UNIT - III

Competitive Strategies

The purpose of its competitive strategy is to build a sustainable competitive advantage over the organization's rivals. This means the ability to anticipate correctly how businesses respond strategically to competitive threats and opportunities.

Competitive strategy is an area of principle concern to managers.

- It provides the framework that guides competitive positioning decisions.
- It examines the way in which an organization can compete more effectively to strengthen its market position.

Competitive Strategy is concerned with how a business competes successfully in a particular market.

Strategic decisions hinge on:

- a company's capabilities,
- strengths, and
- Weaknesses;

in relation to market characteristics and the corresponding capabilities, strengths, and weaknesses of its competitors.

It provides an understanding to decisions in:

- choice of products,
- meeting needs of customers,
- gaining advantage over competitors,
- exploiting or creating new opportunities, etc.

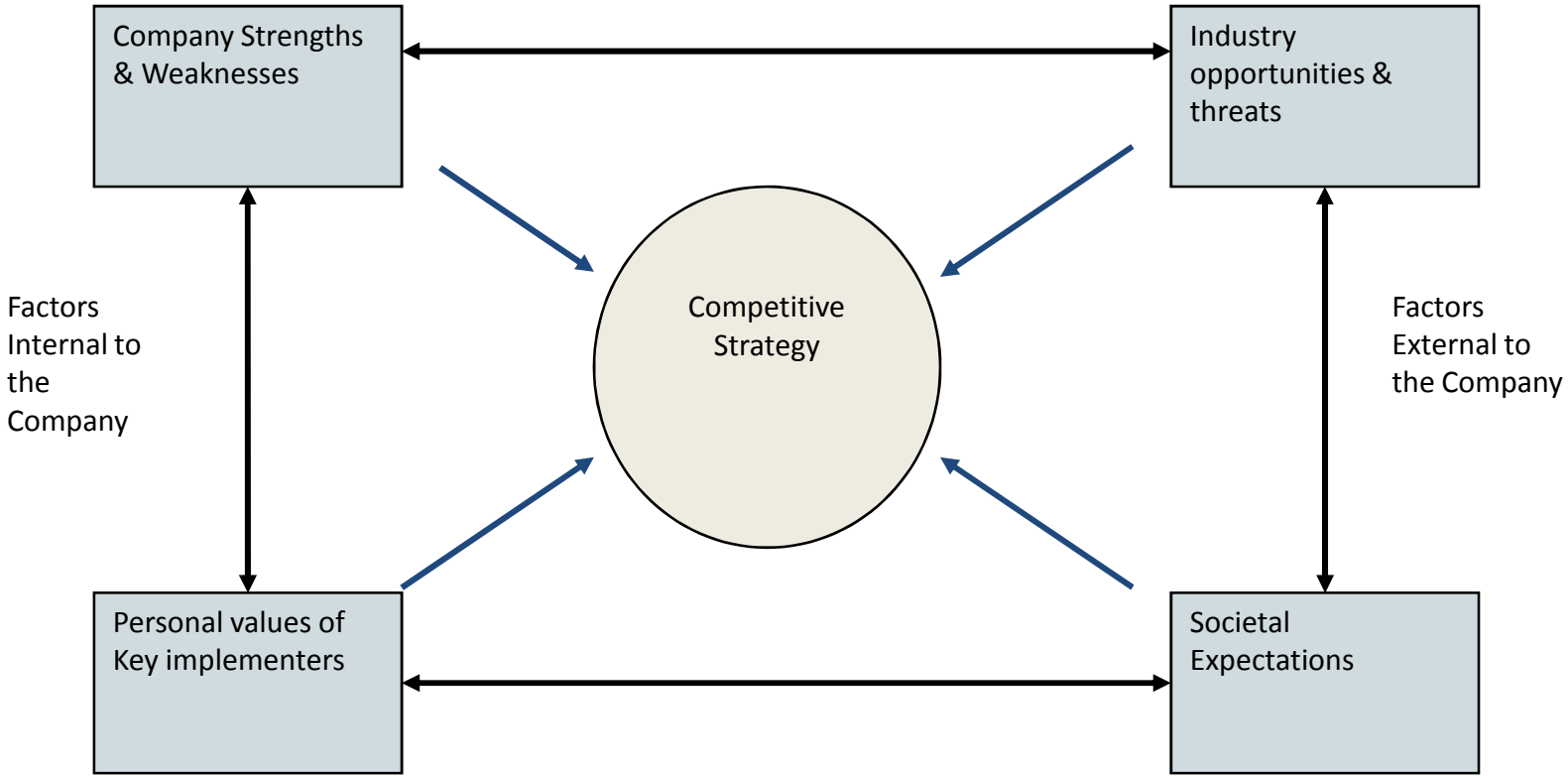
Developing a competitive strategy is developing a broad framework for the business –

