

14th Edition

# Crafting and Executing Strategy

The Quest for Competitive Advantage

CONCEPTS AND CASES

[www.mhhe.com/thompson](http://www.mhhe.com/thompson)

Arthur A. Thompson Jr.

A.J. Strickland

John E. Gamble

# **The Five Generic Competitive Strategies**

Screen graphics created by:  
Jana F. Kuzmicki, Ph.D.  
Troy State University-Florida and Western Region

**“Competitive strategy is about being different. It means deliberately choosing to perform activities differently or to perform different activities than rivals to deliver a unique mix of value.”**

**Michael E. Porter**



# Chapter Roadmap

- ◆ Five Competitive Strategies
- ◆ Low-Cost Provider Strategies
- ◆ Differentiation Strategies
- ◆ Best-Cost Provider Strategies
- ◆ Focused (or Market Niche) Strategies
- ◆ The Contrasting Features of the Five Generic Competitive Strategies: A Summary

# Strategy and Competitive Advantage

- ◆ *Competitive advantage* exists when a firm's strategy gives it an edge in

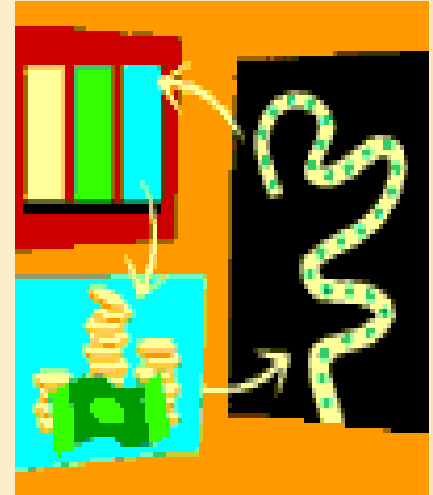
- Attracting customers *and*
- Defending against competitive forces

## Key to Gaining a Competitive Advantage

- ◆ Convince customers firm's product / service offers *superior value*
  - A *good product* at a *low price*
  - A *superior product* worth paying more for
  - A *best-value product*

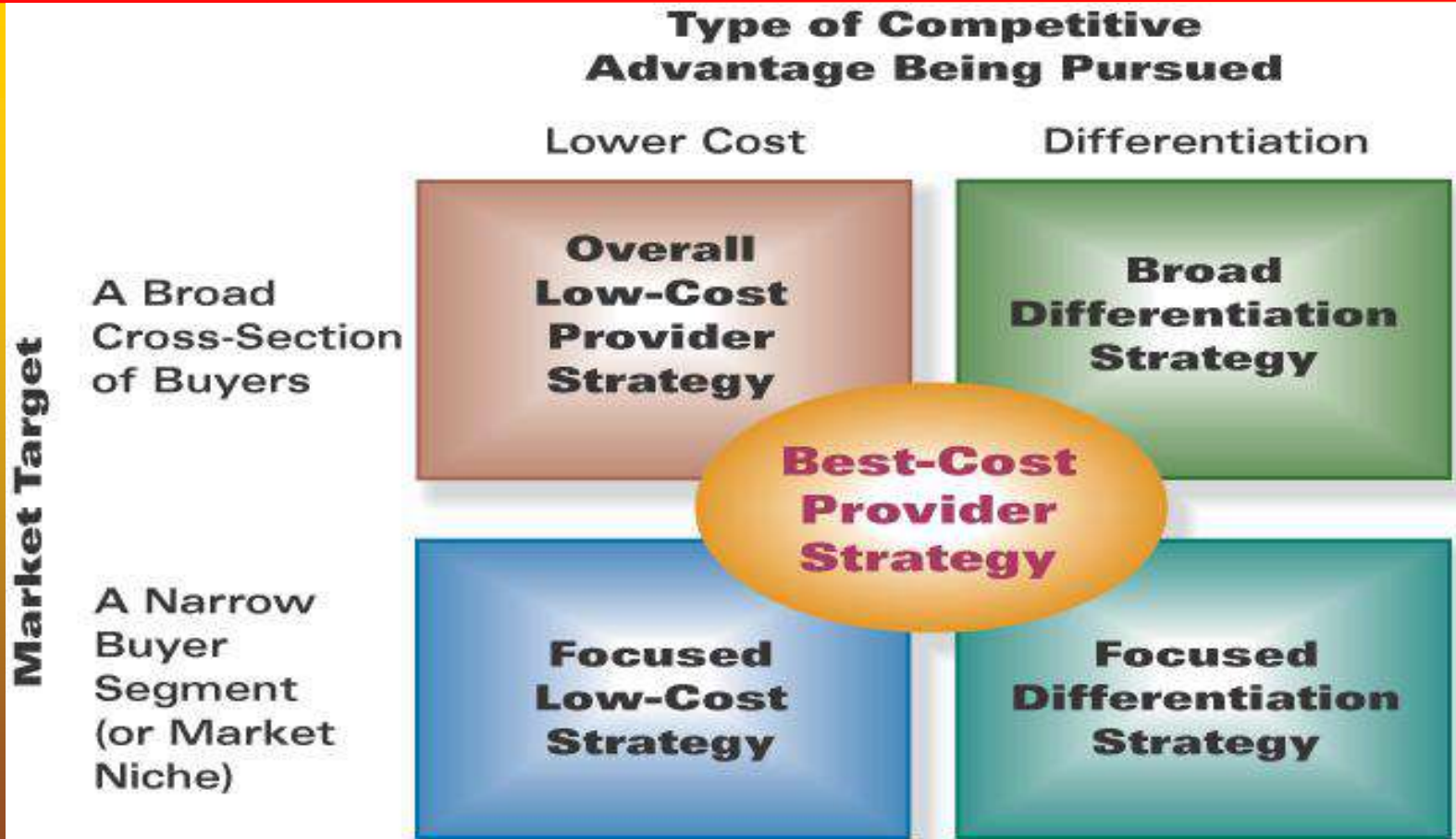
# What Is “Competitive Strategy”?

