Article: STRATEGIC OPTIONS – Approaches to Sustainable Competitive Advantage

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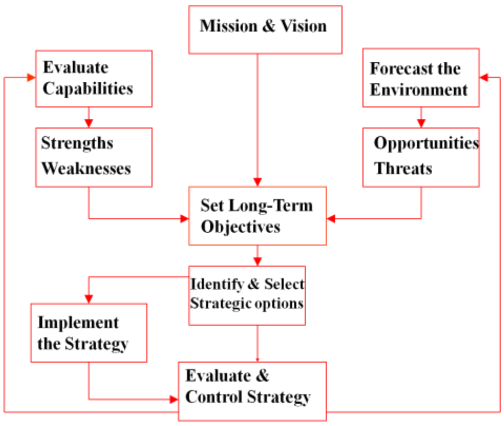
A rational approach to strategic management usually starts with an analysis of the external and internal environment. However these analyses may prove difficult for companies because of the current economic uncertainty that exists at national, European and global levels. Companies are also faced with many new and continued challenges such as the internet/web presence which has increased the speed of globalisation and through the advent of social media which has changed the way business is done. An analysis of the external environment might involve the use of industry analysis, PEST or an equivalent, and also Porter's 5 forces, which would help to identify the opportunities and threats that may exist for a company.



Rational Model of Strategic Management

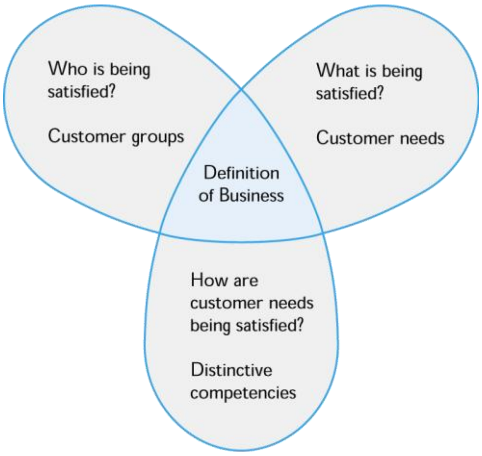
For the internal analysis a company would carry out a resource audit, examining physical, human, and financial resources together with intangibles such as brands, patents, etc and would then look at its value chain as a means of assessing the efficiency and effectiveness of all aspects of its operation. Any element of the value chain is capable of adding or destroying value. The aim of the internal analysis is to identify the company's strengths and weaknesses and as a result the company should be able to identify what it is or is not capable of doing and what it needs to address before pursuing certain strategic options.

The analyses should feed into the mission and vision statements and also the aims and objectives that the company set for the forthcoming strategic period; these should encompass both strategic and financial objectives. It will also help to identify a series of strategic options that the company can consider and will inform the ultimate choices made.

Defining the Business

The Three Dimensional Business Definition Framework is a model that can be used for defining the business. The customer is central in this model not the company itself and is an excellent way of defining the business.

With Abell's model you examine customer needs – product differentiation (what is being satisfied), customer groups – market segmentation (who are you aiming to satisfy) and distinctive competencies – competitive actions (how are you going to satisfy your customers' needs).



Source: Derek F. Abell, *Defining the Business: The Starting Point of Strategic Planning* (Englewood Cliffs, N.J.: Prentice-Hall, 1980), p. 17.

Customers and Value

The focus on satisfying customer needs leads to the principle of providing customer value. This fits with values-based marketing where companies' core marketing values are aligned with their business strategy. Companies should, of course, also align their strategy to the central values they operate under, such as ethical beliefs, CSR etc. Marketing can be seen as identifying, creating, communicating and delivering value. By understanding the value customers want companies can position their strategy to meet this need. The type of value the customer wants satisfied has a direct bearing on the strategy of the company. There are different types of value that a customer might seek.

