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Module IV	Formulation of Strategy
Unit 4	Business Level Strategy
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Keywords
Competitive Advantage, Value Chain, Value Chain Analysis, Cost Advantage, Differentiation Advantage, Generic Strategies, Cost Leadership Strategy, Differentiation Strategy, Focus Strategy, Integrated Strategic Alternatives

Learning Objective

After reading this unit, you will be aware of the importance of competitive advantage and the organisational strategies geared to achieve the firm's overall objectives. The manager will prioritize changes and ways for better value creation for the customers of the firm. A number of the general strategies which a firm may adopt based on Porter's 5 Forces approach is reviewed and offers a useful framework for analysing competitive forces and formulating generic business strategies. In order to make practical use of this information, some examples, tasks and case studies are presented.

Estimated Time

It will take about **90 minutes** to go through this unit. The application of tools and exercises will require additional time.

Introduction

In this unit we present the organisational strategies geared to achieve the firm's overall objectives, being aware that the essence of strategy is in the activities – choosing to perform activities differently or to perform different activities than rivals (Porter, 1996). The manager will prioritize ways to create better value for customers of the firm based on the value chain analysis framework. We review the concept of competitive advantage and a number of the general strategies a firm may adopt based on Porter's approach. His approach offers a useful support for analyzing competitive forces and formulating generic business strategies.

4.1 Competitive Advantage and Value Chain Analysis

4.1.1 What is meant by competitive advantage?

A firm's success is largely determined by the attractiveness of the industry in which it operates but its position within that industry is also important. Although an industry may have deficient effectiveness, a firm that is optimally positioned still can create important profits.

A firm is said to have a **competitive advantage** over its competitors, when maintaining returns that surpass the average in its industry. This advantage is derived from the characteristics of a product that make it superior to competitive products.

In some situations, a competitive advantage can be obtained through technological developments, but it is often difficult to maintain it, because competitors rapidly copy or develop new or improved technology. For such an advantage to be sustained, it often has to be derived from something other than technology or product modifications, such as the product symbolism – what the product means to consumers (brand images) and what consumers experience in purchasing and using it. Marketing researchers recognize that products possess symbolic features and that consumption of some goods may depend more on their social meaning than on their functional utility.

There is actually a tendency towards consumers requiring "personal meaning" in products and services. To innovate is essential in order to respond to the emotions that drive consumer decisions. Consumers are becoming less impressed with new technology and opting for products that "work for me." As a result words like "emotion" and "personal meaning" are finding their way into corporate strategies and it is important to understand the intangible factors associated with the perceived value of the product, and overall positive or negative perceptions. New descriptions such as – “easy", "accessible", "affordable", "empowering" and "personal" – reflect on the person rather than the object. To uncover feelings and attitudes towards products and to gather information on why people prefer one product over the other have now become key strategic elements.

4.1.2 Why is competitive advantage important?

To a large extent, the ambition of business strategy is to achieve a sustainable competitive advantage.

Competitive advantage examines the economics of a firm's business focusing primarily on its ability to generate excess returns on capital and its ability to link the business strategy with fundamental finance and capital markets, for a longer period of time.
In the end, it is a firm's competitive advantage that allows it to earn good returns for its shareholders. Without a competitive advantage, a firm has a limited economic reason to exist – its competitive advantage is its reason to exist. Without it, the firm will not prosper.
Creating a sustainable competitive advantage may be the most important goal of any organisation and may be the most important single attribute on which each firm must place its main focus.

EXERCISE: Take some time to think about your firm. Is there a concern about the sustainability of the company? If so does it have clear and well identified competitive advantages?

4.1.3 How to implement competitive advantage?

Competitive advantages don't just come in one unique form, and it is possible for a firm to have many competitive advantages and in different areas. We illustrate some areas where firms can stand out and ensure their long-term success: market share, brand management, networking, trademarks and patents, cost effectiveness, and high switching costs.

Market Share: Firms with significant market share create a problem for competitors but its fine for the firm since their products are well-known and well-received in the marketplace. However, even when market share is considerable, if the industry has significant profit potential, new entrants can appear with a consequent reduction in market share.

Strong Brand Management: Having a strong brand can ensure a company's long-term success and it also enables firms to earn profits because their brand allows them to charge a premium price. Strong brands tend to create the longest-lasting competitive advantage.

Network Effect: The network effect occurs when a product creates demand from consumers, which then enhance the product. A firm can benefit from the network effect by attracting more sellers. It in turn attracts more buyers, establishing a dominant market share (e.g. EBay). The network effect is not very common but it can be extremely lucrative when it occurs.

Trademarks and Patents: Trademarks and patents can be sources of competitive advantage for some companies.

Cost-effective Structure: Being a low-cost producer has some advantages, although they're often short-lived. A firm can "weaken" its competitors by offering compelling prices for its products, thus attracting many customers.

High Switching Costs: Another way to earn good returns and extend a firm's life is to implement switching costs into the business model. For example, wireless telephone companies require clients to enter into contracts that restrict their capacity to change service providers.

EXERCISE: Take some time to think about possible areas within your firm where it will be possible to create competitive advantages and write down the potential advantages you could gain from them.

4.1.4 How to create value and competitive advantage?

A firm positions itself by leveraging its strengths. Michael Porter has argued that firm´s strengths fall into two basic types of competitive advantage: cost advantage or differentiation. Cost and differentiation advantages are identified as *positional advantages* since they express the firm's position in the industry as a leader in either cost or differentiation.

A firm uses its resources and capabilities to generate a competitive advantage that at last results in superior value creation, as illustrated in Figure 1.

