Lesson 2. Strategies based on competitive advantage

Basic references:

- Johnson, G., Whittington, R., Regner, P., Scholes, K., & Angwin, D. (2017). Exploring Strategy: Text and Cases. Pearson Education Limited.

- Thomson, A., Peteraf, M.A., Gamble, J.E., & Strickland, A.J. (2020). Crafting & Executing Strategy. Concepts and readings. McGraw-Hill Education.

Lesson 2. Strategies based on competitive advantage

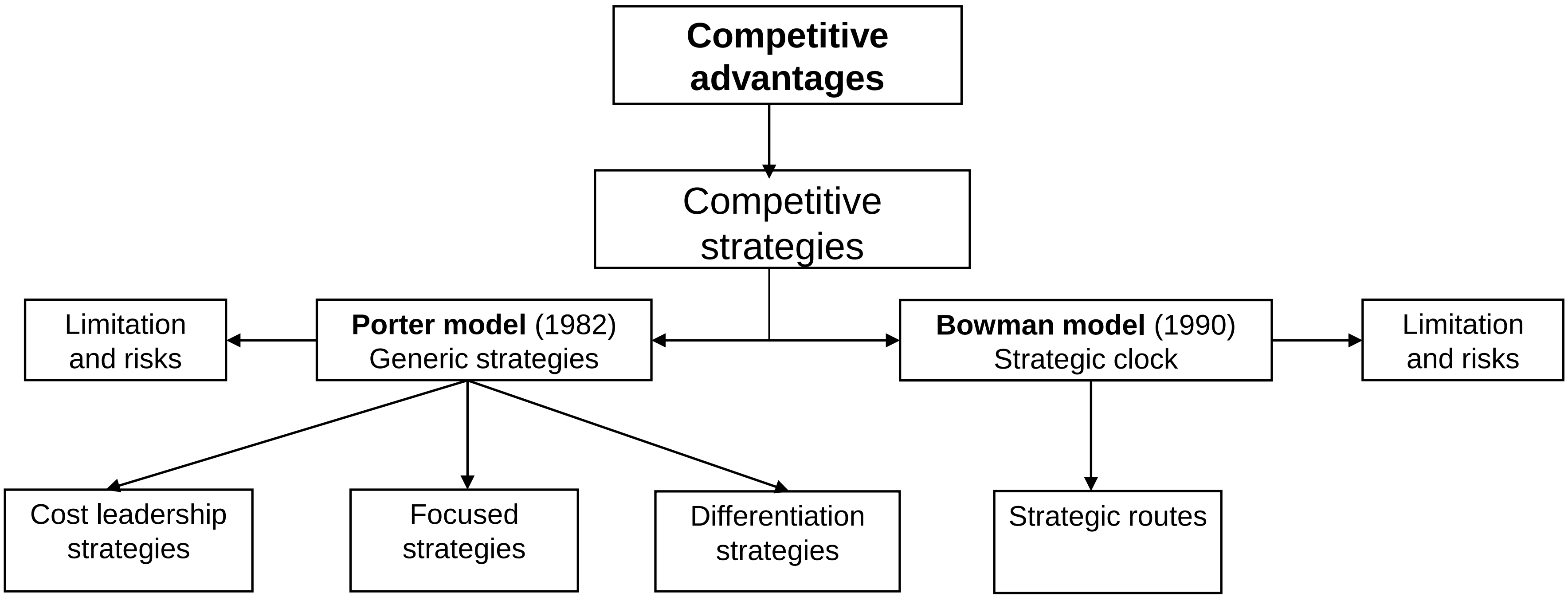
2.1. Competitive argument and competitive advantages

2.2. Generic competitive strategies: cost leadership, differentiation, and segmentation

2.3. Risks of hybrid and intermediate strategies

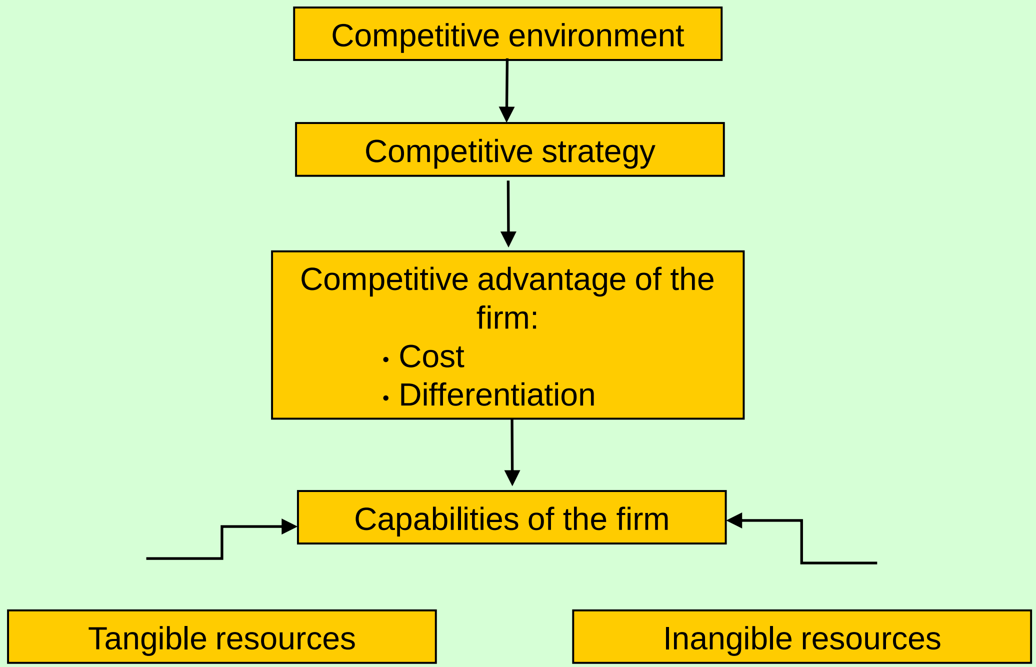
2.4. Strategic clock model

2.1. Competitive argument and competitive advantages



2.1. Competitive argument and competitive advantages

Model general



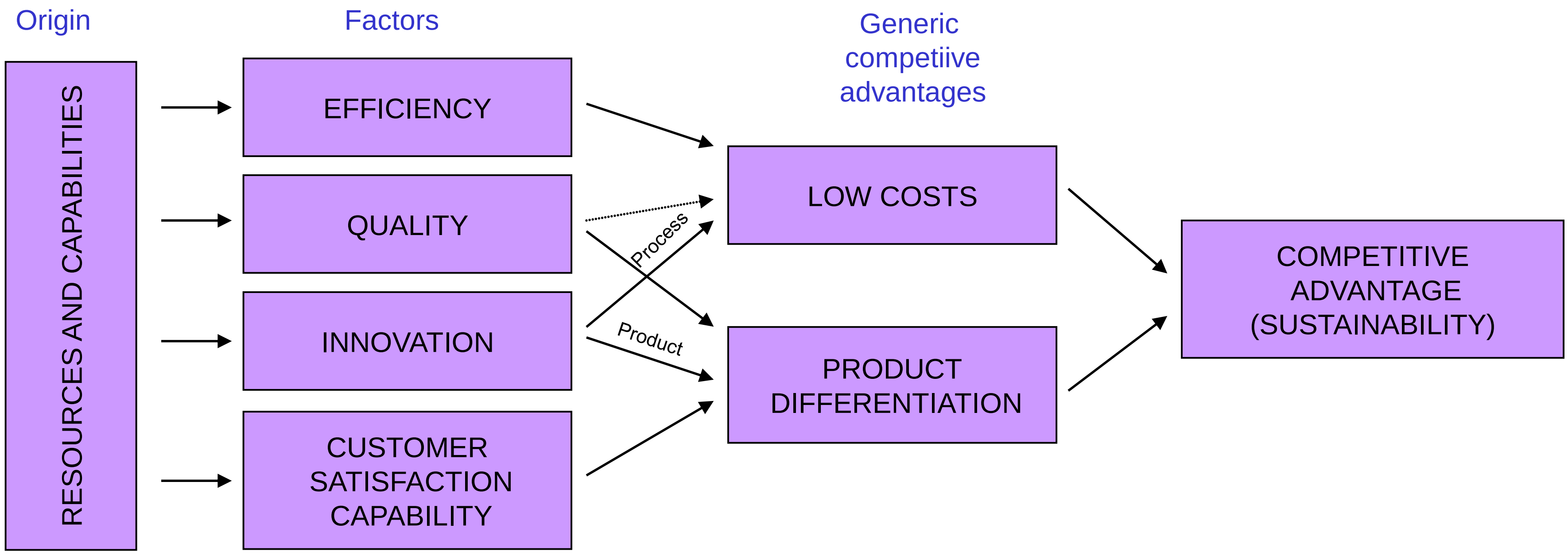
2.1. Competitive argument and competitive advantages

