Undergraduate Diploma in
Business Administration

[Module 5 – Strategic Management]

Lecture Title:5 Selecting Business-Level Strategies

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Lecture 5 – Selecting Business-Level Strategies

1. How is the SWOT framework used for determining strategic issues and strategies?

2. What is a strategic issue and how is it identified and expressed?

3. How to evaluate and develop the ability to identify strategic issues and design appropriate courses of action.

4. Why is an examination of generic strategies valuable?

5. What are the four main generic strategies?

6. What is a best-cost strategy?

- The previous three sessions have dealt with assessing organizational performance, external analysis of the industry, and competitive environments of a firm, and analyzing the internal environment of an organization.

- *What happens to all information that is obtained as a result of all these evaluations?*

- The SWOT framework helps to pull the most important information into a format that can then be used in strategic management to determine the strategic issue the firm needs to address and resolve by consolidating a summary of the other analyses into one framework.

- The SWOT framework is also helpful in the next phase of strategic management, setting strategies.

- A strategic issue is the primary matter faced by an organization that must be addressed for the organization to survive, excel, or achieve a major strategic initiative.

- The strategic issue defines what the organization needs to address and resolve to move the organization forward toward success by analyzing the data and information from the internal and external assessments as presented in the SWOT.

- Once the strategic issue is defined, strategies can be developed that address and resolve the strategic issue and propel the organization toward accomplishing its vision.

- This session discusses how basic business level strategies are developed.

SWOT Framework

- Chess master Bruce Pandolfini has noted the similarities between business and chess.
- In both arenas, you must understand your own abilities as well as your flaws. You must also know your opponents, try to anticipate their moves, and deal with considerable uncertainty.
- A very popular management tool that incorporates the idea of understanding the elements internal and external to the firm is SWOT (strengths, weaknesses, opportunities, and threats) analysis.
- Strengths and weaknesses are assessed by examining the firm, while opportunities and threats refer to external events and trends. These ideas can be applied to individuals too.
- Here are examples of each element of SWOT analysis for organizations and for individuals who are seeking employment.

SWOT point - Strengths

- *Organizational Examples*
- Having high levels of cash flow gives firms discretion to purchase new equipment if they wish to.
- *Individual Examples*
- Strong technical and language skills, as well as previous work experience, can help individuals rise above the competition.

SWOT point - Weaknesses

- *Organizational Examples*
- Dubious leadership and CEO scandals have plagued some corporations in recent years.
- *Individual Examples*
- Poor communication skills keep many job seekers from being hired into sales and supervisory positions.

SWOT point - Opportunities

- *Organizational Examples*
- The high cost of gasoline creates opportunities for substitute products based on alternative energy sources.
- *Individual Examples*
- In various countries it is increasingly services based, suggesting that individuals can enjoy more opportunities in service firms.

SWOT point – Threats

- *Organizational Examples*

- Concerns about worldwide pollution are a threat to petroleum-based products.

- *Individual Examples*

- A tight job market poses challenges to new graduates.

- Porter’s Five Forces analysis examines the situation faced by the competitors in an industry.
- Strategic groups analysis narrows the focus by centering on subsets of these competitors whose strategies are similar.
- SWOT analysis takes an even narrower focus by centering on an individual firm.
- Specifically, SWOT analysis is a tool that considers a firm’s strengths and weaknesses along with the opportunities and threats that exist in the firm’s environment

- Executives using SWOT analysis compare these internal and external factors to generate ideas about how their firm might become more successful.

- In general, it is wise to focus on ideas that allow a firm to leverage its strengths, steer clear of or resolve its weaknesses, capitalize on opportunities, and protect itself against threats.

- For example, untapped overseas markets have presented potentially lucrative opportunities to Subway and other restaurant chains such as McDonald's and KFC.

- Meanwhile, Subway's strengths include a well-established brand name and a simple business format that can easily be adapted to other cultures.

- In considering the opportunities offered by overseas markets and Subway's strengths, it is not surprising that entering and expanding in different countries has been a key element of Subway's strategy in recent years. Indeed, Subway in 2020 had operations in 111 nations.

- The SWOT framework is developed by synthesizing the information developed from the external, competitive, and internal assessments.
- The most important information from these assessments is pulled into the SWOT framework.
- Once complete, the SWOT is helpful in determining the strategic issue facing the organization.
- SWOT is also beneficial in developing the strategies for the firm.

- SWOT analysis is helpful to executives, and it is used within most organizations.

- Important cautions need to be offered about SWOT analysis, however.

- First, in laying out each of the four elements of SWOT, internal and external factors should not be confused with each other.

- It is important not to list strengths as opportunities, for example, if executives are to succeed at matching internal and external concerns during the idea generation process.

- Internal environment assessment tools such as VRIO and Value Chain Analysis can lead to organizational strengths and weaknesses.

- Using external environment analysis tools like PESTEL and Porter’s Five Forces help to determine opportunities and threats. Second, opportunities

- In the case of Subway, it would be a mistake to list “entering new countries” as an opportunity.
- Instead, untapped markets are the opportunity presented to Subway, and entering those markets is a way for Subway to exploit the opportunity.
- Finally, and perhaps most important, the results of SWOT analysis should not be overemphasized.
- SWOT analysis is a relatively simple tool for understanding a firm’s situation.

- As a result, SWOT is best viewed as a brainstorming technique for generating creative ideas, not as a rigorous method for selecting strategies.

- Thus the ideas produced by SWOT analysis offer a starting point for executives' efforts to craft strategies for their organization, not an ending point.

- The SWOT framework is also very helpful in determining the strategic issue facing the firm that will need to be addressed and resolved through the strategies that are developed.