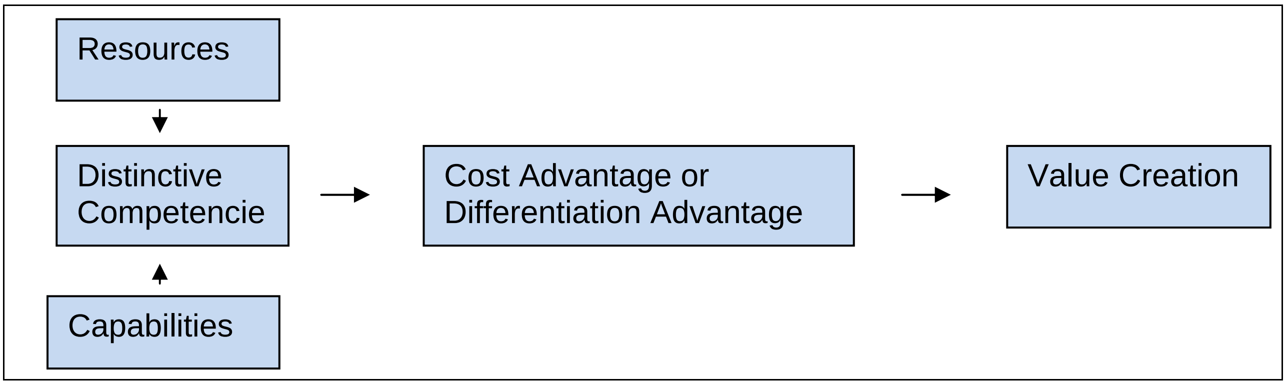


Figure 1: A Model of Competitive Advantage

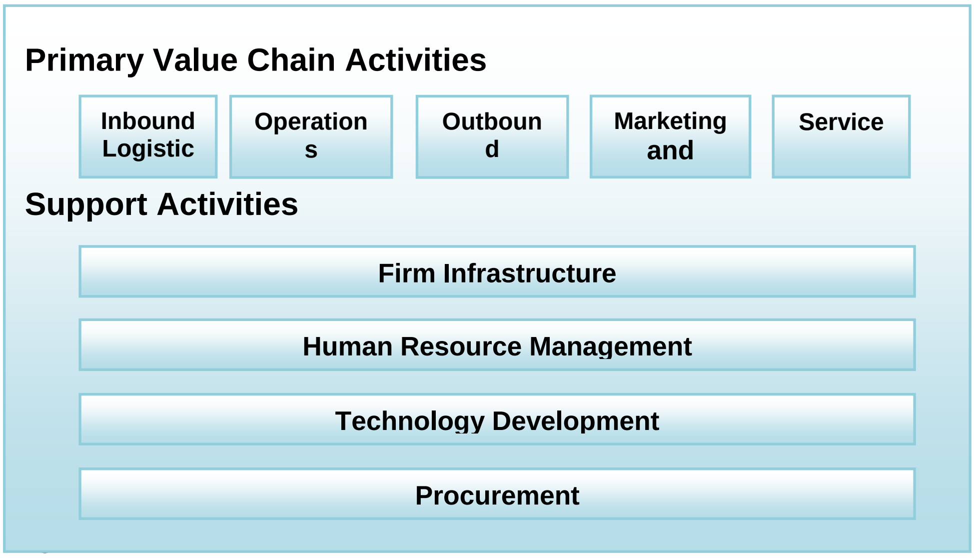
The distinctive competencies (core competencies), resulting from the specific firm's resources and capabilities, facilitate innovation, efficiency, quality and customer receptiveness, all of which can be leveraged to achieve either a lower cost structure or product differentiation.
A firm positions itself in its industry through its choice of low cost or differentiation.
This decision is a central piece of the firm's competitive strategy.

A competitive advantage exists when the firm is able to deliver the same benefits as competitors but at lower costs (**cost advantage**) or deliver benefits that go beyond those of competing products (**differentiation advantage**). Therefore, a competitive advantage allows the firm to create superior value for its customers and profits for itself.

<u>The Value Chain</u>

The value chain helps to analyse particular activities through which firms can generate value and competitive advantage. The firm is represented as a chain of value-creating activities.

Porter (1998) recognized a set of frequent interrelated generic activities in the firms. The resulting model is known as the value chain where Porter identified primary and support activities as illustrated below (Figure 2).



Primary Value Chain Activities
The purpose of these activities is to produce value that exceeds the cost of providing the product or service, i.e. to make a profit.

- ***Inbound Logistics*** includes receiving, storing, inventory control of input materials and their distribution to manufacturing as they are required.
- ***Operations*** includes all the activities that transform the inputs into the final product (such as machining, packaging, assembly, equipment maintenance, testing ...).
- ***Outbound Logistics*** includes the activities required to get the final product to the customers (such as warehousing, order fulfilment, transportation, distribution management).
- ***Marketing and Sales*** includes activities associated with the identification of customer needs and the creation of sales (such as channel selection, advertising, promotion, selling, pricing, retail management, etc).
- ***Service*** includes the activities that maintain and enhance the value after the products and services are sold to the customers (such as customer support, repair services, installation, training, spare parts management, upgrading, etc.).

Every primary activity may be crucial in developing a competitive advantage. For example, logistics activities are critical for a provider of distribution services, and service activities may be crucial for a firm offering on-site maintenance contracts for office equipment. These five categories are generic and described here in a broad way. Each generic activity comprises specific activities that differ from firm to firm.

Support Activities
The primary value chain activities are facilitated by support activities, organised by Porter in four generic categories, detailed according to the firm's specificity.

- ***Firms Infrastructure*** includes general management activities such as planning, finance, legal, accounting, quality management, organisational structure, control systems, firm's culture, etc.
- ***Human Resource Management*** includes the activities associated with recruitment, hiring, training, development, retention and compensation of employees and managers.
- ***Technology Development*** includes technology development to support the value chain activities, such as research and development, process automation, design, redesign.
- **Procurement** includes activities associated with purchasing the raw materials, servicing, spare parts, buildings, machines and other inputs used in the value-creating activities.