- how is it going to compete;
- what are its objectives; and
- what policies will be needed to carry out its objectives.

The competitive strategy is a combination of ‘ends’ for which an organization is striving and ‘means’ by which it is seeking to get there.

Formulating competitive strategy involves the consideration of four key factors.

These factors combine to provide the basis and limits to the competitive strategy a company can successfully adopt.



In order to formulate strategy effectively, the organization must be in a position to answer the following questions:

- What is the current strategy, implicit or explicit?
- What assumptions have to hold for the current strategy to be viable?
- What is happening in the industry, with our competitors, and in general?
- What are our growth, size, and profitability goals?
- What products and services will we offer?
- To what customers or users?
- How will the selling/buying decisions be made?
- How will we distribute our products and services?
- What technologies will we employ?
- What capabilities and capacities will we require?
- Which ones are core?
- What will we make, what will we buy, and what will we acquire through alliance?
- What are our options?
- On what basis will we compete?

Although the process may seem intuitively clear, answering these questions involves a great deal of penetrating analysis. It is in answering these questions that the organization finds its competitive strategy.

Structural Determinants

Industry has been defined in many ways. However, a working definition of industry for our purposes is that industry constitutes a group of business organizations producing products or services that are close substitutes for each other.

Competition in an industry continually works towards driving down the rate of return on invested capital such that it reaches a floor rate.

This rate is equal to the rate of return that would be earned under conditions of perfect competition, the rate that is offered on long term government securities, adjusted for the risk of capital cost.

Investors will not invest in industry if they can get similar returns from government securities. The rates of return need to be higher than the adjusted free market rate of return to motivate inflow of capital into an industry.

The strength of competitive forces in an industry determines the degree to which this inflow of investment occurs and the ability of organizations to sustain above average returns.

Porter's five competitive forces reflect the fact that competition in an industry goes well beyond the established players:

- threat of new entrants;
- threat of substitute products or services;
- bargaining power of suppliers;
- bargaining power of buyers; and
- rivalry among existing firms,

Each of the five forces is a competitor and each one may be more or less prominent depending on the particular circumstances. Jointly, they determine the intensity of industry competition and profitability.

Generic Competitive Strategies

Despite of the enormous proliferation of competing schemes in the business strategy literature, there are two fundamental paradigms that have emerged as the most influential in the last two decades.

First, Competitive Positioning, as proposed by Michael Porter, also known as Porter's Generic Strategies, drawn from the work of organizational economists.

and,

Second, the Resource-Based View of the organization that evolved during the 1990's. C.K. Prahalad and Gary Hamel popularized the approach in their classic paper, "The Core Competence of the Corporation", Harvard Business Review, May- June, 1990.

To obtain a superior rate of return the organization has to achieve competitive advantage i.e. provide customers with what they want, or need, better or more effectively than competitors and in ways the competitors find difficult to imitate.

The best strategy for the organization, therefore, is unique reflecting the particular circumstances it faces.

There are two basic types of competitive advantage a firm can possess:

- low cost, or
- differentiation.

The two basic types of competitive advantage combined with the scope of activities for which a firm seeks to achieve them, lead to three internally consistent generic competitive strategies:

- Cost Leadership
- Differentiation, and
- Focus and Niche Strategies.

The focus and niche strategy has two variants,

- cost focus, and
- differentiation focus.