Functional value is where the customer is buying the product to perform an actual function, for example some customers buy a motor car purely to get them from A to B and often look for the most economical way to achieve that function. Psychological value is where the customer is buying a product for the status or esteem that it brings them. Using our previous example, a customer does not tend to buy a Porsche or Rolls Royce simply to get them from A to B but more for the status they feel from owning an expensive high performance car. A third type of value is Transactional value - this applies where the product or services available are virtually identical so the distinguishing feature will be the ease with which the customer can buy the product or service. Customers tend to buy the perceived highest value offered when deciding between competing product/service.

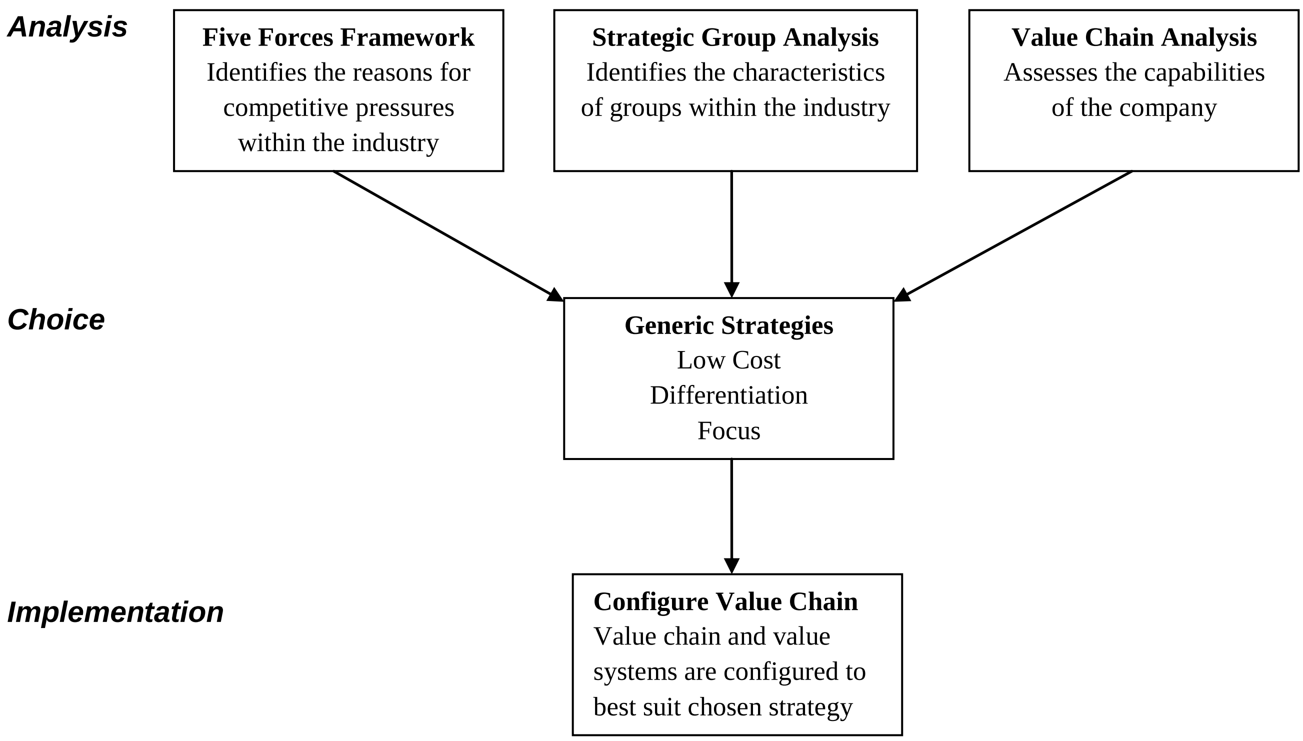
Before moving onto strategic options it is worth developing the concept of customer value a little further. Perceived value is determined by looking at the factors of price and quality and can be summarised by the equation

$$\text{Value} = \frac{\text{Quality (Q)}}{\text{Price (P)}}$$

Value can be increased by lowering price while keeping quality the same, increasing quality while keeping the price the same or moving both by differing degrees.

