

Week 4: Chapter 4

Business-level Strategy

BUSINESS-LEVEL STRATEGY: HOW TO COMPETE IN A SPECIFIC INDUSTRY

Definition: Business level strategy is an integrated and coordinated set of commitments and actions that an organisation uses to gain a competitive advantage by exploiting core competencies in specific product markets

- it constitutes how a firm will compete
- Every business organisation must form and use a business-level strategy for each one of its businesses to be competitive.
- Business-level strategy choices matter because long-term performance is linked to a firm's strategies

An organisation must ask whether their competitive advantage strategy is going to be based on:

- 1. Price or Differentiation
- 2. Scope of operation (broad market or narrow market)

WHEN STRATEGIC COMPETITIVENESS AND ABOVE-AVERAGE RETURNS OCCUR

ONE BUSINESS-LEVEL STRATEGY

A single-product market/single geographic location firm employs one business-level strategy and one corporate-level strategy to identify what industry the firm will compete in.

SEVERAL BUSINESS- LEVEL STRATEGIES

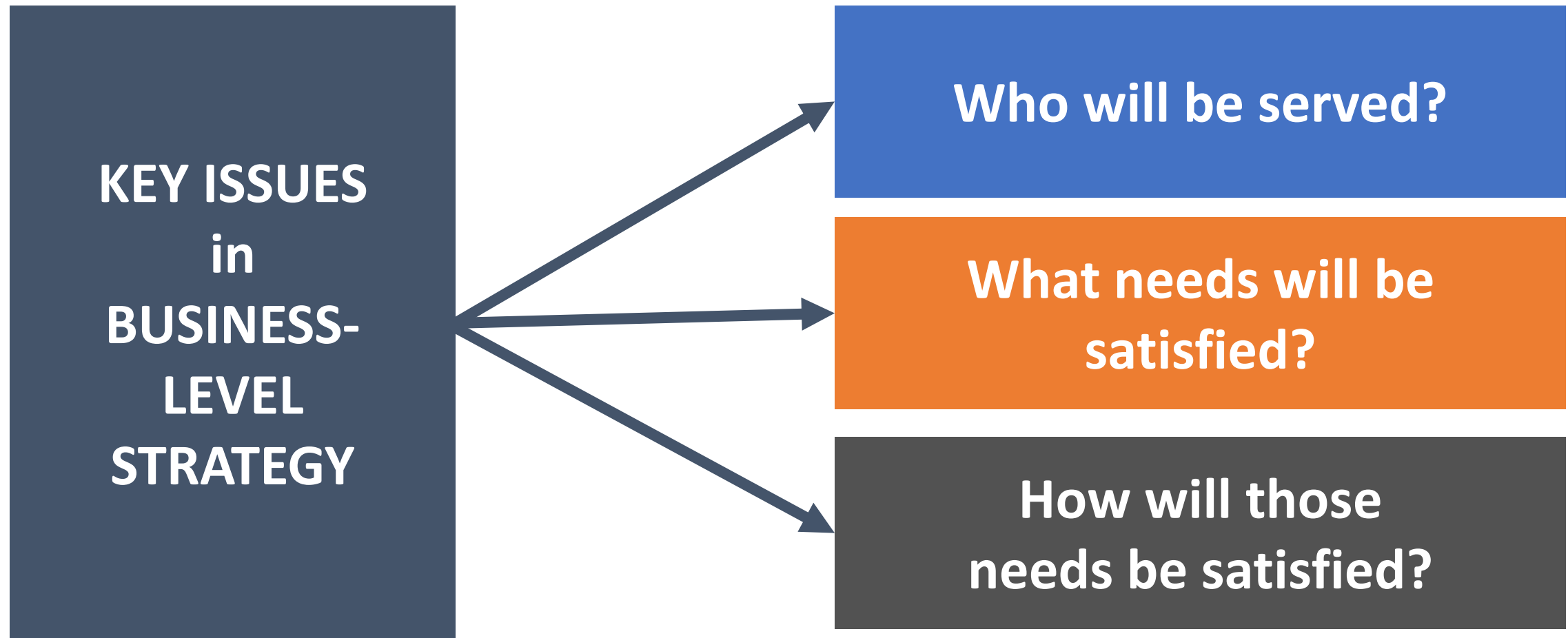
A diversified firm employs a separate business-level strategy for each product market area in which it competes and one or more corporate-level strategies dealing with product and/or geographic diversity.

CORE COMPETENCIES AND STRATEGY

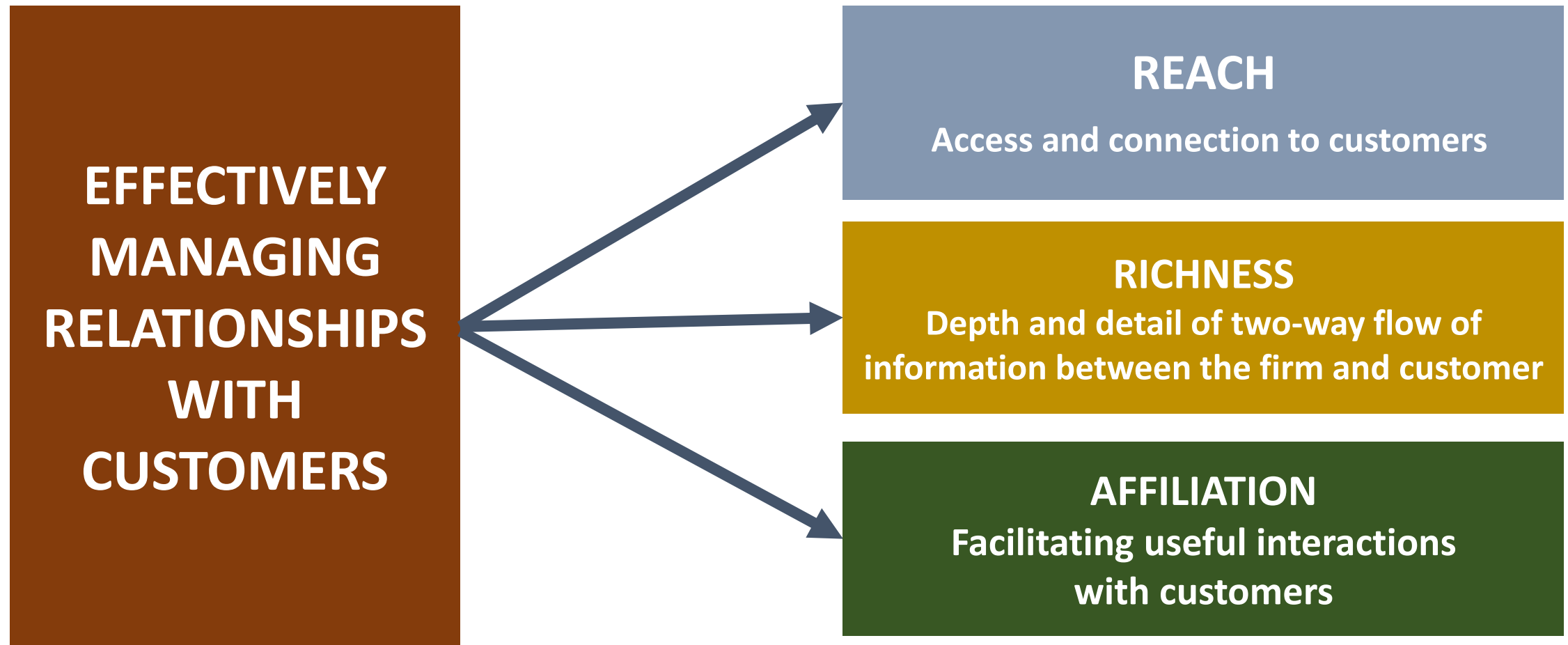


- Resources and superior capabilities that are sources of competitive advantage over a firm's rivals
- An integrated and coordinated set of actions taken to exploit core competencies and gain competitive advantage
- Providing value to customers and gaining competitive advantage by exploiting core competencies in individual product markets

CUSTOMERS: THEIR RELATIONSHIP TO BUSINESS-LEVEL STRATEGIES



CUSTOMERS: THEIR RELATIONSHIP TO BUSINESS-LEVEL STRATEGIES



WHO? DETERMINING THE CUSTOMERS TO SERVE

- **MARKET SEGMENTATION**

A process used to cluster people with similar needs into individual and identifiable groups

Market Group 1 i.e.:
CONSUMER MARKETS

Market Group 2 i.e.:
INDUSTRIAL MARKETS

Table 4.1 Basis for customer segmentation

Consumer markets	<ol style="list-style-type: none">1 Demographic factors (age, income, sex, etc.)2 Socioeconomic factors (social class and stage in the family life cycle)3 Geographic factors (cultural, regional and national differences)4 Psychological factors (lifestyle and personality traits)5 Consumption patterns (heavy, moderate and light users)6 Perceptual factors (benefit segmentation and perceptual mapping)
Industrial markets	<ol style="list-style-type: none">1 End-use segments2 Product segments (based on technological differences or production economics)3 Geographic segments (defined by boundaries between countries or by regional differences within them)4 Common buying factor segments (cut across product market and geographic segments)5 Customer size segments

Source: Based on information in S. C. Jain, 2009, *Marketing Planning and Strategy*, Mason, OH: South-Western-Cengage Custom Publishing.

WHAT? DETERMINING WHICH CUSTOMER NEEDS TO SATISFY

**CUSTOMERS
ARE THE
LIFEBLOOD OF
A FIRM**

- Customer needs are related to a product's benefits and features.
- Customer needs represent desires in terms of features and performance capabilities.
- Successful firms learn how to deliver to customers what they want and when they want it.

HOW? DETERMINING CORE COMPETENCIES NECESSARY TO SATISFY CUSTOMER NEEDS

- Firms use core competencies to implement value-creating strategies that satisfy customers' needs.
- Value means goods or services that provide either low cost with acceptable features or highly differentiated features with acceptable costs.
- Only firms with the capacity to continuously improve, innovate and upgrade their competencies can expect to meet and/or exceed customer expectations over time.

THE PURPOSE OF A BUSINESS-LEVEL STRATEGY

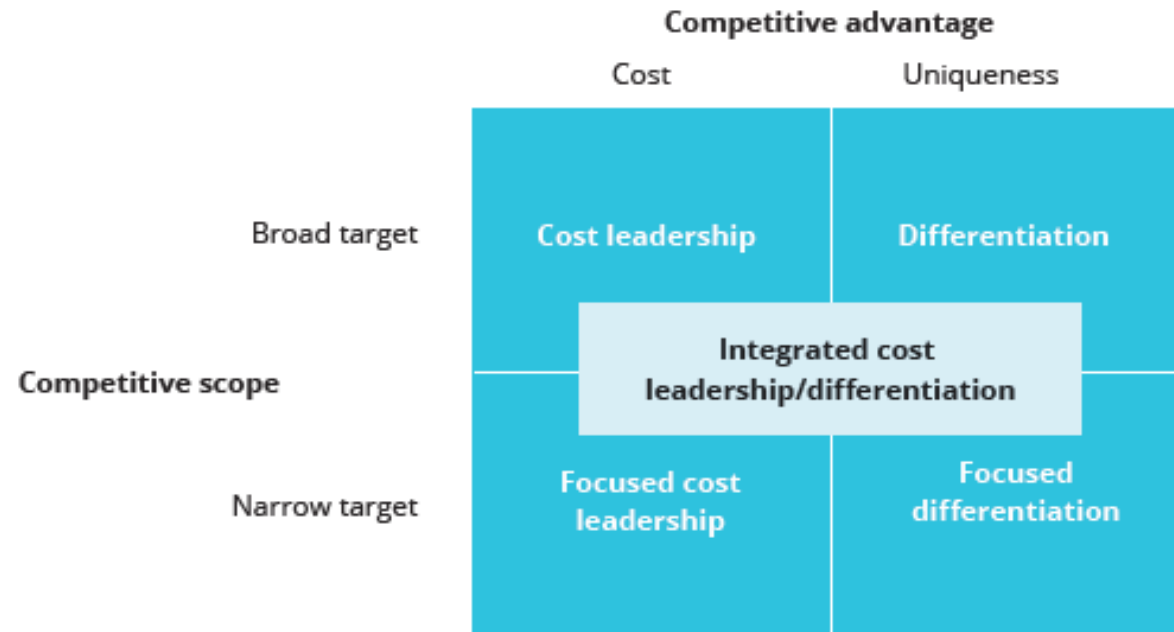
- Business-level strategies are intended to **create differences** between a firm's position relative to those of its rivals.



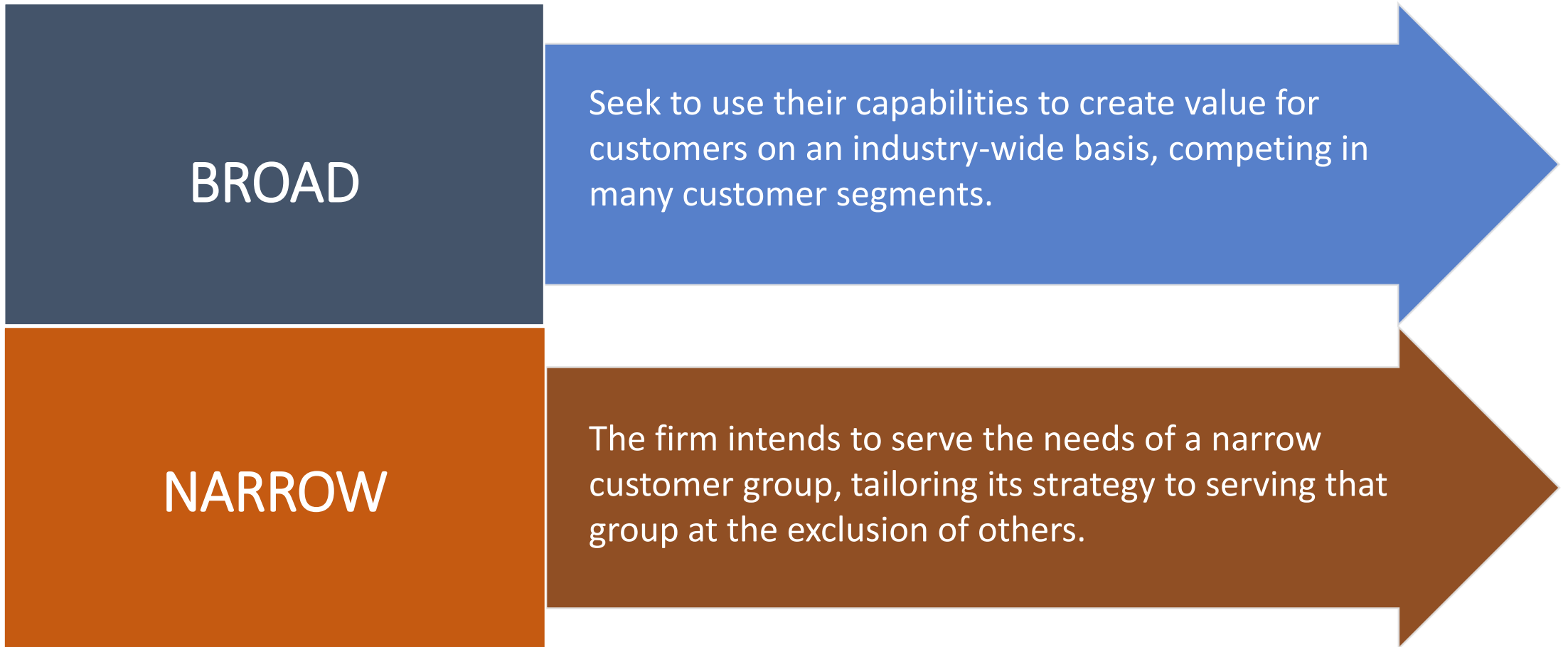
SOURCES OF COMPETITIVE ADVANTAGE

- Achieving lower overall costs than rivals
- Performing activities differently (reducing process costs)
- Providing a low-cost product that customers deem acceptable
- Possessing the capability to differentiate the firm's product or service and command a premium price
- Performing more highly valued activities

Figure 4.1 Five business-level strategies



TARGET MARKETS



THE EFFECTIVENESS OF THE BUSINESS-LEVEL STRATEGY

- None of the five business-level strategies is inherently or universally superior to the others.
- The effectiveness of each strategy is contingent upon external opportunities and threats and internal strengths and weaknesses.
- Need to match **external opportunities and threats with internal strengths** (i.e. its core competencies).

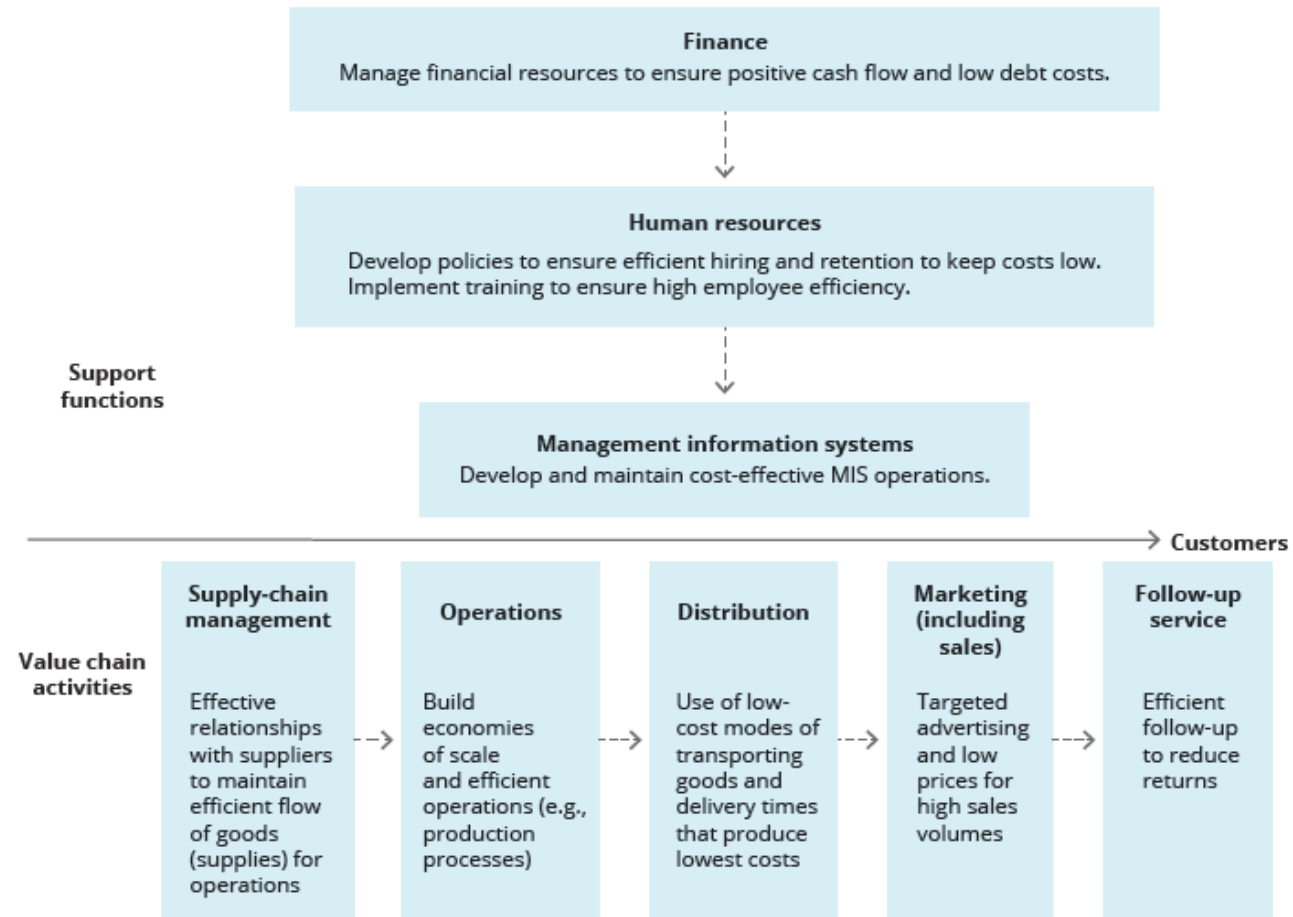
COST LEADERSHIP STRATEGY

- An integrated set of actions taken to produce goods or services with features that are **acceptable to customers at the lowest cost**, relative to that of competitors with features that are acceptable to customers.
- Products:
 - are relatively standardised
 - have features acceptable to many customers
 - offer the lowest competitive price.

COST LEADERSHIP STRATEGY: VALUE CHAIN ACTIVITIES

- Value chain analysis identifies the parts of a firm's operations that create value and those that do not.
- A competitive advantage in logistics creates more value for a cost leadership strategy than for a differentiation strategy.
 - Inbound logistics (materials handling, warehousing and inventory control)
 - Outbound logistics (collecting, storing and distribution)

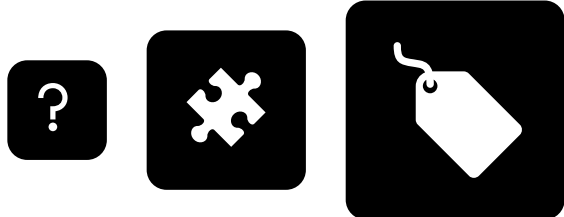
Figure 4.2 Examples of value-creating activities associated with the cost leadership strategy



Sources: Based on M. E. Porter, 1998, *Competitive Advantage: Creating and Sustaining Superior Performance*, New York: The Free Press; D. G. Sirmon, M. A. Hitt & R. D. Ireland, 2007, Managing firm resources in dynamic environments to create value: Looking inside the black box, *Academy of Management Review*, 32: 273–92; J. B. Barney, D. J. Ketchen, Jr, M. Wright, D. G. Sirmon, M. A. Hitt, R. D. Ireland & B. A. Gilbert, 2011, Resource orchestration to create competitive advantage: Breadth, depth and life cycle effects, *Journal of Management*, 37(5): 1390–412.

VALUE-CREATING ACTIVITIES FOR COST LEADERSHIP

■ RECONFIGURE THE VALUE CHAIN FOR COST ADVANTAGE

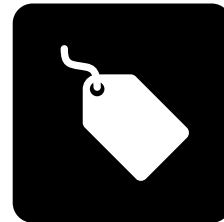
- Cost-effective MIS
 - Few management layers
 - Simplified planning
 - Monitor suppliers' performances
 - Link suppliers' products to production processes
 - Economies of scale
 - Consistent policies
 - Effective training
 - Easy-to-use manufacturing technologies
 - Investments in technologies
 - Finding low-cost raw materials
 - Efficient-scale facilities
 - Effective delivery schedules
 - Low-cost transportation
 - Highly trained sales force
 - Proper pricing
- 

VALUE-CREATING ACTIVITIES FOR COST LEADERSHIP

▪ RECONFIGURE THE VALUE CHAIN FOR COST ADVANTAGE

- Alter production process
- Change in automation
- New raw material

- New distribution channel
- New advertising media



- Forward integration
- Backward integration

- Direct sales in place of indirect sales
- Change location relative to suppliers or buyers

COST LEADERSHIP STRATEGY: COMPETITORS

RIVALRY WITH EXISTING COMPETITORS



Due to the cost leader's advantageous position:

- rivals hesitate to compete on basis of price
- a lack of price competition leads to greater profits
- rivalry may be based on factors such as size, resources, location, market dependence and prior competitive interactions.

COST LEADERSHIP STRATEGY: BUYERS (CUSTOMERS)

BARGAINING POWER OF BUYERS



- The cost leadership strategy can mitigate buyers' power by driving prices far below competitors', causing them to exit and shifting power away from buyers back to the firm.
- Powerful customers can force a cost leader to reduce its prices, but not below the level where the next most-efficient industry competitor can earn average returns.

COST LEADERSHIP STRATEGY: SUPPLIERS

BARGAINING POWER OF SUPPLIERS



- The cost leadership strategy can mitigate suppliers' power by:
 - being able to absorb cost increases due to low-cost position
 - being able to make very large purchases, reducing the chance of the supplier using power
 - outsourcing to reduce costs may also require relationship-building, particularly to a foreign supplier.

COST LEADERSHIP STRATEGY: NEW ENTRANTS

THREAT OF POTENTIAL ENTRANTS



Barriers to potential entrants include:

- their need to enter on a large scale in order to be cost competitive
- the time it takes to move up the learning curve
- the cost leader's efficiency through continuous efforts to reduce costs enhances profit margins.

COST LEADERSHIP STRATEGY: SUBSTITUTES

PRODUCT SUBSTITUTES



The cost leader is well positioned to:

- make investments to be the first to create substitutes
- buy patents developed by potential substitutes
- reduce prices in order to maintain value position
- be more flexible than its differentiated competitors.

COST LEADERSHIP STRATEGY: COMPETITIVE RISKS

- **Obsolescence** – Processes used to produce and distribute goods and services may become obsolete because of competitors' innovations.
- **Cost reductions** – Too much focus on cost reductions may occur at expense of customers' perceptions of differentiation.
- **Imitation** – Competitors, using their own core competencies, may successfully imitate the cost leader's strategy.

DIFFERENTIATION STRATEGY

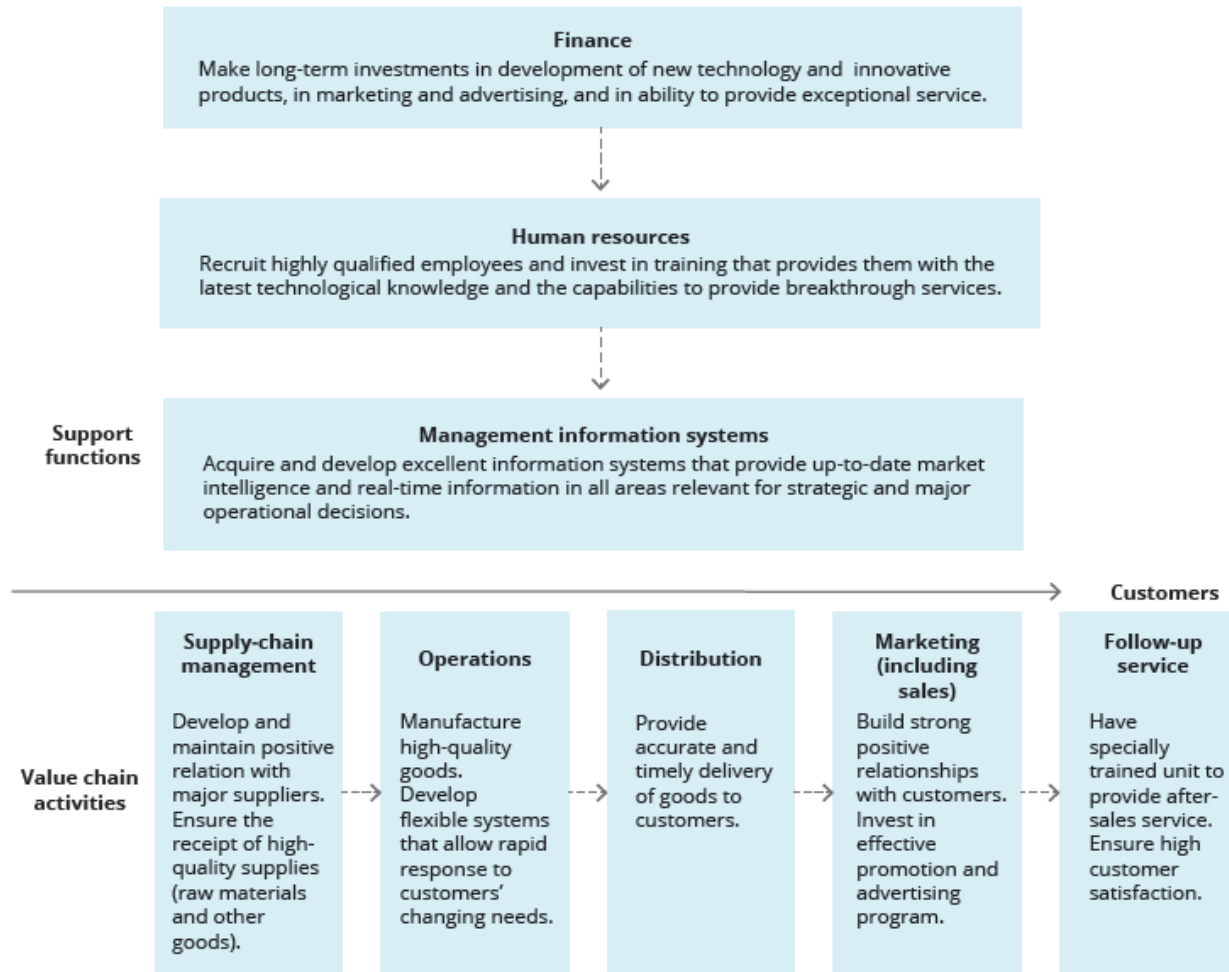
Definition: An integrated set of actions taken to produce goods or services (at an acceptable cost) **that customers perceive as being different** in ways that are important to them

- Focus is on non-standardised products.
- It is an appropriate strategy when customers value differentiated features more than they value low cost.
- Firms must still be able to produce differentiated products at competitive costs to reduce upward pressure on the price that customers pay.

DIFFERENTIATION STRATEGY: DISTINCTIVE ACTIONS

- Firms seek to be different from competitors on as many dimensions as possible.
- Differentiation approaches
 - Unusual features
 - Responsive customer service
 - Rapid product innovations
 - Technological leadership
 - Perceived prestige and status
 - Different tastes
 - Engineering design and performance

Figure 4.3 Examples of value-creating activities associated with the differentiation strategy



Source: Based on M. E. Porter, 1998, *Competitive Advantage: Creating and Sustaining Superior Performance*, New York: The Free Press; D. G. Sirmon, M. A. Hitt & R. D. Ireland, 2007, Managing firm resources in dynamic environments to create value: Looking inside the black box, *Academy of Management Review*, 32: 273-92; J. B. Barney, D. J. Ketchen, Jr, M. Wright, D. G. Sirmon, M. A. Hitt, R. D. Ireland & B. A. Gilbert, 2011, Resource orchestration to create competitive advantage: Breadth, depth and life cycle effects, *Journal of Management*, 37(5): 1390-412.

VALUE-CREATING ACTIVITIES FOR DIFFERENTIATION

■ RECONFIGURE THE VALUE CHAIN FOR DISTINCTIVENESS

- Highly developed MIS
- Emphasis on quality
- Worker rewards for creativity and productivity
- High-quality replacement parts
- Superior handling of incoming raw materials
- Use of subjective performance measures
- Basic research capability
- Attractive products
- Rapid response to customer specifications
- Technology
- High-quality raw materials
- Delivery of products
- Order-processing procedures
- Customer credit
- Personal relationships



DIFFERENTIATION STRATEGY: DISTINCTIVE ACTIONS

- Whereas cost leadership targets a specific industry, differentiation creates value by distinguishing products and services.
- A firm must consistently upgrade differentiated features that customers value and/or create new valuable features (innovate) without significant cost increases.
- Creating value can promote sustainability through:
 - customer perceptions of distinctiveness
 - customer reluctance to switch to non-distinctive products.

DIFFERENTIATION STRATEGY: COMPETITORS

RIVALRY WITH EXISTING COMPETITORS



- The relationship between brand loyalty and price sensitivity insulates a firm from competitive rivalry.
- Reputation can also sustain the competitive advantage of firms following a differentiation strategy.

DIFFERENTIATION STRATEGY: BUYERS (CUSTOMERS)

BARGAINING POWER OF BUYERS



- The differentiation strategy can mitigate buyers' power because well-differentiated products reduce customer sensitivity to price increases.
- Customers are willing to accept a price increase when a product satisfies their perceived unique needs, so long as they do not think that an acceptable product alternative exists.

DIFFERENTIATION STRATEGY: SUPPLIERS

BARGAINING POWER OF SUPPLIERS



- The differentiation strategy can mitigate suppliers' power by absorbing price increases due to higher margins from high-quality components.
- Alternatively, considering buyers' relative insensitivity to price increases and their brand loyalty, firms may pass along higher supplier prices to the buyer.

DIFFERENTIATION STRATEGY: NEW ENTRANTS

THREAT OF POTENTIAL ENTRANTS



There are substantial barriers to potential entrants

- customer loyalty and the need to overcome the uniqueness of a differentiated product
- the need for new products to surpass proven products
- the need for new products to be at least equal to the performance of proven products, but offered at lower prices.

DIFFERENTIATION STRATEGY: NEW ENTRANTS

PRODUCT SUBSTITUTES



Products must be well positioned relative to substitutes because brand loyalty to a differentiated product tends to reduce:

- customers' testing of new products
- switching brands.

DIFFERENTIATION STRATEGY: COMPETITIVE RISKS

- The price differential between the differentiator's and the cost leader's products becomes too large.
- Value diminished occurs when differentiation ceases to provide value for which customers are willing to pay.
- Experience narrows customers' perceptions of the value of differentiated features.
- Counterfeit goods replicate differentiated features of the firm's products.

FOCUSED STRATEGIES

- Definition: an integrated set of actions taken to produce goods or services that serve the needs of a particular competitive segment.
- Target markets include:
 - a particular buyer group (e.g. youths or senior citizens)
 - different segment of a product line (e.g. products for professional painters or the do-it-yourself group)
 - different geographic market (e.g. northern or southern Italy by using a foreign subsidiary).

FOCUSED STRATEGIES

- Types of focused strategies:
 - Focused cost leadership strategy
 - Focused differentiation strategy
- To implement a focus strategy, firms must be able to:

complete various value chain activities in a competitively superior manner in order to develop and sustain a competitive advantage and earn above-average returns.

FACTORS THAT DRIVE FOCUSED STRATEGIES

- Large firms may overlook small niches.
- A firm may lack the resources needed to compete in the broader market.
- A firm is able to serve a narrow market segment more effectively than its larger industry-wide competitors can.
- Focusing allows the firm to direct its resources to certain value chain activities to build competitive advantage.

FOCUSED COST LEADERSHIP STRATEGY

- A firm focuses on a niche market, adding value by leveraging value chain activities that allow value creation through the cost leadership strategy.
 - Competitive advantage: low cost
 - Competitive scope: narrow industry segment

FOCUS STRATEGIES: COMPETITIVE RISKS

- **Out-focused** – A focusing firm may be out-focused by its competitors.
- **Competition** – A large competitor may decide that the market segment served by the focus strategy firm is attractive and worthy of competitive pursuit.
- **Changing preferences** – Customer preferences in the niche market may change to more closely resemble those of the broader market.

INTEGRATED COST LEADERSHIP/DIFFERENTIATION STRATEGY

- Efficiency: sources of low cost
- Differentiation: source of unique value
- Efficiently produced products with differentiated attributes:
 - readily adapt to external environmental changes
 - concentrate simultaneously on two sources of competitive advantage: cost and differentiation
 - require competence and flexibility in several value chain activities.

INTEGRATED COST LEADERSHIP/ DIFFERENTIATION STRATEGY: RISKS

Stuck in the middle

- Strategy is gaining in popularity, but it is risky
 - Products do not offer sufficient value in terms of either low cost or differentiation
 - Cost structure is not low enough for attractive pricing of products
 - Products are not sufficiently differentiated to create value for target customer
- As a result, firms do not earn above-average returns.