Support activities habitually are seen as "overhead", but some firms have used them to build up a competitive advantage, for example, to develop a cost advantage through innovative management of information systems.

Value Chain Analysis
From a value based management point of view, the Value Chain Model helps to build a relative competitive advantage together with Porter's Competitive Advantage thinking. The Value Chain Model can be seen as one of two dimensions in maximizing corporate value creation. The other value creation dimension

is the market/industry attractiveness for which another model from Porter is often used: the Competitive Forces model (the Five Forces model)[1].

Activities leading to a competitive advantage:

1. Identifying the relevant firm-specific activities within the generic value chain;
2. .Mapping the process flows, and
3. Isolating the individual value-creating activities, by means of the flows.

Once the distinct activities are clear, linkages between activities should be recognized. A linkage exists if the performance or cost of one activity affects that of another. Competitive advantage may be gained by optimizing and coordinating linked activities. The value chain is useful in making outsourcing decisions as well. Considering the linkages between activities can lead to more optimal make-or-buy decisions that can result in either a cost advantage or a differentiation advantage.

The value chain model is a helpful analysis tool for defining a firm's core competencies and the activities in which it can achieve a competitive advantage as follows: (1) **Cost advantage**: by better understanding costs and squeezing them out of the value-adding activities and (2) **Differentiation**: by focusing on those activities linked with core competencies and capabilities in order to perform them better than competitors.

The firm's value chain links to the value chains of upstream suppliers and downstream buyers. The result is a larger stream of activities known as the value system. The development of a competitive advantage depends not only on the firm specific value chain, but also on the value system of which the firm is a part.

Identifying ways for creating value

"Value Chain Analysis" is a useful tool for identifying the ways in which the firm can create value for their customers, and afterwards to consider how this value can be maximized, whether through products, services or jobs.

It is possible to use the tool in a three-step process, as follows:

1. Activity Analysis: in the first step, the activities undertaken to deliver the product or service are identified, commonly during a brainstorming session. These include the step-by-step business processes that the firm uses to create customers. Then, register the activities which add value for the firm in a list. A practical way of doing this is to put them down as a basic flow chart.

Do the brainstorming with your team, this will ensure more and better quality suggestions.

2. Value Analysis: in the second step, for each activity, identify what is feasible to do in order to add the greatest value for the customers. For every activity the "Value Factors" (from a customer's point of view) are listed. Then, write down what should be done or changed to confer greater value for each Value Factor.

[1] See unit 2: "*The External Environment*".

3. Evaluation and Planning: in the third step, assess whether it is worth making changes, and if so an action plan is launched. Frequently there is a need to establish some priorities as it may be impossible to undertake all the ideas suggested.

If you have a close relationship with one or more of your customers, it may be important to receive their feedback as regards to the conclusions, either to confirm them or to improve them.

An example of the application of the three-step process is outlined below:

4.1.5 Example[2]

„Lakshmi is a software development manager for a software house and with her team they use value chain analysis to find out how they can offer excellent service to their clients. During the Activity Analysis, they identified the following activities that create value for clients: *Order taking; Enhancement specification; Scheduling; Software development; Programmer testing; Secondary testing; Delivery and Support.* Other non-client-facing activities were also identified as being important, such as Recruitment and Training.
Lakshmi notes the first three client-facing activities in a vertical value chain - „Activity Analysis" box in Figure 3 below:

Step 1: Activity Analysis	**Step 2: Value Analysis**	
Value Chain	**Values Factors**	**Changes Needed**
Order Taking ↓	- Fast answer to phones - Knowledge of customer's situation and system - Understand needs accurately - Manage expectations	- 3 rings rule - Team updates on clients - Team training on systems - Training on client industry - Client briefing at end of call
Specificatio ↓	- Accurate, comprehensive description of changes - Easily understandable - List all activities - Explains basis of price	- Training in writing & proofing - Internal review for clarity - Use a check list to ensure all points considered - Description of all activities
Scheduling ↓	- Set expectations clearly - Clear statement - Meet commitments - Timely job start	- Accurate time estimation - Scheduling system needed - Contingency time in schedule - Need sufficient capacity

Figure 3: Value Chain Analysis Example.

[2] Value Chain Analysis: Achieving Excellence in the Things that Really Matter, viewed 6 August 2009 (adapted), http://www.mindtools.com/pages/article/newTMC_10.htm.

Next, focusing on the order taking process, the internal factors were identified, those that will give the greatest value to customers - the Value Factors, such as:

1. Giving a quick answer to incoming phone calls;
2. Having a good knowledge of the customer's business, situation and system, so that they do not waste the customer's time with unnecessary explanation;
3. Asking all the right questions, and getting a full and accurate understanding of the customer's needs; and
4. Explaining the development process to the customer and managing his/her expectations as to the likely timetable for delivery.

These factors are further considered in the „Value Factors "column (Fig 3) where they then look at what they need to do to deliver the maximum value to the customer. These aspects are shown in the „Changes Needed "column. Subsequently, a similar analysis is made for all the other processes. Once the brainstorming is complete, Lakshmi and her team may be able to identify quick wins, reject low yield or high cost options, and agree on their priorities for implementation.

EXERCISE: Apply the value chain analysis to your firm and find out if it works for you!

1. Following a brainstorming session with your team, complete the following table:

Name of the Firm: _________________ Sector: ______________________________

Value Chain Analysis

Step 1: Activity Analysis	**Step 2: Value Analysis**	
Value Chain	**Values Factors**	**Changes Needed**

Note: add to the table above as many lines as necessary

2. After critically evaluating the ideas which emerged, establish a plan of action. Firstly pick out some of the easy, quick and cheaper ideas. After that, consider the more difficult changes. Some may be unrealistic. Other will bring only minor improvements, but at great costs. Drop these.
3. Finally prioritize the remaining tasks and plan to undertake them in a step-by-step way that enhances your firm's activities.

