

Agenda for today

Generic Business Strategies

- What is Strategy?
- How to conduct a situational analysis of the firm?
- What are business level strategies?
- How can firms obtain cost leadership, and what are its benefits?

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What is Strategy?

Defining the strategy of your organisation

- Objective *endpoint / timeframe.*
- Scope *boundaries.*
- Advantage *value proposition.*

Objectives: plan of action, limited, goals, Roadmap

Mission: why we exist BP

Vision: what we want to be

Values: How we should behave.

Care Innovation Passion Trust India First

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The Strategic Management Process

Difference between Business and Corporate Strategy

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Industry Analysis to Strategy

Five-forces analysis to forecast industry profitability

Porter.

Forecasting Industry Profitability

- If we can forecast changes in industry structure, we can predict likely impact on competition and profitability.

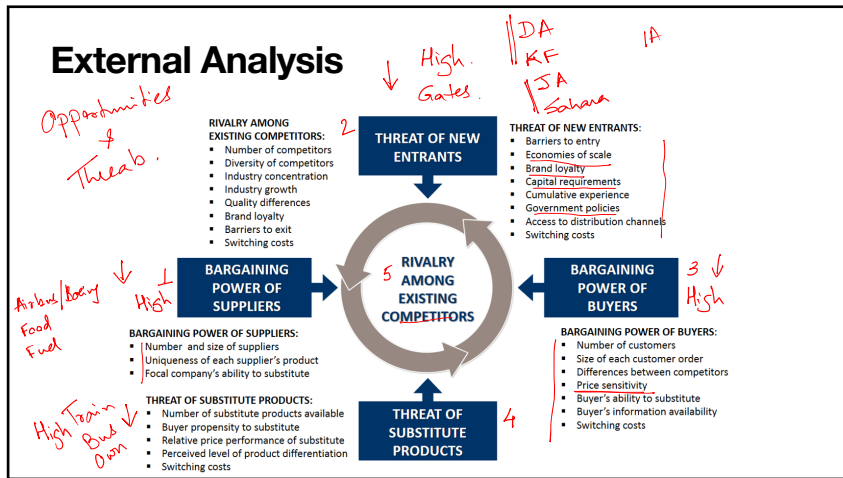
Strategic Positioning

- Once we know which structural features of the industry support profitability and which depress profitability, we can choose a favorable positioning within the industry.

Strategies to Improve Industry Profitability

- Which of the structural variables that are depressing profitability can we change by individual or collective strategies?

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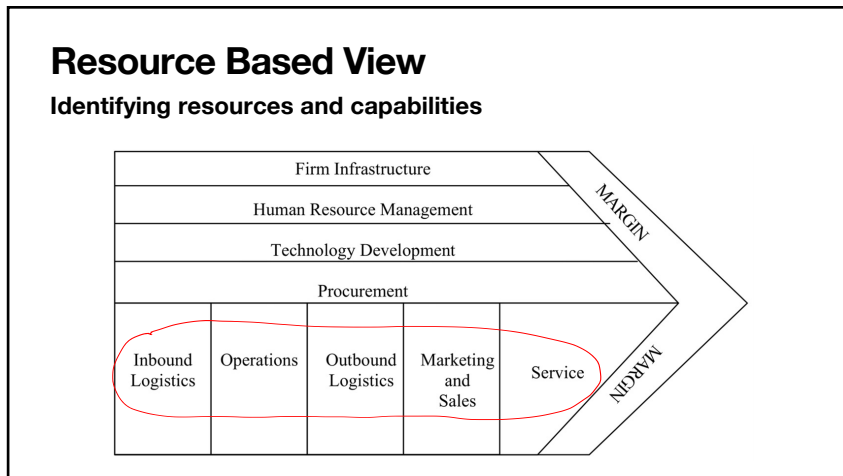
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Theoretical Underpinnings

