chapter 5

The Five Generic Competitive Strategies

LEARNING OBJECTIVES

LO1 Understand what distinguishes each of the five generic strategies and why some of these strategies work better in certain kinds of industry and competitive conditions than in others.

LO2 Learn the major avenues for achieving a competitive advantage based on lower costs.

LO3 Gain command of the major avenues for developing a competitive advantage based on differentiating a company's product or service offering from the offerings of rivals.

LO4 Recognize the required conditions for delivering superior value to customers through the use of a hybrid of low-cost provider and differentiation strategies.

There are several basic approaches to competing successfully and gaining a competitive advantage, but they all involve giving buyers what they perceive as superior value compared to the offerings of rival sellers. A superior value proposition can be based on offering a good product at a lower price, a superior product that is worth paying more for, or a best-value offering that represents an attractive combination of price, features, quality, service, and other appealing attributes.

This chapter describes the five *generic competitive strategy options* for building competitive advantage and delivering superior value to customers. Which of the five to employ is a company's first and foremost choice in crafting an overall strategy and beginning its quest for competitive advantage.

LO1 Understand what distinguishes each of the five generic strategies and why some of these strategies work better in certain kinds of industry and competitive conditions than in others.

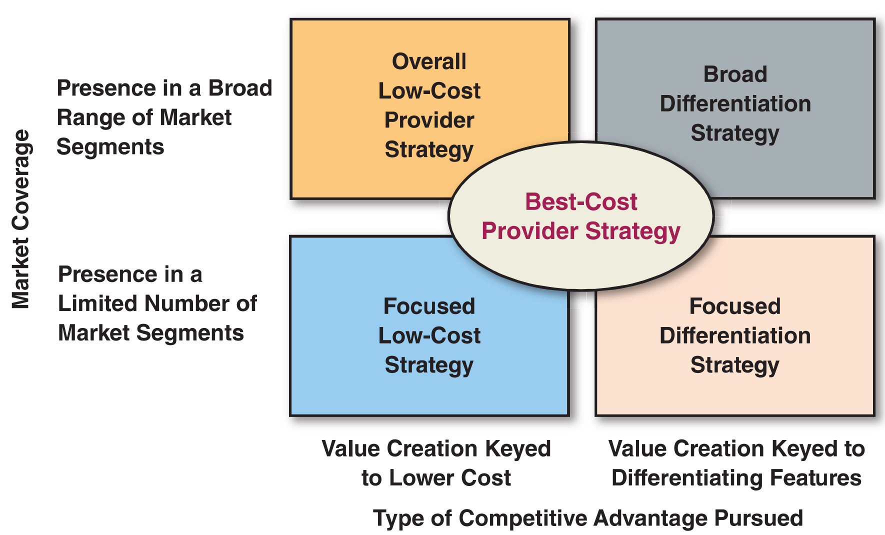
The Five Generic Competitive Strategies

A company's **competitive strategy** *deals exclusively with the specifics of management's game plan for competing successfully*—its specific efforts to please customers, strengthen its market position, counter the maneuvers of rivals, respond to shifting market conditions, and achieve a particular competitive advantage. The chances are remote that any two companies—even companies in the same industry—will employ competitive strategies that are exactly alike. However, when one strips away the details to get at the real substance, the two biggest factors that distinguish one competitive strategy from another boil down to (1) whether a company's market target is broad or narrow, and (2) whether the company is pursuing a competitive advantage linked to lower costs or differentiation. These two factors give rise to the five competitive strategy options shown in Figure 5.1.[1]

CORE CONCEPT

A **competitive strategy** concerns the specifics of management's game plan for competing successfully and securing a competitive advantage over rivals in the marketplace.

FIGURE 5.1 **The Five Generic Competitive Strategies**



Source: This is an author-expanded version of a three-strategy classification discussed in Michael E. Porter, *Competitive Strategy* (New York: Free Press, 1980), pp. 35–40.

1. *A low-cost provider strategy*—striving to achieve lower overall costs than rivals and appealing to a broad spectrum of customers, usually by underpricing rivals
2. *A broad differentiation strategy*—seeking to differentiate the company's product or service from rivals' in ways that will appeal to a broad spectrum of buyers
3. *A focused low-cost strategy*—concentrating on a narrow buyer segment (or market niche) and outcompeting rivals by having lower costs than rivals and thus being able to serve niche members at a lower price
4. *A focused differentiation strategy*—concentrating on a narrow buyer segment (or market niche) and outcompeting rivals by offering niche members customized attributes that meet their tastes and requirements better than rivals' products
5. *A best-cost provider strategy*—giving customers more value for the money by satisfying buyers' expectations on key quality/features/performance/service attributes while beating their price expectations. This option is a *hybrid* strategy that blends elements of low-cost provider and differentiation strategies; the aim is to have the lowest (best) costs and prices among sellers offering products with comparable differentiating attributes.

The remainder of this chapter explores the ins and outs of the five generic competitive strategies and how they differ.

Low-Cost Provider Strategies

LO2 Learn the major avenues for achieving a competitive advantage based on lower costs.

Striving to be the industry's overall low-cost provider is a powerful competitive approach in markets with many price-sensitive buyers. A company achieves low-cost leadership when it becomes the industry's lowest-cost provider rather than just being one of perhaps several competitors with low costs. Successful low-cost providers boast meaningfully lower costs than rivals, but not necessarily the absolutely lowest possible cost. In striving for a cost advantage over rivals, managers must include features and services that buyers consider essential. A product offering that is too frills-free can be viewed by consumers as offering little value, regardless of its pricing.