Approaches to Sustainable Competitive Advantage

There has been debate for a number of years over the way in which companies seek to develop sustainable competitive advantage. In broad terms, two approaches have emerged from this debate – the positioning approach and the resource-based approach.
The positioning approach is associated with Michael Porter and was originally outlined in the 1980s. Porter maintained that a company needed to understand the structure of the industry in which it operated so that it could change its strategy to improve performance and outperform its competitors. It depended on the company exploiting the underlying economic factors within the industry better than competitors and maintaining this over time to achieve sustainable competitive advantage. The analysis-choice-implementation framework can be used to highlight how models can be used within this approach. This is sometimes referred to as an “outside-in” approach.



The company establishes a position to best meet the competitive forces within the industry. Porter argues that if the company chooses a favourable position it can earn above average returns even if general industry conditions are unfavourable.

During the 1990s there were many critiques of the positioning approach which led to the development of the resource-based approach based on broadly similar views from a number of authors such as Prahalad & Hamel (1990), Stalk, Evans & Shulman (1992) and Hall (1994). Although differing slightly, there is a broad agreement on how resources can build capabilities which lead to competences which are difficult for competitors to copy. Under the resource-based approach, the starting point for sources of competitive advantage reside within the company rather than starting by looking at the challenges posed by the external environment, however any resultant strategy can only be viewed as successful if it is valued by the customers and is seen to be different from what other competitors are doing. This is often seen as an "inside-out" approach.

Porter's Generic Strategies

Michael Porter argues that a firm's strengths mean they ultimately make a choice between one of two headings: cost advantage and differentiation. By applying these strengths in either many segments of the industry or just one or two, three generic strategies result: *cost leadership*, *differentiation*, and *focus*. These strategies are applied at the business unit level. They are called generic strategies because they are not firm or industry dependent.

Under a Cost-leadership strategy the company seeks to be the lowest cost provider to most customer segments. If it sells at industry average prices it earns a higher profit than its rivals or it can sell at below these prices to increase market share. The company looks for ways to lower its cost position and these include economies of scale, experience curve effect, improving process efficiencies, and outsourcing. Low-cost leadership means low *overall* costs, not just low manufacturing or production costs! The aim is to make the achievement of low-cost relative to rivals the main focus of the company's strategy. A good example of a company pursuing this strategy would be Ryanair.

(Adapted from M.E.Porter, Competitive Advantage, Free Press 1985)

With a differentiation strategy the company seeks to develop products that offer unique attributes that are valued by customers. Normally this will allow the company to charge a premium price that will more than cover the extra costs incurred thereby increasing margins and profits. Differentiation can be achieved in a number of ways for example by offering superior quality or performance, unusual or unique features, more responsive customer service, and rapid product innovation. Examples of companies pursuing this strategy would be DHL (superior customer service), Caterpillar (spare parts capability) and Toyota (quality manufacture).

When a company uses a focus strategy it concentrates on one or two segments of the market using either a cost or differentiation focus. The sources of cost-leadership and differentiation are similar to those discussed above but the success of a focus strategy depends on the ability of the company to defend the segment from broad scope competitors.

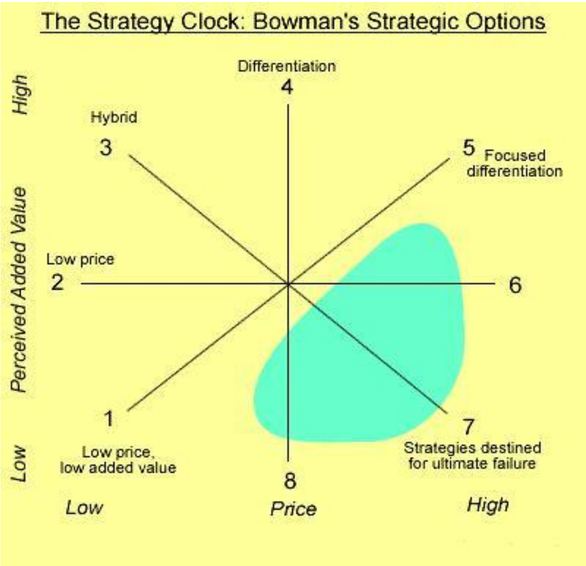
Porter argues that all the activities the organisation carries out can contribute to the strategy. By using the value chain and value system and particularly looking for linkages that improve efficiency or enhance the product/service the company can exploit these as sources of competitive efficiency or value added.

