Business Policy & Strategy
Dr. Richard C. Insinga, April 2011

Lecture #2

Plan for Lecture #2

- Comments on the course
- Key points from Lecture #1
- Topics for tonight
  - Porter's Chapter 2 – Generic competitive strategies
  - Porter's Appendix A – Portfolio techniques in competitor analysis
    - GE/McKinsey and BCG matrices
  - Article – Henderson's Anatomy of Competition
  - Book – Morgan's *Images of Organization*
  - Book – Ohmae's *The Mind of the Strategist*

Comments on the Course

- The course covers the thoughts of many authors on the subject of strategy formulation and its closely related topics.
- The course is compressed, so each lecture covers a substantial amount.
- The lectures focus on foundation knowledge for the manager who formulates strategy.
- The case discussion and papers are for students to practice formulating strategy.

Key Points from Lecture #1

- The need for an explicit strategy
  - Otherwise, the organization has a suboptimal implicit strategy that is a composite of the functional department strategies.
- The Classical Approach to formulating strategy
- SWOT Analysis
- Porter's Five-Forces Model
- Reviews of Porter's book
  - Should be on every manager's bookshelf
  - Conflicting views of the book

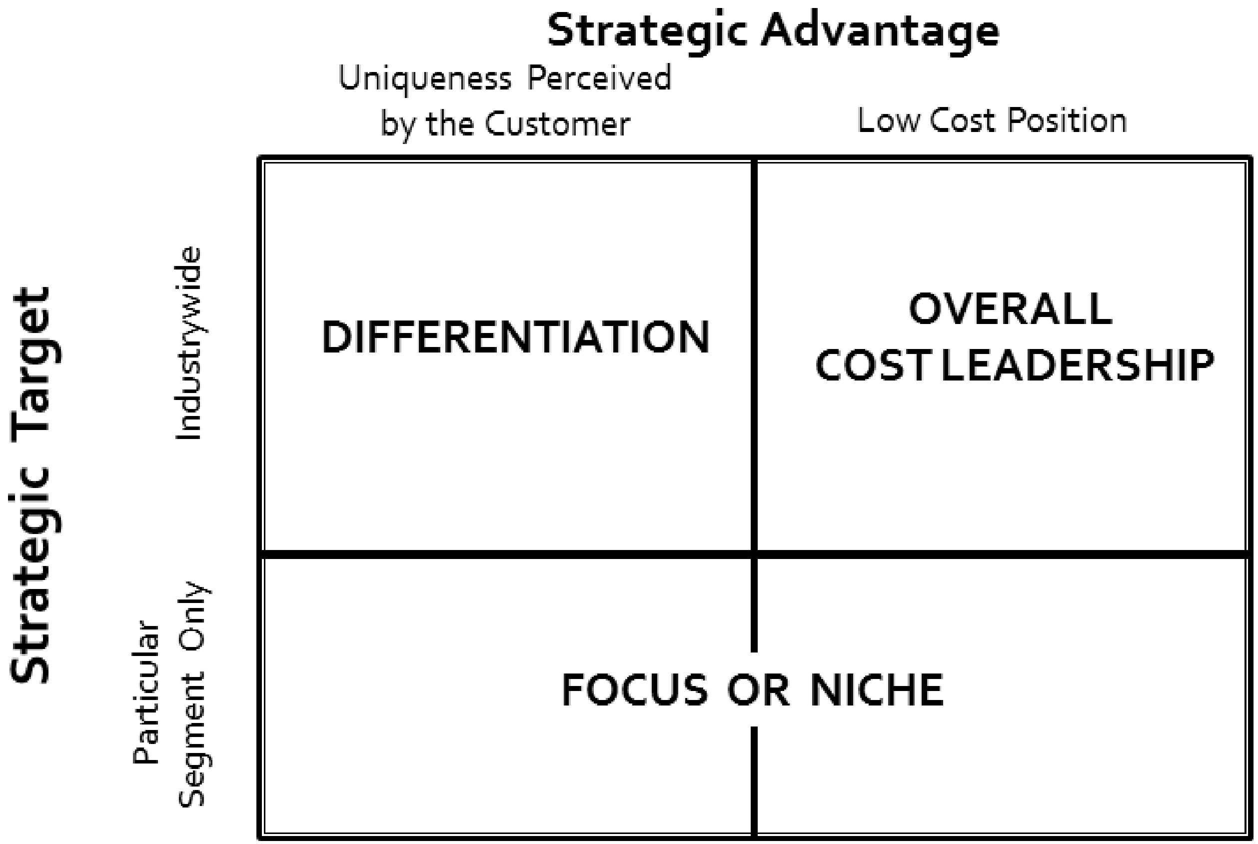
Generic Competitive Strategies

- In coping with the five competitive forces, there are three potentially successful generic competitive strategic approaches to outperforming other firms in an industry:
  - Overall cost leadership
  - Differentiation
  - Focus or Niche
- Sometimes the firm successfully can pursue more than one approach as its primary target, though this is rarely possible.