By using Value Chain Analysis and by following it through to action, you can reach excellence in what actually matters to your customers!

4.1.6 Summary

In this subtopic the relevance of competitive advantage was discussed and how the value chain can help to analyse particular activities through which firms can generate value and competitive advantage. A three-step process to create value at the firm's level was described and illustrated in order to support managers to apply this process to their own situation.

4.2 Generic Strategies

4.2.1 What is meant by generic strategies?

Two of the essential decisions which a firm has to make are related to its position within the industry either by opting for low cost or differentiation, and how broad or narrow a market segment should be. Porter produced a matrix using cost advantage, differentiation advantage and a broad or narrow focus to classify a set of generic strategies that the firm can pursue to generate and maintain a competitive advantage.

By applying those strengths in either a broad or narrow scope, the three generic strategies include: cost leadership, differentiation and focus, shown in Figure 4.

Target Scope	**Advantage**	
	Low Cost	**Product Uniqueness**
Broad (Industry wide)	Cost Leadership Strategy	Differentiation Strategy
Narrow (Market Segment)	Focus Strategy (low cost)	Focus Strategy (differentiation)

Figure 4: Porter´s Generic Strategies

These strategies can be applied in most cases at the SME level. They are called *generic strategies* because they are neither firm nor industry dependent.

Cost Leadership Strategy

It takes a lot of money to look this cheap, said Dolly Parton. Like others in the Low Cost Leadership category, Dolly Parton is a big business.

The Cost Leadership Strategy is frequently the domain of big business. Small firms are not, in general, resourced to achieve cost leadership (which requires economy of scale). This generic strategy emphasizes efficiency once a firm is considered as the best low cost producer in an industry for a given level of quality. Low costs allow firms to sell relatively standardised products that offer features acceptable to many customers at the lowest competitive price, and such low prices will gain competitive advantage thus increasing market share. Whether a cost leadership strategy is sustainable depends on the ability of another competitor to match or develop a cost base that is lower than the cost leader. The lowest cost base must be sustained if leadership is to continue.

Differentiation Strategy

Differentiation strategy is related to the development of a product or service that offers unique attributes that are valued by customers and that customers perceive to be better than or different from the products of the competition. The value added by the uniqueness of the product may allow the firm to charge a premium price for it. The firm hopes that the higher price will cover the extra costs incurred in offering the unique product.

Focus Strategy

Focus is essentially a strategy of segmenting markets and appealing to only one or a few groups of consumers or industrial buyers. It is also called a segmentation strategy or niche strategy. It is hoped that by focusing the marketing efforts on one or two narrow market segments and tailoring the marketing mix to these specialized markets, it is possible to better meet the needs of that target market. At same time it attempts to achieve either a cost advantage or differentiation.

4.2.2 Why do firms implement generic strategies?

Cost Leadership Strategy

Within this strategy the firm sells its standardized products either below the average industry prices to increase market share or at average industry prices to earn a profit higher than that of competitors. Therefore, having a low cost advantage does not always lead to low price. Some firms that are very good at managing their costs sell their products at competitive parity, thus enjoying greater margins than their competitors. In this environment, the low cost business sets industry-standard pricing and brands its products to compete alongside other comparable brands in the category. Its success is measured by its profit. In the occurrence of a price war, the firm can maintain some effectiveness while the competitors suffer losses. Even without a price war, as the industry matures and prices decline, the firms that can produce more inexpensively will remain profitable for a longer period of time. The cost leadership strategy usually targets a broad market.

Differentiation Strategy

Differentiation is a viable strategy for earning above-average returns in an industry, because it creates a defensible position for coping with the five competitive forces. In fact, through product differentiation the firm attempts to gain a competitive advantage by increasing the perceived value of their products and services relative to the perceived value of other firm's products and services. Products sold by two different firms may be exactly the same, but if customers believe the first one is more valuable than the second, then the first product has a differentiation advantage. The existence of product differentiation, in the end, is always a matter of customer perception but firms can take a variety of actions to influence these perceptions.

Focus Strategy

The firm usually tries to gain a competitive advantage through product innovation and/or brand marketing rather than efficiency. Notably, a number of small and medium sized companies have found that the niche strategy is the most useful strategic area for them to explore (Lynch, 2003). While most companies employ cost leadership strategy, differentiation, or a mix of these two strategies, there are relatively fewer companies that adopt a niche strategy.

A focus strategy should target market segments that are less vulnerable to substitutes or where competition is weakest, in order to earn above-average returns on investment. A firm using a focus strategy frequently benefits from a high degree of customer loyalty, and this well-established loyalty discourages other firms from competing openly. Because of their narrow market focus, firms using a focus strategy market lower volumes and therefore have less bargaining power in relation to their suppliers. Nonetheless, firms pursuing a differentiation-focused strategy may be able to pass on higher costs to customers since similar alternative products do not exist.

4.2.3 Where generic strategies can be a risk

Cost Leadership Strategy

A low-cost strategy can be a risk, for example, if other firms may be able to lower their costs as well. As technology improves, the competition may be able to leapfrog a firm's production capabilities, thus eliminating that firm's competitive advantage.

Moreover, several firms following a focus strategy and targeting various narrow markets may be able to achieve even lower cost within their segments and, as a group, still gain significant market share. On the other hand, low cost leadership when combined with low prices can lead to low customer loyalty (Vokurka & Davis, 2004). Relatively low prices can result in creating a negative attitude towards the quality of the product in the mindset of the customers.
Customer's impression regarding such products will enhance the tendency to shift towards a product which might be higher in price but projects an image of quality. A low cost strategy provides the capability to generate a competitive advantage but development and maintenance of a low cost base becomes a difficult task.

