CHAPTER 5

BUSINESS LEVEL STRATEGIES

LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Identify the Business Level Strategies
- Explain Porter's Five Forces Model
- Understand the features and suitability of Cost Leadership Strategy
- Understand the features and suitability of Differentiation Strategy
- Understand the features and suitability of Focus Strategy

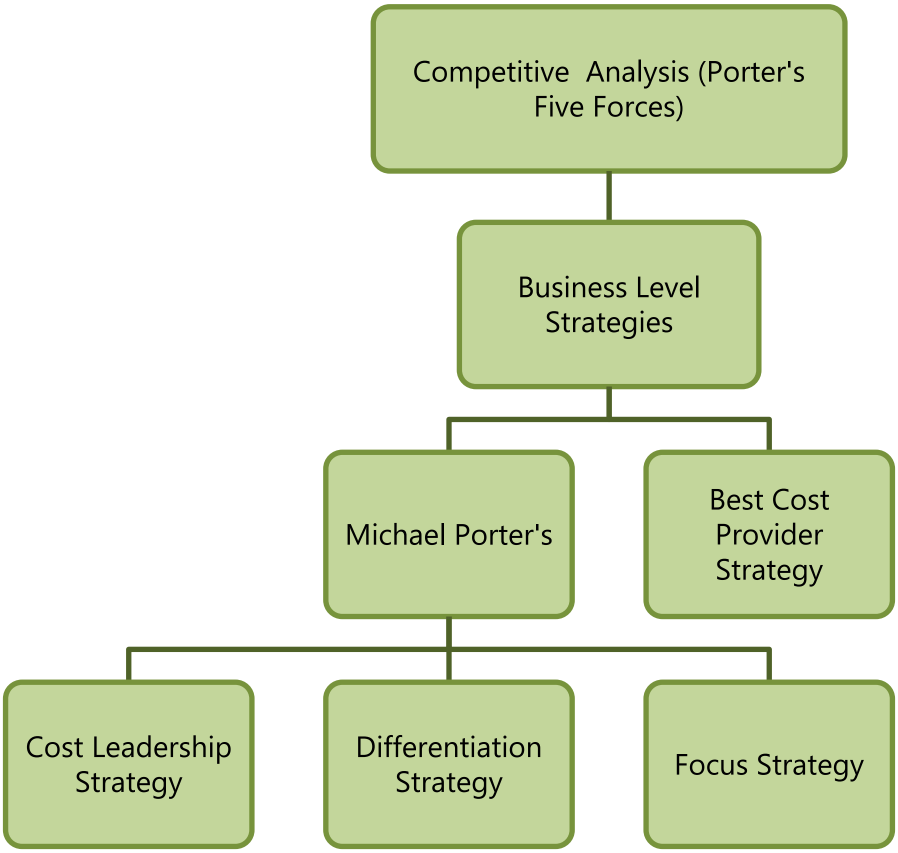
"If all you're trying to do is essentially the same thing as your rivals, then it is unlikely that you'll be very successful."

- Michael Porter

"Strategy is a pattern in a stream of decisions."

Henry Mintzberg

CHAPTER OVERVIEW



5.1 INTRODUCTION

An organization's core competencies should be focused on satisfying customer needs or wants in order to achieve organisational objectives. This is achieved through businesses level strategies. Business level strategies are the course of action adopted by an organisation, for each of its businesses separately, to serve identified customer groups and provide value to those customers by satisfying their needs. In the process, the organisation uses its competencies to gain, sustain and enhance its strategic and competitive advantage.

5.2 PORTER'S FIVE FORCES MODEL- COMPETITIVE ANALYSIS

Every business operates in a competitive environment. The competitive state of an industry has a strong influence on how firms develop their strategies. Michael Porter believed that the basic unit for analysis, is a group of competitors producing goods or services, that compete directly with each other. Competitive advantage is industry specific. An organisation attempts to adopt an approach to win over competitors in the same industry.

The character, mix, and intricacies of competitive forces differ from one industry to another. A powerful and widely used tool for systematically diagnosing the significant competitive pressures in a market, and assessing the strength and importance of each of those pressures, is the Porter's five-forces model of competition. (see figure) This model holds that, the state of competition in an industry is a composite of competitive pressures operating in five major areas of the market:

- Competitive pressures associated with market manoeuvring and jockeying for buyer patronage that goes on among rival sellers in the industry.
- Competitive pressures associated with threat of new entrants in the market.
- Competitive pressures coming from attempts of companies in other industries to win buyers, by offering substitute products.
- Competitive pressures stemming from supplier bargaining power and supplier-seller collaborations.
- Competitive pressures stemming from buyer bargaining power and seller-buyer collaborations.

Strategists can use the five-forces model to determine the competitive landscape of a given industry, by undertaking the following three steps:

Step 1: Identify the specific competitive pressures associated with each of the five forces.

Step 2: Evaluate the strength of pressure comprising each of the five forces (it could be fierce, strong, moderate to normal, or weak).

Step 3: Determine whether the collective strength of the five competitive forces is conducive to earning attractive profits.