Starbucks: **https://www.youtube.com/watch?v=Ogu49pQWF2E**

- Concept of competitive advantage:
  - The company must differ from its competitors
  - The company must be superior to its competitors
- Features of a competitive advantage:
  - Related to a key success factor in the sector
  - Really make a difference compared to competitors
  - Be sustainable over time
- Bases of capabilities that underpin competitive advantage of the company
  - Cost efficiency: cost leadership
  - Generation of added value: differentiation

2.1. Competitive argument and competitive advantages

Internal factors for creation of competitive advantage



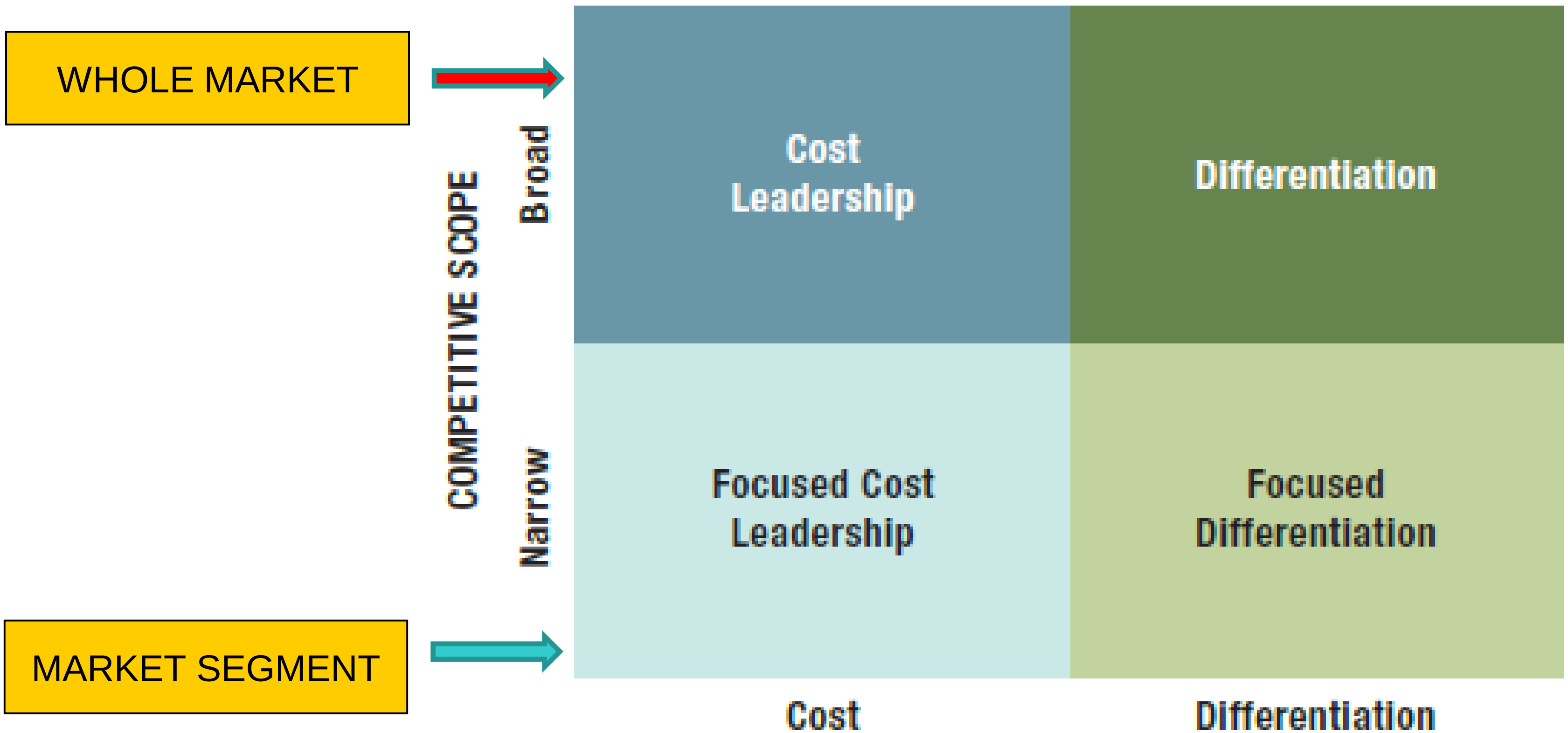
2.1. Competitive argument and competitive advantages

Factors that make a competitive advantage a lasting one

- Barriers to imitation:
  - Experience and insider effect
  - Possession of unique assets or resources
  - Protected knowledge (patents, trademarks) and legal restrictions
  - Causal ambiguity: not knowing the existence of an advantage (of the competitor or of the company itself)
  - Company culture and external image
- Competitors' ability to imitate:
  - Discover the company that has an advantage
  - The competitor's motivation to imitate it
  - Diagnosis or causal ambiguity
  - Acquisition of resources necessary to achieve it
- Dynamism of the sector (changes):
  - Risk of obsolescence: stop having an advantage

2.2. Generic competitive strategies: cost leadership, differentiation, and segmentation

Traditional approach (Porter, 1980)



COMPETITIVE ADVANTAGE
STRATEGIC POSITION

2.2. Generic competitive strategies: cost leadership, differentiation, and segmentation

Traditional approach (Porter, 1980)

- Cost leadership strategy:
  - Strategy to become lowest cost producer.
  - Bases leadership on reducing non-essential costs, economies of scale and experience, and strong cost control.
- Differentiation strategy:
  - Based on getting customers to consider that products in offer are different.
- Focus strategy:
  - Strategy that consists of attending to a better segment than generalists would, either with a cost leadership strategy or with a differentiation strategy (focus on costs and focus on differentiation).

2.2. Generic competitive strategies: cost leadership, differentiation, and segmentation

Cost leadership strategy

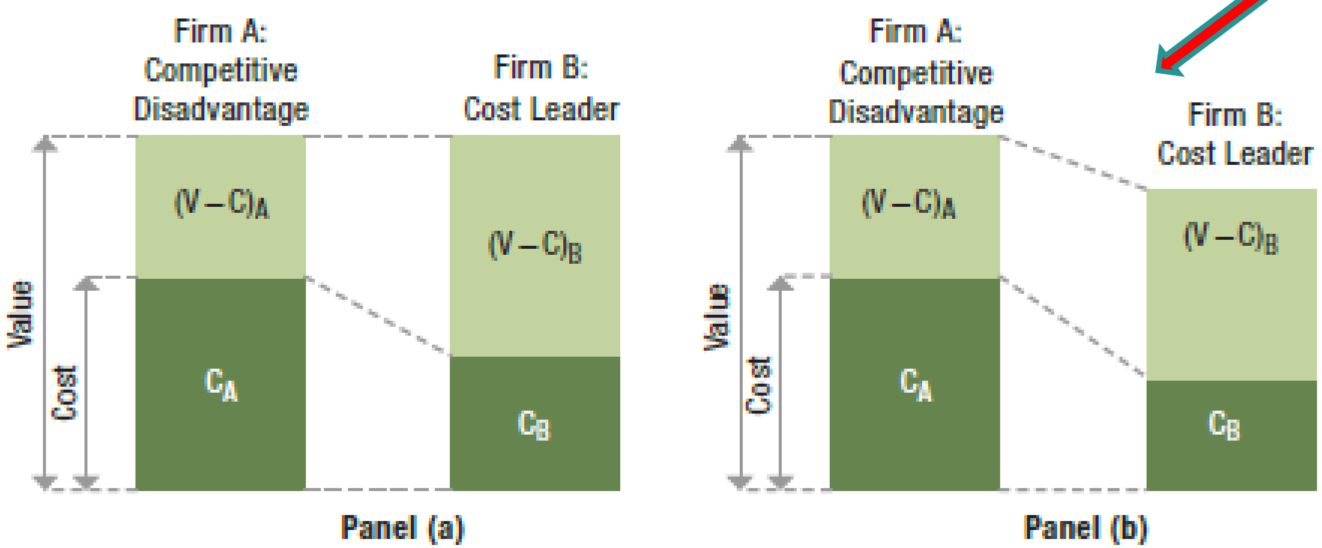
http://estrategiastendencias.blogspot.com.es/2015/11/el-caso-primark.html

