**Session 05 BUSA 7800 - Strategic Management Chapter 05**

Learning Outcomes

At the end of this session you should be able to:

1. Describe the focus of a business – level (competitive) strategy.
2. Explain how to build a competitive advantage for both the overall cost leadership strategy and the differentiation strategy.
3. Recognize why some generic competitive strategies work better in certain kinds of industry and competitive conditions than others.
4. Describe the pitfalls of each competitive strategy.
5. Compare the two different types focus strategies.
6. Explain how firms can effectively combine elements of generic strategies.

**Chapter 5 - Business - Level Strategy: Creating and Sustaining Competitive Advantages**

**I. Introduction**

Why is choosing one of the four generic business-level (competitive) strategies is a company's first and foremost choice in crafting an overall strategy?

* Determines how the firm will build it’s competition advantages and delier superior value to customers

**II. Business (Competitive) Strategies and Industry Positioning**

What does a company’s business (competitive) strategy focus on?

* How will we compete?
* Produce a competive advantage over rivels in the market place

What decisions must firms make in their competitive strategies?

* Target market
  + broad – massmarket
  + narrow – niche market

What are the four generic competitive strategies? (Exhibit 5.1)

1. *Overall Cost Leadership*
2. *Differentiation*
3. *Cost Focus*
4. *Differentiation Focus*

**III. Overall Cost Leadership**

**A. Introduction**

When does a company achieve overall cost leadership?

* When it becomes the lowest cost producer
  + lowest per unit costs

What are the two options for translating a low-cost advantage over rivals into attractive profit performance?

* *Option 1: underprice competition*
* *Option 2: maintain the present price*

When it comes to a firm’s product, what is a limitation that managers see with the overall cost leadership strategy?

* The product needs to have a must have features, if not then customers will find that this products has little value

**B. Overall Cost Leadership and the Value Chain**

What are two ways that firms can use their value chain to achieve a low-cost edge over rivals? (Exhibit 5.2)

1. *Performing essential value chain activities more cost-effectively than rivals.*
2. *Revamping the firm's overall value chain to eliminate or bypass some cost-producing activities.*

What are some examples of cost-efficient management of value chain activities?

* Capturing all available economies of scale trying to operate your facilities
  + full capacity

What are some examples of how a firm can revamp their value chain?

* Selling directly to consumers
* Streamlining operations by eliminating low value – remove unnecessary work (legacy steps)

**C. When a Low-Cost Provider Strategy Works Best**

When does a low-cost provider strategy work best?

1. Price competition among rival sellers is especially vigorous.

Who can survive a price war?

* The lowest avg. cost producer and the one making the most profit

1. There are few ways to achieve product differentiation that have value to buyers.

* culture

1. Buyers incur low costs in switching their purchases from one seller to another.
2. The majority of industry sales are made to a few, large-volume buyers.

* Will bargain the price down

1. Industry newcomers use introductory low prices to attract buyers and build a customer base.

* Get them to sample

**C. The Pitfalls of Overall Cost Leadership Strategies**

* 1. Overly Aggressive Price Cutting

How can a firm get carried away with overly aggressive price cutting and end up with lower, rather than higher, profitability?

* Price drops that are a larger than their cost drops and their sales vlume doesn’t rise
  1. Reliance on easily imitated cost reductions.

What is the major problem with focusing on easily imitated cost reductions?

* Rivals can easily catch up to you and you are right back to where you started
  1. Becoming too fixated on cost reductions.

How can becoming too fixated on cost reductions hurt a business

* some cost cutting measure can lower the enjoyment of the product. Now the product feels cheap
  1. Vulnerability to raw material costs

Why is this strategy more vulnerable to increases in the price of inputs?

* Since you are competing based on your cost and prices these firms are less able to pass the higher costs on as higher prices

**IV. Differentiation**

**A. Differentiation - Key Points**

In general, when are **differentiation** strategies ideal to use?

* When buyers needs and preferences are too diverse to be satisfied by a standardized product

What are the benefits of a successful differentiation strategy?

* Command a price premium
* higher unit sales

What is the requirement to make differentiation feasible?

* The costs required to differentiate must be lower than the added price premium due to the differentiation e.g this differentiation adds $5 costs to production costs/unit but you’re able to sell $10 more per unit

What are a few examples of how firms can differentiate?

