increase value, so that consumers pay a higher price.

The focus of competition:

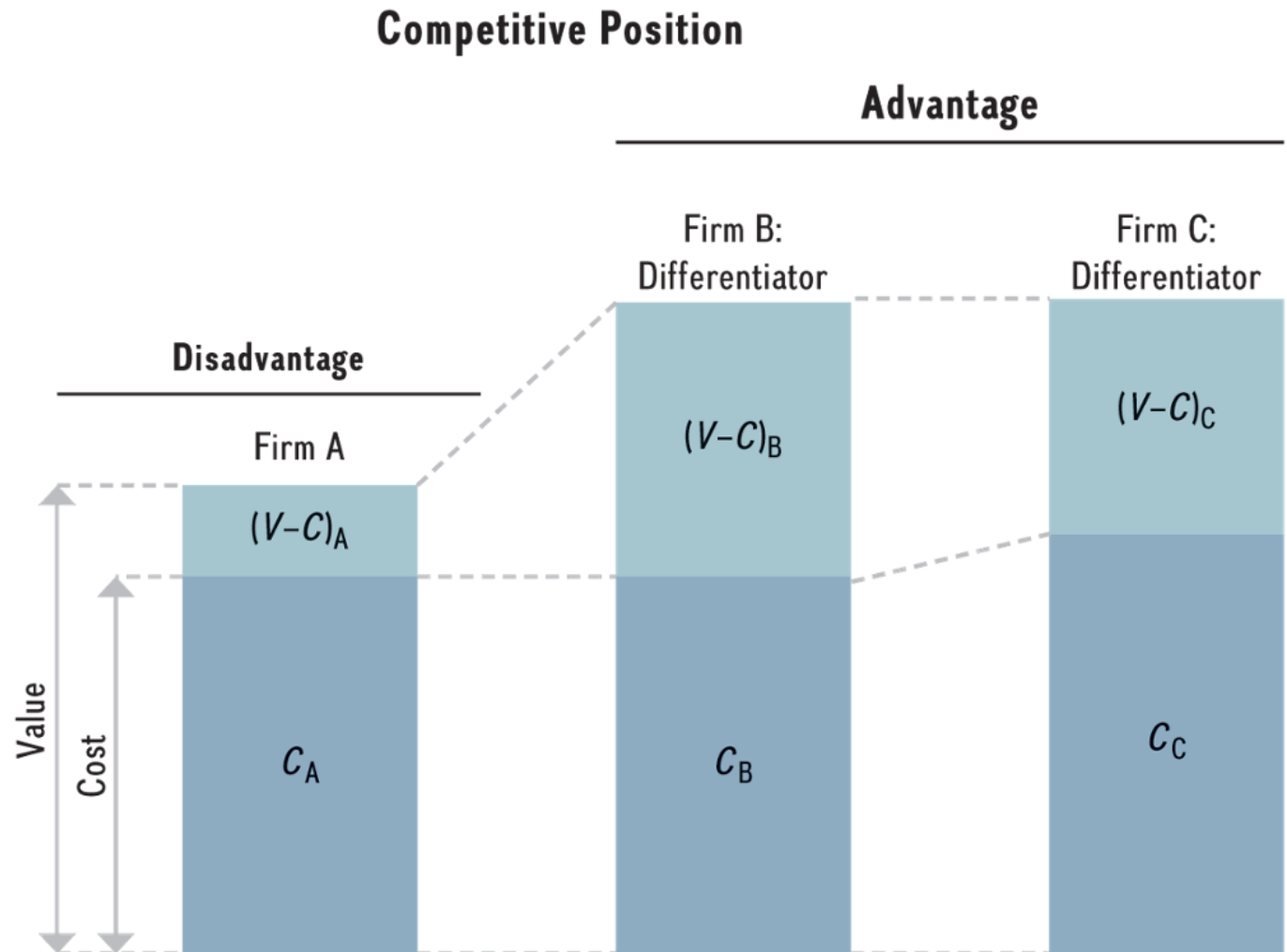
- Unique product features.
- Service.
- New product launches.
- Marketing and promotion.

Competitive advantage achieved when:

- $\text{Value} - \text{Cost} > \text{Competitors}$.

Differentiation Strategy: Achieving Competitive Advantage

Exhibit 6.3



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Economies of Scale and Scope

Economies of **Scale**:

- Decreases in cost per unit.
- Achieved as output increases.