CORE CONCEPT

A **low-cost leader**'s basis for competitive advantage is lower overall costs than competitors'. Success in achieving a low-cost edge over rivals comes from eliminating and/or curbing "nonessential" activities and/or outmanaging rivals in performing essential activities.

A company has two options for translating a low-cost advantage over rivals into attractive profit performance. Option 1 is to use the lower-cost edge to underprice competitors and attract price-sensitive buyers in great enough numbers to increase total profits. Option 2 is to maintain the present price, be content with the present market share, and use the lower-cost edge to earn a higher profit margin on each unit sold, thereby raising the firm's total profits and overall return on investment.

The Two Major Avenues for Achieving Low-Cost Leadership

To achieve a low-cost edge over rivals, a firm's cumulative costs across its overall value chain must be lower than competitors' cumulative costs. There are two major avenues for accomplishing this:[2]

1. Performing essential value chain activities more cost-effectively than rivals.
2. Revamping the firm's overall value chain to eliminate or bypass some cost-producing activities.

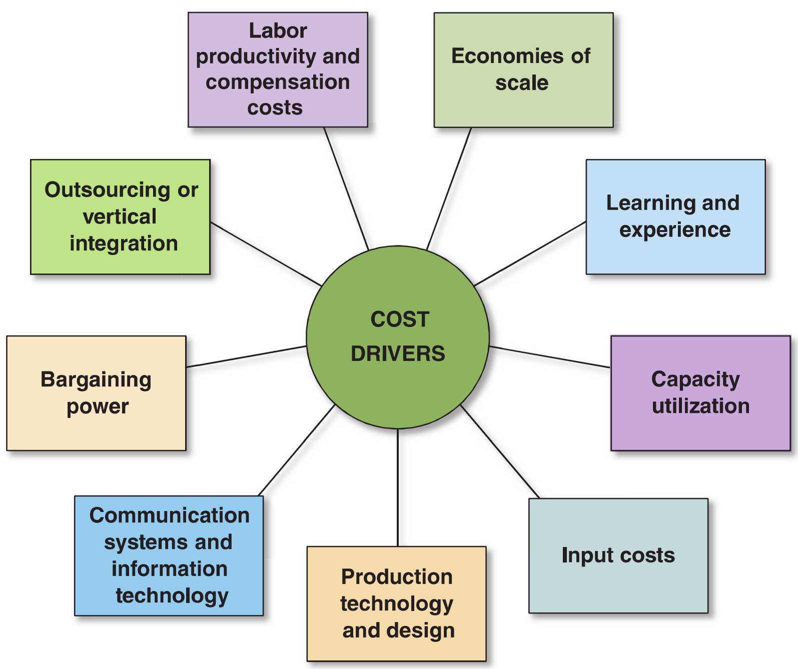
Cost-Efficient Management of Value Chain Activities For a company to do a more cost-efficient job of managing its value chain than rivals, managers must launch a concerted, ongoing effort to ferret out cost-saving opportunities in every part of the value chain. No activity can escape cost-saving scrutiny, and all company personnel must be expected to use their talents and ingenuity to come up with innovative and effective ways to keep costs down. Particular attention needs to be paid to **cost drivers**, which are factors that have an especially strong effect on the costs of a company's value chain activities. The number of products in a company's product line, its capacity utilization, the type of components used in the assembly of its products, and the extent of its employee benefits package are all factors affecting the company's overall cost position. Figure 5.2 shows the most important cost drivers. Cost-saving approaches that demonstrate effective management of the cost drivers in a company's value chain include:

CORE CONCEPT

A **cost driver** is a factor having a strong effect on the cost of a company's value chain activities and cost structure.

- *Striving to capture all available economies of scale.* Economies of scale stem from an ability to lower unit costs by increasing the scale of operation. For example, Anheuser-Busch InBev was able to capture scale economies with its $4 million SuperBowl ad in 2014 because the cost could be distributed over the 370 millions of cases of Budweiser and Bud Light sold that year.
- *Taking full advantage of experience and learning curve effects.* The cost of performing an activity can decline over time as the learning and experience of company personnel build.

FIGURE 5.2 **Important Cost Drivers in a Company's Value Chain**



Sources: Adapted by the authors from M. Porter, *The Competitive Advantage: Creating and Sustaining Superior Performance* (New York: Free Press, 1985).

- *Trying to operate facilities at full capacity.* Whether a company is able to operate at or near full capacity has a big impact on unit costs when its value chain contains activities associated with substantial fixed costs. Higher rates of capacity utilization allow depreciation and other fixed costs to be spread over a larger unit volume, thereby lowering fixed costs per unit.
- *Substituting lower-cost inputs whenever there's little or no sacrifice in product quality or product performance.* If the costs of certain raw materials and parts are "too high," a company can switch to using lower-cost alternatives when they exist.
- *Employing advanced production technology and process design to improve overall efficiency.* Often production costs can be cut by utilizing design for manufacture (DFM) procedures and computer-assisted design (CAD) techniques that enable more integrated and efficient production methods, investing in highly automated robotic production technology, and shifting to production processes that enable manufacturing multiple versions of a product as cost efficiently as mass producing a single version. A number of companies are ardent users of total quality management systems, business process reengineering, Six Sigma methodology, and other business process management techniques that aim at boosting efficiency and reducing costs.
- *Using communication systems and information technology to achieve operating efficiencies.* For example, sharing data and production schedules with suppliers, coupled with the use of enterprise resource planning (ERP) and manufacturing execution system (MES) software, can reduce parts inventories, trim production times, and lower labor requirements.
- *Using the company's bargaining power vis-*à*-vis suppliers to gain concessions.* A company may have sufficient bargaining clout with suppliers to win price discounts on large-volume purchases or realize other cost savings.
- *Being alert to the cost advantages of outsourcing and vertical integration.* Outsourcing the performance of certain value chain activities can be more economical than performing them in-house if outside specialists, by virtue of their expertise and volume, can perform the activities at lower cost.
- *Pursuing ways to boost labor productivity and lower overall compensation costs.* A company can economize on labor costs by using incentive compensation systems that promote high productivity, installing labor-saving equipment, shifting production from geographic areas where pay scales are high to geographic areas where pay scales are low, and avoiding the use of union labor where possible (because costly work rules can stifle productivity and because of union demands for above-market pay scales and costly fringe benefits).

