

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?

1

The Strategic Management Process

Difference between Business and Corporate Strategy

2

Business Level Strategies

Generic Business Level Strategies *Porter.*

** Price*
✓ **Cost Leadership:**
 •generate economic value by having lower costs than competitors
Example: Wal-Mart

Differentiation: *Profits.*
 •generate economic value by offering a product that customers prefer over competitors' product
Example: Harley-Davidson

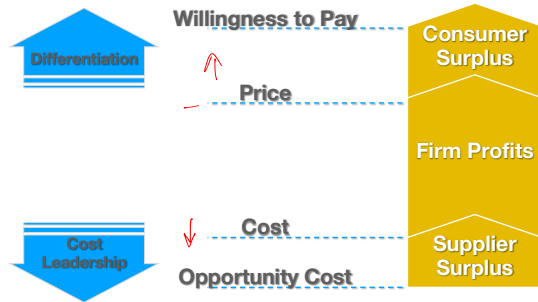
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Porter's Generic Strategies

Cost Leadership & Differentiation

4

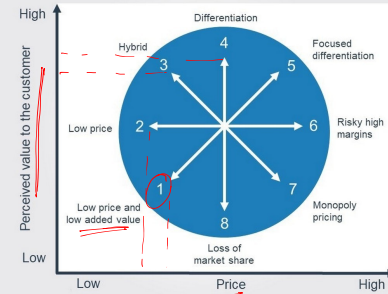
Value creation



Adapted from (Brandenburger & Stuart Jr., 1996)

5

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.

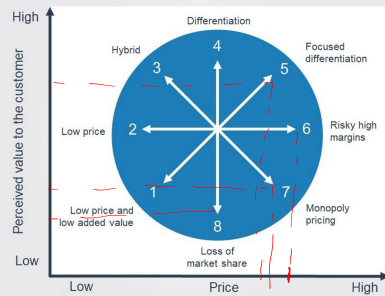
Position 2: Low Price
Low Price, as the name suggests, is a strategy about becoming the lowest cost option for buyers in the marketplace. It's a strategy that can have low margins, so process efficiency and cost reduction is key for it to be successful. With this strategy, you're aiming for high quantity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

Position 3: Hybrid
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.

6

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.

7

Cost Leadership

8

Cost Leadership

Sources of Cost Advantage

1. Economies of Scale *∝ qty. + mkt share.*
2. Diseconomies of Scale *X*
3. Learning Curve Economies *∝ time.*
4. Low-cost access to factors of production *ownership. mgmt.*
5. Technology independent of Scale *R&D.*
6. Policy Choices *tactical. short term*

9

Sources of Cost Advantage

Economies of Scale

40% of mkt 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 *Cost / Sales* *A1 + Vistara + Air Asa*
- Indivisibilities *Costs - lumpy.* *MES* *mkt cost is low*
- Specialization *90 sec Air time* *Airbus A320 neo* *training Cost is low*
- international expansion may allow a firm to have enough sales to justify investing in additional capacity to capture economies of scale *maintenance cost.*

10

Sources of Cost Advantage

Economies of Scale

mkt Sales.

- 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

11

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

12

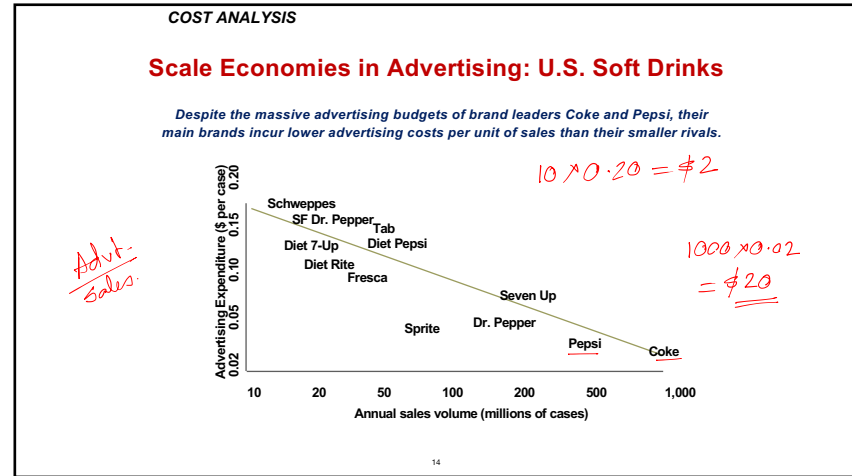
New Product Development Projects

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

Scale
2 billion.

13



14

Sources of Cost Advantage

Diseconomies of Scale

Cost / unit / qty →

- 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

Limited destinations. • CHEMNAI • VZG • KOL • DEL
 Indigo: - Lean HQ bldg. - No swanky bldg. - No Corp Comm / no front office.
 Lease back model. Firm A Firm B → Airbus. Indigo + Teatr Airbus A320neo x 300 planes - debt - depreciation

15

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

Dynamic Pricing Model. Faster turnaround of planes. Longer its in the more money.