- ◆ Deals exclusively with a company’s business *plans* to *compete successfully*
  - ➔ Specific *efforts* to *please customers*
  - ➔ *Offensive and defensive moves* to *counter maneuvers* of rivals
  - ➔ *Responses* to prevailing *market conditions*
  - ➔ *Initiatives* to *strengthen its market position*
- ◆ *Narrower in scope* than business strategy





# Fig. 5.1: The Five Generic Competitive Strategies



# Low-Cost Provider Strategies

## Keys to Success

- ◆ Make achievement of *meaningful lower costs* than rivals the *theme* of firm's strategy
- ◆ Include *features and services* in product offering that buyers consider *essential*
- ◆ Find approaches to *achieve a cost advantage* in ways *difficult* for rivals to *copy or match*



Low-cost leadership means *low overall costs*, not just low manufacturing or production costs!



# Options: Achieving a Low-Cost Advantage

**Option 1:** Use lower-cost edge to

- Underprice competitors and attract price-sensitive buyers in enough numbers to increase total profits



**Option 2:** Maintain present price, be content with present market share, and use lower-cost edge to

- Earn a higher profit margin on each unit sold, thereby increasing total profits



# Nucor Corporation's Low-Cost Provider Strategy

**Eliminate some production processes from value chain used by traditional integrated steel mills; cut investment in facilities and equipment**

**Strive hard for continuous improvement in the efficiency of its plants and frequently invest in state-of-the art equipment to reduce unit costs**

**Carefully select plant sites to minimize inbound and outbound shipping costs and to take advantage of low rates for electricity**

**Hire a nonunion workforce that uses team-based incentive compensation systems**

**Heavily emphasize consistent product quality and maintain rigorous quality systems**

**Minimize general and administrative expenses by maintaining a lean staff at corporate headquarters and allowing only 4 levels of management**

# Approaches to Securing a Cost Advantage

## Approach 1

Do a better job than rivals of performing value chain activities efficiently and cost effectively

## Approach 2

Revamp value chain to bypass cost-producing activities that add little value from the buyer's perspective





# Approach 1: Controlling the Cost Drivers

- ◆ Capture scale economies; avoid scale diseconomies
- ◆ Capture learning and experience curve effects
- ◆ Manage costs of key resource inputs
- ◆ Consider linkages with other activities in value chain
- ◆ Find sharing opportunities with other business units
- ◆ Compare vertical integration vs. outsourcing
- ◆ Assess first-mover advantages vs. disadvantages
- ◆ Control percentage of capacity utilization
- ◆ Make prudent strategic choices related to operations



# Approach 2: Revamping the Value Chain

- ◆ Make greater use of Internet technology applications
- ◆ Use direct-to-end-user sales/marketing methods
- ◆ Simplify product design
- ◆ Offer basic, no-frills product/service
- ◆ Shift to a simpler, less capital-intensive, or more flexible technological process
- ◆ Find ways to bypass use of high-cost raw materials
- ◆ Relocate facilities closer to suppliers or customers
- ◆ Drop “something for everyone” approach and focus on a limited product/service

