MGF3684: Business Strategy

Week 4: Business-Level Strategy

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Week 4 Objectives

1. *Define business-level strategy;*
2. *Explain the differences among business-level strategies; and*
3. *Describe the risks of using each of the business-level strategies.*

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Defining 'Business-level Strategy'

- Business- level strategy:
  - *An integrated and coordinated set of commitments and actions designed to gain a competitive advantage by exploiting core competencies in specific, individual product markets.*
- Business-level strategy is the core strategy: the strategy that the firm forms to describe how it intends to compete in the product market.
- All firms **must** form and use a business-level strategy, unlike corporate-level, merger/acquisition, international and cooperative strategies that will be covered later in the semester.

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The Purpose of Business-level Strategy

- The purpose of business-level strategy is to create differences between the firm's position and those of its competitors.
- To **position** itself differently, the firm must decide whether it intends to perform activities differently or to perform different activities.
- The firm's business-level strategy is a deliberate choice about how it will perform the value chain's primary and support activities to create unique value.

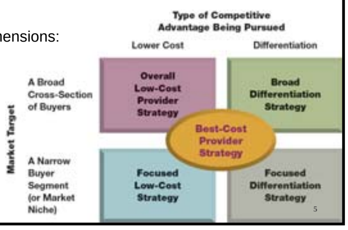
Types of Business-level Strategies

To position the firm, management may choose from ***5*** business-level strategies:

- *Low-cost*
- *Focused low-cost*
- *Best-cost provider*
- *Differentiation*
- *Focused differentiation*

These strategies are based on 2 dimensions:

- Target market
  - *Broad vs Narrow*
- Competitive advantage
  - *Low Cost vs Differentiation*



Types of Business-level Strategies

Competitive Advantage

- *Low Cost*: Lower cost than rivals
  - Performing activities differently from rivals
- *Differentiation*: The ability to differentiate and command a price premium that exceeds the extra cost of doing so
  - Performing different activities from rivals

Target Market

- *Broad*: Using capabilities to create value for customers on an industry-wide basis in many customer segments
- Narrow: Serving the needs of a narrow customer group, tailoring its strategy to suit that group at the expense of others

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Low-Cost Provider Strategy

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 (eg. Geely vs Kia).

Competitive Advantages and Risks:

- Greater total profits and increased market share gained from underpricing competitors.
- Larger profit margins when selling products at prices comparable to and competitive with rivals.
- Low pricing does not attract enough new buyers.
- Rival's retaliatory price cutting set off a price war.

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Cost Drivers: Cost-Cutting Methods

https://www.youtube.com/watch?v=hDqWJEfIyKc

- Striving to capture all available economies of scale.
- Taking full advantage of experience and learning-curve effects.
- Trying to operate facilities at full capacity.
- Improving supply chain efficiency.
- Using lower cost inputs wherever doing so will not entail too great a sacrifice in quality.
- Using the firm's bargaining power vis-à-vis suppliers or others in the value chain system to gain concessions.
- Using communication systems and information technology to achieve operating efficiencies.
- Employing advanced production technology and process design to improve overall efficiency.
- Being alert to the cost advantages of outsourcing or vertical integration.
- Motivating employees through incentives and company culture.

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When a Low-Cost 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.
6. The majority of industry sales are made to a few, large volume buyers.
7. New entrants can use introductory low prices to attract buyers and build a customer base.

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Low-Cost Provider Strategy: Pitfalls to Avoid

- Engaging in overly aggressive price cutting 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.

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Differentiation Strategy

A *differentiation strategy* is an integrated set of actions taken to produce goods or services (at an acceptable cost- see Mercedes vs Maybach) that customers perceive as being different in important ways.

Effective Differentiation Approaches:

- Carefully study buyer needs and behaviours, 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 firm's products

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Uniqueness Drivers: Enhancing Differentiation

- Striving to create superior product features, design, and performance.
- Improving customer service or adding additional services.
- Pursuing production R&D activities.
- Striving for innovation and technological advances.
- Pursuing continuous quality improvement.
- Increasing emphasis on marketing and brand-building activities.
- Seeking out high-quality inputs.
- Emphasizing human resource management activities that improve the skills, expertise, and knowledge of company personnel.

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Differentiation: Delivering Superior Value

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 (e.g., price, packaging, placement, advertising) offering to buyers.

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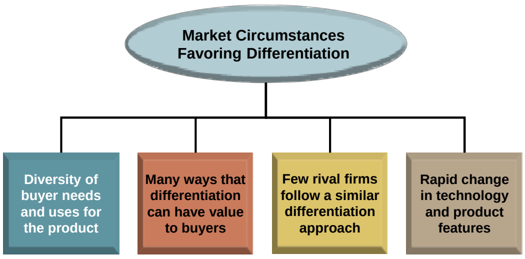
When a Differentiation Strategy Works Best



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Differentiation Strategy: Pitfalls to Avoid

- 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.
- Adding frills and features such that the product exceeds the needs and use patterns of most buyers.
- Charging too high a price premium.

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Focused (Market Niche) Strategy

A *focused strategy* is an integrated set of actions taken to produce goods or deliver services that serve the needs of a particular segment.

- **Types of focused strategy**:
  - *Focused differentiation*
    - *Eg. Bentley* https://www.youtube.com/watch?v=I8RhLzKdEZc
  - *Focused cost leadership*
    - *Eg. IKEA* https://www.youtube.com/watch?v=KomSWbBcpAg

- Firms with a focused strategy gain a competitive advantage in narrow/specific market niches or segments, even though they do not possess an industry-wide competitive advantage.

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Focus Strategy

- Examples of specific market segments that can be targeted by a focus strategy are:
  - *Particular buyer groups*
    - E.g. youths or senior citizens
  - *Different segments of a product line*
    - E.g. professional craftsmen versus do-it-yourselfers
  - *Different geographic markets*
    - E.g. Victoria vs South Australia

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When a Focused 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 interest in the target segment.

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Focused Strategy: Competitive Risks

- Competitors will find ways to match the focused firm's capabilities in serving the target niche.
- The specialized preferences and needs of niche members to shift over time toward the product attributes desired by the majority of buyers.
- As attractiveness of the segment increases, it draws in more competitors, intensifying rivalry and splintering segment profits.

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'Best Cost' Strategy

A *'best cost' strategy* is an integrated set of actions taken to simultaneously pursue low cost and differentiation.

- Firms with this strategy offer efficiently produced products (low cost) with some unique features (differentiation).
- Requires firms to be competent and flexible in an increased number of primary and support activities.
- Examples: Zara and Target ('Expect more. Pay less')

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When a Best Cost Strategy is Attractive

- Product differentiation is the market norm.
- There are a large number of value-conscious buyers who prefer midrange 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.

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Best Cost Strategy: Competitive Risks

- **Difficult Balance** – Firms pursuing the best cost strategy often find it hard to achieve both reduced costs and product differentiation simultaneously.
- **'Stuck in the Middle'** – The firm's cost structure is not low enough to allow it to attractively price its products, and that its products are also not sufficiently unique to create value for the target customer. This may also result from firms failing to implement *either* the cost leadership or differentiation strategies.

* Research indicates firms using 'pure strategies' (either cost leadership or differentiation) outperform firms using 'hybrid strategy' (best cost).

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