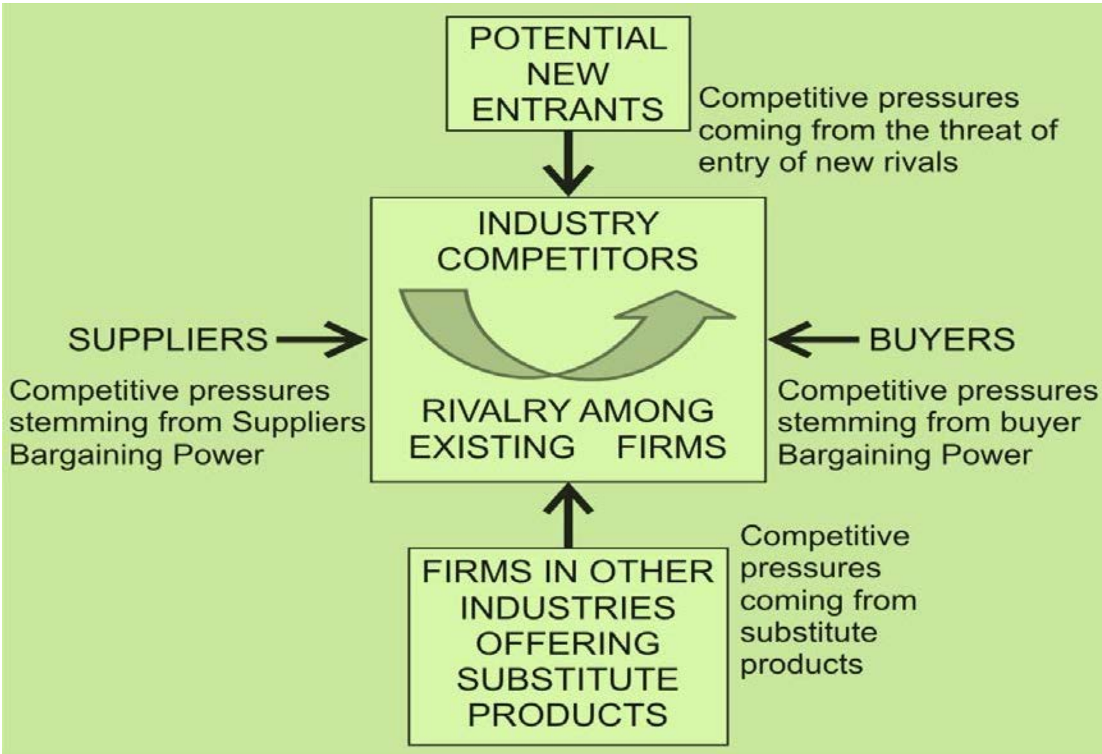


Figure: Michael Porter's Five Forces Model of Competition

Porter's five forces model is one of the most effective and enduring conceptual frameworks used to assess the nature of competitive environment and to understand an industry's structure. The interrelationship amongst these five forces, gives each industry, its own particular competitive environment. By applying Porter's five forces model of industry attractiveness to their own industry, management can gauge their firm's strengths, weaknesses, probable threats and future opportunities.

5.2.1 Threat of New Entrants

New entrants can reduce an industry's profitability, because they add new production capacity, leading to increase in supply of the product, sometimes even at a lower price and can substantially erode existing firm's market share position. However, New entrants are always a powerful source of competition. The new capacity and product range they bring in throws up a new competitive pressure. The bigger the new entrant, the more severe the competitive effect. New entrants also place a limit on prices and affect the profitability of existing players, which is known as Price War. **For Example**, Reliance Jio offered cheap services when it entered the telecom industry in 2016, thus limiting the prices for existing players like Airtel, Vodafone, Idea, etcA firm's profitability tends to be higher when new firms are blocked from entering the industry. To discourage new entrants, existing firms can try to raise barriers to entry. "Barriers to entry" represent economic forces (or 'hurdles') that slow down or impede entry of new firms. Common barriers to entry include:

(i) Capital requirements

(ii) Economies of scale

(iii) Product differentiation

(iv) Switching costs

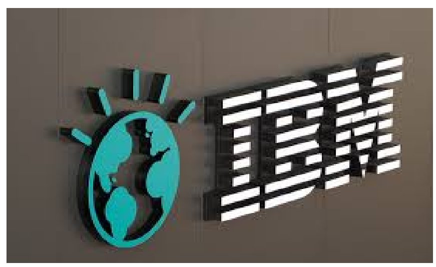
(v) Brand identity

(vi) Access to distribution channels

(vii) Possibility of aggressive retaliation by existing players

(i) Capital Requirements: When a large amount of capital is required to enter an industry, firms lacking funds are effectively barred from that industry, thus, enhancing the profitability of existing firms. ***For example****, huge investments are required to build production facilities and establish brand awareness amongst people for entry into the pharmaceutical industry. This makes entry of new companies into this sector very difficult.*

(ii) Economies of Scale: Many industries are characterized by economic activities driven by economies of scale. Economies of scale refers to the decline in the per-unit cost of production (or other activity) as the volume grows. A large firm that enjoys economies of scale can produce high volumes of goods at successively lower cost. This tends to discourage new entrants who are in expansion stage and have higher costs. ***For example****, in the semiconductor industry, large companies, such as IBM, Intel, Samsung and Texas Instruments, enjoy substantial economies of scale in the production of advanced microprocessors, communication chips and integrated circuits that power most consumer electronics, personal computers (PCs) and cellular phones. This acts as a barrier for new entrants.*



(iii) Product Differentiation: Product differentiation refers to the physical or perceptual differences, or enhancements, that make a product special or unique in the eyes of customers. Firms in personal care and cosmetics industry actively engage in product differentiation to enhance their products' features. Differentiation works to reinforce entry barriers because the cost of creating genuine product differences may be too high for the new entrants.

(iv) Switching Costs: To succeed in an industry, new entrant must be able to persuade existing customers of other companies to switch to its products. To make a switch, buyers may need to test a new firm's product, negotiate new purchase contracts, and train personnel to use the equipment, or modify facilities for product use. Buyers often incur substantial financial (and psychological) costs in switching between firms. When such switching costs are high, buyers are often reluctant to change. ***For example****, high switching costs in moving away from Microsoft's Windows operating systems used in personal computers and corporate servers powered the company's stunning growth over the past decade in the software industry. In other words, Microsoft has marketed its operating system in such a manner that it almost impossible for companies to sell a new operating system and break into the customer loyalty of Microsoft.*

(v) Brand Identity: The brand identity of products or services offered by existing firms can serve as another entry barrier. Brand identity is particularly important for infrequently purchased products that carry a high unit cost to the buyer. New entrants often encounter significant difficulties in building up the brand identity, because to do so they must commit substantial resources over a long period of time. The gestation period of customer loyalty is quite high, when customers identify themselves with existing brands. **For example***, during the 1970s, Japanese companies such as Toyota, Nissan, and Honda had to spend huge sums on new product development and promotional activities to overcome the American consumer's preference for domestic cars. It was a huge challenge for foreign car makers to break into the customer base of Maruti Suzuki in the affordable family car segment, because people identified Maruti Suzuki as India's own family car company.*

(vi) Access to Distribution Channels: The unavailability of distribution channels for new entrants poses another significant entry barrier. Despite the growing power of the internet, many firms may continue to rely on their control of physical distribution channels to create a barrier to entry for rivals. Often, existing firms have significant influence over the distribution channels and can retard or impede (can use restrict) their use by new firms. **For example**, *because of control over distribution channels in India by HUL (Hindustan*

Unilever), P & G (Procter & Gamble) and Godrej etc., small entrepreneurs find it very difficult to sell their products through the existing channels. Similarly, with advent of Patanjali and its strong nation-wide distribution channel, new Ayurvedic FMCG companies are facing a challenge.