Generic Competitive Strategies (cont'd)

- The most appropriate generic strategy for a firm depends on the firm's chosen source of strategic advantage and on its chosen strategy target, i.e., industrywide or a particular segment only.
- Porter presents a matrix to illustrate these choices (see separate presentation on the generic strategies).

Porter's Three Generic Strategies



Focus or Niche

- Focus on a particular segment of the market
- Focus or niche may take many forms, for example:
  - A specific buyer group
  - Segment of the product line
    - A product or service specialty
  - Geographic market

Cost Leadership

- Achieve low cost relative to competitors
- Cost leadership requires, for example:
  - Efficient-scale facilities
  - Cost reductions due to experience
  - Tight cost and overhead control
  - Avoiding marginally profitable customer accounts
  - Cost minimization in areas such as R&D, service, sales force, and advertising
- Low cost is the strategy, but quality, service, and other areas cannot be ignored.

Cost Leadership (cont'd)

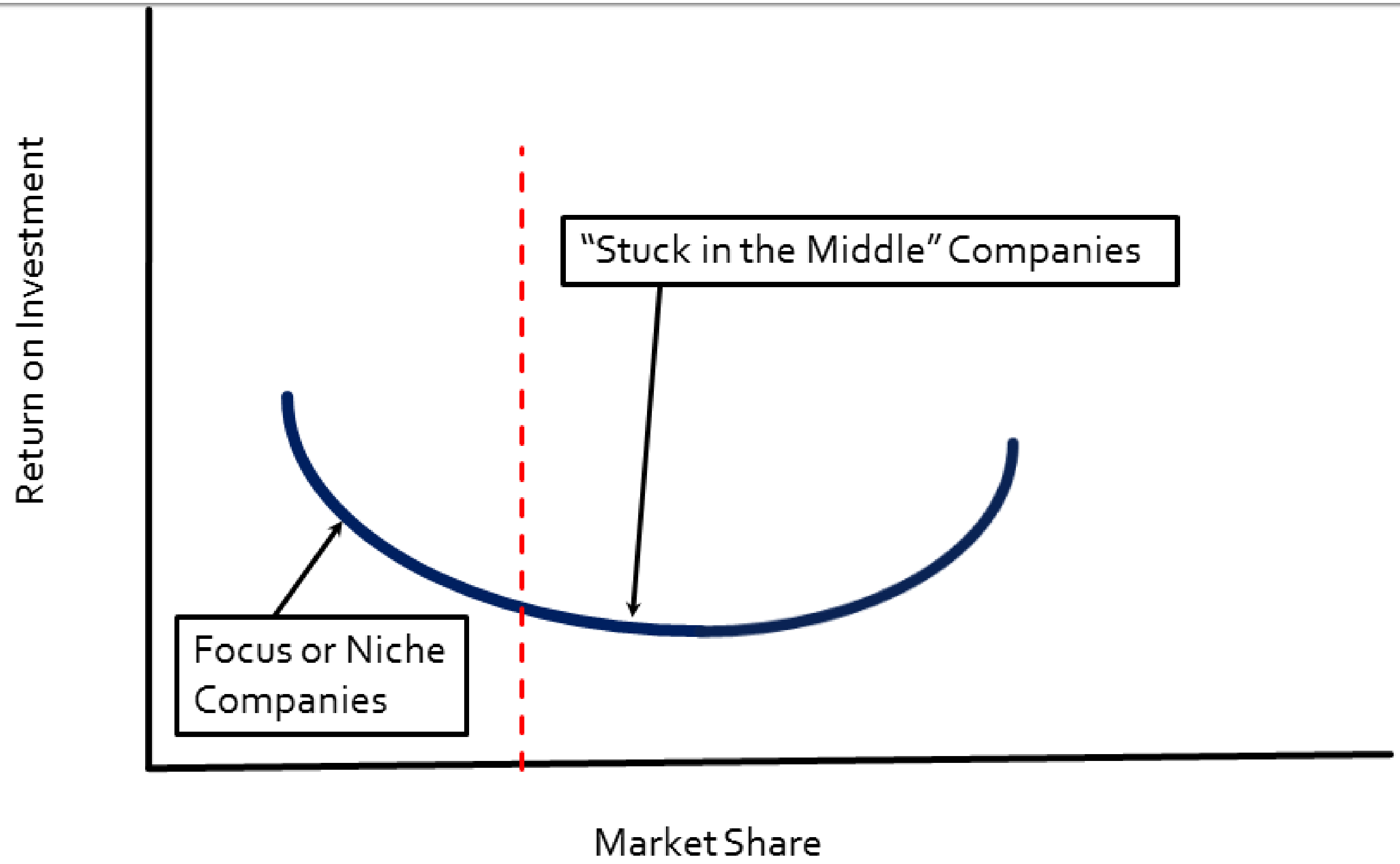
- The low cost relative to competitors can be used to competitive advantage by, for example:
  - Selling at a lower price
  - Selling at the market price and using the excess profits, for example, to offer customers additional:
    - R&D to develop new products or features
    - Advertising
    - Customer service
    - Dealer network