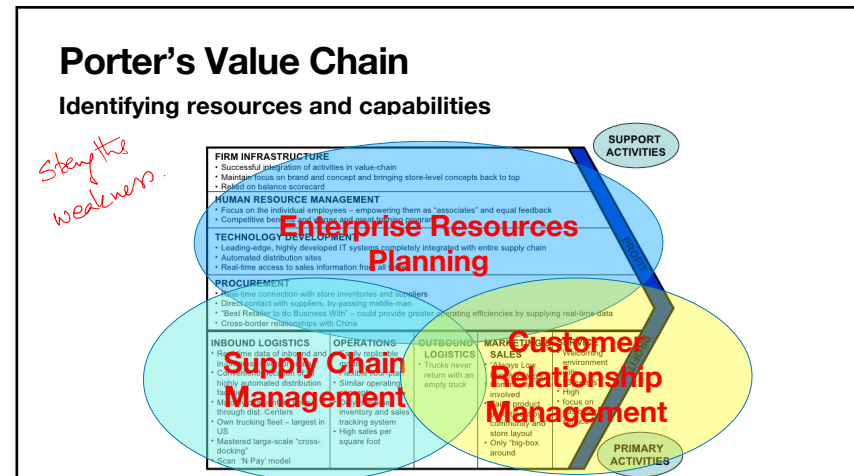
Resource Based View *RBV. Jay Barney.*

- Assumes that a firm's resources and capabilities are the primary drivers of competitive advantage and economic performance
- Resources** can be either tangible and intangible assets of a firm
 - tangible:** factories, products
 - intangible:** reputation
- Capabilities** are a subset of resources that enable a firm to take full advantage of other resources
 - marketing skill, cooperative relationships

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Internal Analysis

V VALUABLE	R RARE	I INIMITABLE	O ORGANIZED	
NO				COMPETITIVE DISADVANTAGE
YES	NO			COMPETITIVE PARITY
YES	YES	NO		TEMPORARY COMPETITIVE ADVANTAGE
YES	YES	YES	NO	UNUSED COMPETITIVE ADVANTAGE
YES	YES	YES	YES	SUSTAINABLE COMPETITIVE ADVANTAGE

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SWOT

Internal - RBV VRIO

The organisation	Strengths - S 1. Existing brand 2. Existing customer base 3. Existing distribution	Weaknesses - W 1. Brand perception 2. Intermediary use 3. Technology/skills 4. X-channel support
External Porter 5-forces	Opportunities - O 1. Cross-selling 2. New markets 3. New services 4. Alliances/Co-branding	SO strategies Leverage strengths to maximise opportunities = <u>Attacking strategy</u>
	Threats - T 1. Customer choice 2. New entrants 3. New competitive products 4. Channel conflicts	ST strategies Leverage strengths to minimise threats = <u>Defensive strategy</u>
		WO strategies Counter weaknesses through exploiting opportunities = <u>Build strengths for attacking strategy</u>
		WT strategies Counter weaknesses and threats = <u>Build strengths for defensive strategy</u> ?

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Business Level Strategies

Generic Business Level Strategies

Cost Leadership:

- generate economic value by having lower costs (not price) than competitors

Example: Wal-Mart, D-Mart, Indigo

Differentiation:

- generate economic value by offering a product that customers prefer over competitors' product

Example: Harley-Davidson, Nike

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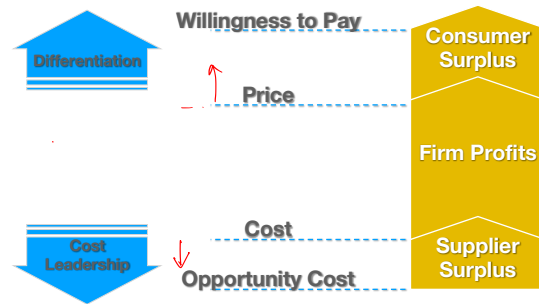
Porter's Generic Strategies

Cost Leadership & Differentiation

iphone

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Value creation



Adapted from (Brandenburger & Stuart Jr., 1996)

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Cost Leadership

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Cost Leadership

Sources of Cost Advantage

1. Economies of Scale
2. Diseconomies of Scale *vs avoid.*
3. Learning Curve Economies
4. Low-cost access to factors of production
5. Technology independent of Scale
6. Policy Choices

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Sources of Cost Advantage

Economies of Scale

mlt share.

- Average cost per unit falls as quantity increases—until the minimum efficient scale is reached
- are a cost advantage because competitors may not be able to match the scale because of capital requirements (barrier to entry)
 - Input – output relationships not linear
 - Indivisibilities
 - Specialization
- international expansion may allow a firm to have enough sales to justify investing in additional capacity to capture economies of scale

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Sources of Cost Advantage

Economies of Scale

- Economies of scale operate when:
 - activities are executed more efficiently at larger volume,
 - the cost of certain activities can be divided over large sales volume, or
 - activities have less proportional cost increases compared with the output growth
- Technology, specialization and minimum size are important factors influencing the dynamics of economies of scale

+ 40% mkt share.

mat mkt

\$100mn. 50%

\$100 Indigo 56%

SpiceJet 25% \$100mn.

training ↓ maintenance ↓ bargaining ↓

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COST ANALYSIS

Economies of Scale: The Long-Run Cost Curve for a Plant

Sources of scale economies:

- technical input/output relationships
- indivisibilities
- specialization

Minimum Efficient Plant Size: the point where most scale economies are exhausted

Units of output per period

vol. mkt sh.