Revamping the Value Chain Dramatic cost advantages can often emerge from reengineering the company's value chain in ways that eliminate costly work steps and bypass certain cost-producing value chain activities. Such value chain revamping can include:

- *Selling directly to consumers and cutting out the activities and costs of distributors and dealers.* To circumvent the need for distributors–dealers, a company can (1) create its own direct sales force (which adds the costs of maintaining and supporting a sales force but may be cheaper than utilizing independent distributors and dealers to access buyers), and/or (2) conduct sales operations at the company's website (costs for website operations and shipping may be a substantially cheaper way to make sales to customers than going through distributor–dealer channels). Costs in the wholesale/retail portions of the value chain frequently represent 35 to 50 percent of the price final consumers pay, so establishing a direct sales force or selling online may offer big cost savings.

- *Streamlining operations by eliminating low-value-added or unnecessary work steps and activities.* Southwest Airlines has achieved considerable cost savings by reconfiguring the traditional value chain of commercial airlines to eliminate low-value-added activities and work steps. Southwest does not offer assigned seating, baggage transfer to connecting airlines, or first-class seating and service, thereby eliminating all the cost-producing activities associated with these features. Also, the company's carefully designed point-to-point route system minimizes connections, delays, and total trip time for passengers, allowing about 75 percent of Southwest passengers to fly nonstop to their destinations and at the same time helping reduce Southwest's costs for flight operations.
- *Improving supply chain efficiency to reduce materials handling and shipping costs.* Collaborating with suppliers to streamline the ordering and purchasing process, to reduce inventory carrying costs via just-in-time inventory practices, to economize on shipping and materials handling, and to ferret out other cost-saving opportunities is a much-used approach to cost reduction. A company with a distinctive competence in cost-efficient supply chain management, such as BASF (the world's leading chemical company), can sometimes achieve a sizable cost advantage over less adept rivals.

Concepts & Connections 5.1 describes Walmart's broad approach to managing its value chain in the retail grocery portion of its business to achieve a dramatic cost advantage over rival supermarket chains and become the world's biggest grocery retailer.

When a Low-Cost Provider Strategy Works Best

A competitive strategy predicated on low-cost leadership is particularly powerful when:

1. *Price competition among rival sellers is especially vigorous.* Low-cost providers are in the best position to compete offensively on the basis of price and to survive price wars.
2. *The products of rival sellers are essentially identical and are readily available from several sellers.* Commodity-like products and/or ample supplies set the stage for lively price competition; in such markets, it is the less efficient, higher-cost companies that are most vulnerable.
3. *There are few ways to achieve product differentiation that have value to buyers.* When the product or service differences between brands do not matter much to buyers, buyers nearly always shop the market for the best price.
4. *Buyers incur low costs in switching their purchases from one seller to another.* Low switching costs give buyers the flexibility to shift purchases to lower-priced sellers having equally good products. A low-cost leader is well positioned to use low price to induce its customers not to switch to rival brands.

Concepts & Connections 5.1

HOW WALMART MANAGED ITS VALUE CHAIN TO ACHIEVE A LOW-COST ADVANTAGE OVER RIVAL SUPERMARKET CHAINS

Walmart has achieved a very substantial cost and pricing advantage over rival supermarket chains by both revamping portions of the grocery retailing value chain and outmanaging its rivals in efficiently performing various value chain activities. Its cost advantage stems from a series of initiatives and practices:

- Instituting extensive information sharing with vendors via online systems that relay sales at its checkout counters directly to suppliers of the items, thereby providing suppliers with real-time information on customer demand and preferences (creating an estimated 6 percent cost advantage).
- Pursuing global procurement of some items and centralizing most purchasing activities so as to leverage the company's buying power (creating an estimated 2.5 percent cost advantage).
- Investing in state-of-the-art automation at its distribution centers, efficiently operating a truck fleet that makes daily deliveries to Walmart's stores, and putting assorted other cost-saving practices into place at its headquarters, distribution centers, and stores (resulting in an estimated 4 percent cost advantage).
- Striving to optimize the product mix and achieve greater sales turnover (resulting in about a 2 percent cost advantage).
- Installing security systems and store operating procedures that lower shrinkage rates (producing a cost advantage of about 0.5 percent).
- Negotiating preferred real estate rental and leasing rates with real estate developers and owners of its store sites (yielding a cost advantage of 2 percent).
- Managing and compensating its workforce in a manner that produces lower labor costs (yielding an estimated 5 percent cost advantage).

Altogether, these value chain initiatives give Walmart an approximately 22 percent cost advantage over Kroger, Safeway, and other leading supermarket chains. With such a sizable cost advantage, Walmart has been able to underprice its rivals and become the world's leading supermarket retailer.

