# Agenda for today

**Generic Business Strategies**

- What are business level strategies?
- How can firms obtain cost leadership and what are its benefits?
- What are the challenges faced in implementation?

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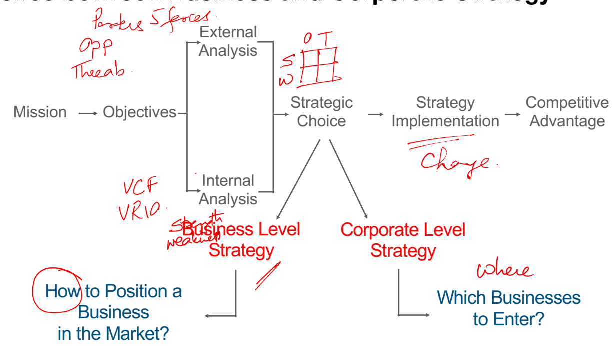
# The Strategic Management Process

**Difference between Business and Corporate Strategy**

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# Business Level Strategies

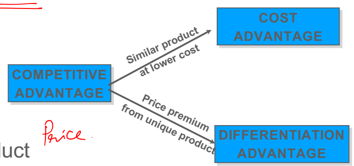
**Generic Business Level Strategies**

**Cost Leadership:**

Price

•generate economic value by having lower costs than competitors

*Example: Wal-Mart*




**Differentiation:**

Price

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

*Example: Harley-Davidson*

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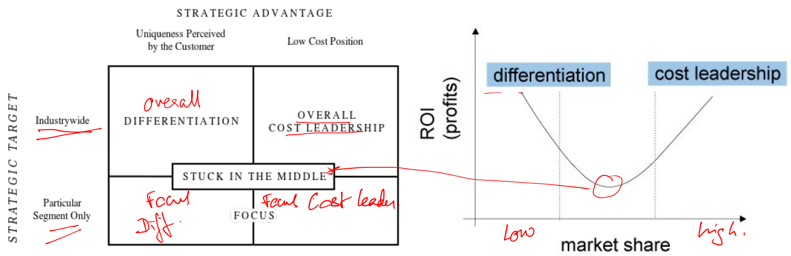
# Porter's Generic Strategies

**Cost Leadership & Differentiation**

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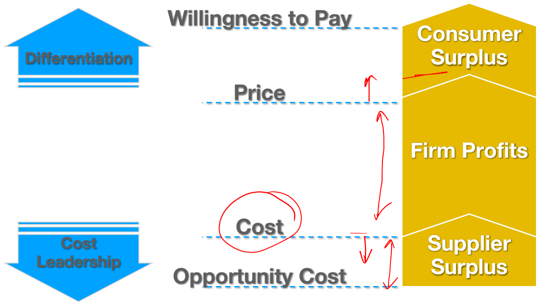
# Value creation




Adapted from (Brandenburger & Stuart Jr., 1996)

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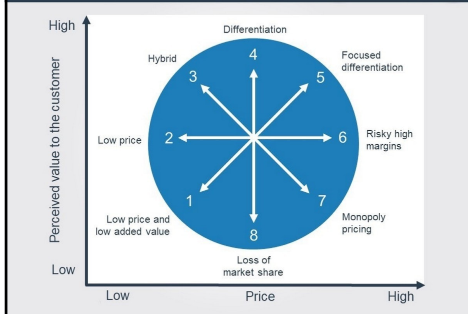
## Bowman's Strategy Clock




**Position 1: Low Price & Low Value Added**
This strategy is about quantity selling. The products or services are low in value and the price point is the lowest possible. The combination makes it the least competitive area on the Strategy Clock.

**Position 2: Low Price**
Low Price, as the name suggests, is a strategy about becoming the lowest cost option for buyers in the marketplace. It's a strategy that can have low margins, so process efficiency and cost reduction is key for it to be successful. With this strategy, you're aiming for high quantity levels, otherwise you can end up with low sales, low price – a fatal combination.

**Position 3: Hybrid** Ambidextrous.
The Hybrid position sits between low price and differentiation. It's around ensuring the price is competitive, ideally with a low perceived price from buyers, while promoting the added value aspects of the product.
The success of the hybrid strategy comes down to the balance between cost and differentiation, attempting to maximise each while maintaining good margins.