SWOT Analysis for Subway in 2020

- Strengths
- Healthy menu options • Economical pricing • Simple business format

- Opportunities
- Untapped international markets • Movement to more healthy eating

- Weaknesses
- Limited menu items • High employee turnover • No hamburgers or french fries

- Threats
- Competitors offering more options • Long-term economic slow-down

Section Video - Business strategy

- SWOT analysis [03:08]
- The video for this lesson discusses SWOT analysis.
- You can view this video here: https://youtu.be/9-NWhwskTO4

Key Takeaway

- Executives using SWOT analysis compare internal strengths and weaknesses with external opportunities and threats to generate ideas about how their firm might become more successful.

- Ideas that allow a firm to leverage its strengths, mitigate or resolve its weaknesses, capitalize on opportunities, and protect itself against threats are particularly helpful.

Exercise

- In addition to organizations, individuals can benefit from applying SWOT analysis to their personal situation.

- What are your key strengths, and how might you build your own personal strategies for success around them?

Zara Case Study | SWOT and PESTLE Analysis

- https://www.youtube.com/watch?v=TtBTvg_QyCY

Strategic Issue Identification

- So, what happens in strategic management once all the external and internal analysis is done and the SWOT framework is complete?
- Is it time to start developing strategies? No, not yet.
- One more thing needs to happen: defining the strategic issue or issues the firm needs to be sure to address.

What is a strategic issue?

- First, it is an issue, something that needs to be addressed and resolved.
- Second, it is strategic. It is a long-term issue whose resolution will help move the organization toward its vision.
- Resolving the strategic issue will have a major impact on the direction and success of the firm.
- The strategic issue is derived from the facts and data provided by the external and internal analysis and its synthesis through the SWOT framework.
- The business decision makers do not define the strategic issue(s) at the beginning of the strategic management process, through a hunch or guess, but after the analysis is completed

- Once defined, the strategic issue helps drive the strategies that the organization develops and pursues.
- A strategic issue, when identified correctly and used effectively, becomes the strategic focus of the organization.
- In this process, more than one strategic issue may surface.
- Generally, decision makers will condense these into a single statement, or deal with less important strategic issues when establishing strategies or lower order goals.
- The word "issue" often connotes a negative situation that a firm may be facing. For example, Southwest Airlines was faced with much lower passenger volumes as a result of the COVID-19 pandemic that started in 2020.

- Ideally, the strategic issue is reduced to one concise sentence, so that it is easily captured and understood.
- Amplifying information may be provided to further explain the situation and justify the choice of the strategic issue.
- Often, the strategic issue starts with the word how.
- In the Southwest Airlines example, the strategic issue could be: *“How does Southwest Airlines adjust to long-term, lower passenger volumes and remain the preferred, low-cost leader in the industry?”*
- For Subway, it may have been *“How does Subway enter untapped international markets? ”*
- Once defined, these companies would develop strategies that move their organization towards its vision, while addressing the strategic issue.

- The strategic issue will change over time, as the external, competitive and internal dynamics change.
- For organizations working through the strategic management process, defining the strategic issue may not be simple.
- The planning team members may interpret data differently or through the lens of their own perspective.
- The Chief Financial Officer (CFO) may see the strategic issue in financial terms, the marketing director as a marketing issue, and the human resources director as an issue with manpower and training.
- One process organizations can use to determine the strategic issue is for planning team members to study the data from the analysis and each draft and share their idea of the strategic issue.
- The team then has a process to prioritize these, dropping some, combining some, until they arrive at a consensus on the wording of the strategic issue.

- Section Video Strategic Issues [01:57]
- The video for this lesson discusses Strategic Issues.
- You can view this video here: https://youtu.be/Zj_dxbJpCqo.

Key Takeaway

- It is important to define the strategic issue of an organization using the information and data from the external and internal analysis and the SWOT framework.

- The strategic issue sets the strategic focus for the development of strategies.

- The strategies will address and attempt to resolve the strategic issue and move the organization toward accomplishing its vision.

Conclusion

- In the analysis stage of the strategic management process, the final phase is to apply the SWOT framework to consolidate a "snapshot" of the internal and external analysis conducted and identify the key strategic issue(s).

- The SWOT pulls together the important information from the external and internal analysis and the organizational performance assessment and displays it in an organized framework.

- The strengths and weaknesses are internal to the organization, and the opportunities and threats are external to the firm. The information and data from the assessments and SWOT are then used to formulate the strategic issue(s).

- *What needs to be addressed and resolved to move the organization forward toward success and its vision?*

- Strategies are then developed that address the resolution of the strategic issue and advance the organization, as discussed in the next section.

Selecting Business-Level Strategies

1. Why is an examination of generic strategies valuable?
2. What are the four main generic strategies?
3. What is a best-cost strategy?
4. What does it mean to be *"stuck in the middle"*?

- Within the strategic management framework, an organization must define and continue to improve its generic, business-level strategy.

- A generic, business-level strategy is also called its generic competitive strategy, because it defines how a firm competes head-to-head against similar products and services in the marketplace.

- According to Michael Porter, a firm may pursue one of five generic/competitive business-level strategies.

- These are broad cost leadership, broad differentiation, focused cost leadership, focused differentiation, and best cost strategies.

- An important point of distinction is that business level strategies are viewed from the perspective of which consumer(s) are being targeted.

- It may be tempting to view business-level strategies in terms of the product lines, but the key point is to evaluate the business-level based on to whom the strategy appeals.

- In this way, a firm can target a broad audience with a single or a few products.

- There are two primary decisions in a generic business strategy.

- *Will the intent of the strategy be on a broad or focused target audience*, and simultaneously, *does the firm organize around a cost or differentiation approach?*

- If selecting a broad cost leadership or broad differentiation strategy, the target market for the product or service is broad, meaning most people who buy within that industry.

- A strategy of broad cost leadership offers the lowest price in the market for that product or service. It appeals particularly to price sensitive customers.

- If the strategy is focused, that target market is narrow, a niche market, and not meant for most people in the industry.

- Firms pursuing a broad differentiation strategy offer something unique that differentiates their product or service from others.

- Typically this uniqueness adds cost and value to the product or service, allowing the company to charge more.