To maintain its cost advantages, which are very much tied to scale and growth, Walmart has adapted to more broadly reach a changing and growing customer base. Walmart stores range from giant, 24-hour Supercenters to Neighborhood Markets and Express stores that better fit the needs of customers in urban or fast-moving locales. In the same way, the company has tailored its international expansion by country. With further innovation in online and fresh delivery sales, Walmart is well poised to continue its growth and low-cost leadership.

Sources: www.walmart.com; and Marco Iansiti and Roy Levien, "Strategy as Ecology," *Harvard Business Review* 82, no. 3 (March 2004), p. 70; and Clare O'Connor, "Walmart vs. Amazon: World's Biggest E-Commerce Battle Could Boil Down to Vegetables," *Forbes Online,* March 2014.

5. *The majority of industry sales are made to a few, large-volume buyers.* Low-cost providers are in the best position among sellers in bargaining with high-volume buyers because they are able to beat rivals' pricing to land a high-volume sale while maintaining an acceptable profit margin.
6. *Industry newcomers use introductory low prices to attract buyers and build a customer base.* The low-cost leader can use price cuts of its own to make it harder for a new rival to win customers.

As a rule, the more price-sensitive buyers are, the more appealing a low-cost strategy becomes. A low-cost company's ability to set the industry's price floor and still earn a profit erects protective barriers around its market position.

Pitfalls to Avoid in Pursuing a Low-Cost Provider Strategy

Perhaps the biggest pitfall of a low-cost provider strategy is getting carried away with *overly aggressive price cutting* and ending up with lower, rather than higher, profitability.

A low-cost/low-price advantage results in superior profitability only if (1) prices are cut by less than the size of the cost advantage or (2) the added volume is large enough to bring in a bigger total profit despite lower margins per unit sold. Thus, a company with a 5 percent cost advantage cannot cut prices 20 percent, end up with a volume gain of only 10 percent, and still expect to earn higher profits!

A second big pitfall is *relying on an approach to reduce costs that can be easily copied by rivals.* The value of a cost advantage depends on its sustainability. Sustainability, in turn, hinges on whether the company achieves its cost advantage in ways difficult for rivals to replicate or match. If rivals find it relatively easy or inexpensive to imitate the leader's low-cost methods, then the leader's advantage will be too short-lived to yield a valuable edge in the marketplace.

A third pitfall is becoming *too fixated on cost reduction.* Low costs cannot be pursued so zealously that a firm's offering ends up being too features-poor to gain the interest of buyers. Furthermore, a company driving hard to push its costs down has to guard against misreading or ignoring increased buyer preferences for added features or declining buyer price sensitivity. Even if these mistakes are avoided, a low-cost competitive approach still carries risk. Cost-saving technological breakthroughs or process improvements by rival firms can nullify a low-cost leader's hard-won position.

Broad Differentiation Strategies

CORE CONCEPT

The essence of a **broad differentiation strategy** is to offer unique product or service attributes that a wide range of buyers find appealing and worth paying for.

Differentiation strategies are attractive whenever buyers' needs and preferences are too diverse to be fully satisfied by a standardized product or service. A company attempting to succeed through differentiation must study buyers' needs and behavior carefully to learn what buyers think has value and what they are willing to pay for. Then the company must include these desirable features to clearly set itself apart from rivals lacking such product or service attributes.

Successful differentiation allows a firm to:

- Command a premium price, and/or
- Increase unit sales (because additional buyers are won over by the differentiating features), and/or
- Gain buyer loyalty to its brand (because some buyers are strongly attracted to the differentiating features and bond with the company and its products).

Differentiation enhances profitability whenever the extra price the product commands outweighs the added costs of achieving the differentiation. Company differentiation strategies fail when buyers don't value the brand's uniqueness and/or when a company's approach to differentiation is easily copied or matched by its rivals.

LO3 Gain command of the major avenues for developing a competitive advantage based on differentiating a company's product or service offering from the offerings of rivals.

Approaches to Differentiation

Companies can pursue differentiation from many angles: a unique taste (Red Bull, Doritos), multiple features (Microsoft Office, Apple iPhone), wide selection and one-stop shopping (Home Depot, Amazon.com), superior service (Ritz-Carlton, Nordstrom), spare parts availability (Caterpillar guarantees 48-hour spare parts delivery to any customer anywhere in the world or else the part is furnished free), engineering design and performance (Mercedes-Benz, BMW), luxury and prestige (Rolex, Gucci, Chanel), product reliability (Whirlpool and Bosch in large home appliances), quality manufacturing (Michelin in tires, Toyota and Honda in automobiles), technological leadership (3M Corporation in bonding and coating products), a full range of services (Charles Schwab in stock brokerage), and a complete line of products (Campbell soups, Frito-Lay snack foods).

The most appealing approaches to differentiation are those that are hard or expensive for rivals to duplicate. Resourceful competitors can, in time, clone almost any product or feature or attribute. If Toyota introduces smartphone integration or backup cameras, so can Ford and Honda; if Firestone offers customers attractive financing terms, so can Goodyear. As a rule, differentiation yields a longer-lasting and more profitable competitive edge when it is based on product innovation, technical superiority, product quality and reliability, comprehensive customer service, and unique competitive capabilities. Such differentiating attributes tend to be tough for rivals to copy or offset profitably, and buyers widely perceive them as having value.

> Easy-to-copy differentiating features cannot produce sustainable competitive advantage; differentiation based on hard-to-copy competencies and capabilities tends to be more sustainable.