**Position 4: Differentiation**
The Differentiation strategy is where a business focuses on differentiating their products or services from competitors by adding high perceived value. This strategy has a wide spectrum from full product diversity through to unique features within a core product.

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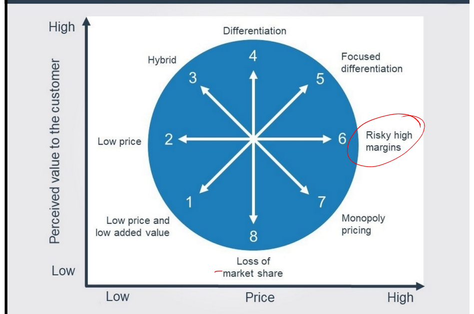
## Bowman's Strategy Clock




**Position 5: Focused Differentiation**
Focused Differentiation is about providing high value at a high price (*not to be confused with Porter's Generic Strategy of the same name, which talks about going to a niche market*). When successfully done, this strategy provides high profits but can be difficult to maintain – the iPhone launch and subsequent early growth is an example of this strategy.

**Position 6: Risky High Margins**
The main thrust of this strategy is to go in with a high price point without any perceived added value.
You're banking on a good brand in order to pull this strategy off, as often buyers will pay more for a known brand, one that has emotions associated to it, than one which is cheaper.

**Position 7: Monopoly Pricing**
In monopoly markets a single company controls the product and pricing, so other factors such as price points, value or competitors play less of a factor. Of course, all monopolies can come to an end – so these companies still need to keep an eye on their external factors.

**Position 8: Loss of Market Share**
This is generally the worst position to be in and suggests that the company is exiting the market or is in decline. It may be that they have chosen this strategy as part of a move to newer markets, or it may be forced upon them due to getting their price or market fit incorrect.

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# Cost Leadership

Indigo.

- On time. Standard Time
- Indigo
- No frills.
- Meals.
- Cost Effective.
- Routes/Scheduling

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# Cost Leadership

### Sources of Cost Advantage

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





# Sources of Cost Advantage

Cost MES qty →

### Economies of Scale

40%

- 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 Manpower Utilisation. $\frac{\text{Mktg}}{\text{Sales}}$ $\frac{10}{100}$ 10%
  - Indivisibilities A320 neo → maintenance → training. $\frac{10}{50}$ 20%
  - Specialization
- international expansion may allow a firm to have enough sales to justify investing in additional capacity to capture economies of scale





# Sources of Cost Advantage

### Economies of Scale

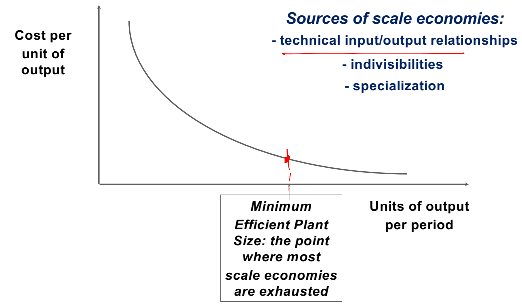
- Economies of scale operate when: Sales
  - activities are executed more efficiently at larger volume,
  - the cost of certain activities can be divided over large sales volume, or
  - activities have less proportional cost increases compared with the output growth
- Technology, specialization and minimum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





*COST ANALYSIS*

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



# New Product Development Projects

## Cost Analysis

| *Product* | *Lead company* | *Estimated development cost* | *Launch date* |
|---|---|---|---|
| F-35 Lightening 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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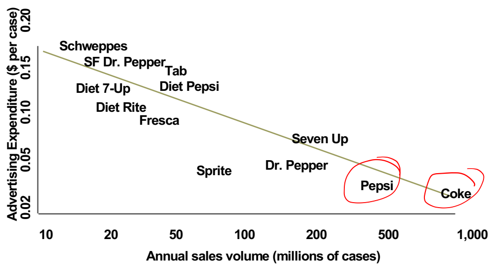
*COST ANALYSIS*

## 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.*

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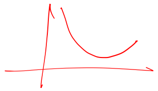
# Sources of Cost Advantage

## 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
Indigo 1 Indigo 2.
buy. lease operates.
Capex
Asset. Debt
Depreciation.
Airbus → 500 planes.
Lean HQ Legal HR Corp Comm
Vizag Kolkata
destination. Early morning late night

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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

Turnaround time.
People mgmt.
machine. – meals
Factories. – SOP.
Dynamic Pricing Model.