Competitive Scope	Competitive Advantage: Lower Cost	Competitive Advantage: Differentiation
Broad Target	1. Cost Leadership	2. Differentiation
Narrow Target	3a. Cost Focus	3b. Differentiation Focus

Cost leadership strategy

A firm pursuing a cost-leadership strategy attempts to gain a competitive advantage primarily by reducing its economic costs below its competitors.

The skills and resources required to be successful in this strategy are:

- sustained capital investment and access to capital;
- superior process engineering skills;
- good supervision and motivation of its labor force;
- product designed for ease in manufacturing; and
- low-cost distribution system.

The organization attempts to exploit economies of scale by aggressive construction of efficient economies of scale through:

- volume of production and specialized machines
- volume of production and cost of plant and equipment
- volume of production and employees specialization
- volume of production and overhead costs

This strategy requires tight cost control. The structure of the organization should be clear-cut and responsibilities clearly laid out.

The low-cost producer strategy works best when:

- buyers are large and have significant bargaining power;
- price competition among rival sellers is a dominant competitive force;
- the industry's product is a standard item readily available from a variety of sellers;
- there are not many ways to achieve product differentiation that have value to the buyer;
- buyers incur low switching costs in changing from one seller to another and are prone to shop for the best price.
- there are no changes in
  - consumer tastes
  - technology
  - exogenous prices/costs

A low-cost leader is in the strongest position to set the floor on market price and this strategy provides attractive defenses against competitive forces.

Its cost position gives it a defense from competitors because its lower costs mean that it can still earn returns after its competitors have competed away their profits through rivalry.

It is protected from powerful buyers because buyers can exert power only to lower prices, and this will be possible only with next most efficient competitor.

Lower cost provides protection against suppliers because there is more flexibility in the organization to cope with input cost increases.

Any new entrant will find it difficult to overcome entry barriers because of scales of economy and as the activities taken to achieve low costs are both rare and costly to imitate.

This policy once achieved provides high margins and a superior return on investments.

Differentiation strategy

In a differentiation strategy a firm seeks to be unique in its industry along some dimensions that are widely valued by buyers.

It selects one or more attributes that many buyers in an industry perceive as important, and uniquely positions it to meet those needs.

Differentiation will cause buyers to prefer the company's product/service over the brands of rivals.

Anything a company can do to create value for buyers represents a potential basis for differentiation, this includes:

- Product features
- Linkage between functions
- Timing
- Location / convenience
- Product mix
- Links with other firms
- Customization
- Product complexity / sophistication
- Marketing (image, etc)
- Service and support

The challenge is finding ways to create value for buyers and that are not easily copied or matched by rivals.

Differentiation requires the organization to have some of these skills and resources:

- strong marketing abilities
- product engineering
- creative flair
- corporate reputation for quality or technological leadership
- strong cooperation from channels
- strong coordination among functions
- amenities to attract highly skilled labor, scientists, or creative people

Successful differentiation provides insulation against competitive rivalry because of brand loyalty of customers and hence lower sensitivity to price.

The customer loyalty also provides a disincentive for new entrants who will have to overcome the uniqueness of the product or service.

Competitors are not likely to follow a similar approach if Buyers value the differentiated products and services. If they do, this will lead to a lose - lose situation for them.

The higher returns of the strategy, provides a higher margin to deal with supplier power.

Buyer power is mitigated as there are no comparable alternatives.

Finally a company that has differentiated itself to achieve customer loyalty should be better placed to compete with substitutes than its competitors.

Competitive advantage through differentiation is sustainable if the activities taken to achieve differentiation are rare and costly to imitate. The most appealing types of differentiation strategies are those least subject to quick or inexpensive imitation.

Focus & Niche Strategies

The generic strategy of focus rests on the choice of a narrow competitive scope within an industry. The focuser selects:

- a segment or group of segments in the industry,
- buyer groups, or
- a geographical market

The firm then tailors its strategy to serving them to the exclusion of others.

The attention is concentrated on a narrow section of the total market with an objective to do a better job serving buyers than rivals. Each functional policy of the organization is built with this in mind.

There are two aspects to this strategy,

- the cost focus, and
- the differentiation focus.

In cost focus a firm seeks a cost advantage in its target market. This is a low cost producer strategy focused on the target market only.

