3.2 Cost-leadership Competitive Strategy

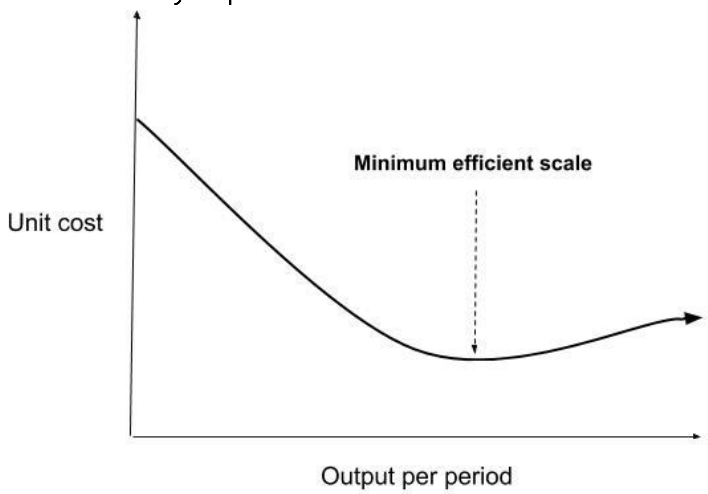
Lets go straight ahead for the definition of this strategy:

Cost-leadership strategy involves the lowest cost organisation in a domain of activity.

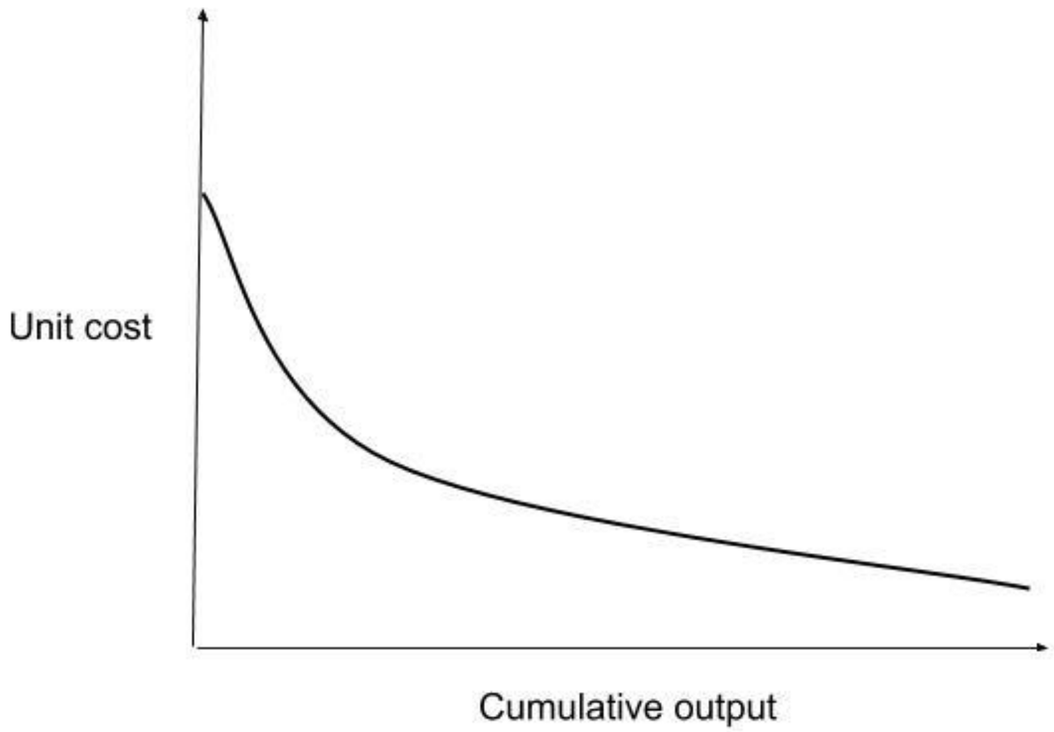
There are now four key **cost drivers** that can help deliver a cost leadership:

Firstly, **input costs** are often very important, for example labour or raw materials. Many companies seek competitive advantage through locating their labour intensive operations in countries with low labour costs. Examples might be service call-centres in India or manufacturing in China.

Secondly, **economies of scale**, refer ti how increasing scale usually reduces the average costs of operation over a particular period of time period, perhaps a month or a year. Economies of scale are particularly important wherever there are high fixed costs. Fixed costs are those costs, which are necessary for even at a minimal level of output: for example, a pharmaceutical company typically needs to do extensive research before it produces a single pill. Thus, it will afterwards try to sell as much as possible of these pills to spread these huge fixed costs. For the cost-leader, it is important to reach **minimum efficient scale**. Note though on the right side of the graph that **diseconomies of scale are possible**. Too large volumes of output might require special overtime payments to workers or involve the neglect of equipment maintenance can soon be very expensive.



Thirdly, **experience** can be a key source of cost efficiency. This experience curve implies that the cumulative experience gained by an organisation with each unit of output leads to reduction in unit costs. There is no time or scale limit this time: simply the more experience the organisation has in an activity, the more efficient it gets doing it. This saving in costs by experience comes from two sources. Firstly, **labour efficiency**, simply the more your labour produces, the more efficient they will be. Secondly, costs are saved through more **efficient design** of workplace, equipment or processes.



Fourhly, **product or process design** also influences costs. Efficiency can be designed in at the outset. For example, engineers can choose to build a product from cheap standard components rather than expensive specialised compoments. Organisations can choose to interact with customers exclusively through cheap web-based methods, rather than via phone or stores.

Alright we have discussed the low-cost strategy. Now it would be good to look at how a market might look like as there is one more important concept to udnerstand - which is **parity vs proximity**.

OFF SCREEN
This is an example of a market with four competitors. We see their strategies or positions highlited on horizontal axis - average competitor, cost leader with parity, cost

leader with proximity and differentiator. Look at the prices that these competitors offer. Diffenrentiator offers much higher price, but probably very differentiated and high quality product. What is of our interest more are the two cost leaders out of which the one with parity offers higher price. The thing is that this cost leader achieved parity, or equivalence in his product offering to average competitor. His product is cheaper to produce and equally good as the product of average competitor. Now cost leader with proximity has equally low costs of producing, however his product is of lower quality as perceived by customer, hence he needs to charge lower price than both average competitor and cost leader with parity.