COMPETITIVE (BUSINESS LEVEL) STRATEGY

In this second aspect of a company's strategy, the focus is on how to compete successfully in each of the lines of business the company has chosen to engage in. The central thrust is how to build and improve the company's competitive position for each of its lines of business. A company has competitive advantage whenever it can attract customers and defend against competitive forces better than its rivals. Companies want to develop competitive advantages that have some sustainability (although the typical term "sustainable competitive advantage" is usually only true dynamically, as a firm works to continue it). Successful competitive strategies usually involve building uniquely strong or distinctive competencies in one or several areas crucial to success and using them to maintain a competitive edge over rivals. Some examples of distinctive competencies are superior technology and/or product features, better manufacturing technology and skills, superior sales and distribution capabilities, and better customer service and convenience.

> **Competitive strategy is about being different. It means deliberately choosing to perform activities differently or to perform different activities than rivals to deliver a unique mix of value.** (Michael E. Porter)
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> **The essence of strategy lies in creating tomorrow's competitive advantages faster than competitors mimic the ones you possess today.** (Gary Hamel & C. K. Prahalad)

We will consider competitive strategy by using Porter's four generic strategies (Porter 1980, 1985) as the fundamental choices, and then adding various competitive tactics.

Porter's Four Generic Competitive Strategies

He argues that a business needs to make two fundamental decisions in establishing its competitive advantage: (a) whether to compete primarily on price (he says "cost," which is necessary to sustain competitive prices, but price is what the customer responds to) or to compete through providing some distinctive points of differentiation that justify higher prices, and (b) how broad a market target it will aim at (its competitive scope). These two choices define the following four generic competitive strategies. which he argues cover the fundamental range of choices. A fifth strategy alternative (best-cost provider) is added by some sources, although not by Porter, and is included below:

1. Overall Price (Cost) Leadership: appealing to a broad cross-section of the market by providing products or services at the lowest price. This requires being the overall low-cost provider of the products or services (e.g., Costco, among retail stores, and Hyundai, among automobile manufacturers). Implementing this strategy successfully requires continual, exceptional efforts to reduce costs -- without excluding product features and services that buyers consider essential. It also requires achieving cost advantages in ways that are hard for competitors to copy or match. Some conditions that tend to make this strategy an attractive choice are:

* The industry's product is much the same from seller to seller
* The marketplace is dominated by price competition, with highly price-sensitive buyers
* There are few ways to achieve product differentiation that have much value to buyers
* Most buyers use product in same ways -- common user requirements
* Switching costs for buyers are low
* Buyers are large and have significant bargaining power

2. Differentiation: appealing to a broad cross-section of the market through offering differentiating features that make customers willing to pay premium prices, e.g., superior technology, quality, prestige, special features, service, convenience (examples are Nordstrom and Lexus). Success with this type of strategy requires differentiation features that are hard or expensive for competitors to duplicate. Sustainable differentiation usually comes from advantages in core competencies, unique company resources or capabilities, and superior management of value chain activities. Some conditions that tend to favor differentiation strategies are:

* There are multiple ways to differentiate the product/service that buyers think have substantial value
* Buyers have different needs or uses of the product/service
* Product innovations and technological change are rapid and competition emphasizes the latest product features
* Not many rivals are following a similar differentiation strategy

3. Price (Cost) Focus: a market niche strategy, concentrating on a narrow customer segment and competing with lowest prices, which, again, requires having lower cost structure than competitors (e.g., a single, small shop on a side-street in a town, in which they will order electronic equipment at low prices, or the cheapest automobile made in the former Bulgaria). Some conditions that tend to favor focus (either price or differentiation focus) are:

* The business is new and/or has modest resources
* The company lacks the capability to go after a wider part of the total market
* Buyers' needs or uses of the item are diverse; there are many different niches and segments in the industry
* Buyer segments differ widely in size, growth rate, profitability, and intensity in the five competitive forces, making some segments more attractive than others
* Industry leaders don't see the niche as crucial to their own success
* Few or no other rivals are attempting to specialize in the same target segment

4. Differentiation Focus: a second market niche strategy, concentrating on a narrow customer segment and competing through differentiating features (e.g., a high-fashion women's clothing boutique in Paris, or Ferrari).

Best-Cost Provider Strategy: (although not one of Porter's basic four strategies, this strategy is mentioned by a number of other writers.) This is a strategy of trying to give customers the best cost/value combination, by incorporating key good-or-better product characteristics at a lower cost than competitors. This strategy is a mixture or hybrid of low-price and differentiation, and targets a segment of value-conscious buyers that is usually larger than a market niche, but smaller than a broad market. Successful implementation of this strategy requires the company to have the resources, skills, capabilities (and possibly luck) to incorporate up-scale features at lower cost than competitors.

This strategy could be attractive in markets that have both variety in buyer needs that make differentiation common and where large numbers of buyers are sensitive to both price and value.