Differentiation Strategy

The risks related to a differentiation strategy comprise imitation by competitors and changes in customer tastes. Furthermore, diverse firms pursuing focus strategies may be able to achieve even greater differentiation in their market segments.

Research suggests that a differentiation strategy is more likely to generate higher profits than a low cost strategy because differentiation creates a better market entry barrier. A low-cost strategy is more likely, however, to generate increases in market share.

Focus Strategy

Some risks of focus strategies include imitation and changes in the target segments. There is a danger that the niche market may disappear, as the business environment and customer preferences change over time. Furthermore, it may be quite simple for a broad-market cost leader to adapt its product so as to compete directly and others using a focus strategy may be able to establish sub-segments that they can better supply.

Possibly one of the most important elements to consider is whether the size of the market is appropriate from the revenue potential aspect, and if the company has the capability to provide the specialised products that the consumers in the niche market want. The focus strategy always implies some limitations on the overall market share achievable and involves a trade-off between profitability and sales volume, but not necessarily a trade-off with overall cost position. The focus on costs can be difficult in industries where economies of scale play an important role.

4.2.4 How can firms acquire advantages through generic strategies?

The Cost Leadership Strategy

Firms can acquire cost advantages by improving process efficiencies, gaining unique access to a large source of lower cost materials, making optimal outsourcing and vertical integration decisions, or avoiding some costs altogether. If competing firms are unable to lower their costs by a similar amount, a firm may be able to sustain a competitive advantage based on cost leadership.

Firms that are successful in cost leadership frequently demonstrate the following internal strengths:

- ***Economies of scale***: Usually, the product needs to be created in large volume, made available to a very large customer base and distributed through the most extensive distribution network possible. A cost leader normally enjoys substantial market share;
- ***Capacity of investment***: to make a significant investment in production assets may represent a barrier to entry that many firms may not surmount;
- ***Efficient manufacturing:*** processes are focused on true product value, eliminating activities that do not contribute to delivering customer value
- ***Efficient distribution channels;***
- ***Good access to important inputs,*** such as raw materials, process engineering, technology, components, skills or the availability of cash to finance the purchasing of the most efficient equipment;
- ***Rigorous and ongoing attention to cost reduction***. Low cost leaders often invest continually in technology and process reengineering that applies to all aspects of the business to strip out cost and maintain the cost-led edge over competitors. Processes that do not contribute towards cost reduction (or minimisation) may be outsourced to third parties.

Differentiation Strategy

Approaches to differentiation include developing unique brand images, unique technology, unique features, unique channels, unique customer service or the like. In other words, the key to differentiation is obtaining an advantage that is readily perceived by the consumer.

Increased costs can usually be passed on to the buyers due to the uniqueness of the product attributes.

Firms that do well in a differentiation strategy frequently have the following internal strengths:

- Access to good research;
- Highly skilled and creative product development team;
- Strong sales team with the ability to successfully communicate the perceived strengths of the product;
- Corporate reputation for quality and innovation.

Focus Strategy

Firms that are successful in a focus strategy are able to tailor a broad range of product development strengths to a relatively narrow geographic market segment, or to a particular buyer group or segment. They also target market segments that are less vulnerable to substitutes or where a competition is weakest in order to to earn above-average return on investment.

Whereas low cost and differentiation strategies are aimed at achieving their objective industry wide, focus is build around serving a particular target or niche extremely well. The strategy is based on the assertion that the firm can serve its narrow strategic target more effectively or efficiently than more broadly based competitors.

The firm may achieve differentiation from better meeting the needs of the particular target or lower costs in serving the target, and may even achieve both. Even though the focus strategy does not achieve low cost or differentiation from the perspective of the market as a whole, it does achieve one or both in its narrow market target.

Often the focus strategy of filling a limited need or offering a product that only a few will purchase, allows for products to be priced at a premium since the firm is satisfying a small group of consumers. Most successful midsize growth companies are leaders in market niches, often in markets they have created through innovation. Such niche strategies are often born of necessity, since these firms lack the resources to fight openly, they succeed by seeking out niches that are too small to be of interest to larger competitors. Alternatively, some firms select niches that can be sustained and protected by serving customers extremely well.

EXERCISE: So, you think you've got it? Let's see... Select the correct answer below:

When Toyota entered the American car market in the late 1970's, the company advertised that its cars were far more fuel efficient than American automobiles, better designed, and less expensive. These 3 product differentiators allowed Toyota to gain a considerable share of the US car market. Which strategy did Toyota use according to Porter's framework?

Cost Leadership Strategy
Product/Service Differentiation Strategies
Focus Strategy
Cost and Differentiation Strategies

Integrated Strategic Alternatives

Porter highlighted the idea that only one strategy, from the three generic business strategies, should be adopted by a firm and failure to do so will result in them being "stuck in the middle"[3]. He argued that there is a risk of losing direction for the organisation when practising more than one strategy. Porter stated that to be successful at multiple strategies, firms frequently create separate business units for each strategy. By separating the strategies into different units having different policies and even different cultures, it is less probable that a firm becomes "stuck in the middle".

Nevertheless, a single generic strategy is not always the best answer since the customers for a product frequently look at various aspects, for instance a mix of quality, style, utility, and price. A high quality producer that follows a single strategy can be affected by the entrance in the market of a new firm with a lower-quality product that better meets the overall customers' needs. Additionally, there is contemporary evidence (Proff, 2000) of firms practising a "hybrid strategy" (low cost and differentiation strategy) with success, doing even better than the ones adopting one generic strategy and resulting in sustainable competitive advantage. Multiple business strategies are essential to reply successfully to any environment condition (Parnell, 2006): In the mid to late 1980's, when business environments were rather stable, flexibility wasn't so crucial in business strategies. To survive in the rapidly changing, extremely volatile current market contexts, however, requires flexibility. If a firm's business strategy cannot cope with environmental and market changes, long term survival becomes difficult. Diverging the strategy, making the most of opportunities and avoiding threats created by market conditions, is a pragmatic approach for any firm. Porter revised his preliminary view and accepted that hybrid business strategies could exist (Porter, 1991, p.101).