Porter's three strategies were modified by Michael Treacy and Fred Wiersema in their book *The Discipline of Market Leaders* (1993). They described three basic "value disciplines" that can create customer value and provide a competitive advantage - operational excellence, product leadership, and customer intimacy.

There have been a number of other adaptations of the generic strategies framework, and one (Bowman's Strategy Clock) will be dealt with shortly. However, one alternative approach is that of "Best Cost Provider". This approach combines a strategic emphasis on low-cost with a strategic emphasis on differentiation with the aim of making an upscale product at a lower cost that give customers more value for their money. Success depends on having the skills and capabilities to provide attractive performance and features at a lower cost than rivals, a best-cost producer can often out-compete both a low-cost provider and a differentiator when standardised features/attributes will not meet the diverse needs of buyers and many buyers are price and value sensitive. This strategy is a compromise though and a best-cost provider may end up being attacked by the strategies of firms using both low-cost and differentiation strategies. Low-cost leaders may be able to siphon customers away with a lower price while high-end differentiators may be able to steal customers away with better product attributes.

Bowman's "Strategy Clock"

The "Strategy Clock" was developed by Cliff Bowman who argued that the key variables as far as positioning is concerned are price and perceived quality which are the determinants of value. Bowman asserts that there are five potentially successful routes.



Position 1: Low Price/Low Value
This is where companies find themselves if their products have little differentiated features so they end up selling on price alone. This is not a position that companies usually choose to compete from.

Position 2: Low Price
This is comparable with the low cost leader position of Porter's generic strategies. Companies in this position drive prices downwards and look for high volume to counteract low margins. Over time they look to become the powerful force in the marketplace. Walmart in the retail sector and Ryanair in the airline sector would be examples of companies taking this position.

Position 3: Hybrid (moderate price/moderate differentiation)
This would be an example of a "Best-Cost Provider" mentioned earlier. This approach combines a low-cost approach with an emphasis on differentiation with the aim of giving customers more value for their money. Southwest Airlines in the U.S. would be an example of a company taking this position.

Position 4: Differentiation
This is similar to Porter's view of Differentiation. The aim is to offer customers high perceived-value and either increase their price for higher margins or keep prices lower for increased market share. Branding is an important element with differentiation strategies as the company wants its name to be synonymous with quality. Nike and Kelloggs are examples of companies taking this position.

Position 5: Focused Differentiation
A company pursuing a focused differentiation strategy aims to offer higher perceived value at a substantial price premium. Consumers buy in this category based on perceived value alone. Gucci, Armani, Rolls Royce are examples of companies pursuing this strategy and they are satisfying the psychological value their customers seek.

Position 6: Increased Price/Standard Product
This is where a company increases its price without any increase in quality. If the price increase is accepted the company will experience increased profits, if it is not accepted their market share declines until they lower the price or add value. This strategy may work in the short term but is doomed to failure in the long run.

Position 7: High Price/Low Value
This is a classic monopoly pricing position where companies can charge what they like with no concern about added value where they have no competition. In a market economy monopolies do not tend to last long and companies are forced to compete on a rational basis.

Position 8: Low Value/Standard Price
If a company has a low value product the price will have to be low to encourage customers to buy it. Any company that pursues this strategy is bound to fail.

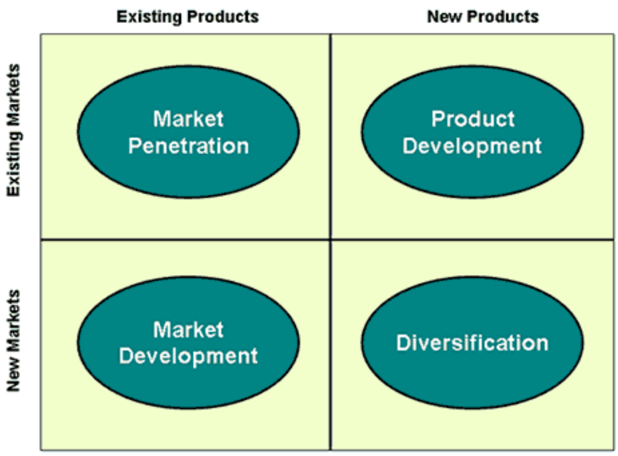
In a truly competitive market place, positions 6, 7, and 8 are bound to fail as the customer will go to companies offering more competitive products or new companies will enter to take business away from companies adopting these positions.