- Origin:
  - The 70s: demand > supply and economic boom
  - Result of the application of experience effect
- Definition:
  - Reduction in company costs
  - Advantage gained when company costs are lower than competition (see figure)
  - May be accompanied by a low-pricing strategy, but price not the same as cost
- Requires:
  - Budgetary control
  - High volumes of production and investment

2.2. Generic competitive strategies: cost leadership, differentiation, and segmentation

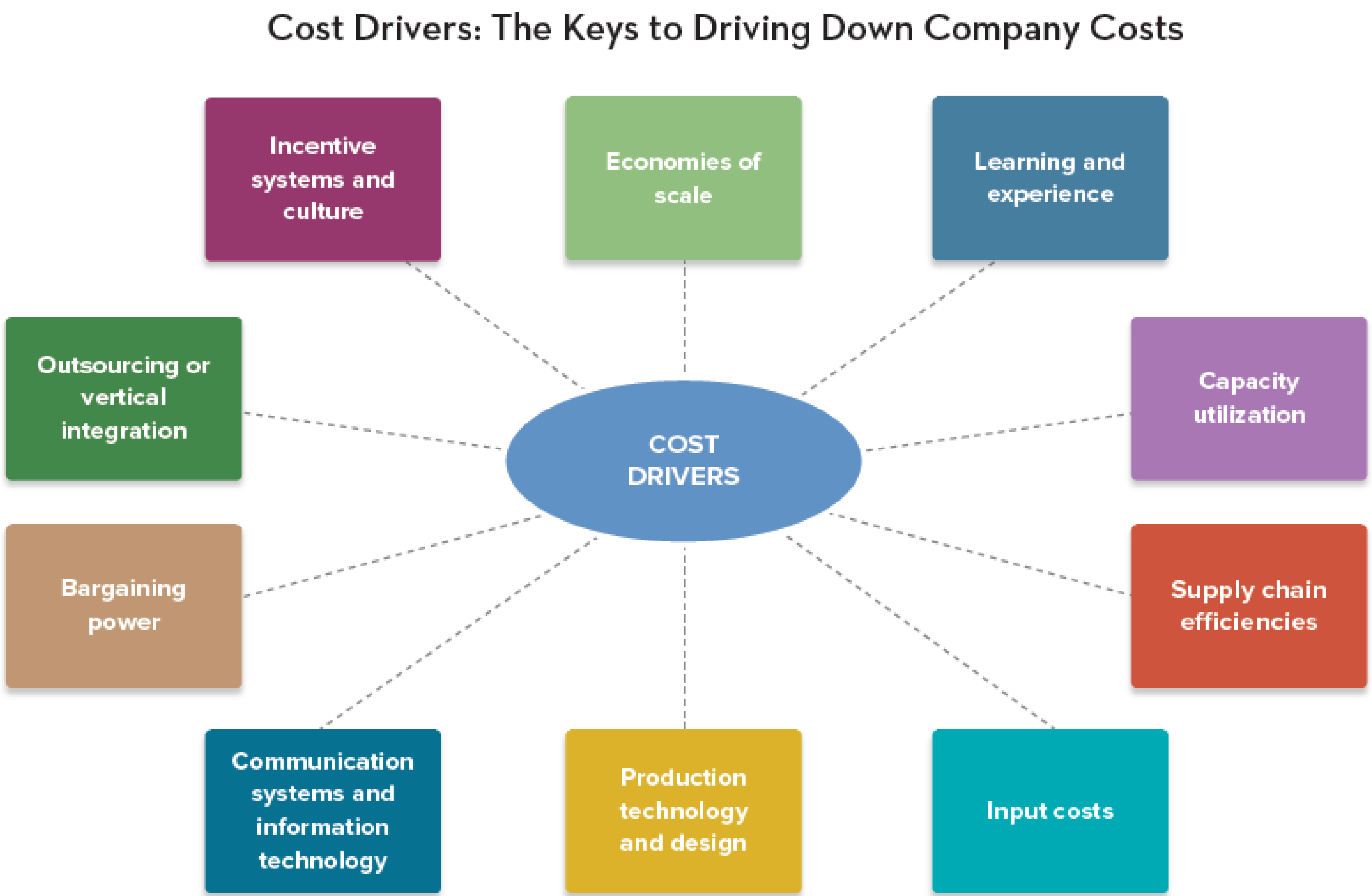
Cost leadership strategy

LOWER VALUE: NO DIFFERENTIATION PARITY



2.2. Generic competitive strategies: cost leadership, differentiation, and segmentation

COST LEADERSHIP STRATEGY



Source: Adapted from Michael E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (New York: Free Press, 1985).

Risks in cost leadership strategy

- Other companies achieve similar cost reduction
- Reduction of costs does not compensate for loss of profits due to lack of quality
- Customers demand higher quality product/service
- Limit to cost reduction appears

Differentiation strategy

- Customers must perceive company's product/service as different
- Quality is an aspect of differentiation - but not the only one
- Higher prices to compensate for increase in costs

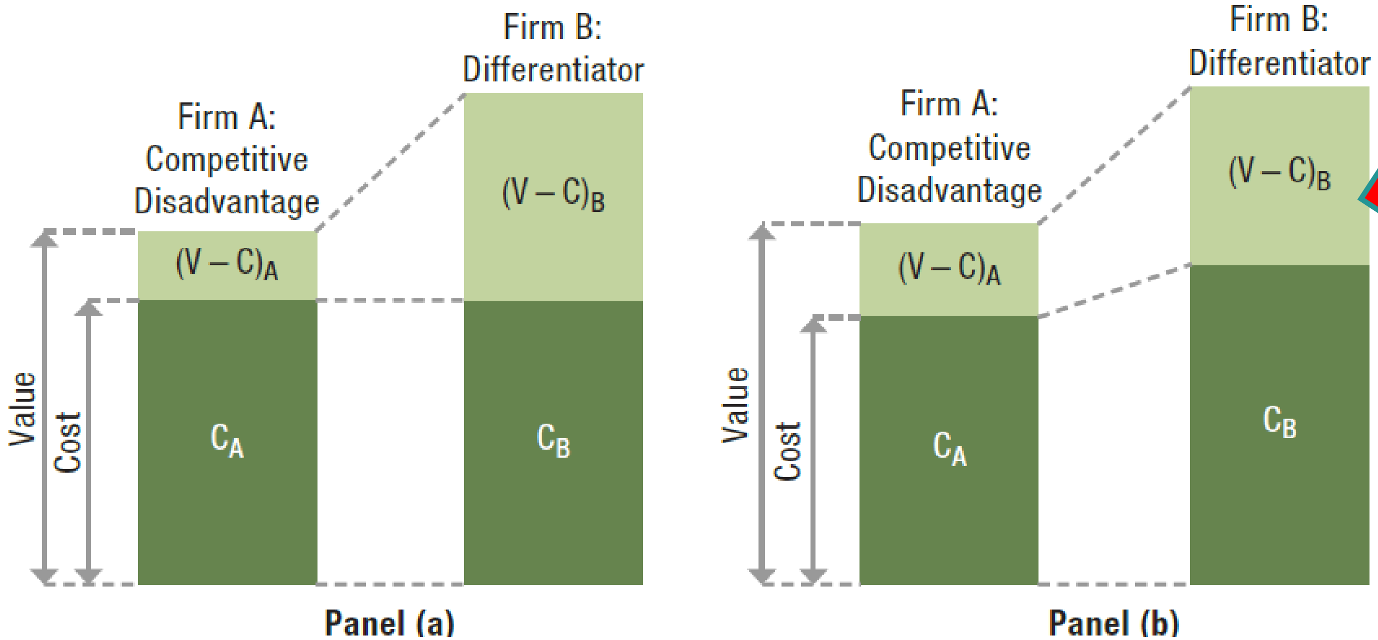
Requires:

- Marketing skills and employee motivation
- Business reputation, especially in quality
- Long tradition in sector and strong coordination
- Strong cooperation in distribution channels

2.2. Generic competitive strategies: cost leadership, differentiation, and segmentation

Differentiation strategy

HIGHER COST: NO COST PARITY



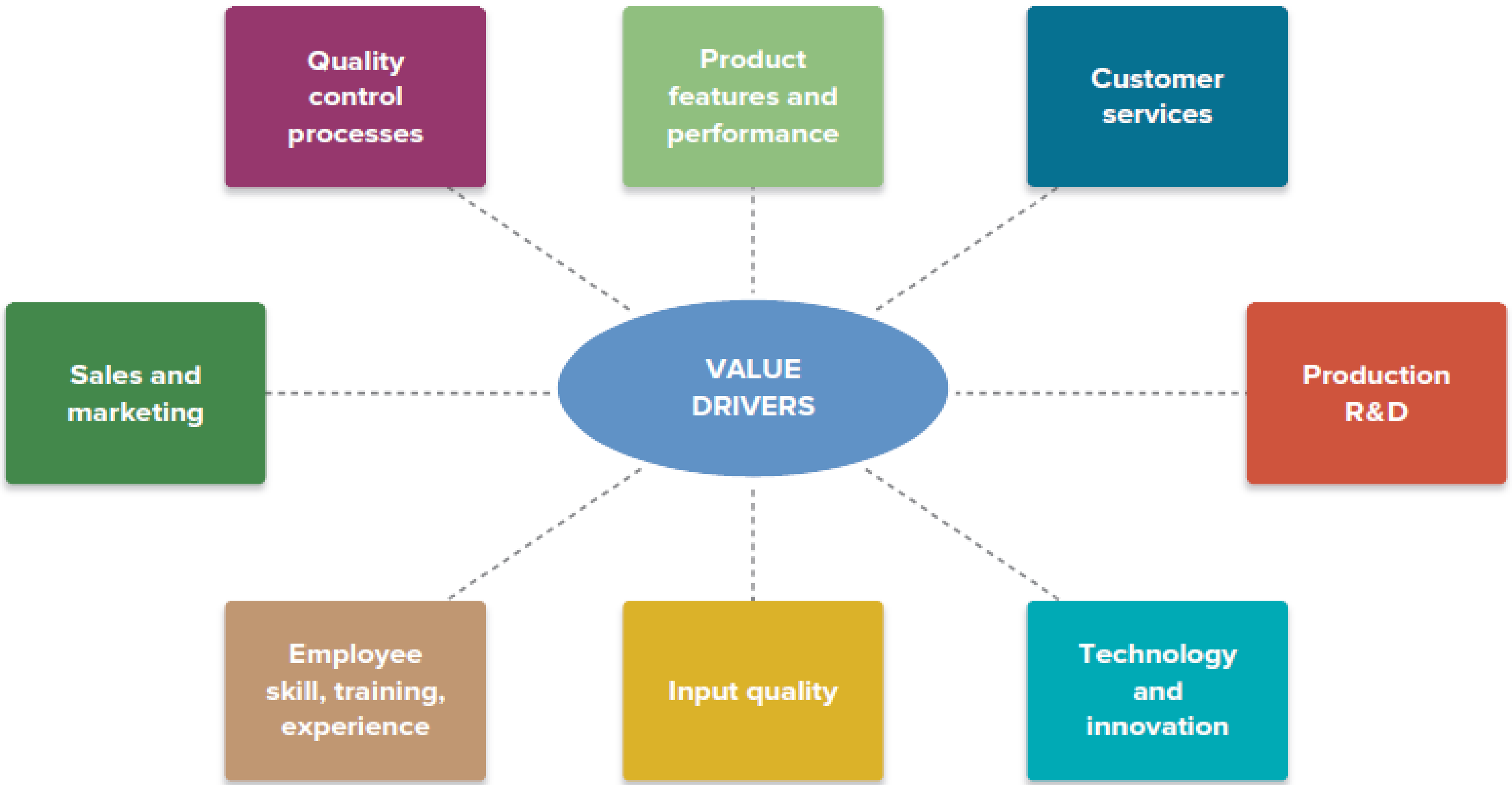
VALUE CREATION

Factors that help differentiation

- Coming from product features:
  - Physical factors: size, shape, etc.
  - Performance factors: reliability, safety
  - Add-ons to main product
  - Intangible factors: social, psychological, aesthetic
- Coming from market characteristics:
  - Perception and evaluation of the product and variety of tastes
  - Customer preferences and needs
- Coming from firm features:
  - How to conceive or run the business
  - How to relate to customers
  - Ethics and prestige of the company (reputation)

2.2. Generic competitive strategies: cost leadership, differentiation, and segmentation

Value Drivers: The Keys to Creating a Differentiation Advantage



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BUSINESS INTANGIBLES IN BUSINESS STRATEGY

Top 20 global brands: 2007 to 2017

Rank 2017	Rank 2014	Rank 2007	Brand	Rank 2017	Rank 2014	Rank 2007	Brand
1	1	33	*Apple* (USA)	11	6	4	*GE* (USA)
2	2	20	*Google* (USA)	12	9	8	*McDonald's* (USA)
3	5	2	*Microsoft* (USA)	13	11	13	***BMW* (Germany)**
4	3	1	*Coca-Cola* (USA)	14	13	9	*Disney (USA)*
5	15	—	*Amazon* (USA)	15	12	7	*Intel (USA)*
6	7	21	*Samsung* (Korea)	16	14	18	*Cisco (USA)*
7	8	6	*Toyota* (Japan)	17	16	27	*Oracle (USA)*
8	29	—	Facebook (USA)	18	22	29	*Nike (USA)*
9	10	10	***Mercedes-Benz* (Germany)**	19	19	17	***Louis Vuitton* (France)**
10	4	3	*IBM* (USA)	20	20	19	*Honda* (Japan)

Note: Nokia dropped from 5th in 2007 to 98th in 2014. *Amazon* and *Facebook* were not in the top 100 in 2007.

Risks in the differentiation strategy

- When difference in quality of product is not enough to compensate for difference in prices: customer is not loyal (banking: internet mortgages)

- When customer no longer sees product as different: change of preferences

- Generalisation of differentiation: imitation by competitors

2.2. Generic competitive strategies: cost leadership, differentiation, and segmentation

Focused strategies

- Direct company activity towards a specific segment of the market
- Meet customer needs more effectively than the competition
- It can be a limitation in the growth of the company
- It can be combined with cost leadership or differentiation

Condition for a focused strategy

- Segment is large enough to be profitable
- Segment has good growth potential
- Segment is not crucial for success of major competitors
- Company has right capabilities and resources to compete in the segment
- Company has image and prestige among customers within segment

Risk of focused strategies

- Competitors can match the company in the market segment: expanding the segment

- The preferences and needs of customers in the segment can change towards the global market: the segment disappears

- If the segment becomes attractive to other companies, they may enter to compete in the segment