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New Product Development Projects

Cost Analysis

Product	Lead company	Estimated development cost	Launch date
F-35 Lightning II joint strike fighter	Lockheed Martin	\$240 billion	2012
B-2 Spirit "stealth bomber"	Northrup Grumman	\$23 billion	December 1993
A380 "super-jumbo"	Airbus Industrie	\$19 billion	October 2007
787 Dreamliner	Boeing	\$16-18 billion	3rd Quarter 2010
Windows Vista	Microsoft	\$7 billion	January 2007
PlayStation 3	Sony	\$7 billion	November 2006
Iridium satellite communication system	Motorola/Iridium Satellite LLC	\$6 billion	July 1999
Ford Contour/Mondeo	Ford Motor Company	\$6 billion	October 1992

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COST ANALYSIS

Scale Economies in Advertising: U.S. Soft Drinks

Despite the massive advertising budgets of brand leaders Coke and Pepsi, their main brands incur lower advertising costs per unit of sales than their smaller rivals.

Advertising Expenditure (\$ per case)

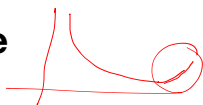
Annual sales volume (millions of cases)

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Sources of Cost Advantage

Diseconomies of Scale



- Diseconomies of scale occur when the increase in the volume of an activity creates complexity in its management and coordination costs
- are an advantage for those who do not have diseconomies of scale
- occur when firms become too large and bureaucratic
- are a risk of international expansion

Lease back model.

depreciation: Company A
loan: Company B
operates: lease Airbus A320.

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Sources of Cost Advantage

Learning Curve Economies

- The costs of activities may decline over time as the activity is performed more efficiently due to learning process.
- Learning improves how processes are performed.
- Learning can occur due to the volume of activity, level of investment, or simply time

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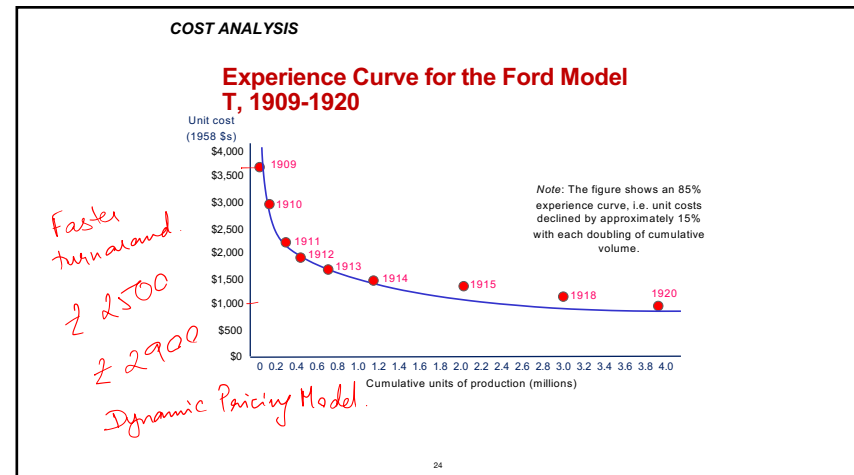
Sources of Cost Advantage

Learning Curve Economies

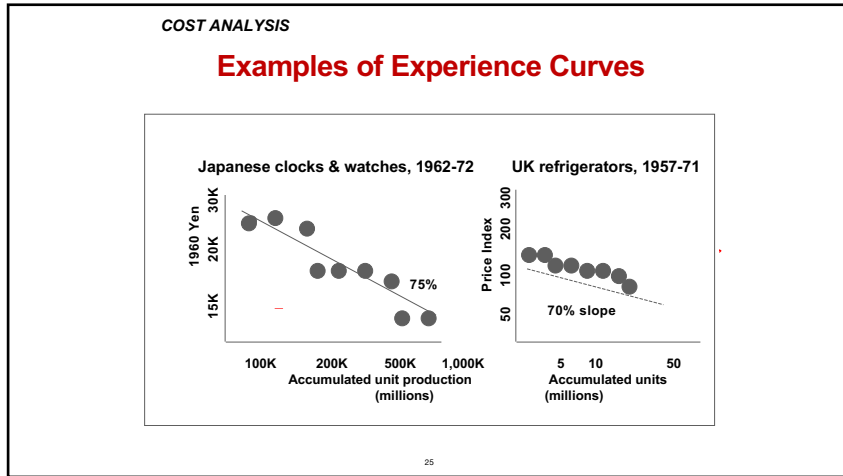
- A firm gets more efficient at a process with experience
- The more complicated/technical the process, the greater the experience advantage.
- International expansion may propel a firm down the experience curve because of higher volumes.

