Generic Strategies and Industry Forces

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- As we have seen with the Five Forces model every firm faces competitive pressures from all sides
- The Five Forces model's yard stick for Industry attractiveness is profitability

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- When we examined each of the Five Forces we were determining whether the force in question positively or negatively affected the profitability of the firm and of course its valuation
- This then becomes the measure of industry attractiveness

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- The response of the firm to these pressures can determine how successful and profitable the firm is
- This brings us to the question of Industry Positioning
- What strategy does the firm adopt to best defend itself against the Five Forces?

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- Michael Porter’s answer to this question is his Generic Strategies Model

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- Even in an industry with relatively low profitability, a firm that positions its self well can make above average returns
- It does this by playing to its strengths

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- Porter argues that these strengths or competitive advantages are either:
  - Cost Advantage
  - Differentiation
- By applying these to either a broad or narrow scope, three generic strategies emerge…

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- Cost Leadership
- Differentiation
- Focus

Target Scope	Advantage	
	Low Cost	Product Uniqueness
Broad (Industry Wide)	Cost Leadership	Differentiation
Narrow (Market Segment)	Focus Low Cost	Focus Differentiation

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- These strategies are generic because they can be applied to any product or service and to organisations of any scale.

Target Scope	Advantage: Low Cost	Advantage: Product Uniqueness
Broad (Industry Wide)	Cost Leadership	Differentiation
Narrow (Market Segment)	Focus Low Cost	Focus Differentiation

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- Cost Leadership - No frills, lowest cost producer - Budget Airlines
- Differentiation - uniquely attractive products and services - Apple
- Focus - specialised service in a niche market

Target Scope	Advantage	
	Low Cost	Product Uniqueness
Broad (Industry Wide)	Cost Leadership	Differentiation
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- Porter split Focus into two parts
  - Cost Focus - cost minimisation within a focused market
  - Differentiation Focus - strategic differentiation within a focused market

Target Scope	Advantage	
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- Cost Leadership can be achieved in two ways:
  - Increase profits while reducing costs and charging industry average prices
  - Increase market share by charging lower prices but still making a reasonable profit on each sale due to lower costs
- The focus is on minimising the cost to the organisation not to the customer which is a separate issue
- Low cost producers are open to competitive pressure from other low cost producers, potentially resulting in a race to the bottom.

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- Before embarking on this strategy, firms need to be confident of success
  - Access to capital to invest in technology to bring costs down
  - Efficient supply chain and logistics
  - Low cost base - labour, raw materials etc.
- If these are not unique to the firm then other competitors may be able to replicate your low cost strategy
- One way to continuously keep costs low is the Kaizen philosophy of continuous improvement

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- Differentiation is about making your products unique to provide them with a competitive advantage
  - Unique features or functionality
  - Durability
  - After sales support
  - Branding - value and brand image in the market

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- Successful Differentiation strategies require:
  - Good R&D and innovation
  - High quality products and services
  - Effective sales and marketing - communicating the benefits of the differentiated products

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- Focus strategies address specific niche markets
  - Market dynamics
  - Customer needs and wants
  - Build brand loyalty - discourages competitors
- Still have to decide whether to pursue Cost Leadership or Differentiation

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- Porter cautioned against trying to hedge your bets and try to follow more than one strategy at a time
- To a degree mutually exclusive - appeals to different market segments
- Cost leadership - internal focus on minimising the cost to the firm
- Differentiation - external focus - creative and communicative marketing and branding
- The do nothing strategy means that your business will end up “stuck in the middle” and competing against firms with a clear generic strategy

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- There is a strong connection between Porter's Five Forces and his Generic strategies
- For each of the Five Forces a firm needs to ask which strategy gives them the best chance of mitigating the impact of the Five Forces…

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- Competitive Rivalry
  - Cost leadership: better able to compete on price
  - Differentiation: brand loyalty creates competitive advantage
  - Focus: competitors cannot address the needs of the customer who is differentiation focused

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- Entry Barriers
  - Cost Leadership: price cutting deters potential entrants
  - Differentiation: customer loyalty barrier
  - Focus: core competences build competitive advantage which is hard to compete with

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- Buyer Power
  - Cost Leadership: ability to offer low prices to strong buyers
  - Differentiation: few close product alternatives reduce scope for buyers to negotiate
  - Focus: few alternatives means less ability to negotiate or switch

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- Supplier Power
  - Cost Leadership: volume sales better protects from powerful suppliers
  - Differentiation: better able to pass on supplier prices to customers
  - Focus: suppliers have power due to lower volumes but differentiation enables firm to pass on price increases to customers who are less price sensitive

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- Threat of Substitutes
  - Cost Leadership: Low prices make market less attractive to substitutes
  - Differentiation: customers desire additional functionality or characteristic so more defendable
  - Focus: specialised products and core competency increases competitiveness against substitutes

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