

Tool: Porter's Generic Strategies

Competitive advantage

Most businesses face competition from other businesses that offer the same or similar products to consumers. If there is more competition in a particular market, it is more difficult for a business to earn profits. Consumers will have many choices among products, so that any one company will likely earn lower revenues and profits.

Concept

Economic sustainability

Economic sustainability refers to the ability of a business to earn profits. Profits enable the business to continue operating because the profits can be used to make investments or adapt to the changing needs and wants of consumers.

Competition from other businesses offering the same products can result in lower profits for a business or can even lead to losses, which threaten the sustainability of the business. Sustaining business activity is important when businesses are providing for human needs, supporting the wellbeing of diverse stakeholders in the community and providing tax revenue to support public services and infrastructure.



Figure 1. Does your product stand out in a competitive market?

Credit: Richard Drury, Getty Images

In highly competitive markets, businesses will look for a competitive advantage over other businesses offering the same product. A competitive advantage is a condition in the business that enables it to offer better products, or products at lower production cost, than its rivals. If a business can offer better products, then consumers may choose those products over others offered by competing businesses. As a result, revenues and profits may rise. And if a business can produce the product with lower costs, then profits may also increase.

Exam tip

For students taking IBDP Economics, it is important not to confuse the business concept of competitive advantage with the economics concept of comparative advantage.

Competitive advantage in the IBDP Business Management course refers to a situation where a business is able to offer better or lower-cost products in a market.

Comparative advantage in the IBDP Economics course refers to a situation where a country or economy is able to produce a product at a lower opportunity cost.

Strategies

Michael Porter, a professor and researcher of competition theory, developed a matrix of four general strategies to help businesses consider how to respond to their external competitive environment. Porter's Generic Strategies matrix (see **Figure 2**) considers two broad competitive strategies: lower cost or differentiation. Differentiation means that a business has made its product different or better than its rival's product. The matrix also considers whether a business is targeting a broad market of consumers or a narrow niche market.

The Generic Strategies mix can apply to both for-profit commercial and for-profit social enterprises. A description of each strategy is given below in **Figure 2**.

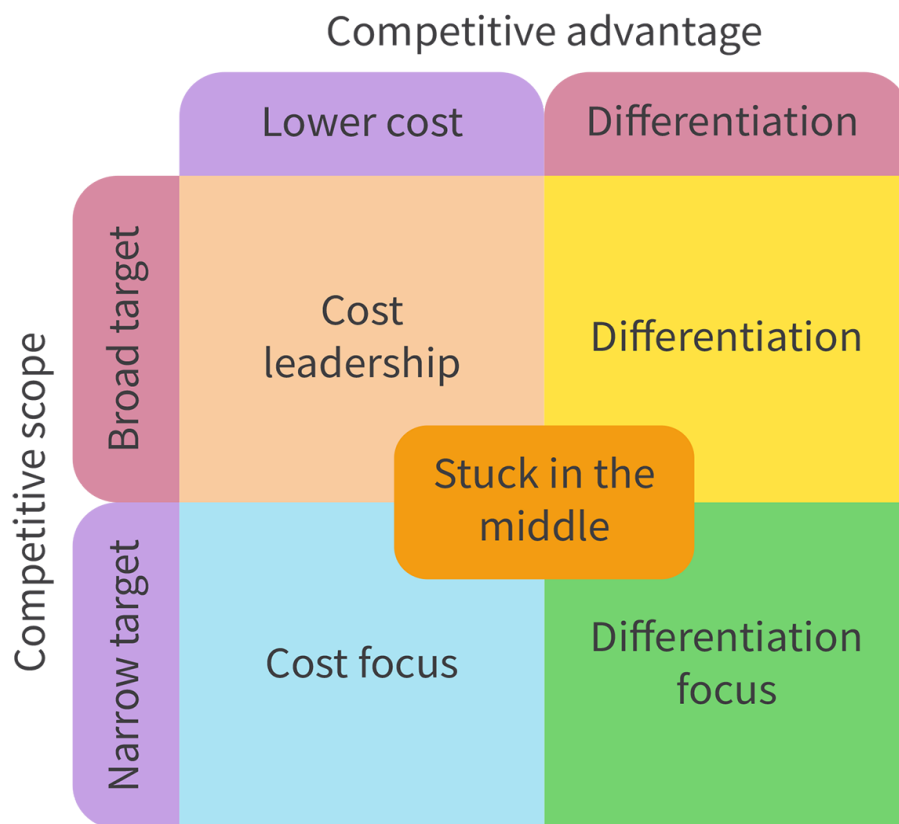


Figure 2. Porter's Generic Strategies.