Economies of **Scope**:

- Savings that come from producing two outputs at less cost.
- Shares the same resources or technology.

Three Drivers That Increase Perceived Value

Product features.

- Increase the perceived value of the product or service offering.

Customer service.

Complements.

- Add value to a product or service when they are consumed in tandem.

Differentiation Strategies: Summary

Focused on adding value:

- Unique features.
- Customer service.
- Effective marketing.

Can increase costs, for example, if R and D / innovation needed.

Customers willing to pay a premium.

Cost Leadership Strategy

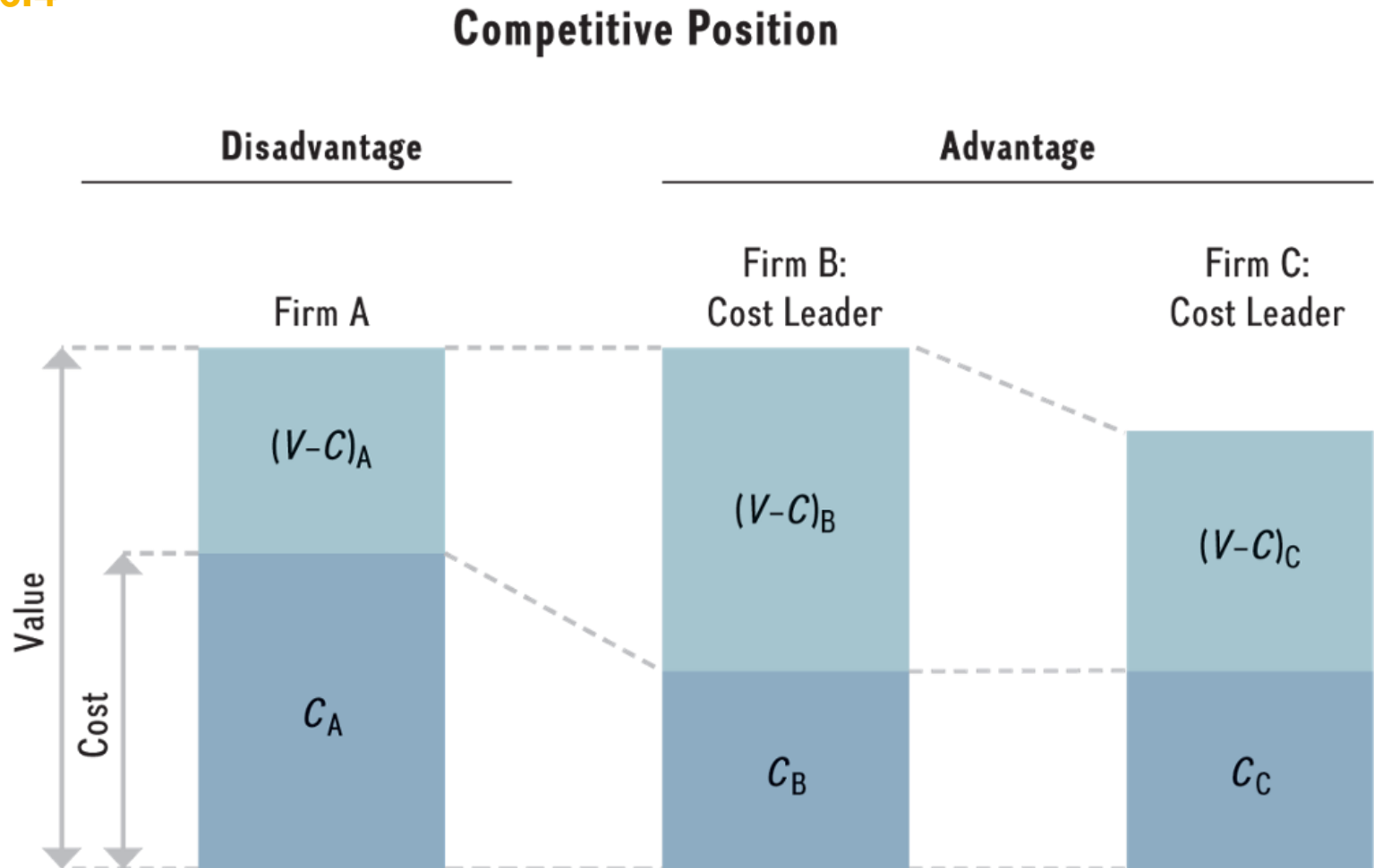
Goals:

1. Reduce cost below competitors.
2. Offer adequate value.
3. Reduce prices for customers.
4. Optimize the value chain for low cost.