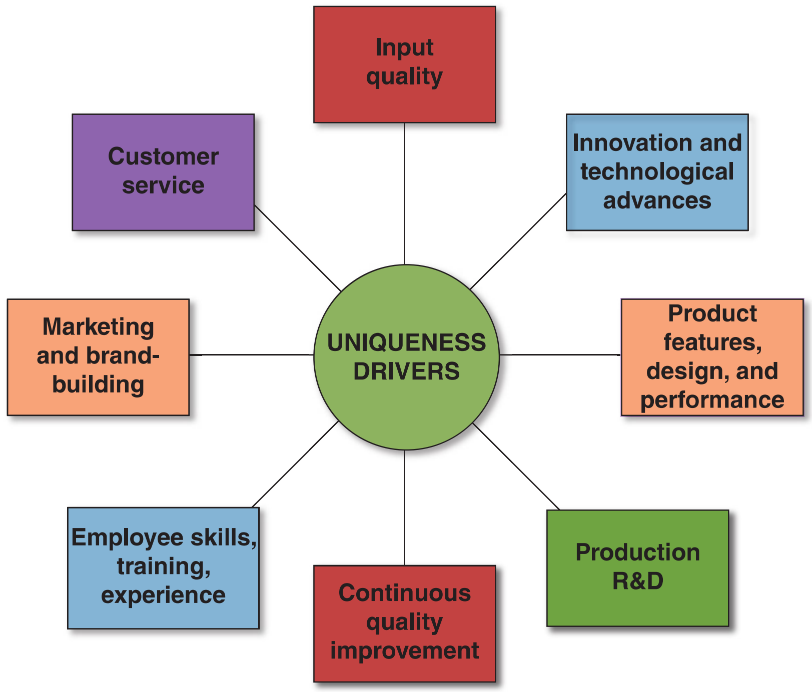
Managing the Value Chain in Ways That Enhance Differentiation

Success in employing a differentiation strategy results from management's ability to offer superior customer value through the addition of product/service attributes and features that differentiate a company's offering from the offerings of rivals. Differentiation opportunities can exist in activities all along an industry's value chain and particularly in activities and factors that meaningfully impact customer value. Such activities are referred to as **uniqueness drivers**—analogous to cost drivers—but have a high impact on differentiation rather than on a company's overall cost position. Figure 5.3 lists important uniqueness drivers found in a company's value chain. Ways that managers can enhance differentiation through the systematic management of uniqueness drivers include the following:

> **CORE CONCEPT**
> A **uniqueness driver** is a value chain activity or factor that can have a strong effect on customer value and creating differentiation.

- *Seeking out high-quality inputs.* Input quality can ultimately spill over to affect the performance or quality of the company's end product. Chipotle Mexican Grill, for example, gets excellent customer reviews at Yelp partly because of its very strict specifications for ingredients purchased from suppliers.
- *Striving for innovation and technological advances.* Successful innovation is the route to more frequent first-on-the-market victories and is a powerful differentiator. If the innovation proves hard to replicate, through patent protection or other means, it can provide a company with a first-mover advantage that is sustainable.
- *Creating superior product features, design, and performance.* The physical and functional features of a product have a big influence on differentiation. Styling and appearance are big differentiating factors in the apparel and motor vehicle industries. Graphics resolution and processing speed matter in video game consoles. Most companies employing broad differentiation strategies make a point of incorporating innovative and novel features in their product/service offering, especially those that improve performance.

FIGURE 5.3 **Important Uniqueness Drivers in a Company's Value Chain**



Source: Adapted from M. Porter, *The Competitive Advantage: Creating and Sustaining Superior Performance* (New York: Free Press, 1985).

- *Investing in production-related R&D activities.* Engaging in production R&D may permit custom-order manufacture at an efficient cost, provide wider product variety and selection, or improve product quality. Many manufacturers have developed flexible manufacturing systems that allow different models and product versions to be made on the same assembly line. Being able to provide buyers with made-to-order products can be a potent differentiating capability.
- *Pursuing continuous quality improvement.* Quality control processes reduce product defects, prevent premature product failure, extend product life, make it economical to offer longer warranty coverage, improve economy of use, result in more end-user convenience, enhance product appearance, or improve customer service.
- *Emphasizing human resource management activities that improve the skills, expertise, and knowledge of company personnel.* A company with high-caliber intellectual capital often has the capacity to generate the kinds of ideas that drive product innovation, technological advances, better product design and product performance, improved production techniques, and higher product quality.
- *Increasing emphasis on marketing and brand-building activities.* The manner in which a company conducts its marketing and brand management activities has a significant influence on customer perceptions of the value of a company's product offering and the price customers will pay for it. A highly skilled and competent sales force, effectively communicated product information, eye-catching ads,

in-store displays, and special promotional campaigns can all cast a favorable light on the differentiating attributes of a company's product/service offering and contribute to greater brand-name awareness and brand-name power.

- *Improving customer service or adding additional services.* Better customer service, in areas such as delivery, returns, and repair, can be as important in creating differentiation as superior product features.

Revamping the Value Chain System to Increase Differentiation Just as pursuing a cost advantage can involve the entire value chain system, the same is true for a differentiation advantage. As was discussed in Chapter 4, activities performed upstream by suppliers or downstream by distributors and retailers can have a meaningful effect on customers' perceptions of a company's offerings and its value proposition. Approaches to enhancing differentiation through changes in the value chain system include:

- *Coordinating with channel allies to enhance customer value.* Coordinating with downstream partners such as distributors, dealers, brokers, and retailers can contribute to differentiation in a variety of ways. Many manufacturers work directly with retailers on in-store displays and signage, joint advertising campaigns, and providing sales clerks with product knowledge and tips on sales techniques—all to enhance customer buying experiences. Companies can work with distributors and shippers to ensure fewer "out-of-stock" annoyances, quicker delivery to customers, more-accurate order filling, lower shipping costs, and a variety of shipping choices to customers.
- *Coordinating with suppliers to better address customer needs.* Collaborating with suppliers can also be a powerful route to a more effective differentiation strategy. This is particularly true for companies that engage only in assembly operations, such as Dell in PCs and Ducati in motorcycles. Close coordination with suppliers can also enhance differentiation by speeding up new-product development cycles or speeding delivery to end customers. Strong relationships with suppliers can also mean that the company's supply requirements are prioritized when industry supply is insufficient to meet overall demand.

