Competition, Strategy, and Competitive Advantage

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WHAT'S COVERED

In this lesson, you will learn the nature of competition and the generic strategies a firm can implement to gain advantage over its rivals. Specifically, this lesson will cover:

1. Introduction to Competition, Strategy, and Competitive Advantage

Now that you understand more about the environment that organizations operate in, let's take a deeper look at exactly how they operate. Businesses exist to make profits by offering goods and services in the marketplace at prices that are higher than the costs they incurred creating those goods and services. Businesses rarely exist alone in an industry; **competition** is usually a key part of any marketplace. This means that businesses must find ways to attract customers to their products and away from competitors' products. **Strategy** is the process of planning and implementing actions that will lead to success in competition.

The analytical tools we discuss here are part of the strategic planning process. Managers cannot successfully plan to compete in an industry if they don't understand its competitive landscape. It is also unlikely that a firm that is planning to launch a new product that they are not equipped to make will be successful.

HINT

You will conduct an internal and external analysis of the organization and add information about their strategy to the presentation you create for the Touchstone assignment.

TERMS TO KNOW

Competition
Business actions a firm undertakes to attract customers to its products and away from competitors' products.

Strategy
Process of planning and implementing actions that will lead to success in competition.

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2. Competition

Porter's Five Forces model is centered around rivalry, a synonym for competition. In any industry, multiple firms compete against each other for customers by offering better or cheaper products than their rivals. Firms use PESTEL to understand what consumers are interested in and use VRIO to evaluate their own resources and capabilities so that they can figure out how to offer products and services that match those consumer interests and that are better in quality and price than the products offered by their competitors.

A firm is described as having a **competitive advantage** when it successfully attracts more customers, earns more profit, or returns more value to its shareholders than rival firms do. A firm achieves a competitive advantage by adding value to its products and services or reducing its own costs more effectively than its rivals in the industry.

TERM TO KNOW

Competitive Advantage
When a firm successfully attracts more customers, earns more profit, or returns more value to its shareholders than rival firms do.

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3. Generic Business-Level Competitive Strategies

When discussing business strategy, a business is a firm or a unit of a firm that centers its activities around one primary type of product or service line. Business-level strategy is the general way that a business organizes its activities to compete against rivals in its product's industry. Michael Porter (the same Harvard professor who developed the Five Forces Model) defined three **generic business-level strategies** that outline the basic methods of organizing to compete in a product market. He called the strategies "generic" because these ways of organizing can be used by any firm in any industry.

TERM TO KNOW

Generic Business-Level Strategies
Basic methods of organizing firm value chain activities to compete in a product market that can be used by any firm in any industry.

3a. Cost Leadership

When pursuing a **cost-leadership strategy**, a firm offers customers its product or service at a lower price than its rivals can. To achieve a competitive advantage over rivals in the industry, the successful cost leader tightly controls costs throughout its value chain activities. Supplier relationships are managed to guarantee the lowest prices for parts, manufacturing is conducted in the least expensive labor markets, and operations may be automated for maximum efficiency. A cost leader must spend as little as possible producing a product or providing a service so that it will still be profitable when selling that product or service at the lowest price.

EXAMPLE Walmart is the master of cost leadership, offering a wide variety of products at lower prices than competitors because it does not spend money on fancy stores, it extracts low prices from its suppliers, and it pays its employees relatively low wages.

TERM TO KNOW

Cost-leadership Strategy
A generic business-level strategy in which a firm tightly controls costs throughout its value chain

activities in order to offer customers low-priced goods and services at a profit.

3b. Differentiation

Not all products or services in the marketplace are offered at low prices, of course. A **differentiation strategy** is exactly the opposite of a cost-leadership strategy. While firms do not look to spend as much as possible to produce their output, firms that differentiate try to add value to their products and services so they can attract customers who are willing to pay a higher price. At each step in the value chain, the differentiator increases the quality, features, and overall attractiveness of its products or services. Research and development efforts focus on innovation, customer service is excellent, and marketing bolsters the value of the firm brand. These efforts guarantee that the successful differentiator can still profit even though its production costs are higher than a cost leader's.

> ↱ EXAMPLE Starbucks is a good example of a differentiator: it makes coffee, but its customers are willing to pay premium prices for a cup of Starbucks coffee because they value the restaurant atmosphere, customer service, product quality, and brand.