Differentiation focus offers niche buyers something different from other competitors. The firm seeks product differentiation in its target market.

Both variants of the focus strategy rest on differences between a focuser's target market and other markets in the industry.

Focus strategy is successful if the organization can choose a market niche where buyers have:

- distinctive preferences,
- special requirements,
- or unique needs

Even though the focus strategy does not achieve low cost or differentiation from the perspective of the market as a whole, it does achieve this in its narrow target. However, the market segment has to be big enough to be profitable and it have growth potential.

Alternatively, the firm has to identify a geographical region where it can make such offerings.

Some of the situations and conditions where a focus strategy works best are:

- When it is costly or difficult for multi-segment rivals to serve the specialized needs of the target market niche;
- When no other rivals are concentrating on the same target segment;
- When a firm's resources do not permit it to go after a wider portion of the market;
- When the industry has many different segments, creating more focusing opportunities and allowing a focuser to pick out an attractive segment suited to its strengths and capabilities

The three generic strategies differ on many dimensions. Implementing them successfully requires different resources and skills.

Generic Strategy	Required Skills and Resources	Organizational Requirements
Cost Leadership	- Sustained Capital Investment capability and access to Capital - Process Engineering Skills - Intense supervision of labor - Product designed for ease in manufacture	- Tight cost control - Frequent, detailed control reports - Structured organization and responsibilities - Incentives based on meeting strict quantitative targets
Differentiation	- Strong marketing abilities - Product engineering - Creative flair - Strong capability in basic research - Reputation for quality or technological leadership - Long tradition in the industry or unique combination of skills from other areas - 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 labor, scientists or creative people
Focus	- Combination of the above, directed at the particular strategic target	- Combination of the above, directed at the particular strategic target

The three strategies are based on competing differently in the marketplace. They construct different types of defenses against competitive forces. The types of risks they face are also different.

However, there are two types of risks that are common to all of them:

- Failing to attain or sustain the strategy, and
- Erosion in the value of the strategic advantage with industry evolution.

A summary of the risks for the different strategic options is given in the table that follows.

Generic Strategy	Risks
Cost Leadership	- Technological change that nullifies past investments or learning - Low cost learning by industry newcomers or followers through imitation or their ability to invest in state-of-art facilities - Inability to see required product or marketing change because of attention placed on cost - Inflation in costs that narrow the firm's ability to enough of a price differential to offset competitor's brand image or differentiation
Differentiation	- The cost differential between low cost competitors and the differentiated firm becomes too great to hold brand loyalty - Buyer's need for the differentiating factor falls. This can happen when the buyers become more sophisticated - Imitation narrows perceived differentiation, a common occurrence as industries mature
Focus	- The cost difference between broad range competitors and the focused firm widens to eliminate the cost advantages or differentiation achieved by the focus - The differences in desired product or services between the strategic target and the market as a whole narrows - Competitors find submarkets within the strategic target and out focus the focuser.

Porter's Winning Formula:

Porter's framework offers a simple approach to business success: pick an attractive industry in which you can excel. An attractive industry is one in which a business can achieve as close to a monopolistic position as possible.

The value chain is used to define the foundations for action aimed at sustaining a competitive advantage. The forces that determine the industry structure of the business – are largely external and not controllable by the organization.

The activities of the value chain are factors that companies can control as they strive to achieve competitive superiority.

By analyzing these activities, managers can identify:

- the success factors central to competing well, and
- understanding how to develop the unique competencies that provide the basis for sound business leadership.

They must achieve sustainable advantage by beating their competitors in as many key activities as possible.

Resource-based Theory

Resource-Based View postulates: What makes one organization different from another is its ability to accumulate and develop resources that are valuable, rare, and difficult to substitute or imitate.

Premium returns depend upon what economists refer to as “Ricardian rents”. The Resource-Based View uses Ricardo’s insight as a framework for competitive strategy.

They regard scarce factors able to generate Ricardian rents as:

- management skills,
- information capabilities, and
- administrative processes

The Resource-Based View sees the central forces of competitive advantage as factor-driven; that is, they depend on the organization’s development of resources and capabilities.