* + Unique taste:
  + Wide selection and one-stop shopping:
  + Superior service:
  + Engineering design and performance: Tesla, Lambo
  + Luxury and prestige: Rolex, Gucci
  + Technological leadership: Amazon, Google

How do firms deliver superior value via a differentiation strategy?

1. Include product attributes and user features that lower the buyer’s costs.

What are some examples of user features that lower the buyer's costs?

* Providing just in time delivery an idle crew at the work site is expensive

1. Incorporate tangible features that improve product performance.

* Such as durability, ease of use, reliable

1. Incorporate intangible features that enhance buyer satisfaction in noneconomic ways.

* Tesla – saving the world
* Rolex - status
  1. **Managing the Value Chain in Ways that Enhance Differentiation**

What are some examples of activities that enhance differentiation?

* Supplier and purchasing activities find more unique inputs
* product R&D activities focus on how the next gen products can be different
  1. **Perceived Value and the Importance of Signaling Value**

Why must the price premium commanded by differentiation reflect the value perceived by the buyer?

* If the prices premium by differentiation > value perceived by buyer

**D. When a Differentiation Strategy Works Best**

Differentiation strategies tend to work best in market circumstance where:

1. Buyer needs and uses of the product are diverse

* Footware

1. There are many ways to differentiate the product or service and many buyers perceive these differences as having value

* hotels – location, size of room, view, furnishing, range of guest services

1. Few rival firms are following a similar differentiation approach

Why can this be a dangerous strategy in this circumstance?

* Low profit differentition few rivals in this area due to lower profits

1. Technological change is fast-paced and competition revolves around rapidly evolving product features

* smart phone, tablets, video games

**E.** **Pitfalls to Avoid in Pursuing a Differentiation Strategy**

Differentiation strategies can fail for any of several reasons.

1. The company’s differentiation strategy produces a ho-hum market reception because buyers see little value in the unique attributes of a company’s product.
2. Over differentiating so that the product quality or service level exceeds buyers’ needs
3. Trying to charge too high a price premium
   1. Premium priced higher than people are willing to pay
4. Competitors can quickly copy most or all of the appealing product attributes a company comes up with.
   1. No longer different
5. Overspending on efforts to differentiate the company’s product offering, thus eroding profitability
6. Being timid and not striving to open up meaningful gaps in quality or service or performance features compared to rivals

**I. Focused (or Market Niche) Strategies**

What sets focused strategies apart from low-cost leadership or broad differentiation strategies?

How can a target segment or niche can be defined?

**A. Cost Focus**

How does a focused strategy based on low cost aims at securing a competitive advantage?

What is an example of a firm using a focused low cost strategy?

**B. Differentiation Focus**

How does a focused differentiation strategy gain a competitive advantage?

**C. When a Focused Low-Cost or Focused Differentiation Strategy is Viable**

A focused strategy becomes increasingly attractive as more of the following conditions are met:

* 1. The target niche is big enough to be profitable and offers good growth potential
  2. Industry leaders do not see that having a presence in the niche is crucial to their own success
  3. The industry has many different niches and segments
  4. Few, if any, other rivals are attempting to specialize in the same target segment
  5. The focuser has a reservoir of customer goodwill and loyalty

**D. The Risks of a Focused Low-Cost or Focused Differentiation Strategy**

What are several risks of the focus strategy?

* 1. The chance that competitors will find effective ways to match the focused firm’s capabilities in serving the target niche
  2. The potential for the preferences and needs of niche members to shift over time toward the product attributes desired by the majority of buyers
  3. The segment may become so attractive it is soon inundated with competitors, intensifying rivalry and splintering segment profits

**II. Combination Strategies: Integrating Overall Low Cost and Differentiation**

Why discuss the idea of combination strategies?

How can the benefits of combining advantages be additive instead of involving a trade off?

What is the aim of combination strategies?

What is the competitive advantage of a firm using a combination strategy?

**A. When Combination Strategies Works Best**

Under what situations does a best cost provider work well?

* 1. Product differentiation is the norm.
  2. The market is comprised of large numbers of value-conscious buyers attracted to economically priced midrange products and services, especially during recessionary times.
  3. A provider can offer either a medium-quality product at a below-average price or a high-quality product at an average or slightly higher-than-average price.

**B. The Danger of an Unsound Combination Strategy**

What is the main danger of a company using the combination strategy?

A combination strategy not done well can result in what Michael Porter described as "Stuck in the Middle". What did Michael Porter mean by being "Stuck in the Middle"?