Source: Adapted from Porter 1980, Competitive Strategy.

The cost leadership and differentiation strategies apply to businesses that are selling their products to a broad target market. A broad target market is a large group of people with different characteristics and preferences, likely in a wide geographical range.

Cost leadership

A cost leadership strategy means that the business becomes the low-cost producer in the industry. If the business is very large, it may reduce unit costs of production through various economies of scale ([Section 1.5.2 \(/study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/internal-and-ext-economies-id-36534\)](https://study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/internal-and-ext-economies-id-36534)). The business may also reduce unit costs of production through specialised technologies or more efficient supply chains.

A cost leadership strategy is most suited to a market where the products are standardised and there is less opportunity to differentiate through product quality, branding or promotion. An example of a company that uses a cost leadership strategy is Bic which is best known for its inexpensive, robust pens and markers. However, the company also makes shavers and lighters. Its small range and economies of scale keep costs of production low as it serves a broad market.



Figure 3. Cost leadership is an appropriate strategy for a business that produces products that are hard to differentiate.

Credit: Fabio Magni / EyeEm, Getty Images

Differentiation

A differentiation strategy means that a business is able to make its product better or different from competitors in the industry. The business will usually identify a special characteristic of the product – its unique selling point (USP) – and aim to make the product the best in the industry on that point. As you learned in Section 4.2.4 (</study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/product-differentiation-and-usp-id-37447>), products can have a unique selling point in any of the seven Ps: produce, price, place, promotion, people, processes or physical evidence.

For example, you learned in Section 4.2.0 (</study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/the-big-picture-id-37443>) that the Columbian for-profit social enterprise Crepes and Waffles was able to differentiate itself in a broad market. Its food products found a gap in the market. Its hiring practices, which focused on women who are heads of households, meant that it had a unique selling point through its people. The business has grown over time and now has outlets in many countries.

If it is successful, the business should sell more products and could even charge a premium price, both of which will increase revenues. Profits may also increase, but only if the business keeps the production and promotion costs related to the differentiation under control.



Figure 4. Differentiation allows a business to make its product better or different from competitors in an industry.

Credit: Peter Dazeley, Getty Images

The next two strategies focus on a smaller market segment called a niche market. A niche market is a small part of a larger market. In niche markets, customers have very specialised needs or wants that are different from the larger market.

Cost focus (niche market)

A cost focus strategy means that the business becomes the low-cost producer in a niche market. A business that is pursuing a cost focus strategy will usually be producing a product that is relatively basic, perhaps a lower-cost copy of a popular and higher-priced product. An example of this could be a career coach who offers low-cost online coaching and support services for people looking to enter a particular field. In-person career coaching can be quite expensive, but if a coach can develop a range of services at lower cost, the coach could also charge lower prices to customers.

Differentiation focus (niche market)

A differentiation focus strategy means that the business is producing a specialised, or differentiated, product for a niche market. The differentiation could be that the product is very high quality, that it is very exclusive or that it provides some kind of special characteristic that the niche market wants. A shoemaker who makes custom shoes for clients would be an example.

A business must understand the needs and wants of the niche market very well for this strategy to work. The business should be able to charge premium prices to increase revenues and compensate for the small market size.



Figure 5. Differentiation focus means to offer a specialised product, such as very large shoes, to a niche market.

Credit: Holly Wilmeth, Getty Images

Stuck in the middle

A business is 'stuck in the middle' when it is not differentiated enough to convince consumers to buy its product. Also its costs of production, and likely its prices, are too high relative to those of competitors. These businesses are probably earning low profits or may be experiencing losses.

Businesses that are stuck in the middle need to change strategies. To increase profits, they need to either cut costs of production, or they need to work on differentiating themselves. They also need to determine whether they are focused on a broad or narrow market. Confusion about the scope of the market can also make marketing strategies unclear.

Activity

Learner profile: Knowledgeable

Approaches to learning: Thinking skills (transfer)

Consider a business and a product with which you are familiar. This could be a widely known product from a multinational company, or it could be something produced locally. If you are attending a school that charges fees and faces competition, you could select that business.

- What strategy does the business seem to be using to compete with its rivals? Identify an appropriate strategy and use evidence from your experience and observations to support your ideas.
- If you think the business is 'stuck in the middle', what change in strategy may be best for the business to improve its profits and become more economically sustainable?