Porter's typology assumes that firms can succeed through either cost leadership or differentiation. Trying to combine these two, Porter suggests, can lead to a firm being stuck in the middle—an undesirable, unsustainable, and ineffective place to be.

TERM TO KNOW

Differentiation Strategy

A generic business-level strategy in which firms add value to their products and services in order to attract customers who are willing to pay a higher price.

3c. Focus

Porter's third generic competitive strategy, **focus**, is a little different from the other two. A firm that focuses still must choose one of the other strategies to organize its activities. It will still strive to lower costs or add value. The difference here is that a firm choosing to implement a focused strategy will concentrate its marketing and selling efforts on a smaller market than a broad cost leader or differentiator. A firm following a focus-differentiation strategy, for example, will add value to its product or service that a few customers will value highly, either because the product is specifically suited to a particular use or because it is a luxury product that few can afford.

TERM TO KNOW

Focus Strategy

A generic business-level competitive strategy that firms use in combination with either a cost-leadership or differentiation strategy in order to target a smaller demographic or geographic market with specialized products or services.

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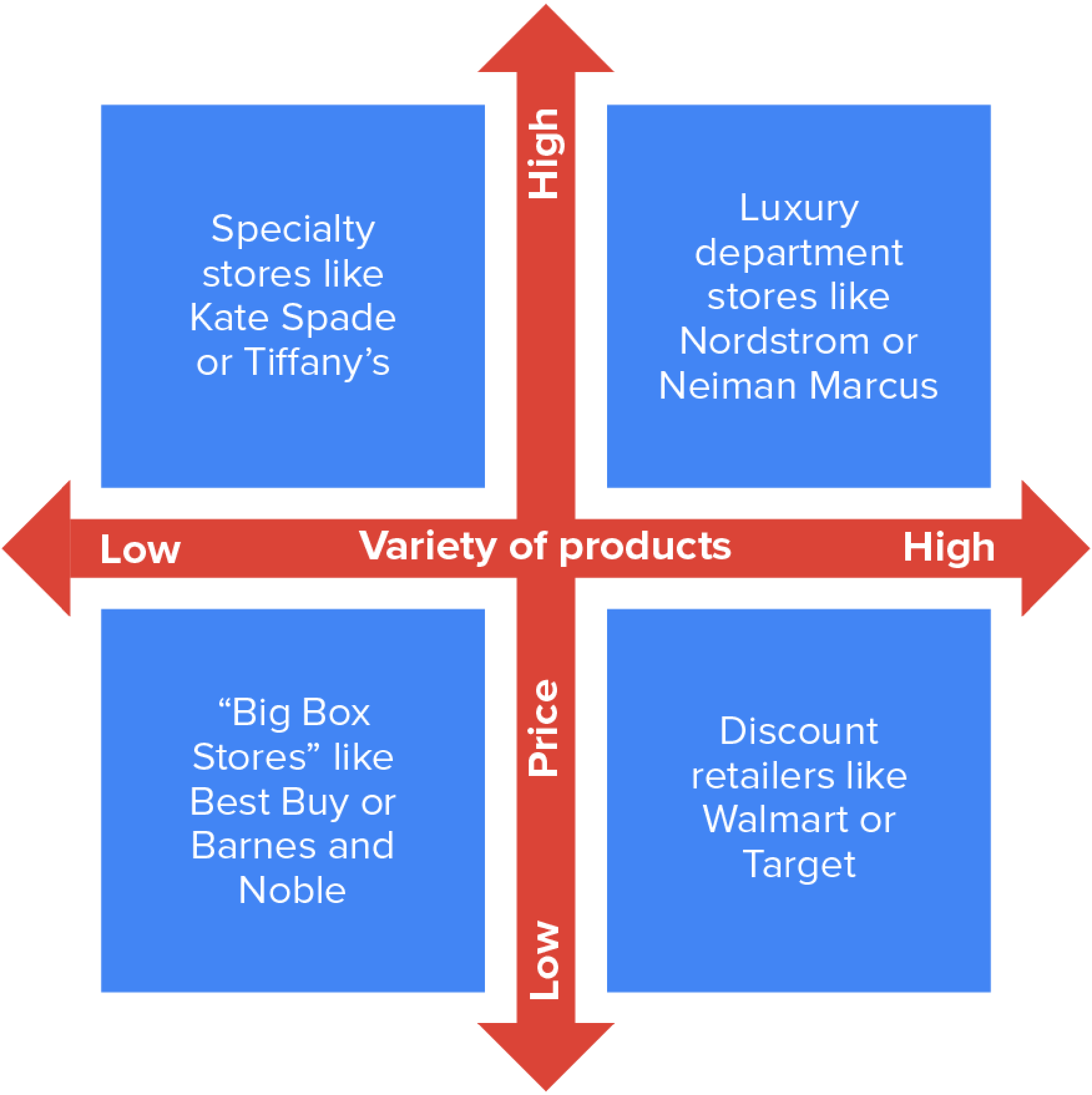
4. Strategic Groups