In short, Porter describes three generic strategies for gaining strategic advantage:

1. *Cost Leadership Strategy* – should we lower our costs?
2. *Product/Service Differentiation* Strategies – should we differentiate our products and services?
3. *Focus* Strategy – should we target a broad market or a narrow one?

Specific actions are required to implement each generic strategy and can vary greatly from one industry to another as well as within a single industry. Selecting and implementing the appropriate strategy is central to achieving long-term competitive advantage in an industry.

Critical analysis done in parallel for the different strategies identifies basic value in all strategies for creating and sustaining a competitive advantage. Reliable and superior performance, when compared to the competition, could be attained when a "hybrid strategy" is adopted, depending on the market and competitive conditions. Hybrid strategies should be adjusted based on the degree to which each generic strategy (cost leadership or differentiation) should be given priority in practise.

[3] Porter 1980

4.2.5 Example and Case Study

EXAMPLE: Focus strategy is illustrated below with a success story:

INDITEX, a European SME success story[4]

The story of INDITEX Group from Spain demonstrates how innovative design and trademarks helped a small family-owned business grow into a solid international firm. INDITEX introduced a revolution in the fashion sector that compelled other companies to rethink their strategy.

INDITEX Group's chairman and founder Amancio Ortega Gaona made his modest start working at the age of 14 as a gofer in a shirt store in La Coruna, Galicia. From the first venture into his own business in 1963, Mr. Ortega reached an initial milestone in 1975 with the opening of the first ZARA store in La Coruna. A decade later, he founded INDITEX as holding company for its various subsidiaries, paving the way for the Group's expansion outside Spain, first to Portugal in 1988, followed by the opening of outlets in New York in 1989 and in Paris in 1990.
INDITEX Group launched the "Pull & Bear" chain of casual wear in 1991 and in the same year purchased 65% of the "Massimo Dutti" Group, a high-end fashion concern, which was fully acquired in 1995. Meanwhile, it continued the drive into the international market by opening various stores in Mexico, Greece, Belgium and Sweden, respectively from 1992-1994.

The Group started the "Bershka" chain targeting the younger female segment in 1998, when it also set up stores in Argentina, Japan, UK, Venezuela, Lebanon, UAE, Kuwait and Turkey. In 1999, INDITEX acquired "Stradivarius", making it the fifth chain of the Group, and opened its stores in new countries namely the Netherlands, Germany, Poland, Saudi Arabia, Bahrain, Canada, Brazil, Chile and Uruguay. In 2000, INDITEX built its headquarters in Arteixo, La Coruna, Spain, while opening stores in four new countries. The company was listed in the Spanish stock market in May 2001 with its shares sold out the day it went public in the year when it added six more countries to its global footprint.

INDITEX has seven different firms with seven different trademarks under its umbrella. It has 1,376 stores in 42 countries across the world.

INDITEX success lies in the goodwill value of the Group's trademarks: Zara for the middle-class segment, Massimo for the high-end, and Pull & Bear for casual clothing line.

The Group does not invest a lot in advertisement campaigns, but it focuses on investment in the "image" of the shops. It focuses on delivering value for money, and the capacity to adapt to consumer's tastes. The Group's future looks promising, with its blueprint of establishing presence worldwide, while launching a new product line: women's underwear.

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[4] http://www.ecap-project.org/articles_publications/specific_topics/inditex_a_european_sme_success.html, Viewed 8 September 2009 (adapted).

CASE STUDY: Please read carefully the following case study:

ABC Furniture Company Limited: A Thai SME[5]

ABC Furniture ECo. Ltd. was founded in December 1992. It is located in the Eastern Region of Thailand. Mr. Ar-rak Suksawat was the managing director. Core products of the company are furniture items made of rubber wood. There are two types of furniture: household furniture (dining table and chairs, cupboard and bedroom set) and office furniture (computer tables, book shelf, table and chairs).

ABC furniture Co. Ltd. received export promotion support for their furniture under the Thailand trade mark from Thailand Export Promotion Department, Ministry of Commerce, since 1996. The company employed a proactive policy in order to expand their market size by attending trade fairs in Japan, Europe and USA. At the beginning, the company could usually get a small volume order from the customers. Later, the amount of orders became larger. There was an expansion of the exhibition area from 9 square meters at the beginning to 40 square meters at present. ABC's major customers are Japanese (80% of total sales). Their requirements are good quality, well designed furniture. In addition, they require punctual delivery with minimal damaged goods.

The company's main policy concentrated on customers and market. The management team regularly visits each customer to get suggestions and comments. Furthermore, they promptly communicate with their customers via e-mail to provide rapid response to customers' needs when there are problems regarding their products.

Vision of ABC Furniture CO. LTD.

The corporate vision of ABC Ltd. is to be recognized as a leader in rubber wood furniture by employing the most capable people and technologies, always bearing in mind that product and customer satisfaction are the heart of the business. They consider that customer satisfaction leads to success and prosperity and believe their customer relationships will create opportunities to exceed expectations and help develop a higher level of performance.

Awards and Success

ABC Furniture Co. Ltd. received the following awards: (1) Best product of the year from Foundation for Thai Society and Sieng Tang Satthakit Newspaper in 1998 and (2) Prime Minster Award for highest growth rate in export from Ministry of Industry in 1999.