A cost leader can achieve a competitive advantage as long as its economic value created ($V - C$) is greater than that of its competitors.

Cost-Leadership Strategy: Achieving Competitive Advantage

Exhibit 6.4



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Drivers That Keep Costs Low

Cost of input factors:

- Raw materials, capital, labor, and IT services.

Economies of scale:

- Decreases in cost per unit as output increases.

Learning-curve effects:

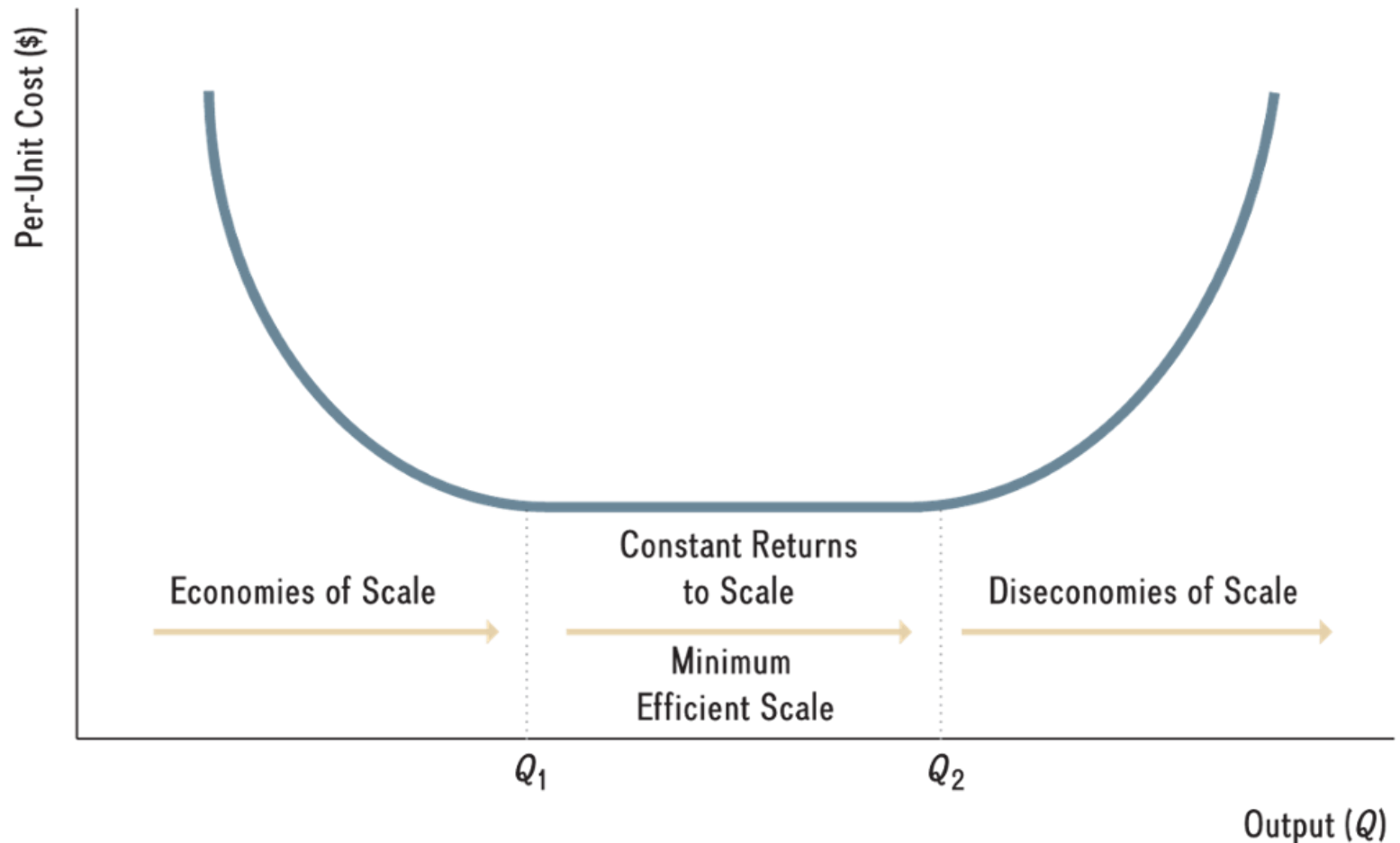
- Less time to produce output with experience.