Companies using the positioning approach need to understand that it is not static, the relative positions of competitors will change as new entrants come into the market or as companies change their strategies in response to other companies or market conditions. Companies must continually monitor changes in the market.

In his original work Porter argued that companies must choose between low cost or differentiation or they ran the risk of being "stuck in the middle", however, in "What is Strategy" published in 1996 he argued that rather than choose between the two strategies companies should look to create greater value by using different sets of activities. This could involve using both strategies.

Directions of Development

In the 1960s Igor Ansoff developed a model describing alternative directions of development. The model looked at combinations of existing and new products and markets. He identified four alternatives – market penetration, market development, product development, and diversification.



Directions of Development framework, H Igor Ansoff, Corporate Strategy. McGraw-Hill. 1965

Market penetration

This is where a company focuses on selling existing products into existing markets. The aim is to maintain or increase market share of existing products through aggressive sales promotion, more competitive pricing etc. This is very much about carrying on as usual as the company focuses on products and markets it already operates in. It is therefore unlikely to require much investment in new market research.

Market development

This is where a company looks to sell its existing products into new markets. This can be new geographical markets, new distribution channels, or new uses for the products. Perhaps one of the best examples of new uses for a product is WD40 (www.wd40.com) where they list over 2000+ uses for this product which have been submitted by customers.

Product development

This is the name given to a growth strategy where a business aims to introduce new products into existing markets. One of the most successful companies for product development is 3M Corporation who among their strategic objectives state an aim that "at least 30% of sales come from products introduced in the past four years**".** This strategy is likely to require the development of new competencies and also significant expenditure on research and development.

Diversification

Diversification differs from the other three strategies in that it requires a company to acquire new skills, new technologies and new facilities. This is an inherently more risky strategy because the company is moving into markets in which it has little or no experience. For a company to adopt a diversification strategy, therefore, it must have a clear idea about what it expects to gain from the strategy and an honest assessment of the risks. Diversification can be related or unrelated, related means there is an existing connection with value chain. However, there are plenty of good reasons for diversification, for example, by extending their range of goods or services a company can either sell more products to their existing customers or reach out to new markets. This can increase their growth prospects.

Conclusion

The aim of a company should not be to gain a short-term victory over its competitors but rather to build a *sustainable* competitive advantage. In his original work Porter suggested that companies had to choose between low cost or differentiation and companies that failed to make a clear choice were often likely to be "stuck in the middle". Proponents of the resource-based view argue that companies should seek to exploit all sources of competitive advantage in order to create a unique strategy. To an extent Porter agreed with this in his 1996 article "What is Strategy" when he emphasised the importance of the unique mix of value created by a different set of activities rather than the straight choice between low cost and differentiation. The "best-cost provider" strategy or Bowman's hybrid strategy best illustrate the drive for this unique mix.

Mention has been made of outside-in or inside-out approaches to strategy. This is more about the underlying ethos of the approach rather than describing the actual process – should the strategy be market-driven or competence driven?

Developing a strategy has never been more challenging than in the current economic climate. Concerns about the availability of finance, the ability to keep up with technology, the threat of rising inflation, the difficulty in retaining customers in increasingly competitive markets, the ability to retain talent are the types of problems companies may face when developing their future strategies. These cover general business strategies but also functional strategies such as HR, Marketing and I.T. for example.

The evaluation and selection of strategic options is an important aspect of the strategic management process, it is essential if companies are to maintain or enhance their competitive position. Consider the following:

"There are three kinds of companies, those that make things happen, those that watch things happen – and those that wondered what happened." (Anonymous)

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