Instead of looking at the industry as the source of profitability, the Resource-Based View of the organization argues that the attention should turn to the organization.

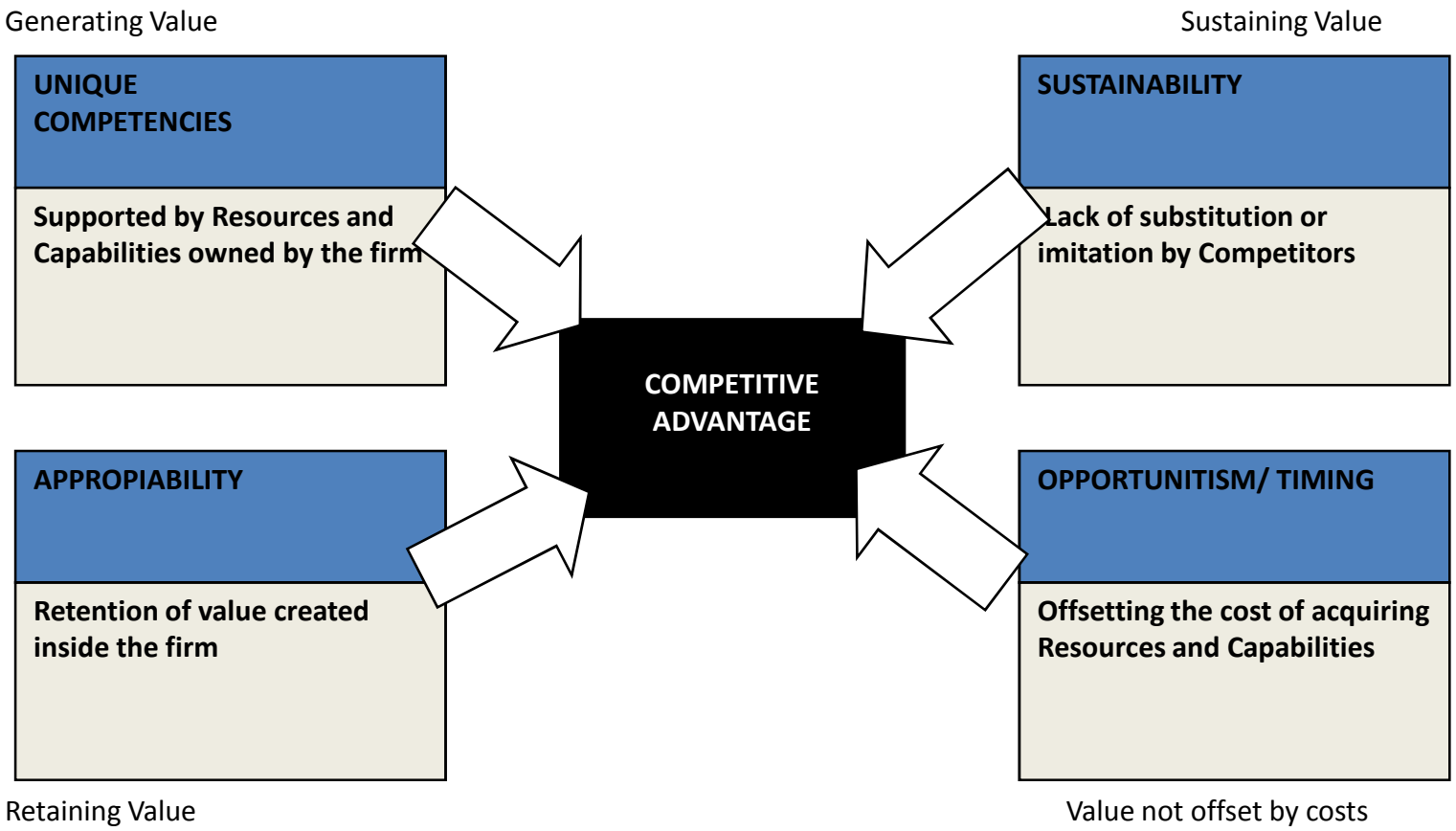
The Resource-Based View has four key components:

- Competitive advantage is created when resources and capabilities owned exclusively by the organization can generate unique core competencies.