Experience-curve effects:

- Improvements to technology and production processes.

Economies of Scale, Minimum Efficient Scale, and Diseconomies of Scale

Exhibit 6.5



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Economies and Diseconomies of Scale

Economies of Scale:

- Spreads fixed costs over a larger output.
- Employs specialized systems and equipment.
- Takes advantage of certain physical properties.

Diseconomies of Scale:

- Firms too big.
- Complexities of too much coordination.
- Inflexible and slow.

Tesla's Learning Curve Producing the Model S

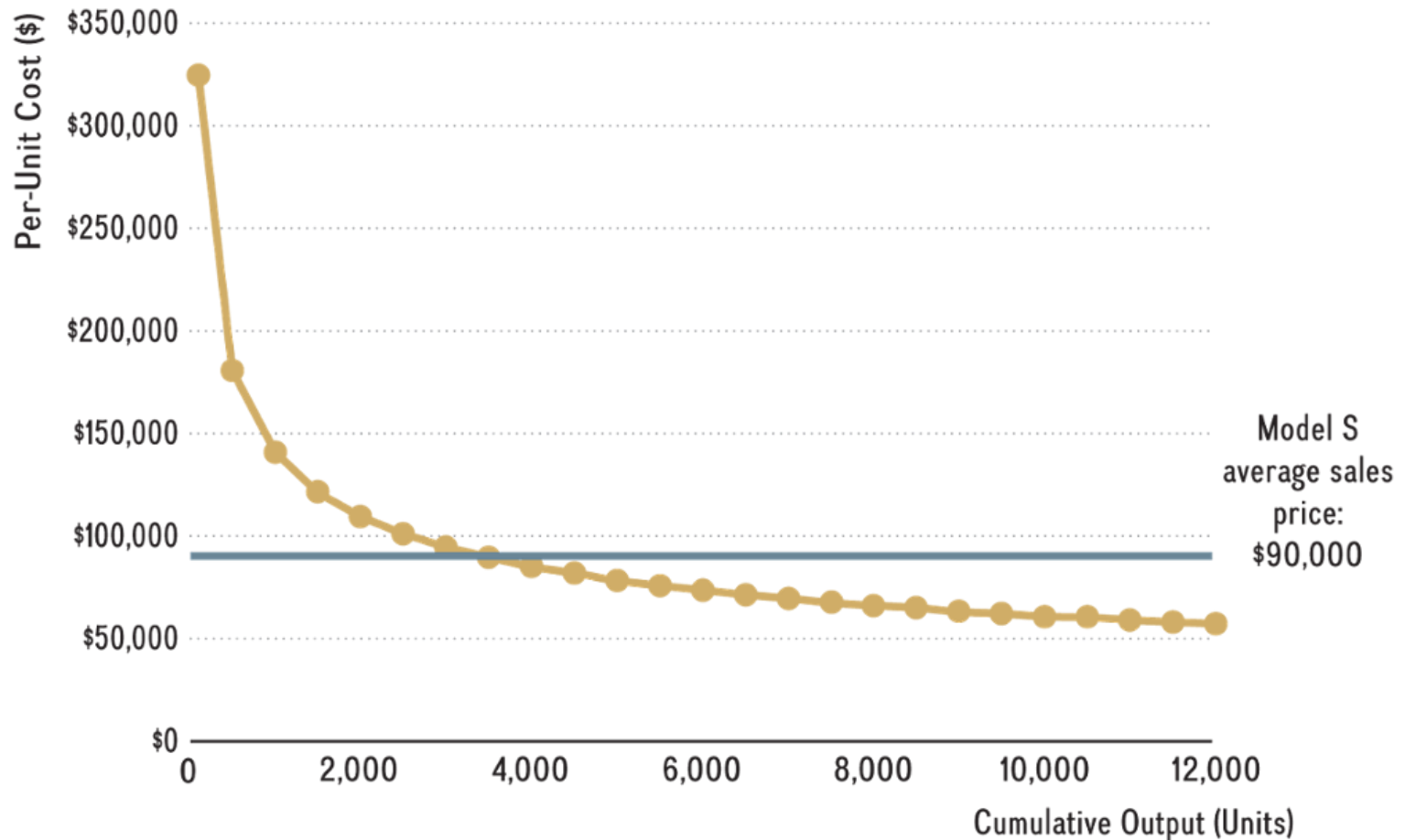


Exhibit 6.6

Source: Depiction of functional relationship estimated in J. Dyer and H. Gregersen (2016, Aug. 24), "Tesla's innovations are transforming the auto industry," *Forbes*