When managers analyze their competitive environment and examine rivalry within their industry, they are not confronted by an infinite variety of competitors. Although there are millions of businesses of all sizes around the globe, a single business usually competes mainly against other businesses offering similar products or services and following the same generic competitive strategy. Groups of businesses that follow similar strategies in the same industry are called **strategic groups**, and it is important that a manager knows the other firms in their strategic group. Rivalry is fiercest within a strategic group, and the actions of one firm in a group will elicit responses from other group members who don't want to lose market share in the industry. Take a look at the diagram below: although all of the firms shown are in the retail industry, they don't all compete directly against one another.



Although some cross-competition can occur (for example, you could buy a Kate Spade wallet at Nordstrom), firms in different strategic groups tend to compete more with each other than against firms outside their group.

Although Walmart and Neiman Marcus both offer a wide variety of products, the two firms do not cater to the same customers, and their managers do not lose sleep at night wondering what each might do next.

DID YOU KNOW

A Walmart manager would be concerned with the products or prices offered at Target; if laundry detergent is on sale at Target, the Walmart manager might lose sales from customers who buy it at Target instead, and so the Walmart manager might respond to Target's sale price by discounting the same detergent at Walmart.

REFLECT

1. What is competition, and what is the role of strategy in competition?
2. When does a firm have a competitive advantage over its rivals?
3. Explain the differences between the three business-level generic competitive strategies.

HINT

This is where the rubber meets the road. Some firms lack strategic direction or attempt to pursue two strategies simultaneously, which often has dire consequences (e.g., low cost + differentiation rarely succeeds). For your Touchstone assignment, you need to identify which of Porter's three generic strategies you feel the organization is pursuing and why, and/or whether they should consider a different generic strategy and why. Sometimes it is not always clear. One thing that can help is to compare your organization to a competitor to gain a clearer understanding. For example, Target pursues a differentiation strategy; whereas, Walmart pursues a low-cost strategy

TERM TO KNOW

Strategic Group
Businesses offering similar products or services and following the same generic competitive strategy.

SUMMARY

In this lesson, you explored an **introduction to competition, strategy, and competitive advantage**. You learned about the nature of **competition**—business action a firm undertakes to attract customers to their products and away from competitors' products—and the **generic business-level competitive strategies** a firm can implement to gain a competitive advantage over its rivals. These strategies are labelled "generic" because they can be used by any firm in any industry, and they include a **cost leadership** strategy to lower costs, a **differentiation** strategy to add value, and a **focus** strategy, which is used in combination with either of the other two strategies in order to target a smaller demographic or geographic market with specialized products or services. Lastly, you learned about **strategic groups**, which are groups of businesses that follow similar strategies in the same industry and among whom rivalry is fiercest.

Best of luck in your learning!

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TERMS TO KNOW

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Competitive Advantage

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Cost-leadership Strategy

A generic business-level strategy in which a firm tightly controls costs throughout its value chain activities in order to offer customers low-priced goods and services at a profit.

Differentiation Strategy

A generic business-level strategy in which firms add value to their products and services in order to attract customers who are willing to pay a higher price.

Focus Strategy

A generic business-level competitive strategy that firms use in combination with either a cost-leadership or differentiation strategy in order to target a smaller demographic or geographic market with specialized products or services.

Generic Business-Level Strategies

Basic methods of organizing firm value chain activities to compete in a product market that can be used by any firm in any industry.

Strategic Group

Businesses offering similar products or services and following the same generic competitive strategy.

Strategy

Process of planning and implementing actions that will lead to success in competition.