(vii) Possibility of Aggressive Retaliation: Sometimes the mere threat of aggressive retaliation by incumbents/existing firms can deter entry of new firms into an existing industry. **For example**, *introduction of products by a new firm may lead incumbents firms to reduce their product prices and increase their advertising budgets*. The same way Hindustan Unilever and Palmolive spent huge sums of money in advertisement to fight Patanjali's Dant Kanti Toothpaste.

5.2.2 Bargaining Power of Buyers

This is another force that influences the competitive condition of an industry. This force becomes heavier depending on the possibility of buyers forming groups or cartels. Mostly, this is a phenomenon seen in industrial products. Quite often, users of industrial products come together formally or even informally, and exert pressure on the producer. The bargaining power of the buyers influences not only the prices that the producer can charge but also influences costs and investments of the producer. This is because powerful buyers usually bargain for better services which involves more investment on the part of the producer.

Buyers of an industry's products or services can sometimes exert considerable pressure on existing firms to secure lower prices or better services. This leverage is particularly evident when;

(i) Buyers have full knowledge of the source(s) of products and their substitutes. Thus, challenging the price being charged by producers.

(ii) They spend a lot of money on the industry's products i.e. they are big buyers. Thus, in a position to demand favourable terms of contract.

(iii) The industry's product is not perceived as critical to the buyer's needs and buyers are more concentrated than firms supplying the product. They can easily switch to the substitutes available.

5.2.3 Bargaining Power of Suppliers

Quite often, suppliers too, exercise considerable bargaining power over purchasing companies. The more specialised the offering from the supplier, greater may be its clout. Further, when the suppliers are limited in number, they may openly exhibit their bargaining power. The bargaining power of suppliers determines the cost of raw materials and other inputs of the industry, and therefore, an industry's attractiveness and profitability.

Suppliers can influence the profitability of an industry in a number of ways. Suppliers can command bargaining power over a firm when;

(i) Their products are crucial to the buyer and substitutes are not available.

(ii) They can erect/ensure high switching costs.

(iii) They are more concentrated than their buyers. Less suppliers, more buyers.

5.2.4 The Nature of Rivalry in the Industry

Rivalry between existing players is quite obvious. This is what is normally understood as competition. For any player, the competitors influence strategic decisions at different strategic levels. The impact is more evident at functional level, like in the prices being charged, more aggressive advertising, and building pressures on costs, product and so on.

The intensity of rivalry in an industry is a significant determinant of an industry's attractiveness and profitability. The intensity of rivalry can influence the costs of suppliers, distribution, and of attracting customers and thus, can directly affect the profitability. "The more intensive the rivalry, the less attractive is the industry". Rivalry among competitors tends to be cutthroat and an industry's profitability is low when;

(i) An industry has no clear leader. Therefore, continuous war for leadership.

(ii) Competitors in the industry are numerous.

(iii) Competitors operate with high fixed costs. Thus, aiming for better Return on Investment with more fierce tactics.

(iv) Competitors face high exit barriers, and therefore, continue to fight for market share.

(v) Competitors have little opportunity to differentiate their offerings.

(vi) The industry faces slow or diminished growth.

(i) Industry Leader: A strong industry leader can discourage price wars by disciplining initiators of such activity. Because of its greater financial resources, a leader can generally outlast smaller rivals in a price war. Knowing this, smaller rivals often avoid initiating such a contest. **Example**, *India's domestic air travel industry has no definite leader, and hence, we often see cut throat price wars.*

(ii) **Number of Competitors:** Even when an industry leader exists, the leader's ability to exert pricing discipline diminishes with the increased number of rivals in the industry as communicating expectations to players becomes more difficult. **For *Example,*** *majorly in unorganised sectors like handicrafts, due to huge number of producers, the internal rivalry is immense.*

(iii) **Fixed Costs:** When organisations operate with high fixed costs, they are motivated to utilize their capacity and therefore, are inclined to drop prices when they have excess capacity. Price cutting causes profitability to fall for all firms in the industry, as the firms seek to produce more to cover costs that must be paid regardless of industry demand, i.e. the fixed costs. For this reason, profitability tends to be lower in industries (***for example****, airline, telecommunications*) characterized by high fixed costs.

(iv) **Exit Barriers:** Rivalry amongst competitors declines, if a few competitors leave the industry. Profitability therefore tends to be higher in industries with few exit barriers. Exit barriers come in many forms. Assets of a firm considering exit may be highly specialized and therefore of little value to any other firm. Therefore, such firm may not be able to find a buyer for its assets. This discourages exit. When barriers to exit are powerful, competitors desiring exit may refrain from leaving. Their continued presence in an industry exerts downward pressure on the profitability of all competitors. The crux is, if an organisation cannot exit, it would fight for its survival, and thus, intensify competition.

(v) **Product Differentiation:** Firms can sometimes insulate themselves from price wars by differentiating their products from those of its rivals. As a consequence, profitability tends to be higher in industries that offer opportunity for differentiation. Profitability tends to be lower in industries involving undifferentiated commodities such as, memory chips, natural resources, processed metals and railroads. **For *Example,*** *ONGC and Indian Oil, can not offer major product differentiation in their products. Hence, the level of competition would always be high.*

(vi) **Slow Growth:** Industries whose growth is declining tend to face more intense rivalry. It is so because, as an industry's growth declines , rivals would often fight harder to grow or sustain their existing market share. The resulting intensive rivalry tends to reduce profitability for all.

5.2.5 Threat of Substitutes

Substitute products are a latent/hidden but existing source of competition in an industry. In many cases they grow to become a major constituent of competition. Substitute products that offer a price advantage and/or performance improvement to the consumers, can drastically alter the competitive character of an industry. Surprisingly, they can bring it about all of a sudden. ***For example**, coir suffered at the hands of synthetic fibre.* Wherever significant investment in R&D is taking place, threats from substitute products can be expected. Substitutes, too, usually limit the prices and profits of an industry.

As per Michael Porter, a final force that can influence an industry's profitability, is the availability of substitutes for that industry's products. To predict profit pressure from this source of competition, firms must search for products that can perform the same, or nearly the same, functionalities as their own products. *Real estate, insurance, bonds and bank deposits **for example** are clear substitutes for common stocks, because they represent alternate ways to invest funds.*

The threat of substitutes is great in many high tech industries as well. ***For example**, introduction of digital film-less cameras virtually replace the film cameras and threatenedthe existence of Eastman Kodak and Fuji Film. Further, the introduction of smart phones has replaced cameras to a great extent.*

The rapidly changing education landscape, with the advent of online courses and degrees, is a perfect example of a substitute to the existing educational system, with better approachability and access.