# Keys to Success in Achieving Low-Cost Leadership

- ◆ Scrutinize each cost-creating activity, identifying cost drivers
- ◆ Use knowledge about cost drivers to manage costs of each activity down year after year
- ◆ Find ways to restructure value chain to eliminate nonessential work steps and low-value activities
- ◆ Work diligently to create cost-conscious corporate cultures
  - ➔ Feature broad employee participation in continuous cost-improvement efforts and limited perks for executives
  - ➔ Strive to operate with exceptionally small corporate staffs
- ◆ Aggressively pursue investments in resources and capabilities that promise to drive costs out of the business





# Characteristics of a Low-Cost Provider

- ◆ Cost conscious corporate culture
- ◆ Employee participation in cost-control efforts
- ◆ Ongoing efforts to benchmark costs
- ◆ Intensive scrutiny of budget requests
- ◆ Programs promoting continuous cost improvement



**Successful low-cost producers *champion frugality* but wisely and aggressively invest in cost-saving improvements !**

# When Does a Low-Cost Strategy Work Best?

- ◆ Price competition is vigorous
- ◆ Product is standardized or readily available from many suppliers
- ◆ There are few ways to achieve differentiation that have value to buyers
- ◆ Most buyers use product in same ways
- ◆ Buyers incur low switching costs
- ◆ Buyers are large and have significant bargaining power
- ◆ Industry newcomers use introductory low prices to attract buyers and build customer base



# Pitfalls of Low-Cost Strategies

- ◆ Being overly aggressive in cutting price
- ◆ Low cost methods are easily imitated by rivals
- ◆ Becoming too fixated on reducing costs and ignoring
  - ➔ Buyer interest in additional features
  - ➔ Declining buyer sensitivity to price
  - ➔ Changes in how the product is used
- ◆ Technological breakthroughs open up cost reductions for rivals



# Differentiation Strategies

## Objective

- ◆ Incorporate *differentiating features* that cause buyers to *prefer* firm's *product or service* over brands of rivals

## Keys to Success

- ◆ Find ways to differentiate that *create value* for buyers and are *not easily matched* or *cheaply copied* by rivals
- ◆ *Not spending more* to achieve differentiation *than* the *price premium* that can be *charged*



# Benefits of Successful Differentiation

A product / service with unique, appealing attributes allows a firm to

→ Command a *premium price and/or*

→ *Increase unit sales and/or*

→ *Build brand loyalty*

= *Competitive Advantage*



# Types of Differentiation Themes

- ◆ *Unique taste* -- Dr. Pepper
- ◆ *Multiple features* -- Microsoft Windows and Office
- ◆ *Wide selection* and *one-stop shopping* -- Home Depot and Amazon.com
- ◆ *Superior service* -- FedEx, Ritz-Carlton
- ◆ *Spare parts availability* -- Caterpillar
- ◆ *More for your money* -- McDonald's, Wal-Mart
- ◆ *Prestige* -- Rolex
- ◆ *Quality manufacture* -- Honda, Toyota
- ◆ *Technological leadership* -- 3M Corporation
- ◆ *Top-of-line image* -- Ralph Lauren, Chanel, Cross



# Sustaining Differentiation: Keys to Competitive Advantage

- ◆ Most *appealing approaches* to differentiation
  - Those *hardest for rivals to match or imitate*
  - Those *buyers will find most appealing*
- ◆ *Best choices* to *gain* a longer-lasting, more profitable *competitive edge*
  - New product innovation
  - Technical superiority
  - Product quality and reliability
  - Comprehensive customer service
  - Unique competitive capabilities



# Where to Find Differentiation Opportunities in the Value Chain

- ◆ Purchasing and procurement activities
- ◆ Product R&D and product design activities
- ◆ Production process / technology-related activities
- ◆ Manufacturing / production activities
- ◆ Distribution-related activities
- ◆ Marketing, sales, and customer service activities





# How to Achieve a Differentiation-Based Advantage

## Approach 1

Incorporate product features/attributes that *lower buyer's overall costs* of using product

## Approach 2

Incorporate features/attributes that *raise the performance a buyer gets* out of the product

## Approach 3

Incorporate features/attributes that *enhance buyer satisfaction* in non-economic or intangible ways