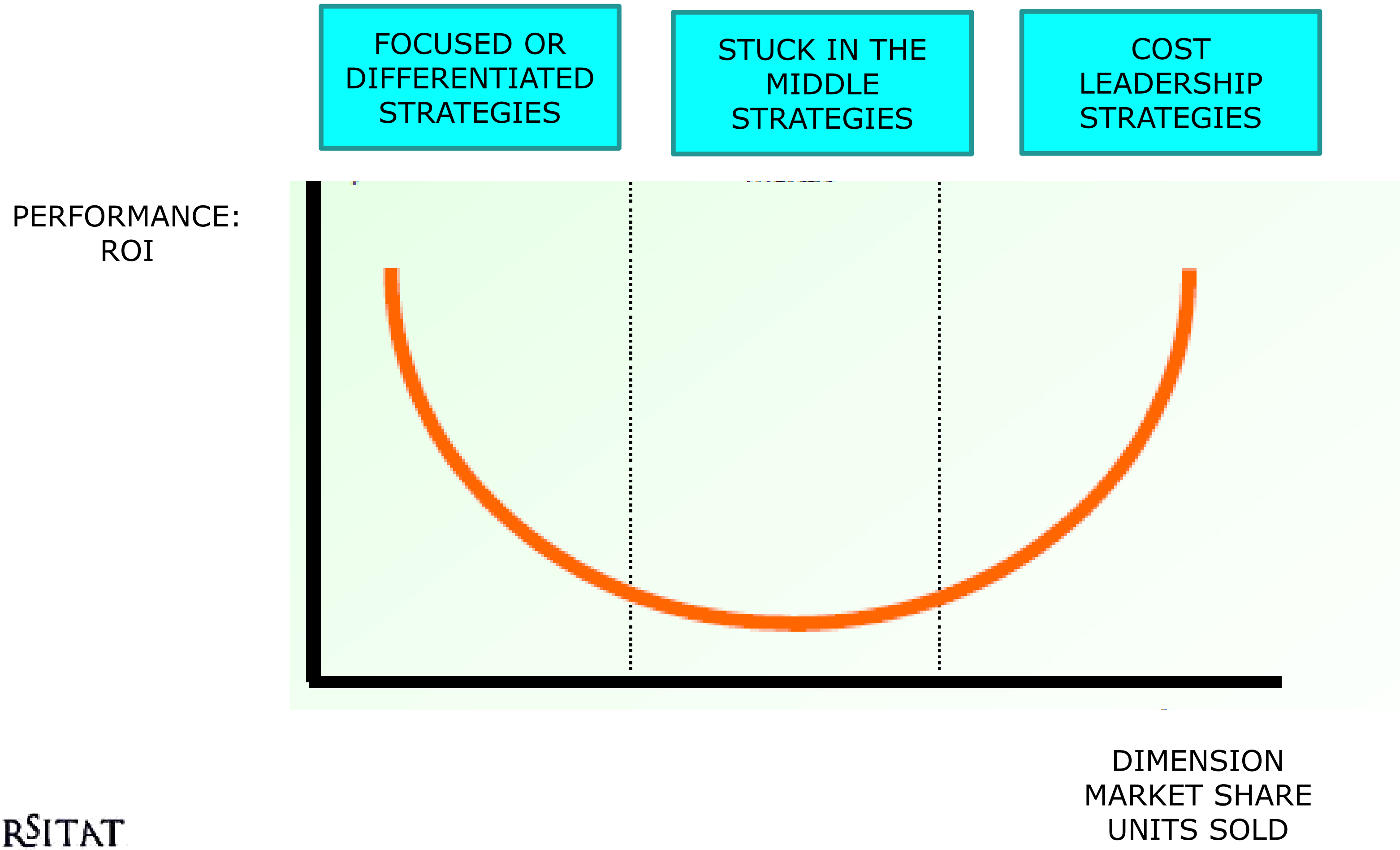
2.3. Risks of hybrid and intermediate strategies

- Porter's Model (1980):
  - Cost leadership and differentiation are incompatible
  - The company can stay: ‘stuck in the middle’
- Justification of Porter's model:
  - Differentiation requires an increase in costs
  - The resources and capabilities required are different
- Empirical evidence:
  - Diversified companies: product complementarity
  - Non-diversified companies: compatibility (mixed strategy)
- Other alternative models: strategic clock

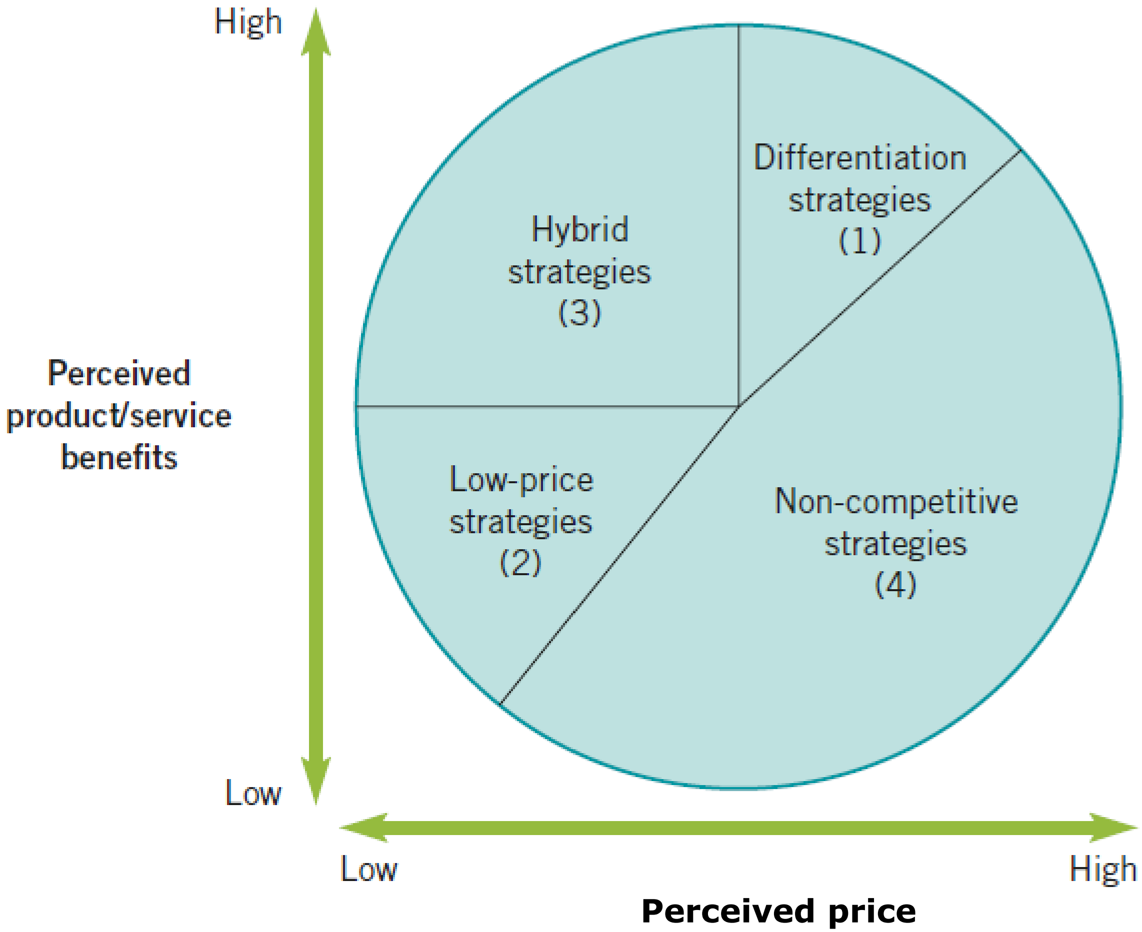
2.3. Risks of hybrid and intermediate strategies

Being “Stuck in the middle”

Generic strategies are superior to those “stuck in the middle”



2.4. Strategic clock model (Bowman, 1992)



2.4. Strategic clock model (Bowman, 1992)

Some features

- Firstly, it is focused on prices to customers rather than costs to the firm: because prices are more visible than costs, the strategy clock can be easier to use for comparing competitors.

- Secondly, the circular design of the clock allows for more continuous choices than a sharp contrast between cost leadership and differentiation: a full range of incremental adjustments that can be made between the 7 o'clock position (bottom of the low-price strategy) and the 2 o'clock position at the bottom of the differentiation strategy.
- It adds the possibility of a dynamic approach (routes).