The above discussed five forces together determine an industry's attractiveness/profitability. This is so because these forces influence the causes, that underlie industry attractiveness/profitability. ***For example**, elements such as cost and investment needed for being a player in the industry decide industry profitability, and all such elements are governed by these forces.* The collective strength of these five competitive forces determines the scope to earn attractive profits. As mentioned in the beginning, the strength of these forces may vary from industry to industry.

5.3 BUSINESS LEVEL STRATEGIES

An organization's core competencies should be focused on satisfying customers' needs and wants in order to achieve better than average returns. This is done through Business-Level Strategies. Business level strategies detail out the actions to be taken to provide value to customers and gain a competitive advantage, by exploiting core competencies. Business-level strategy is concerned with a firm's position in the industry, in relation to its competitors and to the five forces of competition discussed above.

"Customers are the foundation of an organization's business-level strategies". Who will be served, what needs are to be met, and how those needs will be satisfied, are determined by the senior management, while drafting Business Level Strategies

Who are the customers?

Knowing one's customers is of utmost importance in obtaining and sustaining a competitive advantage. Being able to successfully predict and satisfy future customer needs is equally important. Perhaps one of the Tata's mistake in manufacturing Nano, was to not being able to understand the customer's actual need. They wanted a small, affordable city car, but durability was of more importance.

How to satisfy customer needs?

Organizations must determine how to bundle its resources and capabilities, to form core competencies, and then use these core competencies to satisfy customer needs and create value for them.

Having selected a market, the organization must develop a plan to be successful in that market. Business strategy therefore looks at how the organization can compete successfully in the individual markets that it chooses to operate in.

Business level strategy is concerned with issues such as:

- Identifying and Meeting the needs of key customers
- Achieving advantage over competitors
- Avoiding competitive disadvantage

5.4 MICHAEL PORTER'S GENERIC STRATEGIES

We discussed about the five forces of competition as per Michael Porter. Once we identify these forces and their corresponding strength, the task at hand for the management is to respond to these forces strategically. According to Porter, strategies allow organizations to gain competitive advantage from three different bases: cost leadership, differentiation, and focus. Porter called these base generic strategies. These strategies have been termed generic, because they can be pursued by any type or size of business firm and even by not-for-profit organisations.

Cost leadership emphasizes on producing standardized products at a very low per-unit cost for consumers who are price-sensitive.

Differentiation is a strategy aimed at producing products and services considered unique industry-wide and directed at consumers who are relatively price-insensitive.

Focus means producing products and services that fulfil the needs of small groups of consumers with very specific taste.

Porter's strategies imply different organizational arrangements, control procedures, and incentive systems. Larger firms with greater access to resources typically compete on a cost leadership and/or differentiation basis, whereas smaller firms often compete on a focus basis.

COMPETITIVE SCOPE	Broad Target	Cost Leadership	Differentiation
	Narrow Target	Focussed Cost Leadership	Focussed Differentiation
		Low-Cost products/services	Differentiated products/services
		COMPETITIVE ADVANTAGE	

Figure: Michael Porter's Generic Strategies

Porter stresses the need for strategists to perform cost-benefit analysis to evaluate "sharing opportunities" among the firm's existing and potential business units. Sharing activities and resources enhances competitive advantage by lowering costs or raising differentiation. In addition to prompting sharing, Porter stresses the need for firms to "transfer" skills and expertise among autonomous business units effectively in order to gain competitive advantage. Depending upon factors such as type of industry, size of firm and nature of competition, various strategies could yield advantages in cost leadership differentiation, and focus.

5.4.1 Cost Leadership Strategy

It is a low cost competitive strategy that aims at broad mass market. It requires vigorous pursuit of cost reduction in the areas of procurement, production, storage and distribution of product or service and also economies in overhead costs. Because of its lower costs, the cost leader is able to charge a lower price for its products than most of its competitors and still earn satisfactory profits. **For example**, *McDonald's fast food restaurants have successfully followed low cost leadership strategy. Decathlon Group's mega sports stores have been following low cost leadership strategy to gain international recognition and also beat competition.*

A primary reason for pursuing forward, backward, and horizontal integration strategies is to gain cost leadership benefits. Generally, cost leadership must be pursued in conjunction with differentiation. A number of cost elements affect the relative attractiveness of generic strategies, including economies or diseconomies of scale achieved, learning and experience curve effects, the percentage of capacity utilization achieved, and linkages with suppliers and distributors. Other cost elements to consider while choosing among alternative generic strategies include, the potential for sharing costs and knowledge within the organization, R&D costs associated with new product development or modification of existing products, labour costs, tax rates, energy costs, and shipping costs. This internal strategy of sharing resources to build a competitive advantage is called synergy benefit.

Striving to be a low-cost producer in an industry can especially be effective,

- when the market is composed of many price-sensitive buyers and
- when there are few ways to achieve product differentiation.

Further, when buyers do not care much about differences from brand to brand, or when there are a large number of buyers with significant bargaining power. The basic idea is to underprice competitors and thereby gain market share driving some of the competitors out of the market.

A successful cost leadership strategy usually permeates the entire firm, as evidenced by high efficiency, low overheads, limited perks, intolerance of waste, intensive screening of budget requests, wide span of controls, rewards linked to cost containment, and broad employee participation in cost control efforts. Some risks of pursuing cost leadership are; that competitors may imitate the strategy, therefore driving overall industry profits down; that technological breakthroughs in the industry may make the strategy ineffective; or that buyer interests may swing to other differentiating features besides price.

Achieving Cost Leadership Strategy

To achieve cost leadership, following actions could be taken:

1. Prompt forecasting of demand of a product or service.
2. Optimum utilization of the resources to achieve cost advantages.
3. Achieving economies of scale; thus, lower per unit cost of product/service.
4. Standardisation of products for mass production to yield lower cost per unit. *(Example of McDonald's)*
5. Invest in cost saving technologies and using advance technology for smart efficient working.
6. Resistance to differentiation till it becomes essential.

Advantages of Cost Leadership Strategy

Earlier we have discussed Porter's Five Forces Model in detail. A cost leadership strategy may help to remain profitable even with: rivalry, new entrants, suppliers' power, substitute products, and buyers' power.