## Approach 4

Compete on the basis of *superior capabilities*

# Importance of Perceived Value

- ◆ Buyers seldom pay for value that is not perceived
- ◆ Price premium of a differentiation strategy reflects

→ *Value actually delivered* to the buyer *and*

→ *Value perceived* by the buyer



- ◆ Actual and perceived value can differ when buyers are unable to assess their experience with a product

# Signaling Value as Well as Delivering Value

- ◆ Incomplete knowledge of buyers causes them to judge value based on such *signals* as
  - ➔ Price
  - ➔ Attractive packaging
  - ➔ Extensive ad campaigns
  - ➔ Ad content and image
  - ➔ Characteristics of seller
    - Facilities
    - Customers
    - Professionalism and personality of employees
- ◆ *Signals of value* may be as important as *actual value* when
  - ➔ Nature of differentiation is hard to quantify
  - ➔ Buyers are making first-time purchases
  - ➔ Repurchase is infrequent
  - ➔ Buyers are unsophisticated



# When Does a Differentiation Strategy Work Best?

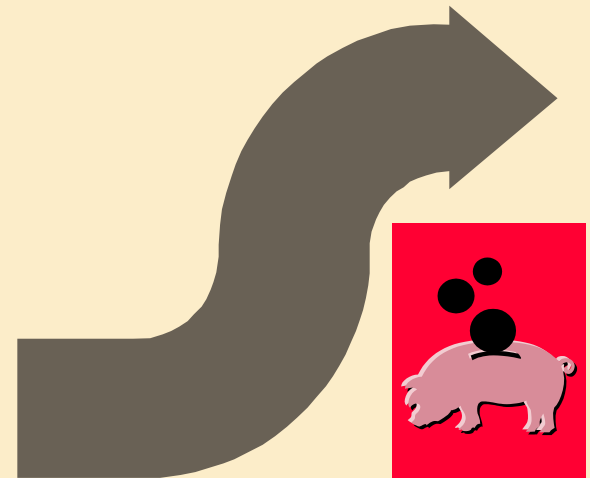
- ◆ There are many ways to differentiate a product that have value and please customers
- ◆ Buyer needs and uses are diverse
- ◆ Few rivals are following a similar differentiation approach
- ◆ Technological change and product innovation are fast-paced





# When Does a Differentiation Strategy Work Best?

- ◆ There are many ways to differentiate a product that have value and please customers
- ◆ Buyer needs and uses are diverse
- ◆ Few rivals are following a similar differentiation approach
- ◆ Technological change and product innovation are fast-paced



# Pitfalls of Differentiation Strategies

- ◆ Buyers see little value in unique attributes of product
- ◆ Appealing product features are easily copied by rivals
- ◆ Differentiating on a feature buyers do not perceive as lowering their cost or enhancing their well-being
- ◆ Over-differentiating such that product features exceed buyers' needs
- ◆ Charging a price premium buyers perceive is too high
- ◆ Not striving to open up meaningful gaps in quality, service, or performance features vis-à-vis rivals' products



# Best-Cost Provider Strategies

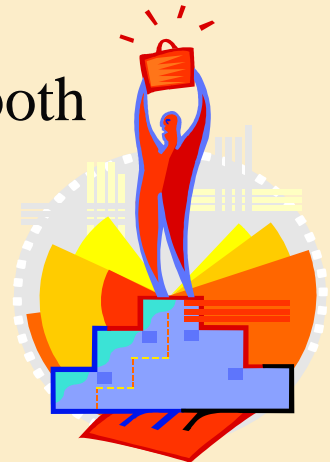
- ◆ *Combine* a *strategic emphasis* on *low-cost* with a strategic emphasis on *differentiation*
  - ➔ Make an upscale product at a lower cost
  - ➔ Give customers more value for the money

## Objectives

- ◆ Deliver superior value by meeting or exceeding buyer expectations on product attributes and beating their price expectations
- ◆ Be the low-cost provider of a product with good-to-excellent product attributes, then use cost advantage to underprice comparable brands

# Competitive Strength of a Best-Cost Provider Strategy

- ◆ A best-cost provider's *competitive advantage* comes from *matching* close rivals on key product attributes and *beating* them on price
- ◆ Success depends on having the skills and capabilities to *provide attractive performance* and *features at a lower cost than rivals*
- ◆ A best-cost producer can often *out-compete* both a low-cost provider and a differentiator when
  - ➔ Standardized features/attributes won't meet diverse needs of buyers
  - ➔ Many buyers are price and value sensitive