2.4. Strategic clock model (Bowman, 1992)

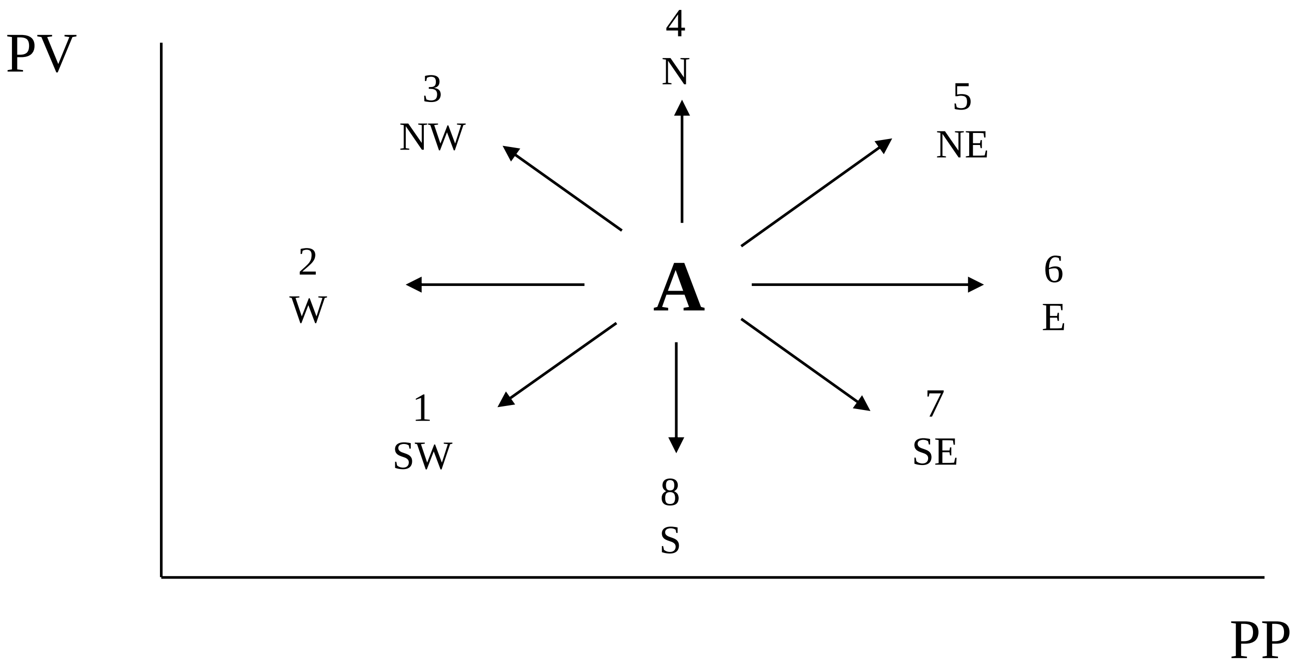
Some features and limitations

- Contributions (movements):
  - Route 3: hybrid strategy
  - Routes 1 and 2: price-based strategies
  - Route 4: differentiation strategy (added value)
  - Route 5: segmentation in differentiation
  - Routes 6, 7 and 8: strategies leading to failure

- Limitations:
  - Identifies perceived price with costs
  - Identify perceived value with differentiation

2.4. Strategic clock model (Bowman, 1992)

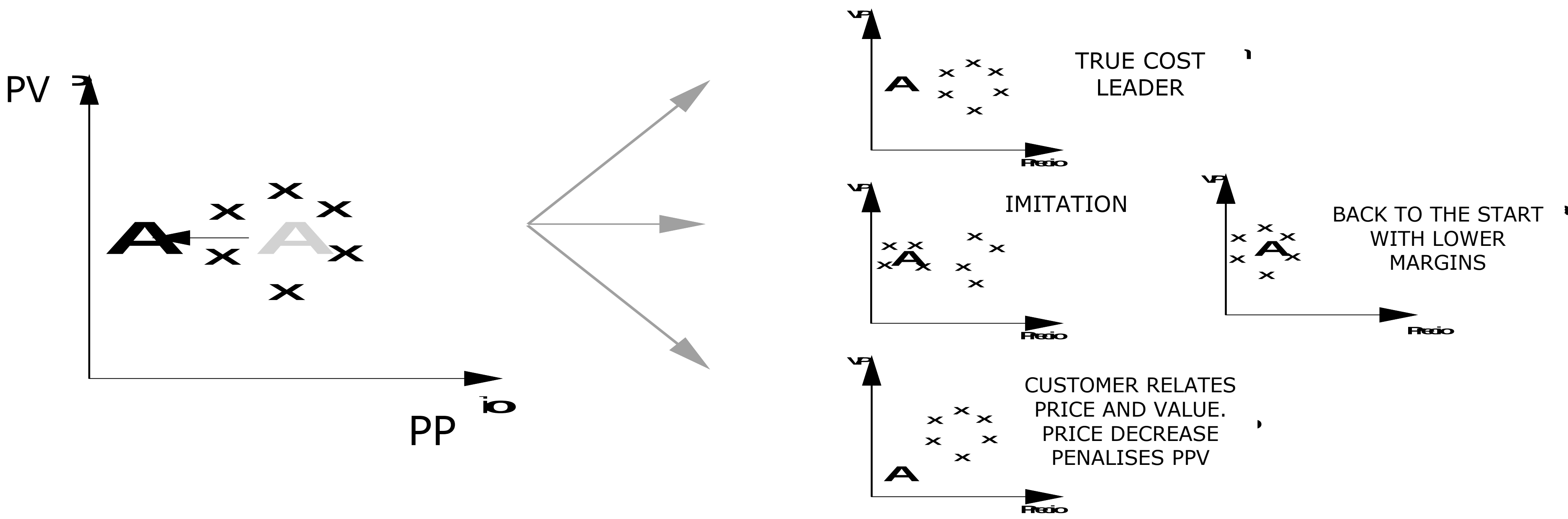
Possible routes for the firm



2.4. Strategic clock model (Bowman, 1992)

Route 2. Price-based competence

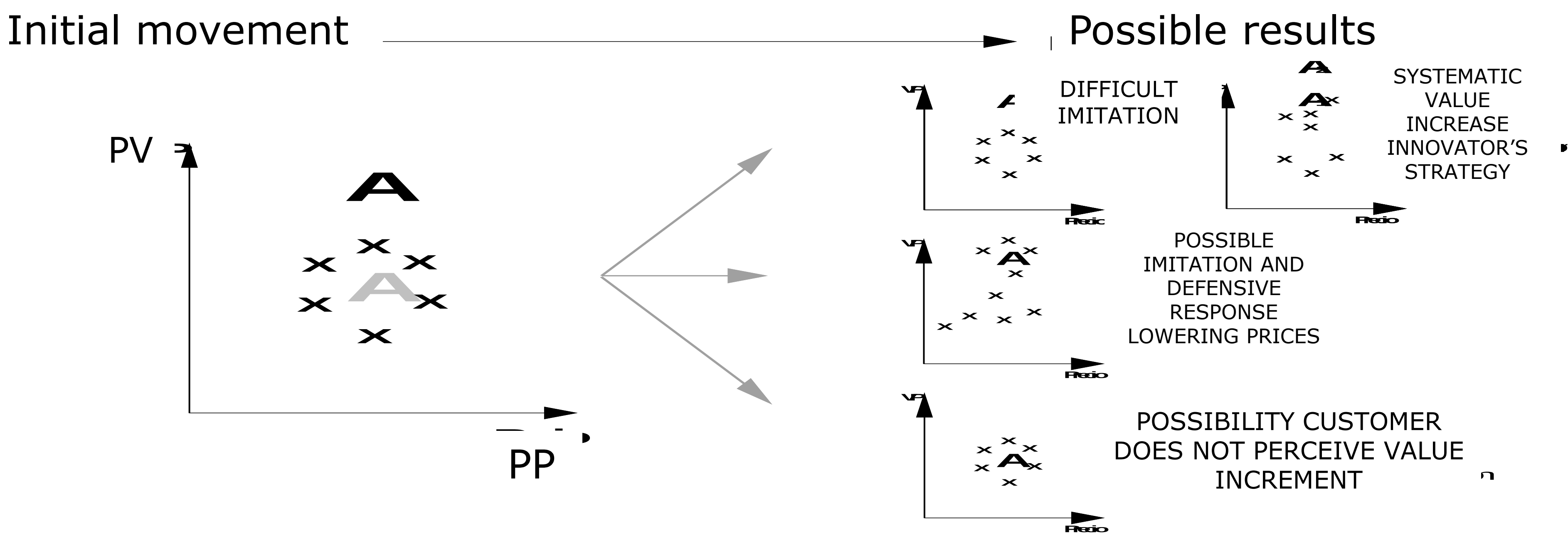
Initial movement → Possible results



Safón, V. y Escribá, a. (1999): "Estrategias competitivas: implicaciones teóricas, prácticas y docentes". Quaderns de Treball, No. 95