1. Rivalry – Competitors are likely to avoid a price war, since the low cost firm will continue to earn profits even after competitors compete away their profits.
2. Buyers – Powerful buyers/customers would not be able to exploit the cost leader firm and will continue to buy its product.
3. Suppliers – Cost leaders are able to absorb greater price increases from suppliers before they need to raise prices for customers.
4. Entrants – Low cost leaders create barriers to market entry through their continuous focus on efficiency and cost reduction.
5. Substitutes – Low cost leaders are more likely to lower the costs to induce existing customers to stay with their products, invest in developing substitutes, and even purchase patents.

Disadvantages of Cost Leadership Strategy

1. Cost advantage may not last long as competitors may imitate cost reduction techniques.
2. Cost leadership can succeed only if the firm can achieve higher sales volume.

3. Cost leaders tend to keep their costs low by minimizing cost of advertising, market research, and research and development, but this approach can prove to be expensive in the long run.

4. Technological advancement are a great threat to cost leaders.

5.4.2 Differentiation Strategy

This strategy is aimed at broad mass market and involves the creation of a product or service that is perceived by the customers as unique. The uniqueness can be associated with product design, brand image, features, technology, dealer network or customer service. Because of differentiation, the business can charge a premium for its product. **For Example,** *Dominoes Pizza has been offering home delivery within 30 minutes or the order is free, is a unique selling point that differentiates if from its rivals.*

Differentiation does not guarantee competitive advantage, especially if standard products sufficiently meet customer needs or if rapid imitation by competitors is possible. Durable products protected by barriers to quick imitation by competitors are better. Successful differentiation can mean greater product flexibility, greater compatibility, lower costs, improved service, less maintenance, greater convenience, or more features. Product development is an example of a strategy that offers the advantages of differentiation.

Differentiation strategy should be pursued only after a careful study of buyers' needs and preferences to determine the feasibility of incorporating one or more differentiating features into a unique product that features the customers' desired attributes. A successful differentiation strategy allows a firm to charge a higher price for its product and to gain customer loyalty, because consumers may become strongly attached to the differentiated features. Special features that differentiate one's product can include superior service, spare parts availability, engineering design, product performance, useful life, gas mileage, or ease of use.

A risk associated with pursuing a differentiation strategy is that the unique product may not be valued high enough by customers to justify the higher price. When this happens, a cost leadership strategy will easily defeat a differentiation strategy. Another risk of pursuing a differentiation strategy is that competitors may develop ways to copy the differentiating features quickly. Firms must find durable sources of uniqueness that cannot be imitated quickly or cheaply by rival firms. **For Example,** *Amazon Prime offers deliver within two hours. This is quite difficult to imitate by its rivals, and thus this differentiating factor helps it to lead the market.*

Basis of Differentiation

There are several basis of differentiation, major being: Product, Pricing and Organization.

- **Product:** Innovative products that meet customer needs can be an area where a company has an advantage over competitors. However, the pursuit of a new product offering can be costly – research and development, as well as production and marketing costs can all add to the cost of production and distribution. The payoff, however, can be great as customer's flock to be among the first to have the new product. **For *Example,*** *Apple iPhone, has invested huge amounts of money in R&D, and the customers' value that. They want to be among the first ones to try the new offerings from the company.*
- **Pricing:** It fluctuates based on its supply and demand, and may also be influenced by the customer's ideal value for a product. Companies that differentiate based on product price can either determine to offer the lowest price, or can attempt to establish superiority through higher prices. **For *Example.*** *Apple iPhone dominates the smart phone segment by charging higher prices for its products.*
- **Organisation:** Organisational differentiation is yet another form of differentiation. Maximizing the power of a brand, or using the specific advantages that an organization possesses can be instrumental to a company's success. Location advantage, name recognition and customer loyalty can all provide additional ways for a company differentiate itself from the competition. **For Example,** *Apple has been building customer loyalty since years and has a fanbase of consumers that are called "Apple Fanboys/Fangirls"*

Achieving Differentiation Strategy

To achieve differentiation, following strategies could be adopted by an organization;:

1. Offer utility to the customers and match products with their tastes and preferences.
2. Elevate/Improve performance of the product.
3. Offer the high quality product/service for buyer satisfaction.
4. Rapid product innovation to keep up with dynamic environment.
5. Taking steps for enhancing brand image and brand value.

6. Fixing product prices based on the unique features of product and buying capacity of the customer.

Advantages of Differentiation Strategy

A differentiation strategy may help an organisation to remain profitable even with: rivalry, new entrants, suppliers' power, substitute products, and buyers' power.

1. Rivalry - Brand loyalty acts as a safeguard against competitors. It means that customers will be less sensitive to price increases, as long as the firm can satisfy the needs of its customers.
2. Buyers – They do not negotiate for price as they get special features and they have fewer options in the market.
3. Suppliers – Because differentiators charge a premium price, they can afford to absorb higher costs of supplies as the customers are willing to pay extra too.
4. Entrants – Innovative features are an expensive offer. So, new entrants generally avoid these features because it is tough for them to provide the same product with special features at a comparable price.
5. Substitutes – Substitute products can't replace differentiated products which have high brand value and enjoy customer loyalty.

Disadvantages of Differentiation Strategy

1. In the long term, uniqueness is difficult to sustain.
2. Charging too high a price for differentiated features may cause the customer to switch-off to another alternative. *As we see a shift of iPhone users to other android flagship smart phones.*
3. Differentiation fails to work if its basis is something that is not valued by the customers. *Home delivery of packed snacks in 30 minutes would not even be a differentiator as the consumer wouldn't value such an offer.*

5.4.3 Focus Strategies

A successful focus strategy depends on an industry segment that is of sufficient size, has good growth potential, and is not crucial to the success of other major competitors. Strategies such as market penetration (new product for existing customers) and market development (new product for new customers) offer substantial focusing advantages. Midsize and large firms can effectively pursue focus-based strategies only in conjunction with differentiation or cost leadership-based strategies. All firms in essence follow a differentiated strategy. Because only one firm can differentiate itself with the lowest cost, the remaining firms in the industry must find other ways to differentiate their products.

Focus strategies are most effective when consumers have distinctive preferences or requirements, and when the rival firms are not attempting to specialize in the same target segment. Risks of pursuing a focus strategy include the possibility of numerous competitors recognizing the successful focus strategy and imitating it, or that consumer preferences may drift towards the product attributes desired by the market as a whole. An organization using a focus strategy may concentrate on a particular group of customers, geographic markets, or on particular product-line segments in order to serve a well-defined but narrow market better than competitors who serve a broader market. **For *Example,*** *Ferrari sports cars.*

5.4.3.1 Focused cost leadership: A focused cost leadership strategy requires competing based on price to target a narrow market. A firm that follows this strategy does not necessarily charge the lowest prices in the industry. Instead, it charges low prices relative to other firms that compete within the target market. Firms that compete based on price and target a narrow market follow a focused cost leadership strategy.