# Risk of a Best-Cost Provider Strategy

- ◆ A *best-cost provider* may get *squeezed* between strategies of firms using *low-cost* and *differentiation* strategies

→ *Low-cost leaders* may be able to *siphon customers* away with a *lower price*

→ *High-end differentiators* may be able to *steal customers* away with *better product attributes*



# Focus / Niche Strategies

- ◆ Involve concentrated attention on a narrow piece of the total market

## Objective

Serve niche buyers better than rivals

## Keys to Success

- ◆ Choose a market niche where buyers have distinctive preferences, special requirements, or unique needs
- ◆ Develop unique capabilities to serve needs of target buyer segment



# Approaches to Defining a Market Niche

- ◆ Geographic uniqueness
- ◆ Specialized requirements in using product/service
- ◆ Special product attributes appealing only to niche buyers



# Examples of Focus Strategies

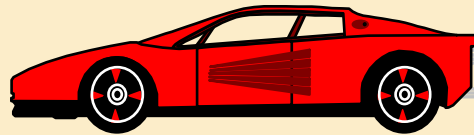
- ◆ eBay

- Online auctions



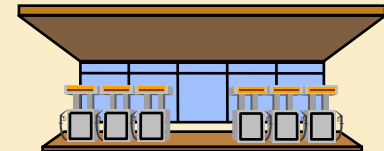
- ◆ Porsche

- Sports cars



- ◆ Jiffy Lube International

- Maintenance for motor vehicles



- ◆ Pottery Barn Kids

- Children's furniture and accessories



- ◆ Bandag

- Specialist in truck tire recapping

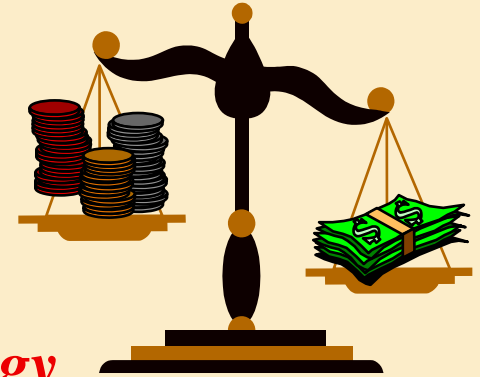


# Focus / Niche Strategies and Competitive Advantage

## Approach 1

- ◆ Achieve lower costs than rivals in serving the segment --

*A focused low-cost strategy*



## Approach 2

- ◆ Offer niche buyers something different from rivals --

*A focused differentiation strategy*



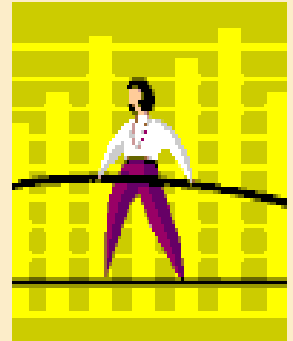
# What Makes a Niche Attractive for Focusing?

- ◆ Big enough to be profitable and offers good growth potential
- ◆ Not crucial to success of industry leaders
- ◆ Costly or difficult for multi-segment competitors to meet specialized needs of niche members
- ◆ Focuser has resources and capabilities to effectively serve an attractive niche
- ◆ Few other rivals are specializing in same niche
- ◆ Focuser can defend against challengers via superior ability to serve niche members



# Risks of a Focus Strategy

- ◆ Competitors find effective ways to match a focuser's capabilities in serving niche
- ◆ Niche buyers' preferences shift towards product attributes desired by majority of buyers – niche becomes part of overall market
- ◆ Segment becomes so attractive it becomes crowded with rivals, causing segment profits to be splintered





# Deciding Which Generic Competitive Strategy to Use

- ◆ Each positions a company differently in its market and competitive environment
- ◆ Each establishes a central theme for how a company will endeavor to outcompete rivals
- ◆ Each creates some boundaries for maneuvering as market circumstances unfold
- ◆ Each points to different ways of experimenting with the basics of the strategy
- ◆ Each entails differences in product line, production emphasis, marketing emphasis, and means to sustain the strategy

# Deciding Which Generic Competitive Strategy to Use

- ◆ Each positions a company differently in its market
- ◆ Each establishes a central theme for how a company will endeavor to outcompete rivals
- ◆ Each creates some boundaries for maneuvering as market circumstances unfold
- ◆ Each points to different ways of experimenting with the basics of the strategy
- ◆ Each entails differences in product line, production emphasis, marketing emphasis, and means to sustain the strategy

The ***big risk*** – Selecting a “***stuck in the middle***” strategy!  
This ***rarely produces*** a ***sustainable competitive advantage*** or a ***distinctive competitive position***.