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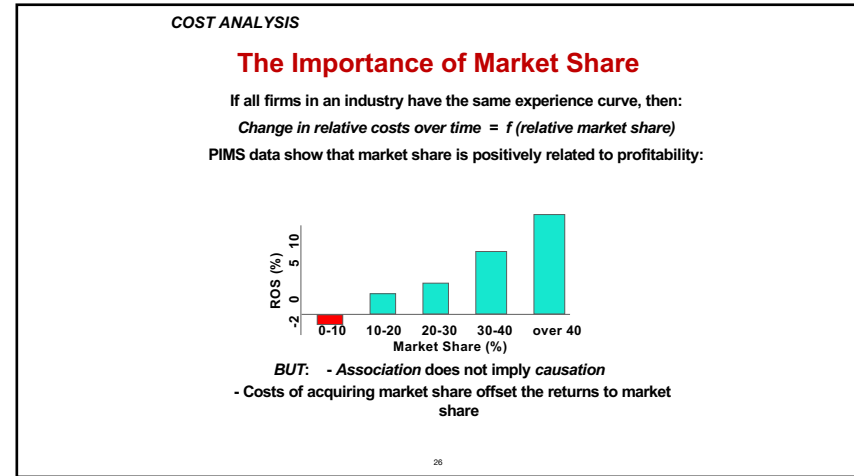
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- Sources of Cost Advantage**
- Low-cost access to factors of production**
- Input costs
 - Location advantages
 - Ownership of low-cost inputs
 - Bargaining power supplier cooperation
 - Managerial and organizational efficiency
 - Organizational slack
- Gates.
Tie-up Airbus.
'Power by Hour'
Airbus A320.*
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- Sources of Cost Advantage**
- Low-cost access to factors of production**
- may result from:
 - history—being in the right place at the right time
 - being first into a market—esp. foreign markets
 - natural endowment—owning a mineral deposit
 - locking up a source—buying all of its output
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Sources of Cost Advantage

Technology Independent of Scale

- may allow small firms to become cost competitive
 - Process technology and process design (business process reengineering)
 - Product design
 - Capacity utilization
- advantage typically accrues to the “owner” of the technology—may or may not be the ones who actually use the technology
- size of the advantage depends both on how valuable and protectable the technology is

*- Shank fine
↳ lesser fuel
- Neo ↗*

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Sources of Cost Advantage

Technology Independent of Scale

- Production
 - Mechanization and automation
 - Efficient utilization of material
 - Increased precision
- Product design and product line
 - Design for automation
 - Design to economise on material
 - Cost of product line complexity

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Sources of Cost Advantage

Technology Independent of Scale

- If the competitive advantage arises from strongly linked activities (internally and externally), then their costs depend on the performance of other activities.
 - Therefore, it is necessary to undergo a systemic evaluation of the drivers by considering all other activities connected.
- When linkages are external, external actors may be integrated into the company (vertical integration) as a way of controlling costs for the activity

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Sources of Cost Advantage

Policy Choices

- Firms get to choose how they will serve the market.
- We'll offer level of quality that is inexpensive to produce.
- Firms can make policy choices that give people incentives to reduce cost at every opportunity.
- Firms ability to reduce “organizational slack” or x-inefficiency

*- Seat
- luggage.
- food.
- fast forward.*

*No Hot food.
↳ weight - fuel.*

*Ramp instead Stairs.
faster*

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Sources of Cost Advantage

Policy Choices

- **Capacity Utilization**
 - If an activity has fixed costs, the utilization of the activity will have an important impact on the production costs per unit.
 - The configuration of the activity (internal factor), as well as demand fluctuations (external factors), determine the utilization of the capacity.
- Certain **strategic choices** can impact on the costs of the activities such as product configurations and variety, service, customer segments, technology, location, human resources policies, and process efficiencies

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Sources of Cost Advantage

Policy Choices

- **Timing** implies enjoying low costs when the assets for the activity are acquired in favorable conditions, e.g. business cycles, or generate more demand for an activity, e.g. being the first mover in a market
- **Economies of Scope**
 - Multi-business companies have activities shared between business units.
 - This type of activities provides the possibility of increasing its output (or utilization) by sharing it among multiple business.
 - Sharing an activity implies obtaining economies of scale and learning