16

Sources of Cost Advantage

Learning Curve Economies

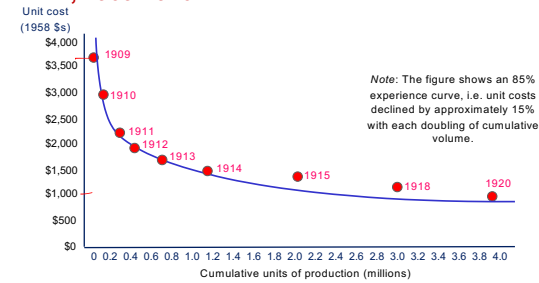
- A firm gets more efficient at a process with experience
- The more complicated/technical the process, the greater the experience advantage.
- International expansion may propel a firm down the experience curve because of higher volumes.

17

17

COST ANALYSIS

Experience Curve for the Ford Model T, 1909-1920

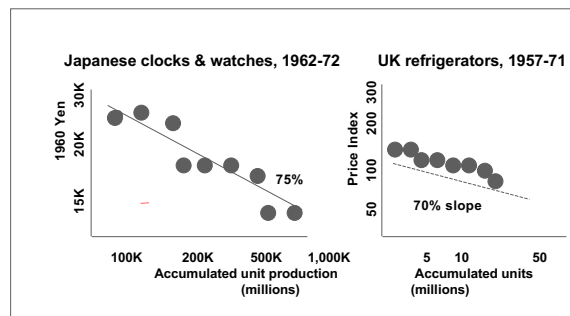


18

18

COST ANALYSIS

Examples of Experience Curves



19

19

COST ANALYSIS

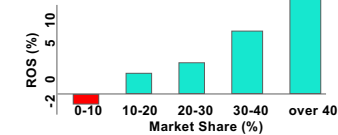
The Importance of Market Share

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

$$\text{Change in relative costs over time} = f(\text{relative market share})$$

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

$$\frac{\text{Profit}}{\text{Sales}} = \text{ROS}$$



BUT: - Association does not imply causation
- Costs of acquiring market share offset the returns to market share

20

20

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

Ownership

US Airline
↳ Patent Capital

Airport Modernization
↳ New Gates

Tie up with Airbus
&
'Power by hour'

outsourced

21

21

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

Indigo - Airbus

22

22

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

shark fin

fuel efficient

neo

23

23

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

24

24

Sources of Cost Advantage

Technology Independent of Scale

*multitasking.
lowest fleet age. → leasing.*

- 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

25

25

Sources of Cost Advantage

Policy Choices

tactical.

- Firms get to choose how they will serve the market. *no. warm food. - Cost ↓ turnaround time.*
- We'll offer level of quality that is inexpensive to produce. *- lower distances. - less cleanup/maintenance. - no heater on plane. ↳ weight ↳ energy cons. ↳ fuel cost*
- 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 instead stairs*

weight ↳ fuel. base fare. ↓ AC 2

Add-ons ↳ extra bags. ↳ fast forward ↳ faster. ↳ seat. ↳ seat plus.

26

26

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

27

27

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

28

28

Implementation Issues

Cost Leadership

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

29

29

Valuable

VRIO

30

30

Rare

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

Generally...	<u>Emerging</u>	→	<u>Mature</u>
Economies of Scale	Not Rare	→	<u>Rare</u>
Diseconomies of Scale	Rare	→	<u>Rare</u>
Learning Curve Economies	Rare	→	<u>Not Rare</u>
<u>Differential Input Access</u>	Rare	→	<u>Rare</u>
Technology	Rare	→	<u>Not Rare</u>
Policy Choices	Rare	→	<u>Rare</u>

31

31

Imitability

LOW COST CONDITIONS	HIGH COST CONDITIONS
<ul style="list-style-type: none"> Unbalanced Industry Capacity and Demand Non-Proprietary Technology Highly Observable Technology Transactional Exchange 	<ul style="list-style-type: none"> Balanced Industry Capacity and Demand Path Dependence (Historical Uniqueness) Protected Technology Highly Unobservable Technology (Causal Ambiguity) Relational Exchange (Social Complexity)
(A cost advantage can be easily imitated)	(A cost advantage cannot be easily imitated)

32

32

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

33

33

Implementation Issues

Sustaining Cost Leadership

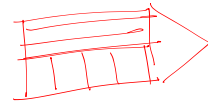
- Obscuring Superior Performance
- Deterrence and Preemption
- Causal Ambiguity and Uncertain Imitability

34

34

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

35

35

Benefits of cost leadership

- Enjoy higher than average profits
- Engage in price war ✓
- 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

36

36

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 *no winners*
- 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

37

37

Summary

Porters Generic Strategies

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

38

38