**table 5.1 Distinguishing Features of the Five Generic Competitive Strategies**

	Low-Cost Provider	Broad Differentiation	Best-Cost Provider	Focused Low-Cost Provider	Focused Differentiation
<b>Strategic target</b>	<ul style="list-style-type: none"> <li>• A broad cross-section of the market</li> </ul>	<ul style="list-style-type: none"> <li>• A broad cross-section of the market</li> </ul>	<ul style="list-style-type: none"> <li>• Value-conscious buyers</li> </ul>	<ul style="list-style-type: none"> <li>• A narrow market niche where buyer needs and preferences are distinctively different</li> </ul>	<ul style="list-style-type: none"> <li>• A narrow market niche where buyer needs and preferences are distinctively different</li> </ul>
<b>Basis of competitive advantage</b>	<ul style="list-style-type: none"> <li>• Lower overall costs than competitors</li> </ul>	<ul style="list-style-type: none"> <li>• Ability to offer buyers something attractively different from competitors</li> </ul>	<ul style="list-style-type: none"> <li>• Ability to give customers more value for the money</li> </ul>	<ul style="list-style-type: none"> <li>• Lower overall cost than rivals in serving niche members</li> </ul>	<ul style="list-style-type: none"> <li>• Attributes that appeal specifically to niche members</li> </ul>
<b>Product line</b>	<ul style="list-style-type: none"> <li>• A good basic product with few frills (acceptable quality and limited selection)</li> </ul>	<ul style="list-style-type: none"> <li>• Many product variations, wide selection; emphasis on differentiating features</li> </ul>	<ul style="list-style-type: none"> <li>• Items with appealing attributes; assorted upscale features</li> </ul>	<ul style="list-style-type: none"> <li>• Features and attributes tailored to the tastes and requirements of niche members</li> </ul>	<ul style="list-style-type: none"> <li>• Features and attributes tailored to the tastes and requirements of niche members</li> </ul>
<b>Production emphasis</b>	<ul style="list-style-type: none"> <li>• A continuous search for cost reduction without sacrificing acceptable quality and essential features</li> </ul>	<ul style="list-style-type: none"> <li>• Whatever differentiating features buyers are willing to pay for; strive for product superiority</li> </ul>	<ul style="list-style-type: none"> <li>• Upscale features and appealing attributes at lower cost than rivals</li> </ul>	<ul style="list-style-type: none"> <li>• A continuous search for cost reduction while incorporating features and attributes matched to niche member preferences</li> </ul>	<ul style="list-style-type: none"> <li>• Custom-made products that match the tastes and requirements of niche members</li> </ul>
<b>Marketing emphasis</b>	<ul style="list-style-type: none"> <li>• Try to make a virtue out of product features that lead to low cost</li> </ul>	<ul style="list-style-type: none"> <li>• Tout differentiating features</li> <li>• Charge a premium price to cover the extra costs of differentiating features</li> </ul>	<ul style="list-style-type: none"> <li>• Tout delivery of best value</li> <li>• Either deliver comparable features at a lower price than rivals or match rivals on prices and provide better features</li> </ul>	<ul style="list-style-type: none"> <li>• Communicate attractive features of a budget-priced product offering that fits niche buyers' expectations</li> </ul>	<ul style="list-style-type: none"> <li>• Communicate how product offering does the best job of meeting niche buyers' expectations</li> </ul>
<b>Keys to sustaining the strategy</b>	<ul style="list-style-type: none"> <li>• Economical prices/good value</li> <li>• Low costs, year after year, in every area of the business</li> </ul>	<ul style="list-style-type: none"> <li>• Stress constant innovation to stay ahead of imitative competitors</li> <li>• A few key differentiating features</li> </ul>	<ul style="list-style-type: none"> <li>• Unique expertise in simultaneously managing costs down while incorporating upscale features and attributes</li> </ul>	<ul style="list-style-type: none"> <li>• Stay committed to serving the niche at lowest overall cost; don't blur the firm's image by entering other market segments or adding other products to widen market appeal</li> </ul>	<ul style="list-style-type: none"> <li>• 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</li> </ul>