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Gaining Competitive Advantage through Leveraging Learning- and Experience-Curve Effects

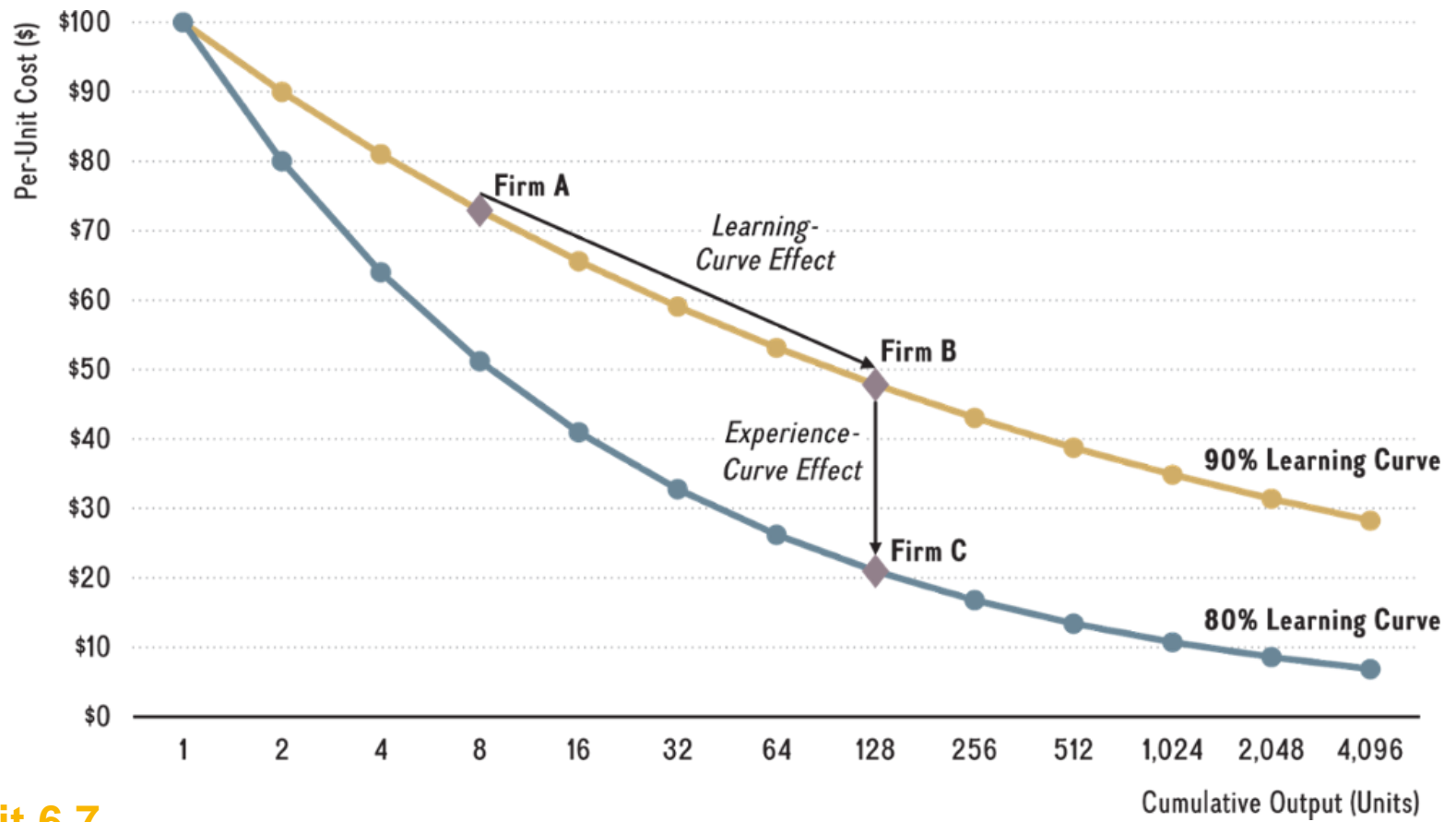


Exhibit 6.7

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Cost Leadership Strategies: Summary

Focus on:

- Offering lower costs than competitors.
- Maintaining acceptable quality.