Delivering Superior Value via a Differentiation Strategy

While it is easy enough to grasp that a successful differentiation strategy must offer value in ways unmatched by rivals, a big issue in crafting a differentiation strategy is deciding what is valuable to customers. Typically, value can be delivered to customers in three basic ways.

1. *Include product attributes and user features that lower the buyer's costs.* Commercial buyers value products that can reduce their cost of doing business. For example, making a company's product more economical for a buyer to use can be done by reducing the buyer's raw materials waste (providing cut-to-size components), reducing a buyer's inventory requirements (providing just-in-time deliveries), increasing product reliability to lower a buyer's repair and maintenance costs, and providing free technical support. Similarly, consumers find value in differentiating features that will reduce their expenses. Rising costs for gasoline prices have spurred the efforts of motor vehicle manufacturers worldwide to introduce models with better fuel economy.

2. *Incorporate tangible features that improve product performance.* Commercial buyers and consumers alike value higher levels of performance in many types of products. Product reliability, output, durability, convenience, and ease of use are aspects of product performance that differentiate products offered to buyers. Tablet computer manufacturers are currently in a race to develop next-generation tablets with the functionality and processing power to capturing market share from rivals and cannibalize the laptop computer market.
3. *Incorporate intangible features that enhance buyer satisfaction in noneconomic ways.* Toyota's Prius appeals to environmentally conscious motorists who wish to help reduce global carbon dioxide emissions. Bentley, Ralph Lauren, Louis Vuitton, Tiffany, Cartier, and Rolex have differentiation-based competitive advantages linked to buyer desires for status, image, prestige, upscale fashion, superior craftsmanship, and the finer things in life.

Differentiation can be based on *tangible* or *intangible* features and attributes.

Perceived Value and the Importance of Signaling Value

The price premium commanded by a differentiation strategy reflects *the value actually delivered* to the buyer and *the value perceived* by the buyer. The value of certain differentiating features is rather easy for buyers to detect, but in some instances, buyers may have trouble assessing what their experience with the product will be. Successful differentiators go to great lengths to make buyers knowledgeable about a product's value and incorporate signals of value such as attractive packaging, extensive ad campaigns, the quality of brochures and sales presentations, the seller's list of customers, the length of time the firm has been in business, and the professionalism, appearance, and personality of the seller's employees. Such signals of value may be as important as actual value (1) when the nature of differentiation is subjective or hard to quantify, (2) when buyers are making a first-time purchase, (3) when repurchase is infrequent, and (4) when buyers are unsophisticated.

Concepts & Connections 5.2 describes key elements of BMW's differentiation strategy that has allowed it to become the number-one luxury automobile brand in the United States.

When a Differentiation Strategy Works Best

Differentiation strategies tend to work best in market circumstances where:

1. *Buyer needs and uses of the product are diverse.* Diverse buyer preferences allow industry rivals to set themselves apart with product attributes that appeal to particular buyers. For instance, the diversity of consumer preferences for menu selection, ambience, pricing, and customer service gives restaurants exceptionally wide latitude in creating differentiated concepts. Other industries offering opportunities for differentiation based upon diverse buyer needs and uses include magazine publishing, automobile manufacturing, footwear, kitchen appliances, and computers.
2. *There are many ways to differentiate the product or service that have value to buyers.* Industries that allow competitors to add features to product attributes are well suited to differentiation strategies. For example, hotel chains can differentiate on such features as location, size of room, range of guest services, in-hotel

Concepts & Connections 5.2

HOW BMW'S DIFFERENTIATION STRATEGY ALLOWED IT TO BECOME THE NUMBER-ONE LUXURY CAR BRAND

BMW entered the U.S. market for automobiles in 1975 with a model line comprised of the two-door 2002 and 3.0 CSL models and the four-door 530i. The BMW brand was so poorly known in the United States that most Americans assumed that BMW meant "British Motor Works." The company set about building brand recognition through its BMW Motorsport program that emblazoned "Bavarian Motor Works" across the upper windshields of its 3.0 CSL cars competing in races at Sebring, Laguna Seca, Riverside, and Talladega. BMW's success on the race track and the instant popularity of its 320i introduced in the United States in 1977 helped build one of the strongest luxury brands in the country by the mid-1980s. The 320i was wildly popular with young professionals, and with each new generation of the 3-series, BMW attracted new young buyers and increased demand for its larger, more expensive models such as the 5-series, 6-series, and 7-series as its repeat buyers moved up in their careers.

BMW's customer value proposition was also keyed to state-of-the-art engineering that resulted in high-performing engines, innovative features, and responsive handling. The company's "Ultimate Driving Machine" tagline signaled its commitment to sports performance along with luxury. Through the late 2000s, the average pricing for BMW models was at the upper end of the industry, which limited its market share and solidified its reputation as an aspirational luxury brand focused on high-income consumers. However, the introduction of the BMW 1-series in 2008 that carried a sticker price of $28,600 vastly expanded the market for BMWs and allowed the company overtake Lexus as the number-one luxury car brand in the United States that same year.