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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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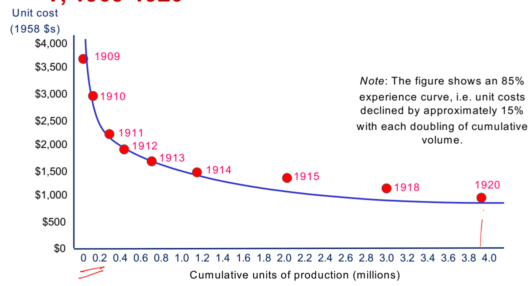
*COST ANALYSIS*

## Experience Curve for the Ford Model T, 1909-1920

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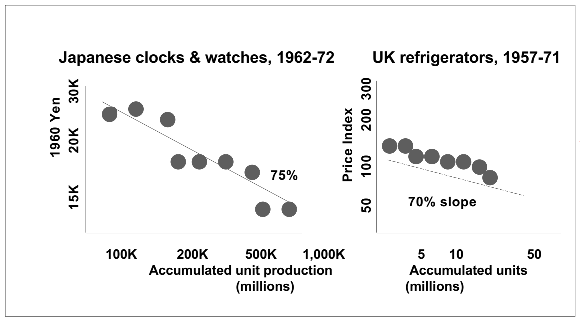
*COST ANALYSIS*

## Examples of Experience Curves

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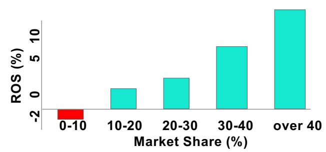
*COST ANALYSIS*

## The Importance of Market Share

**If all firms in an industry have the same experience curve, then:**

***Change in relative costs over time = f (relative market share)***

**PIMS data show that market share is positively related to profitability:**




***BUT*: - *Association* does not imply *causation***

**- Costs of acquiring market share offset the returns to market share**

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## Sources of Cost Advantage

**Low-cost access to factors of production**

land, labor, capital

US airline

Capital < Patent Capital

- Input costs
  - Location advantages
  - Ownership of low-cost inputs
  - Bargaining power supplier cooperation
- Managerial and organizational efficiency
  - Organizational slack

Jet Sahara

KF AD

Barrier to Industry

Gates

AAI

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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

– Scheduling (mileage)*
– new engines
– Indigo standard time
Digital data network
shark fins

- 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

Airbus Indigo "Power by Hour"

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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

Ramps / Stairs.
faster.

No heaters → no warm food.
↳ energy
↳ mileage. (heavy).

- XL.
- baggage.
- food

- fast forward

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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 Issues

**Cost Leadership**

| *Generic strategy* | *Key strategy elements* | *Resource and organizational requirements* |
|---|---|---|
| Cost leadership | •Scale-efficient plants<br>•Design for manufacture<br>•Control of overheads and R&D<br>•Process innovation<br>•Outsourcing/offshoring<br>•Avoiding marginal customers | •Access to capital Cost of Capital<br>•Process engineering skills efficiency<br>•Frequent reports IT<br>•Tight cost control<br>•Specialization of jobs and functions Learning<br>•Incentives linked to quantitative targets numbers<br>accounts |

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# Valuable

300


AC 2 Railways.