Differentiation

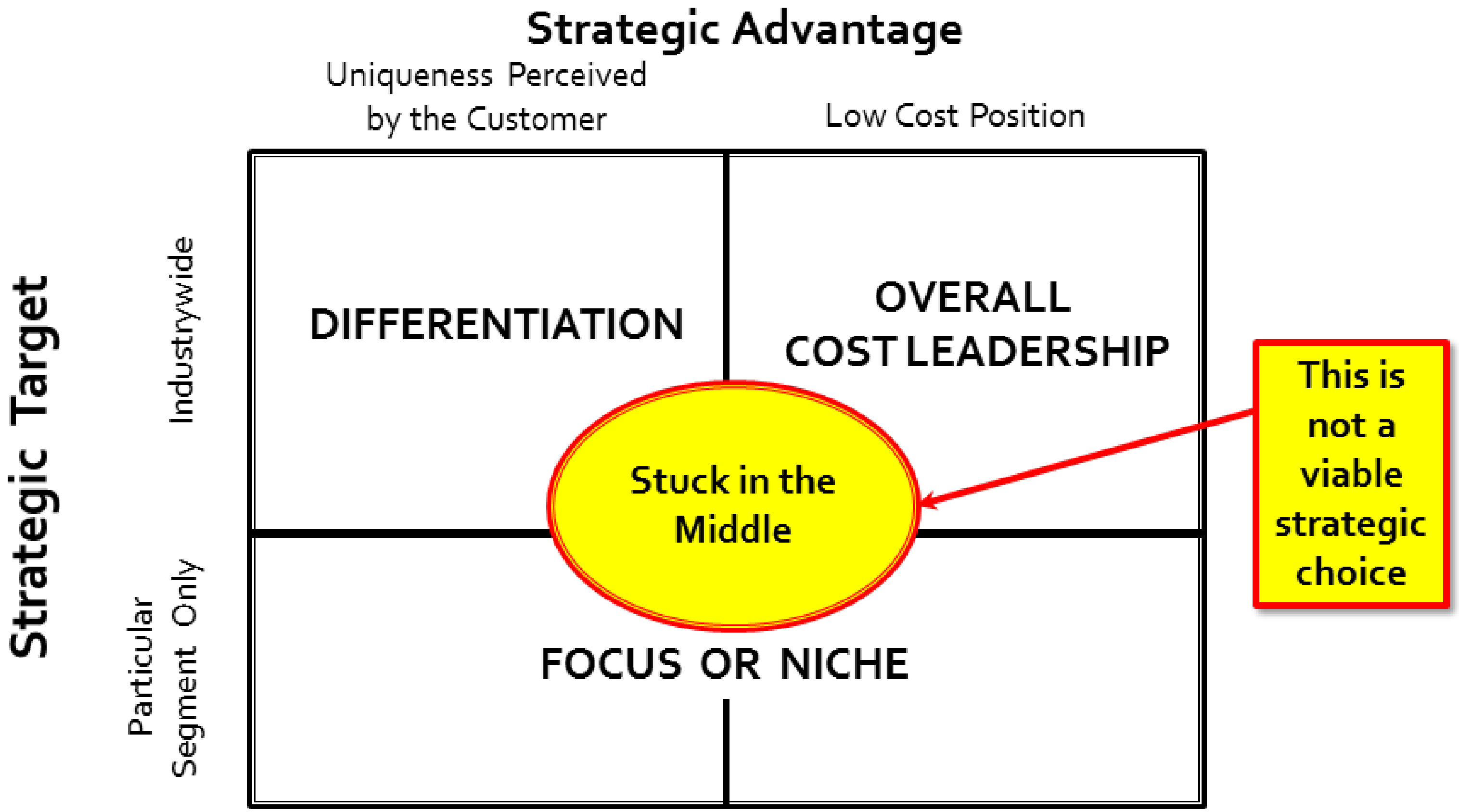
- Differentiate the product or service
- Creating something that is considered to be unique from the competitors, for example:
  - Design or brand image
  - Technology
  - Features
  - Customer service
  - Dealer network
- The uniqueness needs to be perceived as having higher value by the customer

Relationship between ROI and Market Share

From Porter's book and based on PIMS findings



Porter's Three Generic Strategies



Risks of the Overall Low Cost Strategy

- Technological changes that nullifies past investments or learning.
- Low-cost learning by industry newcomers or followers.
- Inability to see required product or marketing change because of the attention placed on cost.
- Inflation in costs that narrow the firm's ability to maintain enough of a price differential to offset competitors' brand images or other approaches to differentiation.

Risks of the Differentiation Strategy

- The cost differential between low-cost competitors and the differentiated firm becomes too great for differentiation to hold brand loyalty.
- Buyers’ need for the differentiating factor falls; this can occur as buyers become more sophisticated.
- Imitation narrows perceived differentiation, which is a common occurrence as industries mature.

Risks of the Focus or Niche Strategy

- The cost differential between broad-range competitors and the focused firm widens to eliminate the cost advantages of serving a narrow target or to offset the differentiation achieved by focus.
- The differences in desired products or services between the strategic target and the broad market narrows.
- Competitors find *submarkets* within the strategic target and outfocus the focuser.