2.4. Strategic clock model (Bowman, 1992)

Route 4. Differentiation-based competence



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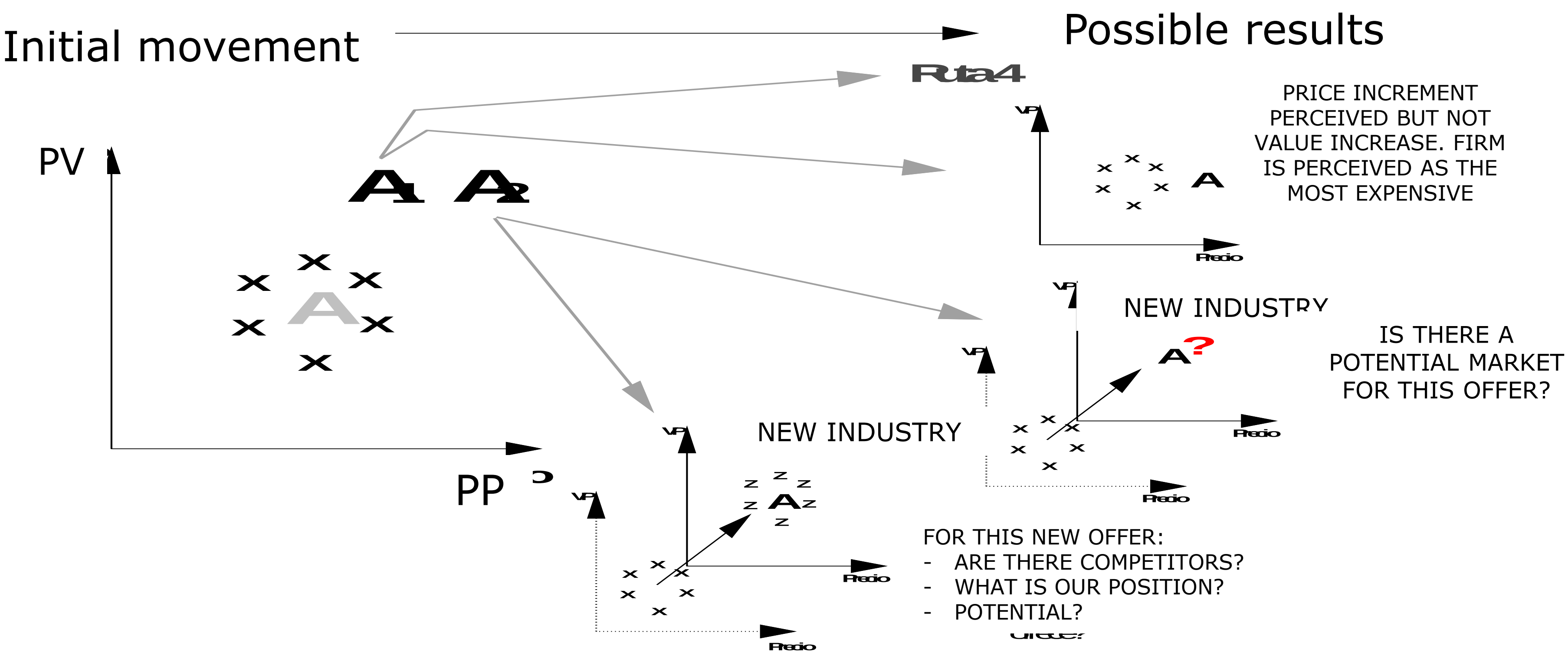
2.4. Strategic clock model (Bowman, 1992)

Route 5. Differentiation and price increase-based competence



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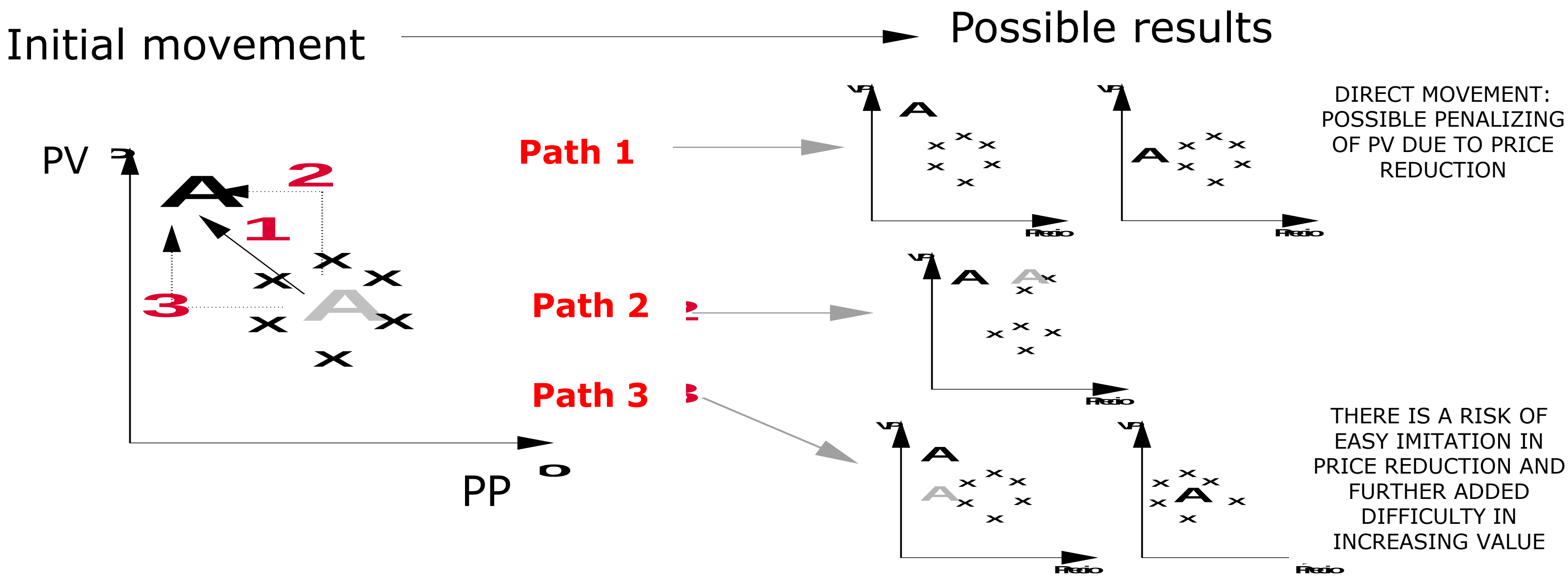
2.4. Strategic clock model (Bowman, 1992)

Route 3. Hybrid competence price-differentiation



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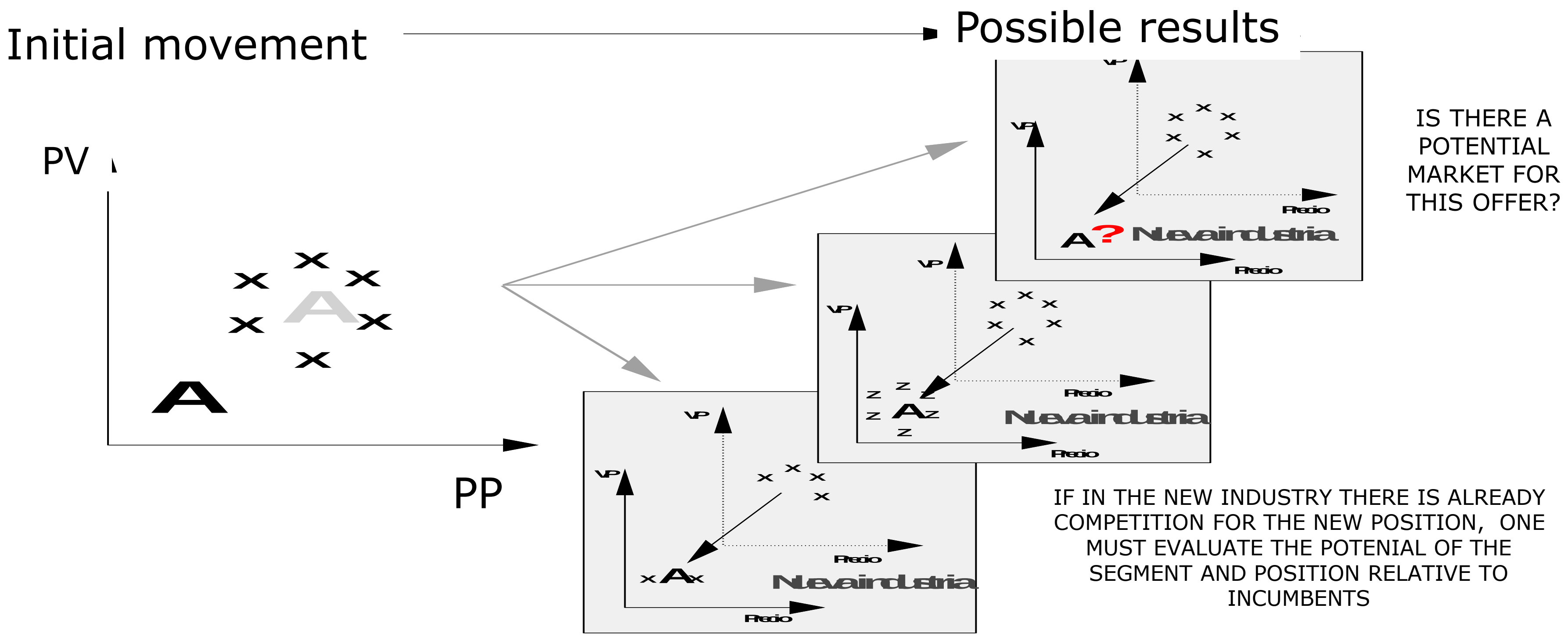
2.4. Strategic clock model (Bowman, 1992)