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# Rare

- The rareness of a source of cost advantage depends heavily on the **industry life cycle**

Generally…

| | Emerging | | Mature |
|---|---|---|---|
| Economies of Scale | Not Rare | → | Rare |
| Diseconomies of Scale | Rare | → | Rare |
| Learning Curve Economies | Rare | → | Not Rare |
| Differential Input Access | Rare | → | Rare |
| Technology | Rare | → | Not Rare |
| Policy Choices | Rare | → | Rare |

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# Imitability

**LOW COST CONDITIONS**

- Unbalanced Industry Capacity and Demand
- Non-Proprietary Technology
- Highly Observable Technology
- Transactional Exchange

**(A cost advantage can be easily imitated)**

**HIGH COST CONDITIONS**

- Balanced Industry Capacity and Demand
- Path Dependence (Historical Uniqueness)
- Protected Technology
- Highly Unobservable Technology (Causal Ambiguity)
- Relational Exchange (Social Complexity)

**(A cost advantage cannot be easily imitated)**

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# Organization

HQ

Mktg Fin Ops

- **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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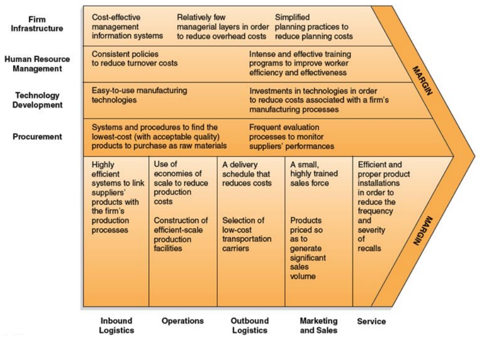
# Implementation Issues

## Catching up with Cost Leaders

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

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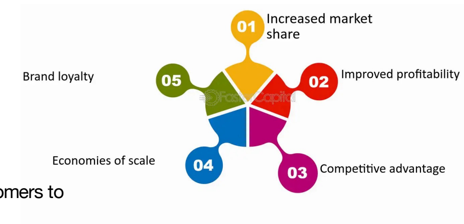
# Benefits of cost leadership

- Enjoy higher-than-average profits
- Engage in price wars
- Eliminate rivals
- Defend/Increase market share
- Build barriers to the entry of newcomers to the market
- Weaken the threat of substitutes
- Enter new markets International.

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# Risks of cost leadership

- It could lead to damaging **price wars** Air-Asia.
  - Vulnerability to even lower-cost operators
  - Dependence on Suppliers may increase Airbus.
- A competitor can eliminate the competitive advantage through
  - A leapfrog in the production capabilities aided by **technology**
  - A **focus strategy** giving them even lower costs within its segment.
- **Quality** compromises may have to be made
  - There might be difficulty in sustaining cost leadership in the long run
  - **Innovation** may be affected

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# Characteristics of Cost Leaders

**WalMart**


- **Efficiency:** High asset utilization, streamlined operations.
- **Simplicity:** Standardized products, limited customization.
- **Scale:** Economies of scale, bulk purchasing.
- **Technology:** Automation and technology to reduce labor costs. warehousing.
- **WalMart** fleet.
  - **Brief Overview:** Introduction to Walmart, a renowned cost leader.
  - **Key Strategies:** Large scale operations, aggressive vendor negotiations, efficient logistics.

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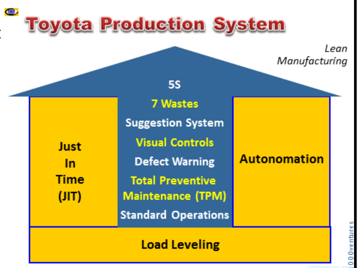
# Key Strategies for Cost Leadership

**Toyota**

- **Economies of Scale:** Expand operations to reduce unit cost.
- **Operational Efficiency:** Streamline processes, reduce waste, improve productivity.
- **Supplier Negotiations:** Leverage buying power to negotiate lower prices.
- **Technology Use:** Automate to reduce labor costs and increase precision.
- **TOYOTA**
  - **Process Improvement:** Implement lean manufacturing principles.
  - Toyota Production System - reducing waste and improving workflow in automotive manufacturing.

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# Steps to Transition to Cost Leadership

- **Step 1:** Conduct a cost audit to identify saving opportunities.
- **Step 2:** Re-engineer processes to improve efficiency.
- **Step 3:** Invest in technology and training.
- **Step 4:** Negotiate better terms with suppliers.
- **Step 5:** Scale operations judiciously.


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# Summary

## Porters Generic Strategies

- **Cost Leadership**
  1. Economies of Scale
  2. Diseconomies of Scale 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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