- If the strategy is focused cost leadership, then the firm attempts to provide the lowest cost to a narrow, niche target market.

- Focused differentiation provides unique or differentiated products or services to a narrow, niche target market.

- Another business-level strategy is called best cost, where the firm attempts to offer a hybrid of both lower cost and differentiated products or services, combining the two basic strategies.

- *A firm pursuing this strategy must be careful to perform both strategies well, or risk not performing either well, and therefore becoming "stuck in the middle," and losing customers to the competition.*

- Once a firm establishes its overall generic business-level strategy, the strategic management process helps the firm to continuously improve upon that strategy.

- The organizational performance, external, and internal assessments, and the development of the strategic issue(s) through the SWOT analysis are then used to plot strategies for the firm to achieve its vision through its business-level strategy.

Case study –
The Competition Takes Aim at Targ

- On January 13, 2011, Target Corporation announced its intentions to operate clothing stores outside the United States for the first time.
- The plan called for Target to enter Canada by purchasing existing leases from a Canadian retailer and then opening 100 to 150 stores in 2013 and 2014 (Target, 2011).
- The chain already included more than 1,700 stores in forty-nine states.
- Given the close physical and cultural ties between the United States and Canada, entering the Canadian market was a logical move for

- In addition to making its initial move beyond the United States, Target had several other sources of pride.

- The company claimed that 96% of American consumers recognized its signature logo, surpassing the percentages enjoyed by famous brands such as Apple and Nike.

- In 2020, Fortune magazine ranked Target twenty-second on its list of the “World’s Most Admired Companies.”

- But not all had been well with Target (Fortune, 2020). They pulled out of Canada in 2015 after just two years and $2 billion in losses. Concern also surrounded Target’s possible vulnerability to competition within the retail industry (Peterson, 2015).

- Since its creation in the early 1960s, Target executives had carved out a lucrative position for the firm. Target offers relatively low prices on brand name consumer staples such as cleaning supplies and paper products, but it also offers chic clothing and household goods.

- This unique combination helps Target to appeal to fairly affluent customers. Perhaps the most tangible reflection of Target’s upscale position among large retailers is the tendency of some customers to jokingly pronounce its name as if it were a French boutique: “Tar-zhay.”

- Target’s lucrative position was far from guaranteed, however. Indeed, a variety of competitors seemed to be taking aim at Target.

- Retail chains such as Kohl’s and Old Navy offered fashionable clothing at prices similar to Target’s.

- Discounters like T.J. Maxx, Marshalls, and Ross offered designer clothing and chic household goods for prices that often were lower than Target’s.

- Closeout stores such as Big Lots offered a limited selection of electronics, apparel, and household goods but at deeply discounted prices.

- All these stores threatened to steal business from Target.

- Walmart was perhaps Target's most worrisome competitor.

- After some struggles in the 2000s, the mammoth retailer's performance was strong enough that it ranked consistently above Target on Fortune's list of the "World's Most Admired Companies" (eighteenth vs. twenty-second in 2020). Walmart also was much bigger than Target.

- The resulting economies of scale meant that Walmart could undercut Target's prices anytime it desired. Just such a scenario had unfolded before.

- A few years ago, Walmart's victory in a price war over Kmart led the latter into bankruptcy

- One important difference between Kmart and Target is that Target is viewed by consumers as offering relatively high-quality goods. But this difference might not protect Target.

- Although Walmart's products tended to lack the chic appeal of Target's, Walmart had begun offering better products during the recession of the late 2000s in an effort to expand its customer base.

- If Walmart executives chose to match Target's quality while charging lower prices, Target could find itself without a unique appeal for customers.

- As 2020 continued, a big question loomed: could Target maintain its unique appeal to customers or would the competitive arrows launched by Walmart and others force Target's executives to quiver?

Understanding Business-Level Strategy through "Generic Strategies"

- Why Examine Generic Strategies?
- Business-level strategy addresses the question of how a firm will compete in a particular industry.

- This seems to be a simple question on the surface, but it is actually quite complex. The reason is that there are a great many possible answers to the question. Consider, for example, the restaurants in your town or city.

- Restaurants compete using a business model that is at least somewhat unique. When an executive in the restaurant industry analyzes her company and her rivals, she needs to avoid getting distracted by all the nuances of different firm's business-level strategies and losing sight of the big picture.

- The solution is to think about business-level strategy in terms of generic strategies.

- A generic business level strategy is a general way of positioning a firm within an industry.

- Focusing on generic strategies allows executives to concentrate on the core elements of firms’ business-level strategies.

- The most popular set of generic strategies is based on the work of Professor Michael Porter of the Harvard Business School and subsequent researchers that have built on Porter’s initial ideas.

- Firms compete on two general dimensions - the source of competitive advantage (cost or differentiation) and the scope of operations (broad or narrow).

- Four possible generic business-level strategies emerge from these decisions.

- An example of each generic business-level strategy from the retail industry is illustrated.

Business-Level Strategies

- Competitive Advantage: Cost

- *Broad Target Market:* Walmart’s cost leadership strategy depends on attracting a large customer base and keeping prices low by buying massive quantities of goods from suppliers.

- *Narrow Target Market:* In using a focused cost leadership, Dollar General does not offer a full array of consumer goods, but those that it does offer are priced to move.

- Competitive Advantage: Differentiation

- *Broad Target Market:*
- Nordstrom builds its differentiation strategy around offering designer merchandise and providing exceptional service.

- *Narrow Target Market:*
- Anthropologie follows a focused differentiation strategy by selling unique (and pricey) women’s apparel, accessories, and home furnishings.

