Topic 10

Porter’s Generic Strategies
Learning outcomes

After completing this topic you should be able to;

• Explain the importance of the concept of Generic Strategy when developing Business Level Strategy
• Be able to explain the requirement for each strategy type
• Understand the success and the risks associated with pursuing each strategy
• Be able to give examples of firms that pursue each strategy type
• Give an example of Best Cost Provider strategy
• Understand Bowman’s Strategy Clock and its similarity to Porters Generic Strategy in achieving competitive advantage
• Apply the concepts to real life examples and past exam papers.
The Five-Forces Model of Competition (Porter)

- Threat of New Entrants
- Rivalry among competitors
- Bargaining power of suppliers
- Bargaining power of Buyers
- Threat of Substitute Products/services
Generic Business Strategies
Sources of Superior Profitability

• Best-practice and empirical research has identified two internally-consistent competitive business strategies:
  
• Low Cost Leadership
  • supplying an identical product/service at a lower cost. (cost-based advantage)

• Differentiation
  • supplying a differentiated product/service in such a way that the customer is willing to pay a price premium that exceeds the cost of the differentiation. (differentiation-based advantage)
The Five Generic Competitive Strategies

Type of Competitive Advantage Being Pursued

- **Lower Cost**
  - A Broad Cross-Section of Buyers
    - **Overall Low-Cost Provider Strategy**
  - A Narrow Buyer Segment (or Market Niche)
    - **Focused Low-Cost Strategy**

- **Differentiation**
  - **Broad Differentiation Strategy**
  - **Focused Differentiation Strategy**

**Best-Cost Provider Strategy**
Competitive Advantages as the Source of Superior Profitability

• Competitive advantages work in two basic ways;
  
  • Avoiding competitors (i.e. lock-outs/valuable resources)
  
  • Outperforming competitors (i.e. productivity and efficiency/distinctive competencies)
  
• Successful businesses use their competitive advantages and resources to develop one of these generic business strategies
## Requirements for successful Generic Competitive Strategies

<table>
<thead>
<tr>
<th>Generic Strategy</th>
<th>Skills and Resources</th>
<th>Organisational Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cost Leadership</strong></td>
<td>• Sustained capital investment</td>
<td>• Frequent and detailed control reporting</td>
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<td></td>
<td>• Emphasis on cost cutting measures</td>
<td>• Structure organization and responsibilities</td>
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<td></td>
<td>• Low cost supplier arrangements</td>
<td>• Incentives based on meeting strict quantitative targets</td>
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<td></td>
<td>• Products designed for ease of production</td>
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<tr>
<td><strong>Differentiation</strong></td>
<td>• Strong marketing and R&amp;D skills</td>
<td>• Strong coordination among functions in marketing, customer services, and operations</td>
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<td></td>
<td>• Creative flair</td>
<td>• Incentives that reward customer service skills</td>
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<td></td>
<td>• Reputation for quality</td>
<td>• Amenities to attract highly skilled labour</td>
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<td></td>
<td>• Superior customer responsiveness</td>
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<tr>
<td><strong>Focus</strong></td>
<td>• Cost leadership skills and resources OR Differentiation skills and resources directed at a particular buyer group or market segment</td>
<td>• Cost Leadership or Differentiator structures, incentives, etc. directed at a particular buyer group or market segment</td>
</tr>
</tbody>
</table>
Cost Leadership - Sources of Cost Advantages

- Scale and experience effects
- Capacity utilisation
- Product design for ease of manufacture
- Location
- Purchasing policy
- Organisational skills
- Strong organization culture of cost cutting.
Cost leadership – the risks

Risks

• For example, other firms may be able to lower their costs as well. As technology improves, the competition may be able to leapfrog the production capabilities, thus eliminating the competitive advantage.

• Additionally, several firms following a focus strategy and targeting various narrow markets may be able to achieve an even lower cost within their segments and as a group gain significant market share.
Differentiation

The essence of strategy lies in creating tomorrow’s competitive advantages faster than competitors can mimic the ones you possess today.

Gary Hamel and C.K. Prahalad
The Five Generic Competitive Strategies

Type of Competitive Advantage Being Pursued

- Lower Cost
- Differentiation

Market Target

- A Broad Cross-Section of Buyers
- A Narrow Buyer Segment (or Market Niche)

Strategies:

- Overall Low-Cost Provider Strategy
- Broad Differentiation Strategy
- Best-Cost Provider Strategy
- Focused Low-Cost Strategy
- Focused Differentiation Strategy
Differentiation – How to create differences

**TANGIBLE**
- Quality
- Brand Image
- Prestige
- Performance
- Packaging
- Complimentary services
- Speed
- After sales service

**INTANGIBLE**
- Image
- Status
- Exclusively
- Identity
Focus Strategy – the requirements

• Concentrates on a narrow segment and within that segment attempts to achieve either a cost advantage or differentiation.