The company also expanded its product line to include a six sedan models, five sports activity vehicle models, seven two-door coupes and convertible models, three hybrid models, the plug-in hybrid i8 sports car, and an all-electric i3 by 2015. The base pricing for BMW's product line in 2015 ranged from $32,100 for the 2-series coupe to $136,500 for the i8.

Sources: www.bmwusa.com; and *BMW Magazine*, Spring/Summer 2015.

dining, and the quality and luxuriousness of bedding and furnishings. Similarly, cosmetics producers are able to differentiate based upon prestige and image, formulations that fight the signs of aging, UV light protection, exclusivity of retail locations, the inclusion of antioxidants and natural ingredients, or prohibitions against animal testing.

3. *Few rival firms are following a similar differentiation approach.* The best differentiation approaches involve trying to appeal to buyers on the basis of attributes that rivals are not emphasizing. A differentiator encounters less head-to-head rivalry when it goes its own separate way to create uniqueness and does not try to outdifferentiate rivals on the very same attributes. When many rivals are all claiming "ours tastes better than theirs" or "ours gets your clothes cleaner than theirs," competitors tend to end up chasing the same buyers with very similar product offerings.
4. *Technological change is fast-paced and competition revolves around rapidly evolving product features.* Rapid product innovation and frequent introductions of next-version products heighten buyer interest and provide space for companies to pursue distinct differentiating paths. In HD TVs, mobile phones, and automobile backup, parking, and lane detection sensors, competitors are locked into an ongoing battle to set themselves apart by introducing the best next-generation products; companies that fail to come up with new and improved products and distinctive performance features quickly lose out in the marketplace.

Pitfalls to Avoid in Pursuing a Differentiation Strategy

Differentiation strategies can fail for any of several reasons. *A differentiation strategy keyed to product or service attributes that are easily and quickly copied is always suspect.* Rapid imitation means that no rival achieves meaningful differentiation, because whatever new feature one firm introduces that strikes the fancy of buyers is almost immediately added by rivals. This is why a firm must search out sources of uniqueness that are time-consuming or burdensome for rivals to match if it hopes to use differentiation to win a sustainable competitive edge over rivals.

Differentiation strategies can also falter when buyers see little value in the unique attributes of a company's product. Thus, even if a company sets the attributes of its brand apart from its rivals' brands, its strategy can fail because of trying to differentiate on the basis of something that does not deliver adequate value to buyers. Any time many potential buyers look at a company's differentiated product offering and conclude "so what," the company's differentiation strategy is in deep trouble; buyers will likely decide the product is not worth the extra price, and sales will be disappointingly low.

Overspending on efforts to differentiate is a strategy flaw that can erode profitability. Company efforts to achieve differentiation nearly always raise costs. The trick to profitable differentiation is either to keep the costs of achieving differentiation below the price premium the differentiating attributes can command in the marketplace or to offset thinner profit margins by selling enough additional units to increase total profits. If a company goes overboard in pursuing costly differentiation, it could be saddled with unacceptably thin profit margins or even losses. The need to contain differentiation costs is why many companies add little touches of differentiation that add to buyer satisfaction but are inexpensive to institute.

Other common pitfalls and mistakes in crafting a differentiation strategy include:

- *Overdifferentiating so that product quality or service levels exceed buyers' needs.* Buyers are unlikely to pay extra for features and attributes that will go unused. For example, consumers are unlikely to purchase programmable large appliances such as washers, dryers, and ovens if they are satisfied with manually controlled appliances.
- *Trying to charge too high a price premium.* Even if buyers view certain extras or deluxe features as "nice to have," they may still conclude that the added benefit or luxury is not worth the price differential over that of lesser differentiated products.
- *Being timid and not striving to open up meaningful gaps in quality or service or performance features vis-*à*-vis the products of rivals.* Tiny differences between rivals' product offerings may not be visible or important to buyers.

A low-cost provider strategy can always defeat a differentiation strategy when buyers are satisfied with a basic product and don't think "extra" attributes are worth a higher price.

Focused (or Market Niche) Strategies

What sets focused strategies apart from low-cost leadership or broad differentiation strategies is a concentration on a narrow piece of the total market. The targeted segment, or niche, can be defined by geographic uniqueness or by special product attributes that appeal only to niche members. The advantages of focusing a company's entire competitive effort on a single market niche are considerable, especially for smaller and medium-sized companies that may lack the breadth and depth of resources to tackle going after a national customer base with a "something for everyone" lineup of models, styles, and product selection. Lagunitas Brewing Company is a craft brewery with a geographic focus on California, Colorado, Texas, Florida, New York, and Illinois. Lagunitas' sales of about 250,000 barrels is a small percentage of total U.S. craft beer sales of about 22 million barrels, but it has become the sixth largest craft brewer in the United States and 13th largest U.S. beer producer with annual sales in excess of $100 million. Examples of firms that concentrate on a well-defined market niche keyed to a particular product or buyer segment include Discovery Channel and Comedy Central (in cable TV), Google (in Internet search engines), Porsche (in sports cars), and CGA, Inc. (a specialist in providing insurance to cover the cost of lucrative hole-in-one prizes at golf tournaments). Local bakeries and cupcake shops, bed-and-breakfast inns, and local owner-managed retail boutiques are all good examples of enterprises that have scaled their operations to serve narrow or local customer segments.