- According to Porter, two competitive dimensions are the keys to business-level strategy.
- The first dimension is a firm's source of competitive advantage. This dimension involves whether a firm tries to gain an edge on rivals by keeping costs down or by offering something unique in the market.
- The second dimension is a firms' scope of operations.
- This dimension involves whether a firm tries to target customers in general or whether it seeks to attract just a narrow segment of customers.
- Four generic business-level strategies emerge from these decisions: (1) broad cost leadership, (2) broad differentiation, (3) focused cost leadership, and (4) focused differentiation.
- In rare cases, firms are able to offer both low prices and unique features that customers find desirable. These firms are following a best-cost strategy. *Firms that are not able to offer low prices or appealing unique features are referred to as "stuck in the middle."*

Understanding the differences that underlie generic strategies is important because different generic strategies offer different value propositions to customers.

A firm focusing on cost leadership will have a different value chain configuration than a firm whose strategy focuses on differentiation.

For example, marketing and sales for a differentiation strategy often requires extensive effort while some firms that follow cost leadership such as Waffle House are successful with limited marketing efforts.

Limitations of Generic Strategies

- Examining business-level strategy in terms of generic strategies has limitations.
- Firms that follow a particular generic strategy tend to share certain features.
- For example, one way that cost leaders generally keep costs low is by not spending much on advertising.
- Not every cost leader, however, follows this path. While cost leaders such as Waffle House spend very little on advertising, Walmart spends considerable money on print and television advertising despite following a cost leadership strategy.
- Thus a firm may not match every characteristic that its generic strategy entails. Indeed, depending on the nature of a firm's industry, tweaking the recipe of a generic strategy may be essential to cooking up success.

- Section Video
- Five Competitive Strategies [02:50]
- The video for this lesson explains the five generic strategies and why some work better in some industries or conditions than others. You can view this video here: https://www.youtube.com/watch?v=xUW6_Nbe8d0&feature=emb_logo

Key Takeaway

- Business-level strategies examine how firms compete in a given industry.

- Firms derive such strategies by executives making decisions about whether their source of competitive advantage is based on price or differentiation and whether their scope of operations targets a broad or narrow market.

Cost Leadership

- Firms that compete based on price and target a broad target market are following a broad cost leadership strategy. Several examples of firms pursuing a broad cost leadership strategy are illustrated.

- Despite its name, Dunkin' Donuts makes more money selling inexpensive coffee than it does from selling donuts. The coffee is often advertised as costing under a dollar, making Dunkin' Donuts a low-priced alternative to Starbucks.

- Supercuts's website makes clear their longstanding cost leadership strategy by noting, "A Supercut is a haircut that has kept people looking their best, while keeping money in their pockets, since 1975."

The Nature of the Cost Leadership Strategy

- It is tempting to think of cost leaders as companies that sell inferior, poor-quality goods and services for rockbottom prices.

- This is not necessarily true, but some companies get this reputation.

- K-Mart, for example, had been a successful discount department store with a cost leadership strategy. As Walmart competed head to head with K-Mart, however, and offered higher quality products at the same or lower prices than its rivals, KMart was doomed. Its reputation for cheap, inferior products and its inability to win a price war with Walmart pushed K-Mart into bankruptcy.

- In contrast to firms such as K-Mart, cost leaders can be very successful.

- A firm following a cost leadership strategy offers products or services with acceptable quality and features to a broad set of customers at a low price.

- Super Shoes, for example, sells name-brand shoes at inexpensive prices

Example

- Perhaps the most famous cost leader is Walmart, which has used a cost leadership strategy to become the largest company in the world.
- The firm's advertising slogans such as "Always Low Prices" and "Save Money. Live Better" communicate Walmart's emphasis on price slashing to potential customers.
- Meanwhile, Walmart has the broadest customer base of any firm in the United States.
- Approximately one hundred million Americans visit a Walmart in a typical week.
- Incredibly, this means that roughly one-third of Americans are frequent Walmart customers. This huge customer base includes people from all demographic and social groups within society.

- Cost leaders tend to share some important characteristics.

- The ability to charge low prices and still make a profit is challenging.

- Cost leaders manage to do so by emphasizing efficiency. At Waffle House restaurants, for example, customers are served cheap eats quickly to keep booths available for later customers.

- As part of the effort to be efficient, most cost leaders spend little on advertising, market research, or research and development.

- Waffle House, for example, limits its advertising to billboards along highways. Meanwhile, the simplicity of Waffle House’s menu requires little research and development.

- Many cost leaders rely on economies of scale to achieve efficiency.

- Economies of scale are created when the costs of offering goods and services decreases as a firm is able to sell more items.

- This occurs because expenses are distributed across a greater number of items.

- Walmart spent approximately $3.5 billion on advertising in 2019 (Guttmann, 2019). This is a huge number, but Walmart is so large that its advertising expenses equal just a tiny fraction of its sales.

- Also, cost leaders are often large companies, which allows them to demand price concessions from their suppliers.

- Walmart is notorious for squeezing suppliers such as Procter & Gamble to sell goods to Walmart for lower and lower prices over time. The firm passes some of these savings to customers in the form of reduced prices in its stores.

- https://www.youtube.com/watch?v=c5_s2v8NZwM

Advantages and Disadvantages of Cost Leadership

- Each generic strategy offers advantages that firms can potentially leverage to enhance their success as well as disadvantages that may undermine their success.

- In the case of cost leadership, one advantage is that cost leaders' emphasis on efficiency makes them well positioned to withstand price competition from rivals.

- Kmart's ill-fated attempt to engage Walmart in a price war ended in disaster, in part because Walmart was so efficient in its operations that it could live with smaller profit margins far more easily than Kmart could.

Executing a Low-Cost Strategy

- ***Low cost, Differentiation and Focus are examples of** Business Strategies*
- Advantages of Low Cost
- High profits can be enjoyed if a cost leader has a high market share.
- An example is Kampgrounds of America, a chain of nearly 500 low cost camping franchises in the United States. Low-cost firms such as many municipal golf courses can withstand price wars because high-priced competitors will not want to compete directly with a more efficient rival.

- Disadvantages

- If perceptions of quality become too low, business will suffer.
- Large volumes of sales are a must because margins are slim.
- The need to keep expenses low might lead cost leaders to be late in detecting key environment trends. Low-cost firms’ emphasis on efficiency makes it difficult for them to change quickly if needed.

- Beyond existing competitors, a cost leadership strategy also creates benefits relative to potential new entrants.

- Specifically, the presence of a cost leader in an industry tends to discourage new firms from entering the business because a new firm would struggle to attract customers by undercutting the cost leaders' prices.

- Thus, a cost leadership strategy helps create barriers to entry that protect the firm - and its existing rivals - from new competition.

- In many settings, cost leaders attract a large market share because a large portion of potential customers find paying low prices for goods and services of acceptable quality to be very appealing.

- This is certainly true for Walmart, for example. The need for efficiency means that cost leaders' profit margins are often slimmer than the margins enjoyed by other firms.

- However, cost leaders' ability to make a little bit of profit from each of a large number of customers means that the total profits of cost leaders can be substantial.

- In some settings, the need for high sales volume is a critical disadvantage of a cost leadership strategy.
- Highly fragmented markets and markets that involve a lot of brand loyalty may not offer much of an opportunity to attract a large segment of customers.
- In both the soft drink and cigarette industries, for example, customers appear to be willing to pay a little extra to enjoy the brand of their choice.
- Lower-end brands of soda and cigarettes appeal to a minority of consumers, but famous brands such as Coca-Cola, Pepsi, Marlboro, and Camel still dominate these markets.
- A related concern is that achieving a high sales volume usually requires significant upfront investments in production and/or distribution capacity.
- Not every firm is willing and able to make such investments.

- Due to the need for cost leaders to have high volumes and slim margins, a focused cost leadership strategy is difficult to achieve.
- By definition, a focused approach is directed at a narrow, niche segment of the market.
- This means lower volumes, therefore contrary to the normal cost leadership strategy.
- An example would be an Hispanic grocery store in Northern Virginia serving the niche market of Hispanics living there, that uses a cost leadership strategy to compete against the other Hispanic grocery stores.

- Cost leaders tend to keep their costs low by minimizing advertising, market research, and research and development, but this approach can prove to be expensive in the long run.
- A relative lack of market research can lead cost leaders to be less skilled than other firms at detecting important environmental changes.
- Meanwhile, downplaying research and development can slow cost leaders’ ability to respond to changes once they are detected.
- Lagging rivals in terms of detecting and reacting to external shifts can prove to be a deadly combination that leaves cost leaders out of touch with the market and out of answers.

- Section Video Low Cost Strategy [03:20]

- The video for this lesson describes the competitive approach of low cost strategy.

- You can view this video here:
- https://www.youtube.com/watch?v=-C0MQzIb7Y4&feature=emb_logo.

Key Takeaway

- Cost leadership is an effective business-level strategy to the extent that a firm offers low prices, provides satisfactory quality, and attracts enough customers to be profitable.

Groups Exercises

1. What are three industries in which a cost leadership strategy would be difficult to implement?

2. What is your favourite cost leadership restaurant? Why?

Differentiation

- Firms that compete on uniqueness and target a broad market are following a differentiation strategy. Several examples of firms pursuing a differentiation strategy are illustrated below.

- FedEx's former slogan "*When it absolutely, positively has to be there overnight*" highlights the commitment to very speedy delivery that differentiates them from competitors such as UPS and the US Postal Service.

- Nike differentiates its athletic shoes through its iconic "swoosh" as well as an intense emphasis on product innovation through research and development. Nike also differentiates their athletic brand through their marketing strategy of highlighting social justice issues regardless of potential public controversy.

- The Walt Disney Company has developed incomparable customer service standards (“the happiest place on earth”) and numerous well-known characters such as Mickey Mouse, the Little Mermaid, and Captain Jack Sparrow that help differentiate their movies, theme parks, and merchandise.

The Nature of the Differentiation Strategy

- A famous cliché contends that *“you get what you pay for.”*
- This saying captures the essence of a differentiation strategy.

- A firm following a differentiation strategy attempts to convince customers to pay a premium price for its goods or services by providing unique and desirable features.

- The message that such a firm conveys to customers is that you will pay a little bit more for our offerings, but you will receive a good value overall because our offerings provide something special.

- In terms of the two competitive dimensions described by Michael Porter, using a differentiation strategy means that a firm is competing based on uniqueness rather than price and is seeking to attract a broad market (Porter, 1980).

- North Face camping equipment offers a good example. If camping equipment such as sleeping bags, lanterns, and stoves fail during a camping trip, the result will be, well, unhappy campers.

- Their sleeping bags, lanterns, and stoves are renowned for their reliability and durability. Cheaper brands are much more likely to have problems.

- Lovers of the outdoors must pay more to purchase their goods than they would to obtain lesser brands, but having equipment that you can count on to keep you warm and dry is worth a price premium in the minds of most campers.

- Successful use of a differentiation strategy depends on not only offering unique features but also communicating the value of these features to potential customers.

- As a result, advertising in general and brand building in particular are important to this strategy.

- FedEx and Nike are two other companies that have done well at communicating to customers that they provide differentiated offerings.

- FedEx's former slogan "When it absolutely, positively has to be there overnight" highlights the commitment to speedy delivery that sets the firm apart from competitors such as UPS and the US Postal Service.

- Nike differentiates its athletic shoes and apparel through its iconic "swoosh" logo as well as an intense emphasis on product innovation through research and development

Advantages and Disadvantages of Differentiation

- Each generic strategy offers advantages that firms can potentially leverage to enjoy strong performance, as well as disadvantages that may damage their performance.
- In the case of differentiation, a key advantage is that effective differentiation creates an ability to obtain premium prices from customers.
- This enables a firm to enjoy strong profit margins. Coca-Cola, for example, currently enjoys a profit margin of approximately 33%, meaning that about 33 cents of every dollar it collects from customers is profit.
- In comparison, Walmart’s cost leadership strategy delivered a margin of under 4% in 2010.

- In turn, strong margins mean that the firm does not need to attract huge numbers of customers to have a good overall level of profit.

- Luckily for Coca-Cola, the firm does attract a great many buyers.

- Overall, the firm made a profit of just under $9.0 billion on sales of just over $37.3 billion in 2019.

- Interestingly, Walmart’s profits were only 2.4 times higher ($22.0 billion) than Coca-Cola’s while its sales volume ($514.4 billion) was 13.8 times higher than Coca-Cola’s (Walmart, 2019; Coca Cola, 2019).

- This comparison of profit margins and overall profit levels illustrates why a differentiation strategy is so attractive to many firms.

- A differentiation strategy offers important advantages and disadvantages for firms that adopt it.

- Below we illustrate a few examples in relation to an often differentiated product - women’s handbags.

- Advantages

- Buyer loyalty is common among handbag buyers. Many individuals enjoy seeing - and being seen with - a designer logo on the products they buy such as the iconic C that is shown on Coach bags.

- Chanel, Burberry, Gucci enjoy strong margins because their well-known name allows them to charge a premium for their handbags.

- Disadvantages
- Less expensive bags from retailers such as Target provide enough of a trendy look to satisfy many price-sensitive buyers.
- These individuals will choose to save their money by avoiding expensive bags from top-end designers.
- Imitations may steal customers, such as is common with knock-off handbags sold by street vendors.

- To the extent that differentiation remains in place over time, buyer loyalty may be created.

- Loyal customers are very desirable because they are not price sensitive.

- In other words, buyer loyalty makes a customer unlikely to switch to another firm's products if that firm tries to steal the customer away through lower prices.

- Many soda drinkers are fiercely loyal to Coca-Cola's products.

- Coca-Cola's headquarters are in Atlanta, and loyalty to the firm is especially strong in Georgia and surrounding states.

- Pepsi and other brands have a hard time convincing loyal Coca-Cola fans to buy their beverages, even when offering deep discounts. This helps keep Coca-Cola's profits high because the firm does not have to match any promotions that its rivals launch to keep its customers.

- Meanwhile, Pepsi also has attracted a large set of brand-loyal customers that Coca-Cola struggles to steal. This enhances Pepsi’s profits.

- In contrast, store-brand sodas such as Sam’s Choice, which is sold at Walmart, or Freeway Cola from Lidl seldom attract loyalty. As a result, they must be offered at very low prices to move from store shelves into shopping carts.

- Beyond existing competitors, a differentiation strategy also creates benefits relative to potential new entrants.

- Specifically, the brand loyalty that customers feel to a differentiated product makes it difficult for a new entrant to lure these customers to adopt its product.

- A new soda brand, for example, would struggle to take customers away from Coca-Cola or Pepsi. Thus, a differentiation strategy helps create barriers to entry that protect the firm and its industry from new competition.

- The big risk when using a differentiation strategy is that customers will not be willing to pay extra to obtain the unique features that a firm is trying to build its strategy around.

- Department store Dillard’s stopped carrying men’s sportswear made by Nautica because the seafaring theme of Nautica’s brand had lost much of its cache among many men.

- Because Nautica’s uniqueness had eroded, Dillard’s believed that space in its stores that Nautica had been occupying could be better allocated to other brands.

- In some cases, customers may simply prefer a cheaper alternative.

- For example, products that imitate the look and feel of offerings from Ray-Ban, Gucci, and Burberry are attractive to many value-conscious consumers.

- Firms such as these must work hard at product development and marketing to ensure that enough customers are willing to pay a premium for their goods rather than settling for ‘knockoffs.’

- In other cases, customers desire the unique features that a firm offers, but competitors are able to imitate the features well enough that they are no longer unique.

- If this happens, customers have no reason to pay a premium for the firm’s offerings.

- Section Video Differentiation Strategy [04:28]

- The video for this lesson discusses differentiation strategies. You can view this video here:
- https://www.youtube.com/watch?v=NshI_qoaf7g&feature=emb_log

Exercise

- Identify a company that is using a differentiated strategy effectively?

- What are it’s Success Factors?

- Example - Qatar Airways

- Customers voted the business class section of Qatar Airways the best in the world because of its Qsuites.
- Walled off rooms create a sense of privacy on a crowded plane.
- Internal separators can be removed to join up to four rooms while belongings go into convenient storage drawers to leave the large seating area clear.

- **What Qatar Airways Offers That Other Airlines Don't**

- Qatar Airlines has all the luxuries and necessities business people desire, and it has a ton to offer that other airlines don't.

- https://www.thetravel.com/what-qatar-airways-offers/#customers-voted-the-experience-1-in-the-world

Key Takeaway

- Differentiation can be an effective business-level strategy to the extent that a firm offers unique features that convince customers to pay a premium for their goods and services.

As with other business-level strategies, there are advantages and disadvantages in pursuing a differentiation strategy.

How To Differentiate Your Brand:

Brand Differentiation Strategies for Business Success

- https://www.youtube.com/watch?v=iTTHzLCeRZU&t=207s

Focused Cost Leadership and Focused Differentiation

- Companies that use a cost leadership strategy and those that use a differentiation strategy share one important characteristic: both groups try to be attractive to customers in general.

- These efforts to appeal to broad markets can be contrasted with strategies that involve targeting a relatively narrow niche of potential customers. These latter strategies are known as focus strategies (Porter, 1980).

The Nature of the Focus Cost Leadership Strategy

- Focused cost leadership is the first of two focus strategies.
- A focused cost leadership strategy requires competing based on price to target a narrow market.
- A firm that follows this strategy does not necessarily charge the lowest prices in the industry.
- Instead, it charges low prices relative to other firms that compete within the target market.

- Firms that compete based on price and target a narrow market are following a focused cost leadership strategy.