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Implementation

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Implementation Issues

Cost Leadership

<i>Generic strategy</i>	<i>Key strategy elements</i>	<i>Resource and organizational requirements</i>
Cost leadership	<ul style="list-style-type: none"> • Scale-efficient plants • Design for manufacture • Control of overheads and R&D • Process innovation • Outsourcing/offshoring • Avoiding marginal customers 	<ul style="list-style-type: none"> • Access to capital <i>low cost</i> • Process engineering skills <i>efficiency</i> • Frequent reports ↑ • Tight cost control • Specialization of jobs and functions • Incentives linked to quantitative targets accounts

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Organization

- **Functional Structure** (U-Form: Unitary)
 - specialization within functions facilitates cost reduction
 - ensure best cost reduction practices are shared among divisions
 - allow and encourage decision-making by those who are in the best positions to do so—those close to decisions
 - ensure that functions are coordinating efforts in pursuit of a common strategy
- **Organizational Controls and Cost Leadership**
 - Management controls and compensation policies can be focused on cost reduction.
 - supply contracts that stipulate cost reductions over time
 - Tight credit policies
 - austere travel policies (e.g., no first class)
 - bonuses tied to cost reduction targets

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Implementation Issues

Sustaining Cost Leadership

- Obscuring Superior Performance
- Deterrence and Preemption
- Causal Ambiguity and Uncertain Imitability

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Implementation Issues

Catching up with Cost Leaders

- Strategic Cost Analysis
 - Check value added at each step of the value chain.
 - Identify shifts in key cost components for your firm and competitors
 - Assess future cost increases



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Benefits of cost leadership

- Enjoy higher than average profits
- Engage in price war || → *AL 2 tier.*
- Eliminate rivals
- Defend market share
- Increase market share
- Build barriers to the entry of newcomers to the market
- Weaken the threat of substitutes
- Enter new markets

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Risks of cost leadership

- Vulnerability to even lower cost operators
- As technology improves, a competitor may be able to leapfrog the production capabilities, thus eliminating the competitive advantage
- It could lead to a damaging price wars
- There might be difficulty in sustaining cost leadership in the long run
- A firm following a focus strategy might be able to achieve even lower cost within their segment

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Implementation Issues

Firm as an activity system

- Competitive advantage grows out of the strategic fit among the various activities performed by the firm
 - First order fit is simple consistency between each activity and the overall strategy
 - Second order fit occurs when activities are reinforcing.
 - Third order fit looks at optimization of effort.
- It is harder for competitors to match an array of interlocked activities

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What is strategy?

Positioning

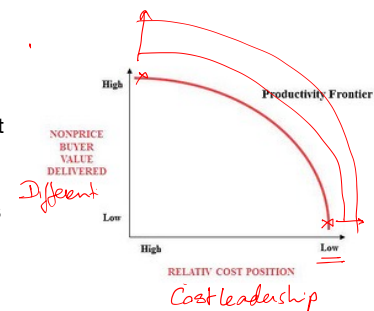
- Strategy is the creation of a unique and valuable position
 - Serving few needs of many customers
 - Serving broad needs of many customers
 - Serving broad need of many customers in a narrow market
- The essence of Strategy is choosing what not to do
- Strategy is creating a fit among a company's activities

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Positioning

What a company must do

- Deliver greater value to customers
(higher average unit price)
- Create comparable value at a lower cost
(lower average unit cost)
- Performing different activities than rivals



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Operational effectiveness

Is it enough?

- Performing similar activities better than rivals
- Operational effectiveness necessary but not sufficient
 - Can be replicated
 - Over capacity
 - Reduced capability for innovation

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Strategic positioning

Ways to get Competitive Advantage

- Performing *different* activities or performing similar activities in *different* ways
 - **Variety based positioning:** particular product or service *nos. of cities*
 - **Needs based positioning:** particular customer segment *price sensitive*
 - **Access based positioning:** delivery channel *online*
- **Marketing myopia:** companies fail to adapt and respond to constantly changing consumer tastes and demands

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Imitation of Strategic Positioning

Why straddling or repositioning is difficult...

- Strategic positioning is not sustainable unless there is trade-off with other positions
 - Inconsistencies in image or reputation
 - Inflexibility in activities
 - Limits on internal coordination and control

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Summary

Porters Generic Strategies

- **What is Strategy?** *External → Porter's 5 forces*
- **Situational Analysis** *Internal → RBV*
- **Cost Leadership**
 1. Economies of Scale
 2. Diseconomies of Scale
 3. Learning Curve Economies
 4. Low-cost access to factors of production
 5. Technology independent of Scale
 6. Policy Choices

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