5.4.3.2 Focused differentiation: A focused differentiation strategy requires offering unique features that fulfil the demands of a narrow market. Similar to focused low-cost strategy, narrow markets are defined in different ways in different settings. Some firms using a focused differentiation strategy concentrate their efforts on a particular sales channel, such as selling over the internet only. Others target particular demographic groups. Firms that compete based on uniqueness and target a narrow market are following a focused differentiations strategy. **For example**, *Rolls-Royce sells limited number of high-end, custom-built cars.*

Achieving Focused Strategy

To achieve focused cost leadership/differentiation, following strategies could be adopted by an organization:

1. Selecting specific niches which are not covered by cost leaders and differentiators.
2. Creating superior skills for catering such niche markets.
3. Generating high efficiencies for serving such niche markets.
4. Developing innovative ways in managing the value chain.

Advantages of Focused Strategy

1. Premium prices can be charged by the organisations for their focused product/services.
2. Due to the tremendous expertise in the goods and services that the organisations following focus strategy offer, rivals and new entrants may find it difficult to compete.

Disadvantages of Focused Strategy

1. The firms lacking in distinctive competencies may not be able to pursue focus strategy.
2. Due to the limited demand of product/services, costs are high, which can cause problems.
3. In the long run, the niche could disappear or be taken over by larger competitors by acquiring the same distinctive competencies.

5.5 BEST-COST PROVIDER STRATEGY

The new model of best cost provider strategy is a further development of above three generic strategies. It is directed towards giving customers more value for the money by emphasizing on both, low cost and upscale differences. The objective is to keep costs and prices lower than those of other sellers of "comparable products".

Figure: The Five Generic Competitive Strategies

Best-cost provider strategy involves providing customers more value for the money by emphasizing on lower cost and better quality differences. It can be done through:

(a) offering products at lower price than what is being offered by rivals for products with comparable quality and features or

(b) charging similar price as by the rivals for products with much higher quality and better features.

For Example, *android flagship phones from OnePlus, Xiaomi, Oppo, Vivo, etc, are all rooting for giving better quality at lowest prices to the customers. They are following the best-cost provider strategy to penetrate market.*

Distinctive Features of the generic competitive strategies are given below:

Features	**Low-Cost Provider**	**Broad Differentiation**	**Best-Cost Provider**	**Focused Low-Cost and Focused Differentiation**
Strategic Target	A broad cross-section of the market	A broad cross section of the market	Value-conscious buyer	A narrow market niche where buyer needs and preferences are distinctively different from the rest of the market
Basis of competitive advantage	Lower costs than competitors	An ability to offer buyers something different from competitors	More value for the money	Lower cost in serving the niche (focused low cost) or special attributes that appeal to the tastes or requirements of niche members (focused differentiation)
Market emphasis	Try to make a virtue out of product features that lead to low cost	Build in whatever features buyers are willing to pay for Charge a premium price to cover the extra cots of differentiating features	Either under price rival brands with comparable features or match the price of rivals and provide better features to build a reputation for	Communicate how the focuser's product attributes and capabilities aim at catering to niche member tastes and/or specialised requirements

			delivering the best value	
Sustaining the strategy	Offer economical prices/good value Aim at contributing to a sustainable cost advantage-the key is to manage costs down, year after year, in every area of the business	Communicate the points of difference in credible ways Stress constant improvement and use innovation to stay ahead of initiative competitors Concentrate on a few differentiating features; tout them to create a reputation and brand image.	Develop unique expertise in simultaneously managing costs down and upscaling features and attributes	Remain totally dedicated to serving the niche better than other competitors; don't blunt the firm's image and efforts by entering other segments or adding other product categories to widen market appeal.
Product line	A good basic product with few frills (acceptable quality and limited selection)	Many product variations, wide selection, strong emphasis on differentiating features	Good-to-excellent attributes, several-to-many upscale features	Features and attributes that appeal to the tastes and/or special needs of the target segment
Product emphasis	A continuous search for cost reduction without sacrificing acceptable quality and essential features	Creation of value for buyer; strive for product superiority	Incorporation of upscale features and attributes at low cost	Tailor-made for the tastes and requirements of niche members

SUMMARY

To gain a deeper understanding of competitive environment of a business organisation, we learnt, Michael Porter's five forces of competition model. The five forces being – threat of new entrants, bargaining power of customers, bargaining power of suppliers, rivalry among current players and threats from substitutes – they impact organizations in significant and different manner.

Business level strategies - detail out the actions to be taken to provide value to customers and gain a competitive advantage by exploiting core competencies in specific, individual product or service markets.

Michael Porter has further given three generic strategies that are used to help organizations establish a competitive advantage over their industry rivals. Firms may choose to compete across a broad market or a focused market. These strategies are - cost leadership strategy, differentiation strategy, and focus strategy.

A combination of above - to provide better features at similar prices of the rivals, or similar features at lower prices from the rivals - an organisation can also opt for Best Cost Provider Strategy.

TEST YOUR KNOWLEDGE

Scenario Based Questions

Question 1

Airlines industry in India is highly competitive with several players. Businesses face severe competition and aggressively market themselves with each other. Luxury Jet is a private Delhi based company with a fleet size of 9 small aircrafts with seating capacity ranging between 6 seats to 9 seats. There aircrafts are chartered by big business houses and high net worth individuals for their personalised use. With customised tourism packages their aircrafts are also often hired by foreigners. Identify and explain the Michael Porter's Generic Strategy followed by Luxury Jet.

Answer

The Airlines industry faces stiff competition. However, Luxury Jet has attempted to create a niche market by adopting focused differentiation strategy. A focused differentiation strategy requires offering unique features that fulfil the demands of a narrow market.

Luxury Jet compete in the market based on uniqueness and target a narrow market which provides business houses, high net worth individuals to maintain strict schedules. The option of charter flights provided several advantages including, flexibility, privacy, luxury and many a times cost saving. Apart from conveniences, the facility will provide time flexibility. Travelling by private jet is the most comfortable, safe and secure way of flying your company's senior business personnel.

Chartered services in airlines can have both business and private use. Personalized tourism packages can be provided to those who can afford it.