A Focused Low-Cost Strategy

A focused strategy based on low cost aims at securing a competitive advantage by serving buyers in the target market niche at a lower cost and a lower price than rival competitors. This strategy has considerable attraction when a firm can lower costs significantly by limiting its customer base to a well-defined buyer segment. The avenues to achieving a cost advantage over rivals also serving the target market niche are the same as for low-cost leadership—outmanage rivals in keeping the costs to a bare minimum and searching for innovative ways to bypass or reduce nonessential activities. The only real difference between a low-cost provider strategy and a focused low-cost strategy is the size of the buyer group to which a company is appealing.

Focused low-cost strategies are fairly common. Producers of private-label goods are able to achieve low costs in product development, marketing, distribution, and advertising by concentrating on making generic items similar to name-brand merchandise and selling directly to retail chains wanting a low-priced store brand. The Perrigo Company has become a leading manufacturer of over-the-counter health care products with 2014 sales of more than $4.1 billion by focusing on producing private-label brands for retailers such as Walmart, CVS, Walgreens, Rite Aid, and Safeway. Even though Perrigo doesn't make branded products, a focused low-cost strategy is appropriate for the makers of branded products as well. Concepts & Connections 5.3 describes how Aravind's focus on lowering the costs of cataract removal allowed the company to address the needs of the "bottom of the pyramid" in India's population where blindness due to cataracts is an endemic problem.

A Focused Differentiation Strategy

Focused differentiation strategies are keyed to offering carefully designed products or services to appeal to the unique preferences and needs of a narrow, well-defined group of buyers (as opposed to a broad differentiation strategy aimed at many buyer groups and market segments). Companies such as Four Seasons Hotels and Resorts, Chanel, Gucci, and Louis Vuitton employ successful differentiation-based focused strategies

Concepts & Connections 5.3

ARAVIND EYE CARE SYSTEM'S FOCUSED LOW-COST STRATEGY

Cataracts, the largest cause of preventable blindness, can be treated with a quick surgical procedure that restores sight; however, poverty and limited access to care prevent millions worldwide from obtaining surgery. The Aravind Eye Care System has found a way to address this problem with a focused low-cost strategy that has made cataract surgery not only affordable for more people in India but also free for the very poorest. On the basis of this strategy, Aravind has achieved world renown and become the largest provider of eye care in the world.

High volume and high efficiency are at the cornerstone of Aravind's strategy. The Aravind network of five eye hospitals in India has become one of the most productive systems in the world, conducting about 350,000 surgeries a year in addition to seeing more than 2.8 million outpatients each year. Using the unique model of screenings at camps all over the country, Aravind reaches a broad cross-section of the market for surgical treatment. Additionally, Aravind attains very high staff productivity with each surgeon performing more than 2,500 surgeries annually, compared to 125 for a comparable American surgeon.

This level of productivity (with no loss in quality of care) was achieved through the development of a standardized system of surgical treatment, capitalizing on the fact that cataract removal is a fairly routine process. Aravind streamlined as much of the process as possible, reducing discretionary elements to a minimum and tracking outcomes to ensure continuous process improvement. At Aravind's hospitals, no time is wasted between surgeries as different teams of support staff prepare patients for surgery and bring them to the operating theater; surgeons simply turn from one table to another to perform surgery on the next prepared patient. Aravind also drove costs down through the creation of its own manufacturing division, Aurolab, to produce intraocular lenses, suture needles, pharmaceuticals, and surgical blades in India.

Aravind's low costs allow it to keep prices for cataract surgery very low—about $10 per patient, compared to an average cost of $1,500 in the United States. Nevertheless, the system provides surgical outcomes and quality comparable to those of clinics in the United States. As a result of its unique fee system and effective management, Aravind is also able to provide free eye care to 60 percent of its patients from the revenue generated from paying patients.

Sources: Developed with Avni V. Patel. G. Natchiar, A. L. Robin, R. Thulasiraj, et al., "Attacking the Backlog of India's Curable Blind; The Aravind Eye Hospital Model," *Archives of Ophthalmology* 112, no. 7 (July 1994), pp. 987–93; D. F. Chang, "Tackling the Greatest Challenge in Cataract Surgery," *British Journal of Ophthalmology* 89, no. 9 (September 2005), pp. 1073–77; and McKinsey & Co., "Driving Down the Cost of High-Quality Care," *Health International*, December 2011.

targeted at affluent buyers wanting products and services with world-class attributes. Indeed, most markets contain a buyer segment willing to pay a price premium for the very finest items available, thus opening the strategic window for some competitors to pursue differentiation-based focused strategies aimed at the very top of the market pyramid.

Another successful focused differentiator is "fashion food retailer" Trader Joe's, a 457-store, 42-state chain that is a combination gourmet deli and food warehouse. Customers shop Trader Joe's as much for entertainment as for conventional grocery items; the store stocks out-of-the-ordinary culinary treats such as raspberry salsa, salmon burgers, and jasmine fried rice, as well as the standard goods normally found in supermarkets. What sets Trader Joe's apart is not just its unique combination of food novelties and competitively priced grocery items but also its capability to turn an otherwise mundane grocery excursion into a whimsical treasure hunt that is just plain fun.

When a Focused Low-Cost or Focused Differentiation Strategy Is Viable

A focused strategy aimed at securing a competitive edge based on either low cost or differentiation becomes increasingly attractive as more of the following conditions are met:

- The target market niche is big enough to be profitable and offers good growth potential.
- Industry leaders have chosen not to compete in the niche—focusers can avoid battling head-to-head against the industry's biggest and strongest competitors.
- It is costly or difficult for multisegment competitors to meet the specialized needs of niche buyers and at the same time satisfy the expectations of mainstream customers.
- The industry has many different niches and segments, thereby allowing a focuser to pick a niche suited to its resource strengths and capabilities.
- