

Business Policy and Strategy

CHAPTER 5

The Five Generic Competitive Strategies

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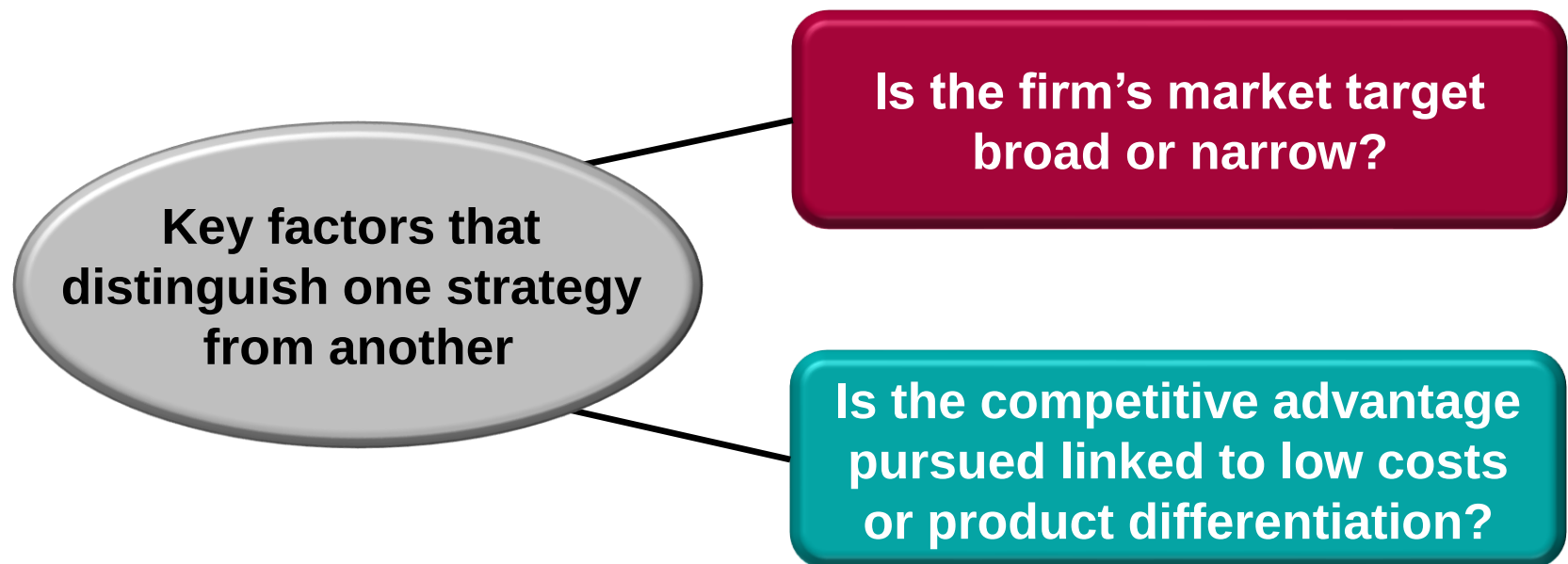
LEARNING OBJECTIVES

THIS CHAPTER WILL HELP YOU UNDERSTAND:

1. What distinguishes each of the five generic strategies and why some of these strategies work better in certain kinds of competitive conditions than in others
2. The major avenues for achieving a competitive advantage based on lower costs
3. The major avenues to a competitive advantage based on differentiating a company's product or service offering from the offerings of rivals
4. The attributes of a best-cost provider strategy—a hybrid of low-cost provider and differentiation strategies

WHY DO STRATEGIES DIFFER?

A firm's competitive strategy deals exclusively with the specifics of its efforts to position itself in the market-place, please customers, ward off competitive threats, and achieve a particular kind of competitive advantage.



[Jump to Appendix 1 long image description](#)

THE FIVE GENERIC COMPETITIVE STRATEGIES

Low-cost provider	Striving to achieve lower overall costs than rivals on products that attract a broad spectrum of buyers
Broad differentiation	Differentiating the firm's product offering from rivals' with attributes that appeal to a broad spectrum of buyers
Focused low-cost	Concentrating on a narrow price-sensitive buyer segment and on costs to offer a lower-priced product
Focused differentiation	Concentrating on a narrow buyer segment by meeting specific tastes and requirements of niche members
Best-cost provider	Giving customers more value for the money by offering upscale product attributes at a lower cost than rivals

CORE CONCEPTS

- ◆ A **low-cost provider's** basis for competitive advantage is lower overall costs than competitors.
- ◆ Successful **low-cost leaders**, who have the lowest industry costs, are exceptionally good at finding ways to drive costs out of their businesses and still provide a product or service that buyers find acceptable.
- ◆ A **cost driver** is a factor that has a strong influence on a firm's costs.

MAJOR AVENUES FOR ACHIEVING A COST ADVANTAGE

◆ Low-cost advantage

- Cumulative costs across the overall value chain must be lower than competitors' cumulative costs.

◆ How to gain a low-cost advantage

- Perform value-chain activities more cost-effectively than rivals
- Revamp the firm's overall value chain to eliminate or bypass cost-producing activities

REVAMPING THE VALUE CHAIN SYSTEM TO LOWER COSTS

- ◆ Selling direct to consumers and bypassing the activities and costs of distributors and dealers by using a direct sales force and a company website
- ◆ Streamlining operations to eliminate low value-added or unnecessary work steps and activities
- ◆ Reduce materials handling and shipping costs by having suppliers locate their plants or warehouses close to the firm's own facilities

THE KEYS TO BEING A SUCCESSFUL LOW-COST PROVIDER

- Spending aggressively on resources and capabilities that promise to drive costs out of the business
- Carefully estimating the cost savings of new technologies before investing in them
- Constantly reviewing cost-saving resources to ensure they remain competitively superior

WHEN A LOW-COST PROVIDER STRATEGY WORKS BEST

1. Price competition among rival sellers is vigorous.
2. Identical products are available from many sellers.
3. There are few ways to differentiate industry products.
4. Most buyers use the product in the same ways.
5. Buyers incur low costs in switching among sellers.

PITFALLS TO AVOID IN PURSUING A LOW-COST PROVIDER STRATEGY

- ◆ Engaging in overly aggressive price cutting that does not result in unit sales gains large enough to recoup forgone profits
- ◆ Relying on a cost advantage that is not sustainable because rival firms can easily copy or overcome it
- ◆ Becoming too fixated on cost reduction such that the firm's offering is too features-poor to gain the interest of buyers
- ◆ Having a rival discover a new lower-cost value chain approach or develop a cost-saving technological breakthrough

STRATEGIC MANAGEMENT PRINCIPLE

Reducing price does not lead to higher total profits unless the added gains in unit sales are large enough to bring in a bigger total profit despite lower margins per unit sold.

STRATEGIC MANAGEMENT PRINCIPLE

A low-cost provider's product offering must always contain enough attributes to be attractive to prospective buyers. Low price, by itself, is not always appealing to buyers.

BROAD DIFFERENTIATION STRATEGIES

◆ Effective Differentiation Approaches

- Carefully study buyer needs and behaviors, values, and willingness to pay for a *unique* product or service
- Incorporate features that both appeal to buyers and create a sustainably distinctive product offering
- Use higher prices to recoup differentiation costs

◆ Advantages of Differentiation

- Command premium prices for the firm's products
- Increased unit sales due to attractive differentiation
- Brand loyalty that bonds buyers to the differentiating features of the firm's products

CORE CONCEPT

Differentiation enhances profitability whenever a company's product can command a sufficiently higher price or produce sufficiently greater unit sales to more than cover the added costs of achieving the differentiation.

CORE CONCEPTS

The essence of a **broad differentiation strategy** is to offer unique product attributes that a wide range of buyers find appealing and worth paying for.

A **uniqueness driver** is a factor that can have a strong differentiating effect.

DELIVERING SUPERIOR VALUE VIA A BROAD DIFFERENTIATION STRATEGY

Broad Differentiation: Offering Customers Something That Rivals Cannot

- | | |
|----|---|
| 1. | Incorporate product attributes and user features that lower the buyer's overall costs of using the firm's product |
| 2. | Incorporate tangible features (e.g., styling) that increase customer satisfaction with the product |
| 3. | Incorporate intangible features (e.g., buyer image) that enhance buyer satisfaction in noneconomic ways |
| 4. | Signal the value of the firm's product offering to buyers (e.g., price, packaging, placement, advertising) |

- ◆ Differentiation can be based on tangible or intangible attributes.
- ◆ Easy-to-copy differentiating features cannot produce a sustainable competitive advantage.
- ◆ Any differentiating feature that works well is a magnet for imitators.
- ◆ Overdifferentiating and overcharging are fatal strategy mistakes.

SUCCESSFUL APPROACHES TO SUSTAINABLE DIFFERENTIATION

- ◆ Differentiation that is difficult for rivals to duplicate or imitate
 - Company reputation
 - Long-standing relationships with buyers
 - A unique product or service image

PITFALLS TO AVOID IN PURSUING A DIFFERENTIATION STRATEGY

- ◆ Relying on product attributes easily copied by rivals
- ◆ Introducing product attributes that do not evoke an enthusiastic buyer response
- ◆ Eroding profitability by overspending on efforts to differentiate the firm's product offering
- ◆ Offering only trivial improvements in quality, service, or performance features vis-à-vis the products of rivals
- ◆ Over-differentiating the product quality, features, or service levels exceeds the needs of most buyers
- ◆ Charging too high a price premium

FOCUSED (OR MARKET NICHE) STRATEGIES



WHEN A FOCUSED LOW-COST OR FOCUSED DIFFERENTIATION STRATEGY IS ATTRACTIVE

- ◆ The target market niche is big enough to be profitable and offers good growth potential.
- ◆ Industry leaders chose not to compete in the niche; focusers avoid competing against strong competitors.
- ◆ It is costly or difficult for multi-segment competitors to meet the specialized needs of niche buyers.
- ◆ The industry has many different niches and segments.
- ◆ Rivals have little or no entry interest in the target segment.

Canada Goose's Focused Differentiation Strategy

- ◆ Targeting upscale buyers and providing an uniquely functional and stylish jacket



Canada Goose's Focused Differentiation Strategy

- ◆ Canada Goose chose to cease production of private-label products as well as non-outerwear products in order to focus on its luxury outerwear market.
- ◆ The company further differentiated its products by maintaining its Canadian production operation and using locally supplied raw material such as down and fur.

THE RISKS OF A FOCUSED LOW-COST OR FOCUSED DIFFERENTIATION STRATEGY

1. Competitors will find ways to match the focused firm's capabilities in serving the target niche.

THE RISKS OF A FOCUSED LOW-COST OR FOCUSED DIFFERENTIATION STRATEGY

Example: Budget Motel Chains

Motel 6, Sleep Inn, Super 8

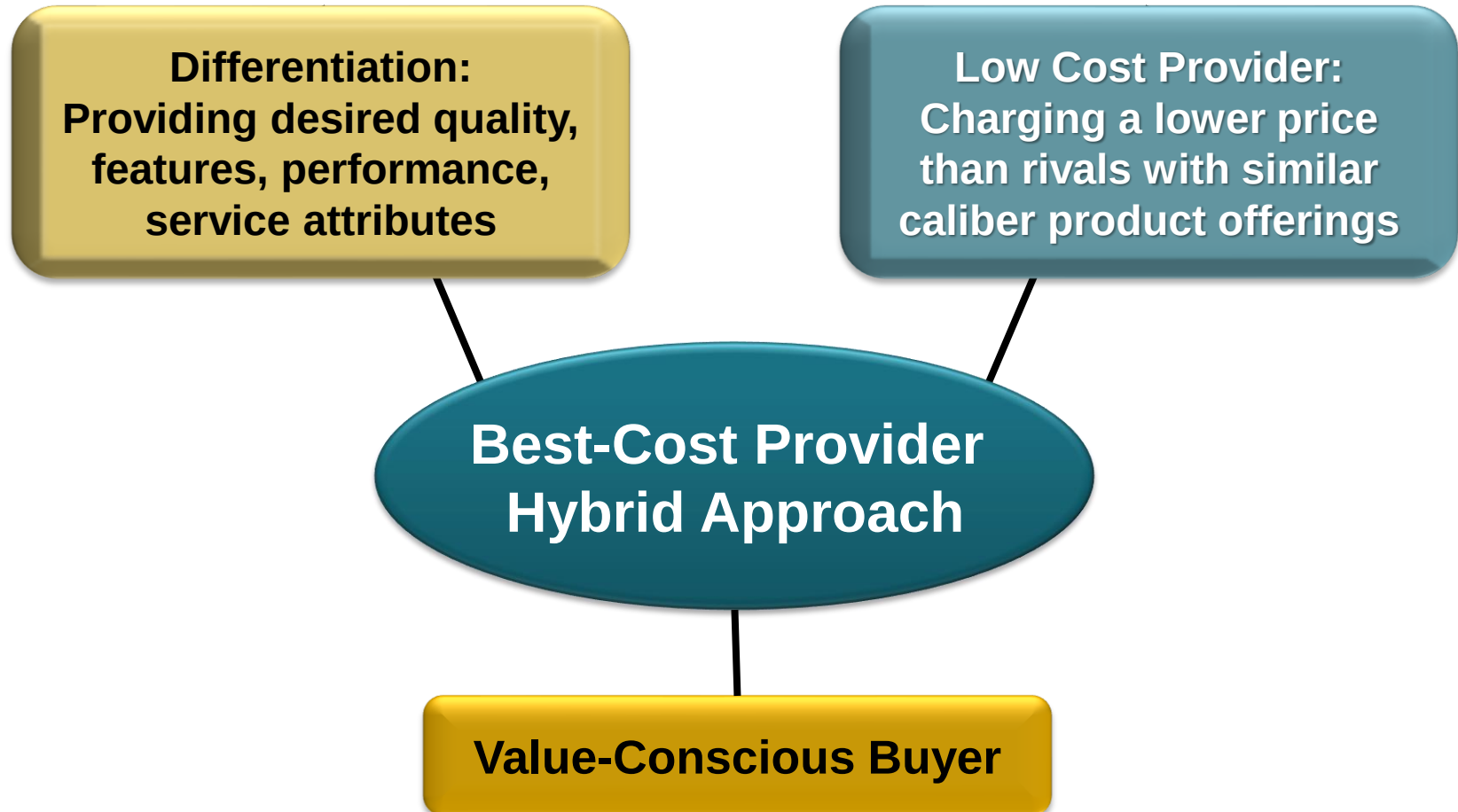
Multibrand strategies: Marriott (Fairfield Inn & Suites)



THE RISKS OF A FOCUSED LOW-COST OR FOCUSED DIFFERENTIATION STRATEGY

2. The specialized preferences and needs of niche members shift over time toward the product attributes desired by the majority of buyers.
3. As attractiveness of the segment increases, it draws in more competitors, intensifying rivalry and splintering segment profits.

BEST-COST PROVIDER STRATEGIES



[Jump to Appendix 7 long image description](#)

CORE CONCEPT (5 of 5)

Best-cost provider strategies are a hybrid of low-cost provider and differentiation strategies that aim at providing more desirable attributes (quality, features, performance, service) while beating rivals on price.

WHEN A BEST-COST PROVIDER STRATEGY WORKS BEST

- ◆ Product differentiation is the market norm.
- ◆ There are a large number of value-conscious buyers who prefer mid-range products.
- ◆ There is competitive space near the middle of the market for a competitor with either a medium-quality product at a below-average price or a high-quality product at an average or slightly higher price.
- ◆ Economic conditions have caused more buyers to become value-conscious.

BEST-COST PROVIDER STRATEGY

Lexus

- ◆ Value-conscious luxury car buyers
- ◆ High-tech upscale-quality
- ◆ Lexus dealers are separate from Toyota dealers
- ◆ Provide exceptional customer service



THE RISK OF A BEST-COST PROVIDER STRATEGY—GETTING SQUEEZED ON BOTH SIDES



THE RISK OF A BEST-COST PROVIDER STRATEGY—GETTING SQUEEZED ON BOTH SIDES

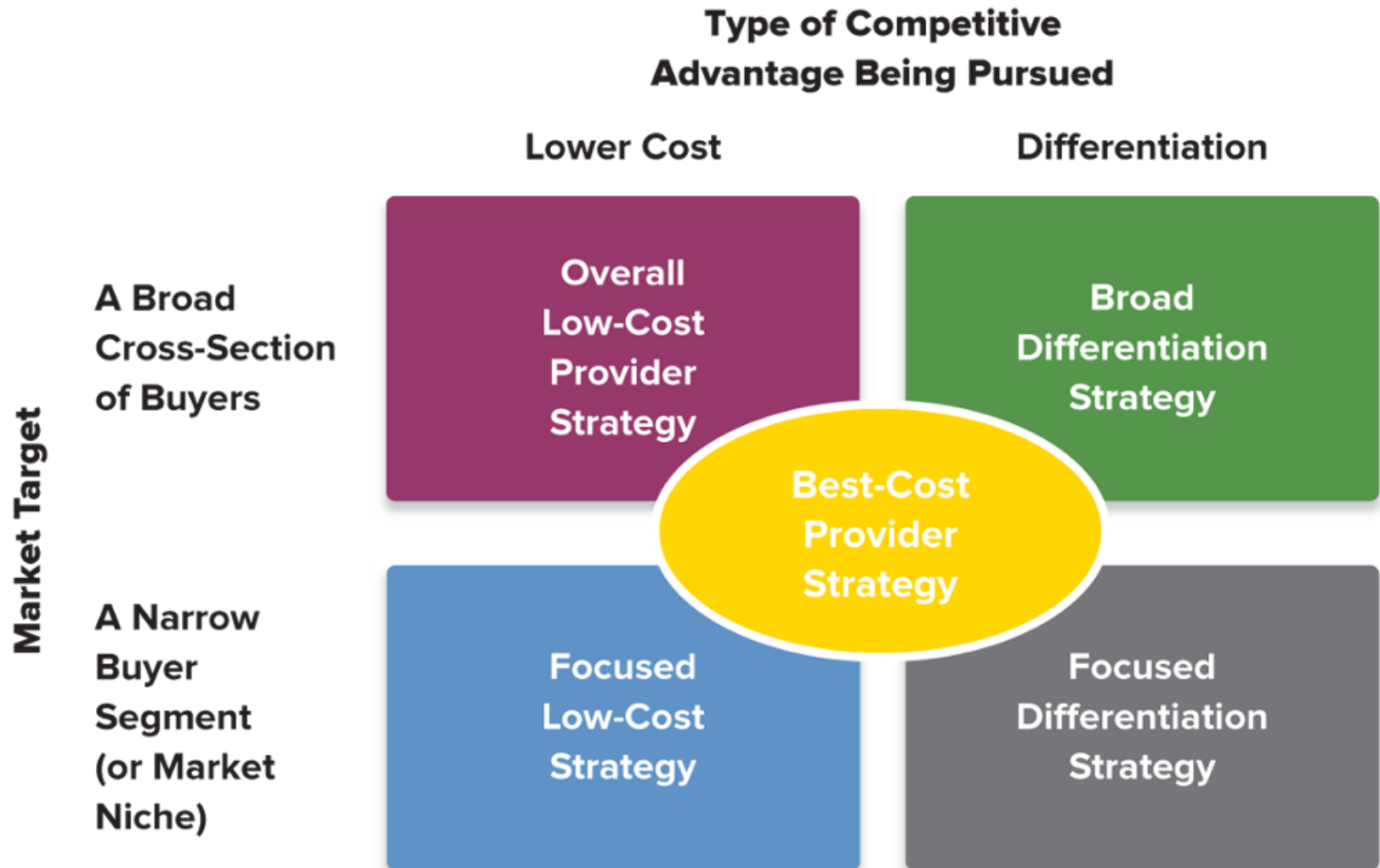


THE CONTRASTING FEATURES OF THE FIVE GENERIC COMPETITIVE STRATEGIES: A SUMMARY

Each generic strategy:

- Positions the firm differently in its market
- Establishes a central theme for how the firm intends to outcompete rivals
- Creates boundaries or guidelines for strategic change as market circumstances unfold
- Entails different ways and means of maintaining the basic strategy

FIGURE 5.1 The Five Generic Competitive Strategies



[Jump to Appendix 2 long image description](#)

Table 5.1 Distinguishing Features of the Five Generic Competitive Strategies (1 of 2)

	Low-Cost Provider	Broad Differentiation	Focused low-cost provider	Focused differentiation	Best-Cost Provider
Strategic target	A broad cross-section of the market	A broad cross-section of the market	A narrow market niche where buyer needs and preferences are distinctively different	A narrow market niche where buyer needs and preferences are distinctively different	Value-conscious buyers. Or, a middle-market range
Basis of competitive strategy	Lower overall costs than competitors	Ability to offer buyers something attractively different from competitors' offerings	Lower overall cost than rivals in serving niche members	Attributes that appeal specifically to niche members	Ability to offer better goods at attractive prices
Product line	A good basic product with few frills (acceptable quality and limited selection)	Many product variations, wide selection, emphasis on differentiating features	Features and attributes tailored to the tastes and requirements of niche members	Features and attributes tailored to the tastes and requirements of niche members	Items with appealing attributes and assorted features; better quality, not best
Production emphasis	A continuous search for cost reduction without sacrificing acceptable quality and essential features	Build in whatever differentiating features buyers are willing to pay for; strive for product superiority	A continuous search for cost reduction for products that meet basic needs of niche members	Small-scale production or custom-made products that match the tastes and requirements of niche members	Build in appealing features and better quality at lower cost than rivals