Question 2

Gennex is a company that designs, manufactures and sells computer hardware and software. Gennex is well known for its innovative products that has helped the company to have advantage over its competitors. It also spends on research and development and concerned with innovative softwares. Often the unique features of their product, that are not available with their competitors helps them to gain competitive advantage. Gennex using the strategy is consistently gaining its position in the industry over its competitors.

Identify and explain the Porter's generic strategy which Gennex has opted to gain the competitive advantage.

Answer

According to Porter, strategies allow organizations to gain competitive advantage from three different bases: cost leadership, differentiation, and focus. Porter called these base generic strategies.

Gennex has opted differentiation strategy. Its products are designed and produced to give the customer value and quality. They are unique and serve specific customer needs that are not met by other companies in the industry. Highly differentiated and unique hardware and software enables Gennex to charge premium prices for its products hence making higher profits and maintain its competitive position in the market.

Differentiation strategy is aimed at broad mass market and involves the creation of a product or service that is perceived by the customers as unique. The uniqueness can be associated with product design, brand image, features, technology, dealer network or customer service.

Question 3

Rahul Sharma is Managing Director of a company which is manufacturing trucks. He is worried about the entry of new businesses. What kind of barriers will help Rahul against such a threat?

Answer

A firm's profitability tends to be higher when other firms are blocked from entering the industry. New entrants can reduce industry profitability because they add new production capacity leading to increase supply of the product even at a lower price and can substantially erode existing firm's market share position. Barriers to entry represent economic forces that slow down or impede entry by other firms. Common barriers to entry include:

(i) **Capital Requirements:** When a large amount of capital is required to enter an industry, firms lacking funds are effectively barred from the industry, thus enhancing the profitability of existing firms in the industry.

(ii) Economies of Scale: Many industries are characterized by economic activities driven by economies of scale. Economies of scale refer to the decline in the per-unit cost of production (or other activity) as volume grows.

(iii) Product Differentiation: Product differentiation refers to the physical or perceptual differences, or enhancements, that make a product special or unique in the eyes of customers.

(iv) Switching Costs: To succeed in an industry, new entrant must be able to persuade existing customers of other companies to switch to its products. When such switching costs are high, buyers are often reluctant to change.

(v) Brand Identity: The brand identity of products or services offered by existing firms can serve as another entry barrier. Brand identity is particularly important for infrequently purchased products that carry a high unit cost to the buyer.

(vi) Access to Distribution Channels: The unavailability of distribution channels for new entrants poses another significant entry barrier. Despite the growing power of the internet, many firms may continue to rely on their control of physical distribution channels to sustain a barrier to entry to rivals.

(vii) Possibility of Aggressive Retaliation: Sometimes the mere threat of aggressive retaliation by incumbents can deter entry by other firms into an existing industry.

Question 4

Sohan and Ramesh are two friends who are partners in their business of making biscuits. Sohan believe in making profits through selling more volume of products. Hence, he believes in charging lesser price to the customers. Ramesh, however of the opinion that higher price should be charged to create an image of exclusivity and for this, he proposes that the product to undergo some change.

Analyse the nature of generic strategy used by Sohan and Ramesh.

Answer

Considering the generic strategies of Porter there are three different bases: cost leadership, differentiation and focus. Sohan and Ramesh are contemplating pricing for their product.

Sohan is trying to have a low price and high volume is thereby trying for cost leadership. Cost leadership emphasizes producing standardised products at a very low per unit cost for consumers who are price sensitive.

Ramesh desires to create perceived value for the product and charge higher prices. He is trying to adopt differentiation. Differentiation is aimed at producing products and services considered unique industry wide and directed at consumers who are relatively price insensitive.

Question 5

Infant care is a successful store chain that caters products for expectant mothers and new moms. They offer everything from nursing classes to strollers, toys, infant clothes, diapers and baby furniture. Due to a one-stop shop for infants, they are charging a premium for its products.

Identify and explain how the strategy adopted by infant care.

Answer

Infant care is opting for differentiation strategy. A one-stop shop is a benefit for this type of customers, seeking convenience in a time. Infant care is catering the products only related to an infant that is perceived by the customers as unique. Because of differentiation, the Infant care is charging a premium for its product.

Question 6

A century-old footwear company "Mota Shoes" had an image of being the footwear choice for formal occasions. In an attempt to reinvent its brand, it tied up with a foreign footwear giant "Buffrine" to manufacture and sell its Hideseek brand in the country. Putting its best foot forward, it launched extra soft, casual and relaxed footwear for young. Aiming at a brand and image makeover the "Mota Shoes" decided to price the Hide Seek products at premium.

What kind of Michael Porter business level strategy is being used by "Mota Shoe company"? State its advantages.

Answer

Mota shoes is trying to use differentiation. This strategy is aimed at broad mass market and involves the creation of a product or service that is perceived by the customers as unique. The uniqueness can be associated with product design, brand image, features, technology, dealer network or customer service. Because of differentiation, the business can charge a premium for its product.

A differentiation strategy has definite advantages as it may help to remain profitable even with rivalry, new entrants, suppliers' power, substitute products, and buyers' power.

i. **Rivalry:** Brand loyalty acts as a safeguard against competitors. It means that customers will be less sensitive to price increases, as long as the firm can satisfy the needs of its customers.

ii. **Buyers:** They do not negotiate for price as they get special features and also they have fewer options in the market.

iii. **Suppliers:** Because differentiators charge a premium price, they can afford to absorb higher costs of supplies and customers are willing to pay extra too.

iv. **New entrants:** Innovative features are expensive to copy. So, new entrants generally avoid these features because it is tough for them to provide the same product with special features at a comparable price.

v. **Substitutes:** Substitute products can't replace differentiated products which have high brand value and enjoy customer loyalty.

Question 7

Eco-carry bags Ltd., a recyclable plastic bags manufacturing and trading company has seen a potential in the ever-growing awareness around hazards of plastics and the positive outlook of the society towards recycling and reusing plastics.

A major concern for Eco-carry bags Ltd. are paper bags and old cloth bags. Even though they are costlier than recyclable plastic bags, irrespective, they are being welcomed positively by the consumers.

Identify and explain that competition from paper bags and old cloth bags fall under which category of Porter's Five Forces Model for Competitive Analysis?

Answer

Eco-carry bags Ltd. faces competition from paper bags and old cloth bags and falls under *Threat of Substitutes* force categories in Porter's Five Forces Model for Competitive Analysis. Paper and cloth bags are substitutes of recyclable plastic bags as they perform the same function as plastic bags. Substitute products are a latent source of competition in an industry. In many cases, they become a major constituent of competition. Substitute products offering a price advantage and/or performance improvement to the consumer can drastically alter the competitive character of an industry.