- Several examples of firms pursuing a focused cost leadership strategy are illustrated

Examples

- Pursuing a Focused Cost Leadership Strategy Redbox rents DVDs and video games through vending machines for only $1.

- Papa Murphy's targets its inexpensive take-and-bake pizzas at value-conscious families. Because the pizzas are baked at home rather than in the store, Papa Murphy's is permitted to accept food stamps. This allows the firm to attract customers that might not otherwise be able to afford a restaurant-quality pizza.

- Providing indoor seating creates expenses for fast food restaurants. Checkers Drive In keeps its costs low by not offering indoor seating. Checkers targets drive-thru customers and offers them big burgers at rock-bottom prices.

Advantages and Disadvantages of the Focused Strategies

- Each generic strategy offers advantages that firms can potentially leverage to enhance their success as well as disadvantages that may undermine their success.
- In the case of focus differentiation, one advantage is that very high prices can be charged. Indeed, these firms often price their wares far above what is charged by firms following a differentiation strategy.
- Recreational Equipment Inc. (REI), for example, commands a hefty premium for its outdoor sporting goods and clothes that feature name brands, such as The North Face and Marmot.
- Nat Nast's focused differentiation strategy centers on selling men's silk camp shirts with a 1950s retro flair. These shirts retail for more than $100. Focused cost leaders such as Checkers Drive In do not charge high prices like REI and Nat Nast do, but their low cost structures enable them to enjoy healthy profit margins.

- A second advantage of using a focus strategy is that firms often develop tremendous expertise about the goods and services that they offer.

- In markets such as camping equipment where product knowledge is important, rivals and new entrants may find it difficult to compete with firms following a focus strategy.

- Disadvantages

- Limited demands exist for specialized goods and services, so every potential sale counts.

- The area of focus may be taken over by others or even disappear over time. Many gun stores went out of business after large retailers such as Walmart started carrying an array of firearms.

- Other firms may provide an even narrower focus. An outdoor sporting goods store, for example, might lose business to a store that focuses solely on ski apparel because the latter can provide more guidance about how skiers can stay warm and avoid broken bones.

- Section Video

- Focused Strategy [03:47] The video for this lesson explains that focused strategies concentrate on a narrow segment of the total market. You can view this video here: https://www.youtube.com/watch?v=cSMD6MoNeBo&feature=emb_logo.

Key Takeaway

- Focus strategies can be effective business-level strategies to the extent that a firm can match their goods and services to specific niche markets.

- As with the other business-level strategies, there are advantages and disadvantages to focus strategies.

Case Study

- Airbnb

- Does this company follow a focused, niche oriented strategy?

- How?

- **Airbnb, Sustainable Competitive Advantage — Business Strategy and The Key Success Factors**

- In 2008, three recent college graduates Chesky, Gebbia, and Blecharczyk, started a website called Airbed & Breakfast(which became Airbnb) to allow people to rent out part of their homes to travelers — An alternate for expensive hotels. The idea itself was not new, and the market already had similar websites — *HomeAway.com, VRBO.com, Couchsurfing.com, BedandBreakfast.com, and Craiglist.*

- Though Airbnb was a late entrant, it began to climb up the ladder quickly.

- By 2016, within eight years, the valuation of Airbnb reached $30 billion whereas, HomeAway was at $4 billion.

- The new company had 140 million guest arrivals in that year. It was phenomenal growth.

- What were the reasons behind Airbnb growth?

- How did the brand build its sustainable competitive advantage?

- **Finding a Niche Market**
- The general rule is to start small.
- Focus on a particular need, work on it, make your product distinctive, and dominate the niche market.
- Narrower the segment, it is easier for the entire company to focus and meet the customer's needs, wants, and desires.
- Once you become a leader in the niche market, you could grow your market.

Niche - The Millenials

- Chesky and Gebbia, being millennials themselves, had sound knowledge of the target customer's needs, pains, and desires. *A critical factor for succeeding in business is to have a thorough understanding of the proposed customer segment.*

- Millennials wanted a greater sense of adventure at an affordable cost. Most of them were comfortable with venturing into the home of someone they'd connected with online. It's not the same for other segments.

- An Airbnb report says that most millennials would prioritize travel over buying a home or paying off debt.

- Millennials are also called Digital Natives as they grew up interacting with the virtual world. They would be the ideal segment for a web platform like Airbnb.

- Airbnb also focused on another niche - They targeted hosts from cities instead of vacation destinations in resort areas. *The company was so focused on its niche, unlike its competitors.*

VALUE PROPOSITIONS

- To identify value propositions, we need to think from a customer's shoes
- What do they need? What do they desire?

- Affordability — Airbnb's target customer segment was millennials. The one critical thing they needed most is the affordability of the stay— *Airbnb's sharing economy has given them several options on a budget to escape the pricey hotel rooms.*

- Experience — Another thing that attracted millennials were the adventurous experience — Rather than staying in traditional tourist zones, a person, could stay in people's home in neighborhoods. They could gain a localized, authentic experience at an affordable cost. *The Millenials loved it.*

- So, Airbnb's initial value proposition was Authentic Local Experience for much less than the cost of a hotel. That has become their category of differentiation.

The real story about how Airbnb was founded - Nathan Blecharczyk Co-founder Airbnb – Startup Success

- https://www.youtube.com/watch?v=M6GBqqk2mY4

Best-Cost Strategy

- Firms that charge relatively low prices and offer substantial differentiation are following a best-cost strategy.

- This strategy is difficult to execute, but it is also potentially very rewarding. Several examples of firms pursuing a bestcost strategy are illustrated

- Examples of Firms Pursuing a Best-Cost Strategy

- Southwest Airlines provides low cost flights to vacation destinations such as San Antonio, San Diego, and Orlando. While many airlines make passengers feel like cattle loaded onto a truck, Southwest creates fun by, for example, getting children excited about visiting Sea World when they see this custom Shamu plane design.