Route 1. Price competence with decrease in PV



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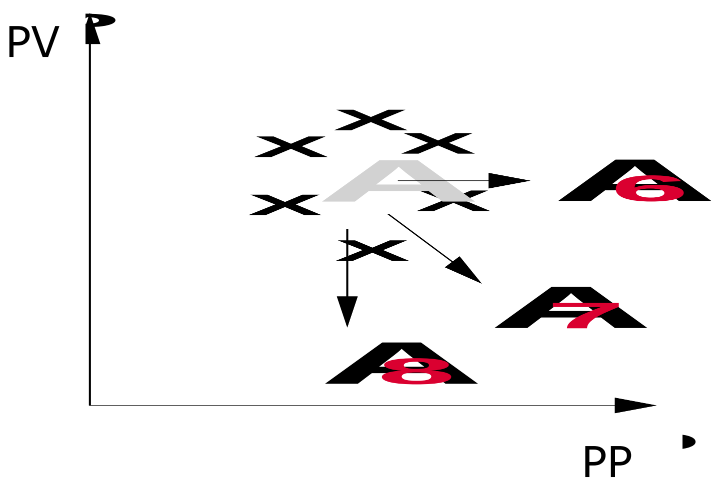
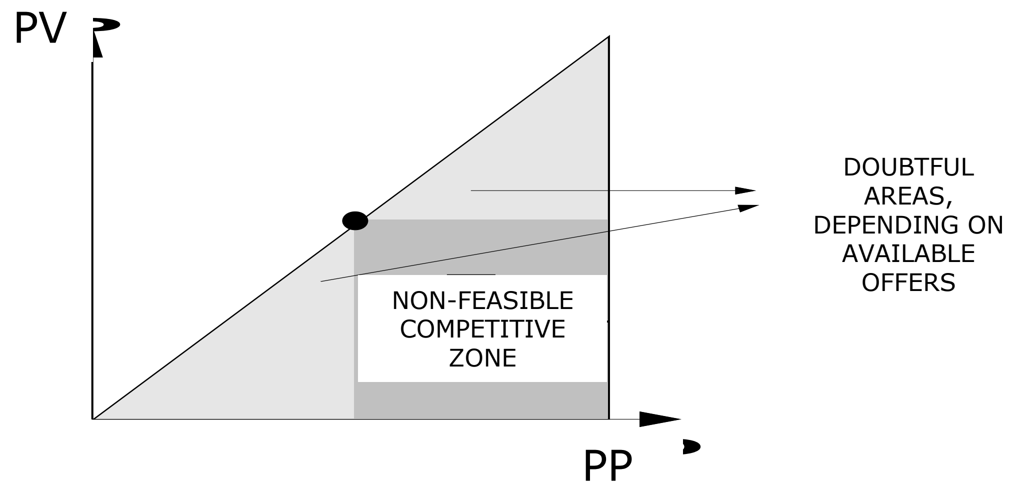
2.4. Strategic clock model (Bowman, 1992)

Routes 6, 7 + 8. Failure-bound competence





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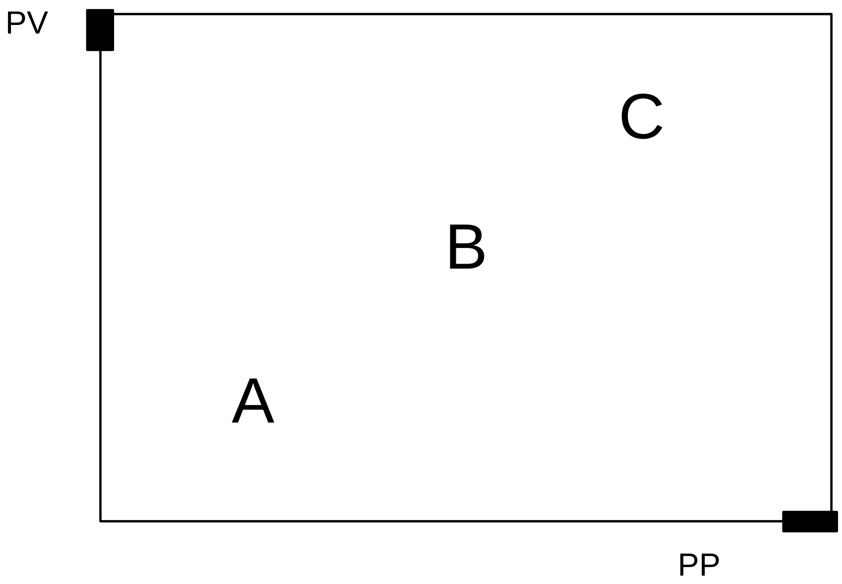
2.4. Strategic clock model (Bowman, 1992)

Which firms are best positioned?



Competitive parity line (CPL)

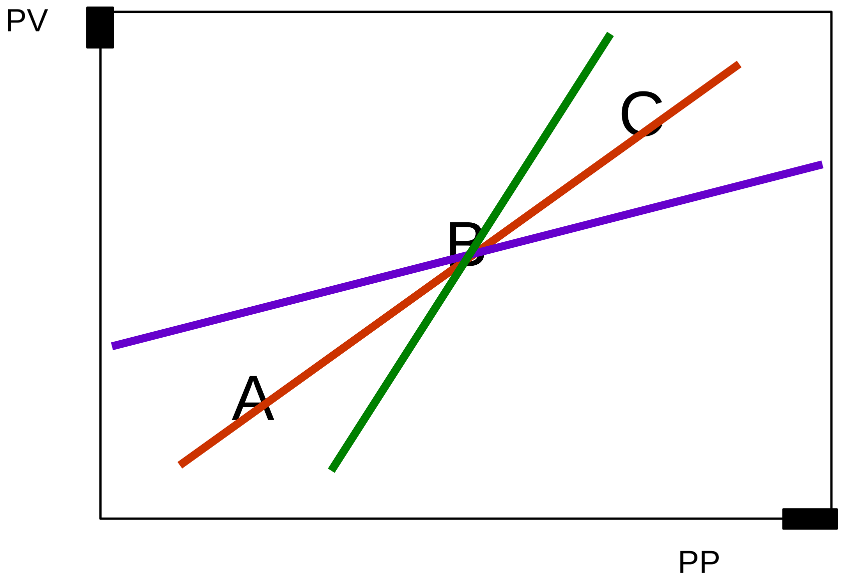
It establishes the positions that customers consider to be equally attractive.

The slope depends on the relative weight that customers attribute to each dimension of the watch: price versus the other attributes.

If we compare the position of each company with the LPC, we can determine the attractiveness of the positions.

2.4. Strategic clock model (Bowman, 1992)

Competitive parity line



CPL=45º equal importance of both dimensions (all firms are equally positioned)

CPL <45º PV attributes more important than price (C better positioned than the others)

CPL >45º Price attributes more important than PV (A better positioned than others)