Question 8

Baby Turtle is a children's clothing brand that has been created a new age demand for washable diapers. The major benefit for the brand has been that not many companies have shown interest in the product, thinking it is not viable, however, customers, majorly working mothers are loving their product. The core material needed for production is also used in many other water proofing products in various industries. Baby Turtle sources this material from a renowned supplier at comparatively low prices. Which of the five forces of competitive pressure would Baby Turtle experience due to above setup and what are major factors that create such pressure for a product? Do you think Baby Shark has an advantage in some way to fight off this pressure?

Answer

Baby Turtle would experience, Bargaining Power of Suppliers, as a competitive pressure for their washable diaper product. This is because the core material for production is sourced from a single supplier, who is renowned and in a position to create pressure in terms of prices.

Further, other factors that lead to such pressure are:

1. Their products are crucial to the buyer and substitutes to the material required for production are not available.
2. Suppliers can manipulate switching cost as the brand is in inception stage and making margins are important.

An advantage that Baby Turtle has is even though the material required has no subsititutes but it used to make many other products and thus there are many other suppliers who can provide that material. It might affect operations in short term but will help to fight off the pressure created by existing supplier.

Question 9

Domolo is a premium cycles and cycling equipments brand which targets high spending customer with a liking for quality and brand name. Their cycles range from rupees fifteen thousand to rupees one lac. The recent trend of fitness through cycling has created humongous demand for cycles and peripherals like helmets, lights, braking systems, fitness applications, etc. The customer base has grown 150% in the last three months. Mr. Vijay, who is an investor wants to tap in this industry and bring about cheaper options to people who cannot spend so much. Which business level strategy would best suit for Mr. Vijay's idea and what are the major sub-strategies that can be implemented to capture maximum market?

Answer

The Best Cost Provider strategy would ensure a better reach to the not so affluent customers and provide them with good quality cycles and equipments, thus tapping in on the increasing trend of cycling.

Two sub-strategies that can be implemented are:

1. Offering lower prices than rivals for the same quality of products
2. Charging same prices for better quality of products

The idea of Mr.Vijay is to provide almost same quality of products in terms of functionality if not so in terms of branding, to customer who do not have huge sums of money to pay. Thus, sub-strategy number one, offering lower prices for almost same quality should be implemented to become the best cost provider of cycles and related equipments in the market.

Descriptive Questions

Question 10

Explain Porter's five forces model as to how businesses can deal with the competition.

Answer

To gain a deep understanding of a company's industry and competitive environment, managers do not need to gather all the information they can find and waste a lot of time digesting it. Rather, the task is much more focused. A powerful and widely used tool for systematically diagnosing the significant competitive pressures in a market and assessing the strength and importance of each is the Porter's five-forces model of competition. This model holds that the state of competition in an industry is a composite of competitive pressures operating in five areas of the overall market:

- Competitive pressures associated with the market manoeuvring and jockeying for buyer patronage that goes on among rival sellers in the industry.
- Competitive pressures associated with the threat of new entrants into the market.
- Competitive pressures coming from the attempts of companies in other industries to win buyers over to their own substitute products.
- Competitive pressures stemming from supplier bargaining power and supplier-seller collaboration.
- Competitive pressures stemming from buyer bargaining power and seller-buyer Collaboration.

Question 11

Distinguish between Cost Leadership and Differentiation Strategies.

Answer

Cost leadership emphasizes producing standardized products at a very low per-unit cost for consumers who are price-sensitive. Differentiation is a strategy aimed at producing products and services considered unique industry wide and directed at consumers who are relatively price-insensitive.

A primary reason for pursuing forward, backward, and horizontal integration strategies is to gain cost leadership benefits. But cost leadership generally must be pursued in conjunction with differentiation. Different strategies offer different degrees of differentiation. A differentiation strategy should be pursued only after a careful study of buyers' needs and preferences to determine the feasibility of incorporating one or more differentiating features into a unique product. A successful differentiation strategy allows a firm to charge a higher price for its product and to gain customer loyalty.

Question 12

What are the five competitive forces in an industry as identified by Michael Porter?

Answer

Five forces model of Michael Porter is a powerful and widely used tool for systematically diagnosing the significant competitive pressures in the market and assessing their strength and importance. The model holds that the state of competition in an industry is a composite of competitive pressures operating in five areas of the over all market. These five forces are:

1. **Threat of new entrants**: New entrants are always a powerful source of competition. The new capacity and product range they bring in throw up new competitive pressure. And the bigger the new entrant, the more severe the competitive effect. New entrants also place a limit on prices and affect the profitability of existing players.

2. **Bargaining power of customers**: This is another force that influences the competitive condition of the industry. This force will become heavier depending on the possibilities of the buyers forming groups or cartels. Mostly, this is a phenomenon seen in industrial products. Quite often, users of industrial products come together formally or informally and exert pressure on the producer. The bargaining power of the buyers influences not only the prices that the producer can charge but also influences in many cases, costs and investments of the producer because powerful buyers usually bargain for better services which involve costs and investment on the part of the producer.

3. **Bargaining power of suppliers**: Quite often suppliers, too, exercise considerable bargaining power over companies. The more specialised the offering from the supplier, greater is his clout. And, if the suppliers are also limited in number they stand a still better chance to exhibit their bargaining power. The bargaining power of suppliers determines the cost of raw materials and other inputs of the industry and, therefore, industry attractiveness and profitability.

4. **Rivalry among current players**: The rivalry among existing players is quite obvious. This is what is normally understood as competition. For any player, the competitors influence strategic decisions at different strategic levels. The impact is evident more at functional level in the prices being charged, advertising, and pressures on costs, product and so on.

5. **Threats from substitutes**: Substitute products are a latent source of competition in an industry. In many cases they become a major constituent of competition. Substitute products offering a price advantage and/or performance improvement to the consumer can drastically alter the competitive character of an industry. And they can bring it about all of a sudden. **For example**, coir suffered at the hands of synthetic fibre. Wherever substantial investment in R&D is taking place, threats from substitute products can be expected. Substitutes, too, usually limit the prices and profits in an industry.

The five forces together determine industry attractiveness/profitability. This is so because these forces influence the causes that underlie industry attractiveness/ profitability. **For example**, elements such as cost and investment needed for being a player in the industry decide industry profitability, and all such elements are governed by these forces. The collective strength of these five competitive forces determines the scope to earn attractive profits. The strength of the forces may vary from industry to industry.