• Because of their narrow market focus, firms pursuing a focus strategy have lower volumes and therefore less bargaining power with their suppliers. However, firms pursuing a differentiation-focused strategy may be able to pass higher costs on to customers since close substitute products do not exist.
Best-Cost Provider

• Stuck in the middle or unique advantage?

• Example
  Dell

Stuck in the middle or Mass Customisation?
The Five Generic Competitive Strategies

Type of Competitive Advantage Being Pursued

Lower Cost

Differentiation

Overall Low-Cost Provider Strategy

Broad Differentiation Strategy

Best-Cost Provider Strategy

Focused Low-Cost Strategy

Focused Differentiation Strategy

Market Target

A Broad Cross-Section of Buyers

A Narrow Buyer Segment (or Market Niche)
Stuck in the Middle?

• These generic strategies are not necessarily compatible with one another. If a firm attempts to achieve an advantage on all fronts, in this attempt it may achieve no advantage at all.

• For this reason, Michael Porter argued that to be successful over the long-term, a firm must select only one of these three generic strategies. Otherwise, with more than one single generic strategy the firm will be "stuck in the middle" and will not achieve a competitive advantage.

• Porter argued that firms that are able to succeed at multiple strategies often do so by creating separate business units for each strategy. By separating the strategies into different units having different policies and even different cultures, a corporation is less likely to become "stuck in the middle."
<table>
<thead>
<tr>
<th>Variable</th>
<th>Cost leader</th>
<th>Differentiator</th>
<th>Focus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitive Advantage</td>
<td>Cost reduction through constant cost control</td>
<td>Differentiation by quality, style, image, brand etc.</td>
<td>Premium brand development</td>
</tr>
<tr>
<td>Segmentation</td>
<td>None – one size fits all</td>
<td>Multiple segments</td>
<td>Niche marketing</td>
</tr>
<tr>
<td>Key selling point</td>
<td>The cheapest – ‘no frills’</td>
<td>Price/Quality relationship</td>
<td>Superior quality</td>
</tr>
<tr>
<td>Key requirement</td>
<td>Volume and scale and experience effects</td>
<td>Profit through quality</td>
<td>Customers not price sensitive</td>
</tr>
<tr>
<td>Sustainable advantage</td>
<td>Frequent capital investment</td>
<td>Building brand image</td>
<td>Superior quality and after sales service</td>
</tr>
<tr>
<td>Management focus</td>
<td>Financial performance Business by the numbers</td>
<td>Maintaining market share</td>
<td>Perceived excellence</td>
</tr>
<tr>
<td>Risk</td>
<td>Ease of imitation</td>
<td>Sub segmentation by competitors</td>
<td>Changing consumer tastes</td>
</tr>
<tr>
<td>Marketing slogan</td>
<td>‘Look at us we are the cheapest’</td>
<td>‘Look at us we are better’</td>
<td>‘Look at us we are the best’</td>
</tr>
<tr>
<td>Examples; Local International</td>
<td>Ryanair  Mc Donald's</td>
<td>British Airways  Harley Davidson</td>
<td>Brown Thomas  Rolls Royce  Montblanc</td>
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</tbody>
</table>
Bowman's Strategy Clock

An alternative point of View
The strategy clock: Bowman’s competitive strategy options

Source: Based on the work of Cliff Bowman.
Using the strategy clock, generic strategy options available to an organisation.
## The strategy clock

<table>
<thead>
<tr>
<th></th>
<th>Low price/low added value</th>
<th>Likely to be segment specific</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Low price</td>
<td>Risk of price war and low margins/need to be cost leader</td>
</tr>
<tr>
<td>3</td>
<td>Hybrid</td>
<td>Low cost base and reinvestment in low price and differentiation</td>
</tr>
<tr>
<td>4</td>
<td>Differentiation</td>
<td>Perceived added value by user, yielding market share benefits</td>
</tr>
<tr>
<td></td>
<td>(a) Without price premium</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(b) With price premium</td>
<td>Perceived added value sufficient to bear price premium</td>
</tr>
<tr>
<td>5</td>
<td>Focused differentiation</td>
<td>Perceived added value to a particular segment, warranting price premium</td>
</tr>
<tr>
<td>6</td>
<td>Increased price/standard value</td>
<td>Higher margins if competitors do not follow/risk of losing market share</td>
</tr>
<tr>
<td>7</td>
<td>Increased price/low value</td>
<td>Only feasible in monopoly situation</td>
</tr>
<tr>
<td>8</td>
<td>Low value/standard price</td>
<td>Loss of market share</td>
</tr>
</tbody>
</table>

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How will this help with your exam?

• This is an area that has been examined in the past and given its importance in strategy development it is likely that the examiner will continue to examine this area.