Table 5.1 Distinguishing Features of the Five Generic Competitive Strategies (2 of 2)

	Low-Cost Provider	Broad Differentiation	Focused low-cost provider	Focused differentiation	Best-Cost Provider
Marketing emphasis	Low prices, good value Also, try to make a virtue out of product features that lead to low cost	Tout differentiating features. Also, charge a premium price to cover the extra costs of differentiating features	Communicate attractive features of a budget-priced product offering that fits niche buyers' expectations	Communicate how product offering does the best job of meeting niche buyers' expectations	Emphasize delivery of best value for the money
Keys to maintaining the strategy	Economical prices, good value Also, strive to manage costs down, year after year, in every area of the business	Stress constant innovation to stay ahead of imitative competitors Also, concentrate on a few key differentiating features.	Stay committed to serving the niche at the lowest overall cost; don't blur the firm's image by entering other market segments or adding other products to widen market appeal	Stay committed to serving the niche better than rivals; don't blur the firm's image by entering other market segments or adding other products to widen market appeal.	Unique expertise in simultaneously managing costs down while incorporating upscale features and attributes
Resources and capabilities required	Capabilities for driving costs out of the value chain system. Examples: large-scale automated plants, an efficiency-oriented culture, bargaining power	Capabilities concerning quality, design, intangibles, and innovation Examples: marketing capabilities, R&D teams, technology	Capabilities to lower costs on niche goods Examples: Lower input costs for the specific product desired by the niche, batch production capabilities	Capabilities to meet the highly specific needs of niche members Examples: custom production, close customer relations.	Capabilities to simultaneously deliver lower cost and higher-quality or differentiated feature Examples: TQM practices, mass customization

Class Exercise

- ◆ How would you characterize Best Buy's competitive strategy?
- ◆ Should it be classified as a low-cost provider strategy? a differentiation strategy? a best-cost strategy? Explain your answer.



Class Exercise

- ◆ USAA is a Fortune 500 insurance and financial services company with 2014 annual sales exceeding \$24 billion.
- ◆ The company was founded in 1922 by 25 Army officers who decided to insure each other's vehicles and continues to limit its membership to active-duty and retired military members, officer candidates, and adult children and spouses of military-affiliated USAA members.



How would you characterize USAA's competitive strategy? Should it be classified as a low-cost provider strategy? A differentiation strategy? A best-cost strategy?

Class Exercise

- ◆ How USAA's strategy meets many of the criteria for a successful focused low-cost strategy?



Class Exercise

- ◆ The target niche is big enough to be profitable and offers good growth potential
- ◆ b. Industry leaders have chosen not to compete in the niche.
- ◆ c. It is costly or difficult for multi-segment competitors to put capabilities in place to meet specialized needs of the target market niche and at the same time satisfy the expectations of their mainstream customers
- ◆ d. The industry has many different niches and segments
- ◆ e. Few, if any, other rivals are attempting to specialize in the same target segment

Summary

Why Do Strategies Differ?

Two key factors that distinguish one strategy from another

1. Is the firm's market target broad or narrow?
2. Is the competitive advantage pursued linked to low costs or product differentiation?

Summary

1. Overall low-cost provider strategy (lower cost or a broad cross-section of buyers)
2. Focused low-cost strategy (lower cost or a narrow buyer segment)
3. Broad differentiation strategy (differentiation or a broad cross-section of buyers)
4. Focused differentiation strategy (differentiation or a narrow buyer segment)
5. Best-Cost Provider strategy (an equal balance of competitive advantages and market targets)

Simulation Exercise

- ◆ Which one of the five generic competitive strategies best characterizes your company's strategic approach to competing successfully?
- ◆ Which rival companies appear to be employing a low-cost provider/broad differentiation/ best-cost provider/ some type of focused strategy?