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Description	2001(US$)	2000(US$)	1999(US$)
Revenue	8,591,422.55	7,558,875.50	**5,953,711.05**
Expense	7,762,942.67	6,928,363.75	**5,815,261.89**
Profit	**828,479.75**	**630,511.75**	**138,449.15**

Figure 5: total revenue and profit of the company from 1999 to 2001.

In addition, the company also achieved ISO 9001 and ISO 9002 Quality assurance standards.

Objectives and Methodology

This case aims to examine how customer focus was implemented and to investigate the critical success factors of the company. To obtain details about the practices that were implemented comprehensive data was gathered by directly interviewing the manager and all the staff in the company. The interview is centred on customer and market needs, enhancing company use of customer complaint data and the organization's processes for minimizing customer dissatisfaction and loss of customers. In addition, it focuses on identifying current and potential customers for both existing and new products and services.

Customer and Market Focus

The company follows their vision by concentrating on their customers and learning more about the market. They maintain good relationships with their customers. The following activities are considered their good practices.

1. Knowing Customers and Market

One of the major factors that help the company to formulate effective marketing strategies is the knowledge about their customers and market. They can response correctly to the need of their customers by knowing their target customers and their needs. They learn more about their customers because of the following activities:

<u>1.1. Target customer analysis</u>: Products of the company are furniture for export market. Customers in foreign markets regard this kind of wood as white teak. The company sets their target customers as a group having high purchasing power. This group likes high-quality products, good design and good craftsmanship, made of natural materials. They live in countries with limited wood production and high labour costs. Their main target customers are customers in Japan, Europe and USA. Management studies the customer taste and requirements with respect to their usage of the furniture. They carefully study the culture of these countries. Sources of information are mainly the customers themselves. Details of customers' needs and requirements are different from country to country. For example, Japanese and Europeans focus on design and quality of each piece of work, unlike US customers, which focus on piece of work which is fashionable and usable.

Factors which affect the selection of customer groups are:
(1) Geographical factors: region, population size, population density, climate and geography;
(2) Demographical factors: age, gender, family size, marital status, income, occupation, religion, education, ethnic, nationality, and social group;
(3) Customer buying behaviour: usage rate, brand loyalty, attitude towards products, reaction towards marketing mix and
(4) External environments: laws and regulations, economic situation, financial institutions.

1.2. Learning from target customer: ABC Furniture Co. Ltd. focuses on customer satisfaction. They frequently listen to customers' suggestions, opinions, and complaints. They have follow-up calls to their customers to secure feedback. Customer analysis is carried out in order to understand their expectations, needs and perception with regard to the products and service of the company. The results of the analysis are communicated to all personnel within the company. Furthermore, the company develops its strategies for building up long term relationships with the customers.

They use following steps to handle the information gathered through customers' suggestions, opinions and complaints:
(1) Record all information;
(2) Prioritizing according to important issues;
(3) Analyzing causes of problem;
(4) Providing ways and means for solving problems;
(5) Implementing selected alternatives and
(6) Writing a report to inform customers and the company manager.

The above information gathered from customers' opinions helps the company to prioritize factors affecting the buying decisions of their customers. Domestic customers' buying decisions are affected by price, delivery time, quality, design and service. However, the buying decision of foreign customers is mainly affected by design, price, production potential, and quality, as well as punctualdelivery and service.

In addition, the information will enhance the company's ability to design furniture, provide services and set its marketing mix based on the expectation of its customers. The service quality of salespersons has been acknowledged by customers.

2. Building Customer Relationship

Building good relation with customers is the main policy of the company. They pay a regular visit to every customer and treat them as partners not customers. Both the company and the customers share information and technical knowledge in terms of production techniques and marketing information.

For each meeting with their customers, the sales staff: (1) Prepare a sale kit which includes catalogue, company profile, and a price list and detailed description of the product; (2) Study the background of customers and prepare answers for any questions regarding the product and (3) Study the code of conduct, culture of each country.

During the past year, ABC Furniture Co. Ltd. has secured good business from their customers. Large customers order products regularly from the company. Six Japanese and 2 American customers repeat their orders every month. Another 10 customers put their orders 3-5 times each year.

3. Building Customer Satisfaction

The company adopts both customer acquisition and customer retention strategies. The following are their strategies.

3.1 Product: ABC's products are developed every 3 months by experienced designers to respond to the needs of their customers. They add more value by using different materials such as marble, glass and cloth in producing their furniture. Every year there are 7-8 new designs of dining sets, 2-3 new designs of cupboards and 10 new designs for kitchen furniture.

3.2 Price: The company sets a competitive price for their furniture. They study the price movement both in domestic and foreign markets. They give discount to their regular customers in order to increase their sale volumes.

3.3 Distribution Channel: ABC Furniture Co. Ltd. sells their furniture directly to their customers by attending different trade fairs e.g. Thailand Furniture Fair, Tokyo Fair, Cologne Fair and Chicago Fair. Internet is another route for the company to present their products via the company web site. They have permanent showrooms inside Thailand and Japan. Customer can order by mail or directly at the company's home center.

3.4 Packaging: There are different categories of customers ranging from retail to wholesale. ABC Furniture Co. Ltd. prepares different types of packaging to fit with the needs of each category of customer. There are labels to show details about the product outside the package.

3.5 Delivery Time: The company can always deliver their products on time because of its good location. Furthermore, the marketing department will create a plan together with the customers to estimate the demand in the coming period. This information will help the company to plan production and manage stock.

3.6 Handle Process of Customer Complaints: Responding to customer complaints is a major issue for the company. They set up a system to deal with complaints so that they can respond as quickly as possible. They never ignore customers' suggestions and opinions. Customers will receive an answer within 2-3 days after complaints. The solution will be reported back at once when they can remedy the problem.