- The advantage that results from generating core competencies can be sustained due to the lack of substitution and imitation capacities by the organization's competitors.
- As the core competencies are unique, the benefits derived from these advantages are retained inside the organization: they are not appropriated by others
- The timing of the acquisition of the necessary resources and capabilities is so opportune that their cost will not offset the resulting benefits.

If all these conditions are met, then the competitive advantage that is created will generate economic value for the organization.

The different components of the Resource- Based View as have been shown in the figure.



Unique Competencies:

The organization's resources and capabilities are the sources of its unique competencies.

Resources can be:

- tangible (e.g., financial and physical assets), or
- intangible (e.g. reputation, customer orientation, high quality, and technological superiority).

Resources are converted into capabilities when the organization develops the necessary routines to use them effectively. Often, resources and capabilities are the results of investment in durable, specialized, and non-tradable factors.

These factors can be viewed as commitment or 'strategic intent'.

Strategic Intent explains the persistence in an individual organization's performance, and the differences in profitability enjoyed by different organizations competing in the same industry.

These investments represent both factors that have durability and are not easily lost to competition, and the stakes put up by the organization that also are not easily reversed.

Sustainability:

The organization has to develop its resources so that they reflect the uniqueness of the organization and they continue to remain within the organization.

For a business unit's competitive advantage to be sustainable, its resources must be:

- valuable,
- scarce, and
- difficult to imitate or substitute.

Appropriability:

The issue of appropriability addresses the question of who will capture that value. It is not always necessary that the owners of the business appropriate all the value created. This is because of a gap between ownership and control.

Non-owners might control complementary and specialized factors that divert the cash proceeds away from the business.

This type of dissipation of value is called 'holdup'.

The second issue of economic value is referred to as 'slack'. It measures losses in the economic value.

Slack is often the result of inefficiencies or unwarranted benefits that prevent the accumulation of economic rents by a business.

One of the major sources of slack through large parts of the world has been confrontations between management and labor unions.

These two factors reduce the level of generation of economic value to the organization. While 'hold-up' changes the distribution of the total wealth created, 'slack' reduces the overall size of this wealth.

Opportunism and Timing:

The cost of implementing the strategy should be less than the value generated by it. This is the final necessary condition for competitive advantage.

The cost of implementing the strategy is measured in terms of the cost the establishment of a superior resource position. In other words, the cost incurred in acquiring the resources must be lower than the value created by them.

There are three main ideas.

- Competitive advantage arises from an ability of an organization to build, less expensively and more rapidly than competitors, the core competencies that generate unanticipated products.

  The real source of advantage is to be found in management's ability to consolidate company-wide technologies and production skills into competencies that empower individual businesses to adapt quickly to changing opportunities.

- Second, the link between identified core competencies and end products are the core products. The core products are the physical embodiment of one or more core competencies.
- And third, strategic architecture is a necessary requirement for building and enhancing the core competencies of the organization.

  The most important function of senior management is to develop a corporate strategic architecture that establishes objectives for competency building. Strategic architecture is the road map to the future; it helps determine which core competencies to build and helps identify their constituent technologies.

The Organization's Winning Formula:

- Develop resources and capabilities that are unique, valuable, and non-tradable, and that constitute the unique competencies of the organization
- Make the resulting advantages sustainable by preventing imitation or substitution by competitors
- Appropriate the resulting economic rent by preventing negative hold-up and slack conditions
- Ensure that the implementation process is done in such a way that its associated costs do not overwhelm the resulting benefits.

In addition, develop core competencies at the corporate level; apply them to create core products as opposed to end products; and use a strategic architecture to guide competence building.

Porter's framework and the Resource-Based View basically perceived the primary role of strategy as achieving a unique competitive advantage.

In both these approaches 'competitive' is the common principle. The objective of strategy becomes beating your competitor either by excelling in the activities of your value chain that allows you to establish a dominant position in your industry, or through the mobilization of unique resources and capabilities.

These frameworks jointly contribute to the development of a strong business strategy. Since they emphasize different dimensions of strategy, they can richly complement each other.