Porter might argue that this strategy is often temporary, and that a business should choose and achieve one of the four generic competitive strategies above. Otherwise, the business is stuck in the middle of the competitive marketplace and will be out-performed by competitors who choose and excel in one of the fundamental strategies. His argument is analogous to the threats to a tennis player who is standing at the service line, rather than near the baseline or getting to the net. However, others present examples of companies (e.g., Honda and Toyota) who seem to be able to pursue successfully a best-cost provider strategy, with stability.

Competitive Tactics

Although a choice of one of the generic competitive strategies discussed in the previous section provides the foundation for a business strategy, there are many variations and elaborations. Among these are various tactics that may be useful (in general, tactics are shorter in time horizon and narrower in scope than strategies). This section deals with competitive tactics, while the following section discusses cooperative tactics.

Two categories of competitive tactics are those dealing with timing (when to enter a market) and market location (where and how to enter and/or defend).

Timing Tactics: When to make a strategic move is often as important as what move to make. We often speak of *first-movers* (i.e., the first to provide a product or service), *second-movers* or rapid followers, and *late movers* (wait-and-see). Each tactic can have advantages and disadvantages.

Being a first-mover can have major strategic advantages when: (a) doing so builds an important image and reputation with buyers; (b) early adoption of new technologies, different components, exclusive distribution channels, etc. can produce cost and/or other advantages over rivals; (c) first-time customers remain strongly loyal in making repeat purchases; and (d) moving first makes entry and imitation by competitors hard or unlikely.

However, being a second- or late-mover isn't necessarily a disadvantage. There are cases in which the first-mover's skills, technology, and strategies are easily copied or even surpassed by later-movers, allowing them to catch or pass the first-mover in a relatively short period, while having the advantage of minimizing risks by waiting until a new market is established. Sometimes, there are advantages to being a skillful follower rather than a first-mover, e.g., when: (a) being a first-mover is more costly than imitating and only modest experience curve benefits accrue to the leader (followers can end up with lower costs than the first-mover under some conditions); (b) the products of an innovator are somewhat primitive and do not live up to buyer expectations, thus allowing a clever follower to win buyers away from the leader with better performing products; (c) technology is advancing rapidly, giving fast followers the opening to leapfrog a first-mover's products with more attractive and full-featured second- and third-generation products; and (d) the first-mover ignores market segments that can be picked up easily.

Market Location Tactics: These fall conveniently into offensive and defensive tactics. Offensive tactics are designed to take market share from a competitor, while defensive tactics attempt to keep a competitor from taking away some of our present market share, under the onslaught of offensive tactics by the competitor. Some offensive tactics are:

* *Frontal Assault:* going head-to-head with the competitor, matching each other in every way. To be successful, the attacker must have superior resources and be willing to continue longer than the company attacked.

* *Flanking Maneuver:* attacking a part of the market where the competitor is weak. To be successful, the attacker must be patient and willing to carefully expand out of the relatively undefended market niche or else face retaliation by an established competitor.

* *Encirclement:* usually evolving from the previous two, encirclement involves encircling and pushing over the competitor's position in terms of greater product variety and/or serving more markets. This requires a wide variety of abilities and resources necessary to attack multiple market segments.

* *Bypass Attack:* attempting to cut the market out from under the established defender by offering a new, superior type of produce that makes the competitor's product unnecessary or undesirable.

* *Guerrilla Warfare:* using a "hit and run" attack on a competitor, with small, intermittent assaults on different market segments. This offers the possibility for even a small firm to make some gains without seriously threatening a large, established competitor and evoking some form of retaliation.

Some Defensive Tactics are:

* *Raise Structural Barriers:* block avenues challengers can take in mounting an offensive

* *Increase Expected Retaliation:* signal challengers that there is threat of strong retaliation if they attack

* *Reduce Inducement for Attacks:* e.g., lower profits to make things less attractive (including use of accounting techniques to obscure true profitability). Keeping prices very low gives a new entrant little profit incentive to enter.

The general experience is that any competitive advantage currently held will eventually be eroded by the actions of competent, resourceful competitors. Therefore, to sustain its initial advantage, a firm must use both defensive and offensive strategies, in elaborating on its basic competitive strategy.

Cooperative Strategies

Another group of "competitive" tactics involve cooperation among companies. These could be grouped under the heading of various types of strategic alliances, which have been discussed to some extent under Corporate Level growth strategies. These involve an agreement or alliance between two or more businesses formed to achieve strategically significant objectives that are mutually beneficial. Some are very short-term; others are longer-term and may be the first stage of an eventual merger between the companies.

Some of the reasons for strategic alliances are to: obtain/share technology, share manufacturing capabilities and facilities, share access to specific markets, reduce financial/political/market risks, and achieve other competitive advantages not otherwise available. There could be considered a continuum of types of strategic alliances, ranging from: (a) mutual service consortiums (e.g., similar companies in similar industries pool their resources to develop something that is too expensive alone), (b) licensing arrangements, (c) joint ventures (an independent business entity formed by two or more companies to accomplish certain things, with allocated ownership, operational responsibilities, and financial risks and rewards), (d) value-chain partnerships (e.g., just-in-time supplier relationships, and out-sourcing of major value-chain functions).