3.7 Customer Satisfaction Evaluation: The improvement of product quality is analysed by the evaluation of customer satisfaction level, carried out by interviewing old and new customers. Old customers are regularly interviewed regarding price, quality, services and delivery time. Information on new customers' needs, with respect to product characteristics such as design, colour, and price range, is gathered through interviews by questionnaire.

Critical Success Factors

There are several critical success factors, such as:

1. Leadership: Managing director of the company has clear a vision and is adequate good leader. He works with his employees and shows them how serious he is regarding customer service.

2. Cooperation between Marketing and Production Departments: There are regular meetings between marketing and production departments. The production plan is synchronized with the marketing plan. They can deliver their products on time, solve customer problems quickly and provide the products according to customer's need.

3. Modern Production Technology: They constantly study new production technology and invest in modern technologies in order to produce high quality products and simultaneously create high productivity. The company always improves the production process and eliminates non-value-added activities out of the process. The employees are a team that among other things controls production costs.

4. Employee Training Programme: There are several in-house training programs organized for different departments. Salespersons learn about types of machine, tools and production technologies to enable them to communicate correctly with their customers. Furthermore, staff frequently attends seminars and training courses organized by educational institutes and government institutes. They hire experts in specific area to train their production personnel in how to use methods of production correctly.

5. Employee Morale and Incentive Programme: Keeping the working environment safe is a way to boost the morale of the employees. Light, air ventilations, dust reduction techniques, etc. are employed to help protect employees' health.

Problems and Obstacles

There are several problems for the company to solve such as increasing costs, product copying and competitors.

- *Increasing Production Costs:* High price for rubber wood which is the main raw material of furniture means increasing production costs. They are trying to solve the problem by adding other material to their furniture such as cloth and particle board. In addition, they increase their productivity by a more effective usage of labour and material.
- *Product Copying:* There is fierce competition in the furniture industry. A product can be easily copied. The competitor can copy and sell at a lower price. The company has to come up with a newly designed product at a competitive price. Not only that, the company has to deliver on time and provide a top quality service.
- *Competitors:* ABC Furniture Co. Ltd. focuses on customers in order to face competitors. In fact, Thai SMEs now deal with competitors from foreign countries such as Vietnam and China that possess several comparative advantages, such as

low labour cost. Thai SMEs have to move away from its reactive, low-cost-based strategy that relies on cheap labour and instead develop a new competitive edge based on Customer focus.

In conclusion, ABC Furniture Co. Ltd. provides a model that combines consumer needs with technology development. They present innovative and flexible products with high quality, good value and consistent services. The company utilizes data and information gathered from customers to produce high quality products and to meet customer requirements. Partnerships between the company and their customers exist, because they trust each other. This is the model that creates value for the company.

Think now about the following questions:
1. What does the case study above mean to you?
2. ABC Furniture Co has developed the most suitable strategy based on its vision. Do you agree? Please justify your answer!
3. What can you learn from this case study?

And now why don’t you take five minutes to find out if these strategies work for your firm?

After reading and reflecting about the generic strategies, the INDITEX example and the ABC Furniture case study, what would be the most convenient one(s) for your firm? Please illustrate your choice with at least five arguments.

4.2.6 Summary

The skills and resources necessary and the organisational requirements of each of the three generic strategies suggested by Porter are summarized in Figure 6.

Generic Strategies	Commonly Required Skills and Resources	Common Firm Requirements
Cost Leadership	Sustained capital investment and access to capital Process engineering skills Intense supervision of labour Products designed for ease in manufacture Low-cost distribution system	Strict cost control Frequent, detailed control reports Structured firm and responsibilities Incentives based on meeting strict quantitative targets
Differentiation	Strong marketing abilities Product engineering Creative flair Strong capability in basic research Corporate reputation for quality or technological leadership Long tradition in the industry or unique combination of skills drawn from other business Strong cooperation from channels	Strong coordination among functions in R&D, product development, and marketing Subjective measurement and incentives instead of quantitative measures Amenities to attract highly skilled labour, scientists, or creative people
Focus	Combination of the above policies directed at the particular strategic target	Combination of the above policies directed at the particular strategic target

Figure 6: Porter’s Three Generic Strategies and Their Requirements[6]

[6] Certo, S. Peter, J.P. (1990), *Strategic Managemnt- A Focus on Process*, McGraw-Hill Inc. p.103 (adapted).

Each of these strategies is designed to give a firm a competitive advantage, but each has several risks associated with it, as listed in Figure 7.

Risks of Cost Leadership	**Risks of Differentiation**	**Risks of Focus**
Cost Leadership is not sustained: • Competitors imitate • Technology changes • Other bases for cost leadership erode	Differentiation is not sustained: • Competitors imitate • Bases for differentiation become less important to buyers	The focus strategy is imitated The target segment becomes structurally unattractive • Structure erodes • Demand disappears
Proximity in differentiation is lost	Cost proximity is lost	Broadly targeted competitors overwhelm the segment • The segment's differences from other segments narrow • The advantages of a broad line increase
Cost focusers achieve even lower cost in segments	Differentiation focusers achieve even greater differentiation in segments	New focusers sub-segment the industry

Figure 7: Risks of the Generic Strategies[7]

And keep in mind that reliable and superior performance, rather than competition, could be attained when "hybrid strategy" is adopted, depending on the market and competitive conditions of your firm.

Summary of Key Points

The main objective of this unit was to raise awareness about the importance of competence advantage and organisational strategies geared to achieve the firm's overall objectives.

Awareness about the importance of good business strategies for the firm as well as creating better value for the customers is highlighted.

[7] Certo, S. Peter, J.P. (1990), *Strategic Managemnt- A Focus on Process*, McGraw-Hill Inc. p.104 (adapted).

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