Appeals to the bargain-conscious buyer:

- Attracts increased sales.

Can be profitable over a long period of time.

Successful Business Strategy

A successful strategy:

- Leverages the firm internal strengths.
- Mitigates internal firm weaknesses.
- Exploits external opportunities.
- Avoids external threats.

There is no single correct business strategy for a specific industry.

Choose a strategy that:

- Provides a strong position that attempts to maximize economic value creation.
- Is effectively implemented.

What Is Blue Ocean Strategy?

A strategy that combines both differentiation and cost-leadership activities.

- A firm offers a differentiated product or service at a low cost.
- Examples: Trader Joe's, Cirque du Soleil.

Uses value innovation to reconcile trade-offs.

Blue oceans represent:

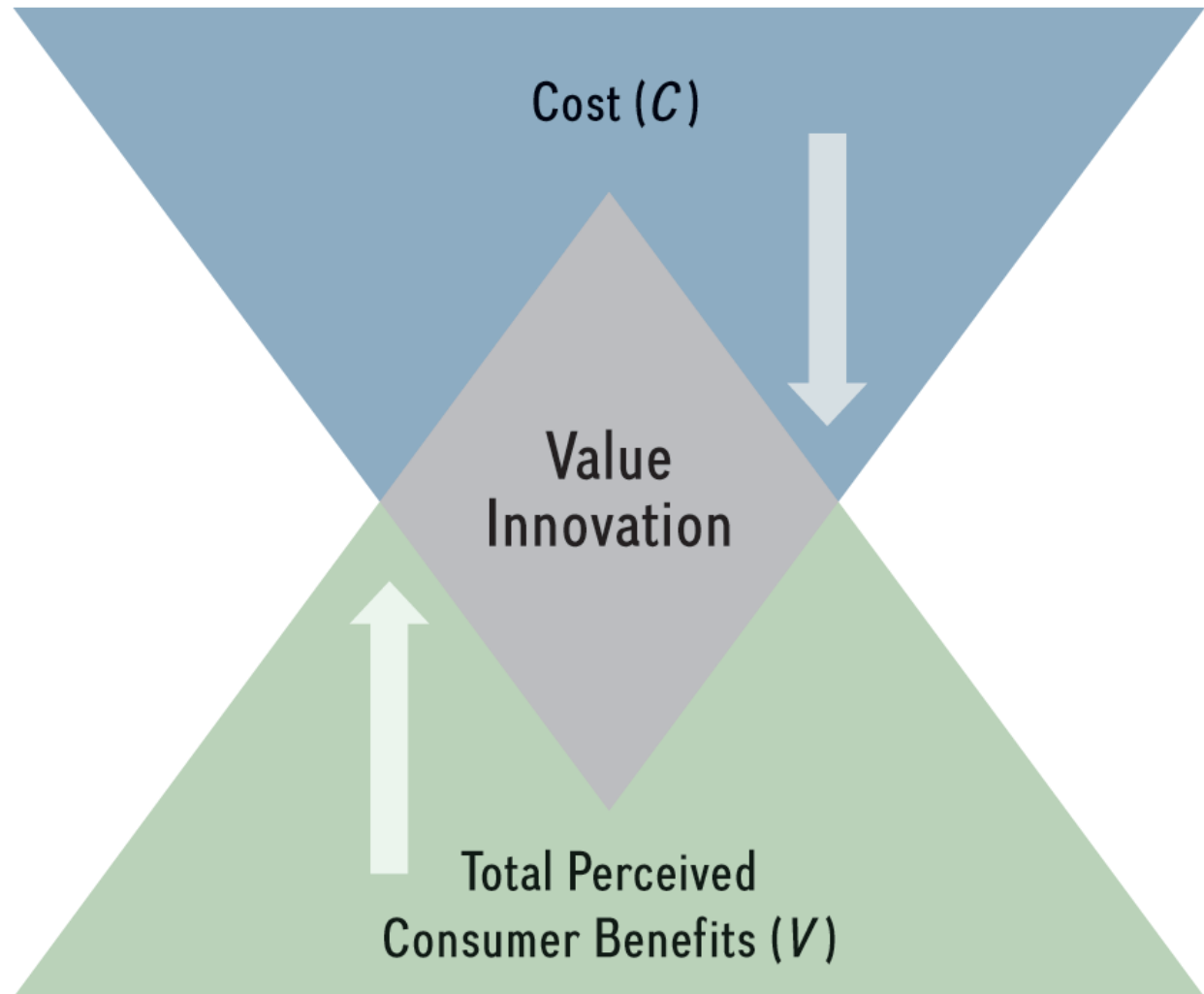
- Untapped market space.
- Creation of additional demand.
- Opportunities for highly profitable growth.