FUNCTIONAL STRATEGIES

Functional strategies are relatively short-term activities that each functional area within a company will carry out to implement the broader, longer-term corporate level and business level strategies. Each functional area has a number of strategy choices, that interact with and must be consistent with the overall company strategies.

Three basic characteristics distinguish functional strategies from corporate level and business level strategies: shorter time horizon, greater specificity, and primary involvement of operating managers.

A few examples follow of functional strategy topics for the major functional areas of marketing, finance, production/operations, research and development, and human resources management. Each area needs to deal with sourcing strategy, i.e., what should be done in-house and what should be outsourced?

Marketing strategy deals with product/service choices and features, pricing strategy, markets to be targeted, distribution, and promotion considerations. Financial strategies include decisions about capital acquisition, capital allocation, dividend policy, and investment and working capital management. The production or operations functional strategies address choices about how and where the products or services will be manufactured or delivered, technology to be used, management of resources, plus purchasing and relationships with suppliers. For firms in high-tech industries, R&D strategy may be so central that many of the decisions will be made at the business or even corporate level, for example the role of technology in the company's competitive strategy, including choices between being a technology leader or follower. However, there will remain more specific decisions that are part of R&D functional strategy, such as the relative emphasis between product and process R&D, how new technology will be obtained (internal development vs. external through purchasing, acquisition, licensing, alliances, etc.), and degree of centralization for R&D activities. Human resources functional strategy includes many topics, typically recommended by the human resources department, but many requiring top management approval. Examples are job categories and descriptions; pay and benefits; recruiting, selection, and orientation; career development and training; evaluation and incentive systems; policies and discipline; and management/executive selection processes.

CHOOSING THE BEST STRATEGY ALTERNATIVES

Decision making is a complex subject, worthy of a chapter or book of its own. This section can only offer a few suggestions. Among the many sources for additional information, I recommend Harrison (1999), McCall & Kaplan (1990), and Williams (2002). Here are some factors to consider when choosing among alternative strategies:

* It is important to get as clear as possible about objectives and decision criteria (what makes a decision a "good" one?)
* The primary answer to the previous question, and therefore a vital criterion, is that the chosen strategies must be effective in addressing the "critical issues" the company faces at this time
* They must be consistent with the mission and other strategies of the organization
* They need to be consistent with external environment factors, including realistic assessments of the competitive environment and trends
* They fit the company's product life cycle position and market attractiveness/competitive strength situation
* They must be capable of being implemented effectively and efficiently, including being realistic with respect to the company's resources
* The risks must be acceptable and in line with the potential rewards
* It is important to match strategy to the other aspects of the situation, including: (a) size, stage, and growth rate of industry; (b) industry characteristics, including fragmentation, importance of technology, commodity product orientation, international features; and (c) company position (dominant leader, leader, aggressive challenger, follower, weak, "stuck in the middle")
* Consider stakeholder analysis and other people-related factors (e.g., internal and external pressures, risk propensity, and needs and desires of important decision-makers)
* Sometimes it is helpful to do scenario construction, e.g., cases with optimistic, most likely, and pessimistic assumptions.

SOME TROUBLESOME STRATEGIES TO AVOID OR USE WITH CAUTION

Follow the Leader: when the market has no more room for copycat products and look-alike

competitors. Sometimes such a strategy can work fine, but not without careful consideration of the company's particular strengths and weaknesses. (e.g., Fujitsu Ltd. was driven since the 1960s to catch up to IBM in mainframes and continued this quest even into the 1990s after mainframes were in steep decline; or the decision by Standard Oil of Ohio to follow Exxon and Mobil Oil into conglomerate diversification)

Count On Hitting Another Home Run: e.g., Polaroid tried to follow its early success with instant photography by developing "Polavision" during the mid-1970s. Unfortunately, this very expensive, instant developing, 8mm, black and white, silent motion picture camera and film was displayed at a stockholders' meeting about the time that the first beta-format video recorder was released by Sony. Polaroid reportedly wrote off at least $500 million on this venture without selling a single camera.

Try to Do Everything: establishing many weak market positions instead of a few strong ones

Arms Race: Attacking the market leaders head-on without having either a good competitive advantage or adequate financial strength; making such aggressive attempts to take market share that rivals are provoked into strong retaliation and a costly "arms race." Such battles seldom produce a substantial change in market shares; usual outcome is higher costs and profitless sales growth

Put More Money On a Losing Hand: one version of this is allocating R&D efforts to weak products instead of strong products (e.g., Polavision again, Pan Am's attempt to continue global routes in 1987)

Over-optimistic Expansion: Using high debt to finance investments in new facilities and equipment, then getting trapped with high fixed costs when demand turns down, excess capacity appears, and cash flows are tight

Unrealistic Status-Climbing: Going after the high end of the market without having the reputation to attract buyers looking for name-brand, prestige goods (e.g., Sears' attempts to introduce designer women's clothing)

Selling the Sizzle Without the Steak: Spending more money on marketing and sales promotions to try to get around problems with product quality and performance. Depending on cosmetic product improvements to serve as a substitute for real innovation and extra customer value.

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