- Target offers extremely competitive prices, but the firm also differentiates itself from other discount retailers by carrying products from trendy designers such as Michael Graves, Isaac Mizrahi, Fiorruci, and Universal Thread.

The Challenge of Following a Best-Cost Strategy

- Some executives are not content to have their firms compete based on offering low prices or unique features.
- They want it all!
- Firms that charge relatively low prices and offer substantial differentiation are following a best-cost strategy.
- This strategy is difficult to execute in part because creating unique features and communicating to customers why these features are useful generally raises a firm's costs of doing business. Product development and advertising can both be quite expensive. However, firms that manage to implement an effective best-cost strategy are often very successful.

- Target appears to be following a best-cost strategy.

- The firm charges prices that are relatively low among retailers while at the same time attracting trend-conscious consumers by carrying products from famous designers, such as Michael Graves, Isaac Mizrahi, Fiorucci, Universal Thread, and others.
- This is a lucrative position for Target, but the position is under attack from all sides.
- Cost leader Walmart charges lower prices than Target. This makes Walmart a constant threat to steal the thriftiest of Target's customers.
- Focus differentiators such as Anthropologie that specialize in trendy clothing and home furnishings can take business from Target in those areas.

- Many firms would like to use a best cost strategy but struggle to meet the strategy’s dual requirements of charging low prices and providing differentiation features.
- One way to help make the best cost strategy a reality is to use a business model that slashes fixed costs.
- Amazon.com, for example, can charge low prices in part because it does not have to absorb the overhead involved in operating stores.
- Similarly, some talented chefs are pursuing a best cost strategy by operating food trucks and thereby avoiding the overhead required to run a restaurant such as rent and utilities. Several examples are illustrated

A best cost strategy offers advantages and disadvantages.

- Advantages
- Best cost can attract both the cost-conscientious buyer and one looking for better quality.
- Best cost can also result in the best value for the buyer.
- Disadvantages
- Trying to achieve best cost can result in not having low enough prices to attract the cost-conscious buyer.
- Neither achieving a low enough price nor sufficient differentiation can result in accomplishing neither, and getting "stuck in the middle".

Section Video Best-Cost Provider Strategy [03:29]

- The video for this lesson discusses companies that use best-cost strategies.
- You can view this video here: https://www.youtube.com/watch?v=zOaMXfFHzwQ&feature=emb_logo.

Group Exercise

What is an example of an industry in which you think a best-cost strategy could be successful?

Stuck in the Middle

- *A firm is said to be stuck in the middle if it does not offer features that are unique enough to convince customers to buy its offerings and its prices are too high to effectively compete based on price.*

- *Firms that are stuck in the middle generally perform poorly because they lack a clear market or competitive pricing*.

- Several examples of such firms are illustrated

- Examples of Firms that are Stuck in the Middle

- Arby's signature roast beef sandwiches are neither cheaper than other fast food nor are they standouts in taste.

- Sears and their famous catalog once dominated US retailing, but the failure to cultivate customers among newer generations and prices that are higher than those of rivals have severely wounded the company. Sears filed for bankruptcy in 2018.

- Electronics retailer Circuit City found itself squeezed by the superior service offered by rival Best Buy and the cheaper prices charged on electronics by Walmart and Target. Headquartered in Richmond, Virginia, the firm went bankrupt in 2009 after sixty years in business.

Doing Everything Means Doing Nothing Well

- Michael Porter has noted that strategy is as much about executives deciding what a firm is not going to do as it is about deciding what the firm is going to do (Porter, 1996).

- In other words, a firm's business-level strategy should not involve trying to serve the varied needs of different segments of customers in an industry. No firm could possibly pull this off.

Getting Outmaneuvered by Competitors

- In many cases, firms become stuck in the middle not because executives fail to arrive at a well-defined strategy but because firms are simply outmaneuvered by their rivals.
- IBM’s personal computer business offers an example. IBM tried to position its personal computers via a differentiation strategy.
- In particular, IBM’s personal computers were offered at high prices, and the firm promised to offer excellent service to customers in return.
- Unfortunately for IBM, rivals such as Dell were able to provide equal levels of service while selling computers at lower prices.
- Nothing made IBM’s computers stand out from the crowd, and the firm eventually exited the business.

- At its peak in the mid-2000’s, Blockbuster operated approximately 9,000 video rental stores.

- By 2010, the firm filed for bankruptcy. This rapid demise can be traced to the firm becoming outmaneuvered by Netflix.

- When Netflix began offering inexpensive DVD rentals through the mail, customers defected in droves from Blockbuster and other video rental stores such as Movie Gallery.

- Netflix customers were delighted by the firm’s low prices, vast selection, the convenience of not having to visit a store to select and return videos, and were among the first to transition to streaming movies.

- The low price strategy of RedBox also hurt the firm.

- Blockbuster was stuck in the middle - its prices were higher than those of Redbox and Netflix, and Netflix’s service was superior. Once individuals lacked a compelling reason to be Blockbuster customers, the firm’s fate was sealed.

Key Takeaway

- When executing a business-level strategy, a firm must not become stuck in the middle between viable generic business-level strategies by neither offering unique features nor competitive pricing.

Groups Exercise

- Each group should select a different industry.
- Find examples of each generic business-level strategy for your industry.
- Discuss which strategy seems to be the most successful in your selected industry.

Conclusion

- This session explained generic business-level strategies that executives select to keep their firms competitive.
- Executives must select their firm’s source of competitive advantage by choosing to compete based on low-cost versus more expensive features that differentiate their firm from competitors.
- In addition, targeting either a narrow or broad market helps firms further understand their customer base.
- Based on these choices, firms will follow broad cost leadership, broad differentiation, focused cost leadership, or focused differentiation strategies.
- Another potentially viable business strategy, best cost, exists when firms offer relatively low prices while still managing to differentiate their goods or services on some important value-added aspects.
- All firms pursuing a best cost strategy can fall victim to being “stuck in the middle” by not offering unique features or competitive prices.