(Red oceans are the known market space of existing industries)

Value Innovation Accomplished through Simultaneously Pursuing Differentiation ($V \uparrow$) and Low Cost ($C \downarrow$)

Exhibit 6.9

Source: Adapted from C.W. Kim and R. Mauborgne (2005), *Blue Ocean Strategy: How to Create Uncontested Market Space and Make Competition Irrelevant* (Boston, MA: Harvard Business School Publishing).



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To Achieve Successful Value Innovation

Lower costs:

- **Eliminate**: Which of the factors should be eliminated?
- **Reduce**: Which of the factors should be reduced?

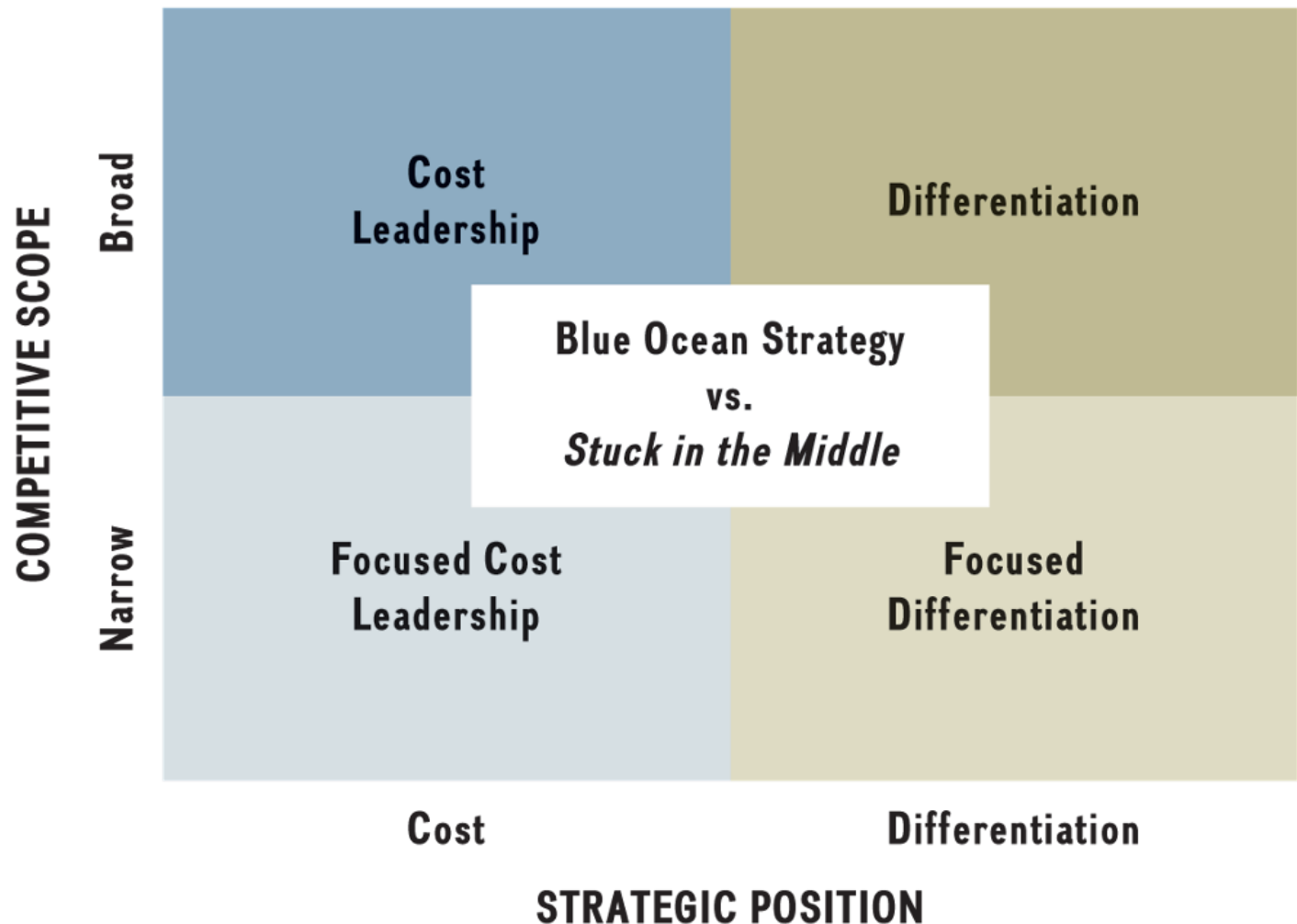
Increase perceived consumer benefits:

- **Raise**: Which of the factors should be raised?
- **Create**: Which factors should be created?

It is difficult to succeed at value innovation

Value Innovation vs. Stuck in the Middle

Exhibit 6.10



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The Strategy Canvas

Graphical depiction of a company's performance:

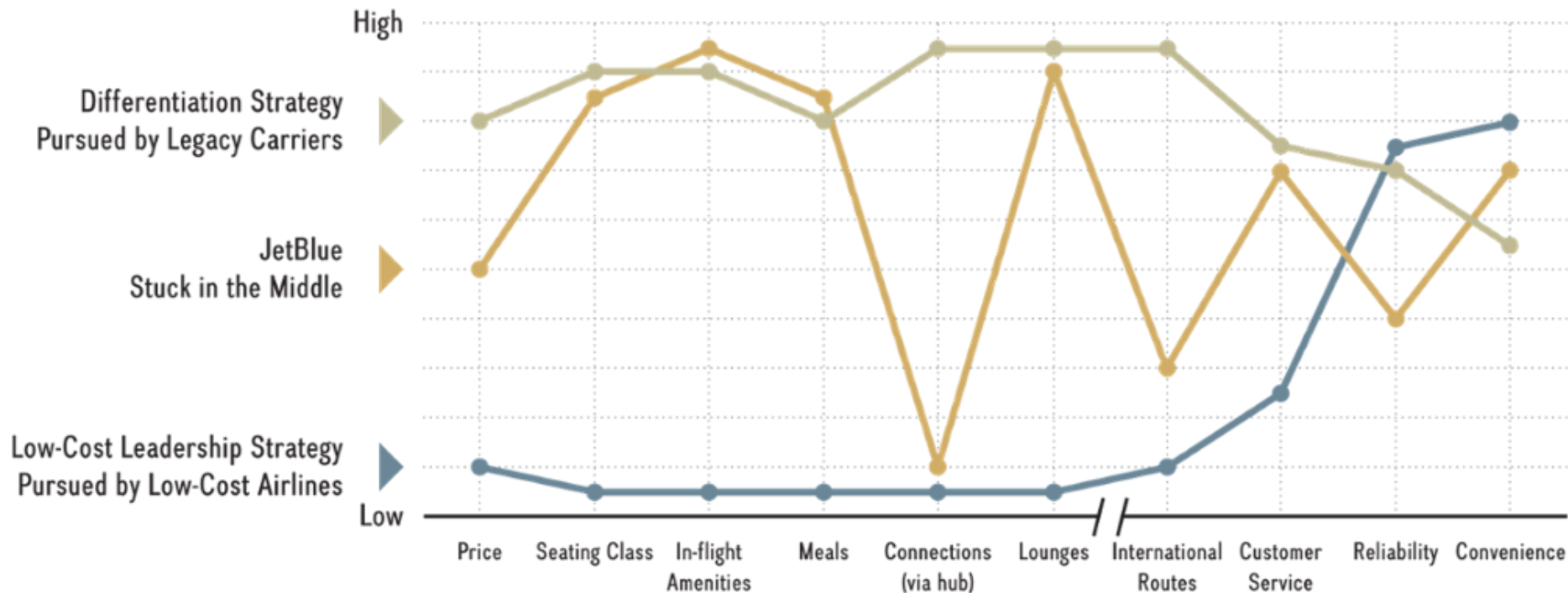
- Relative to its competitors.
- Shows focus or divergence.

Viewed across the industry's factors of competition.

Reveals key strategic insights.

Strategy Canvas of JetBlue vs. Low-Cost Airlines and Legacy Carriers

Exhibit 6.11



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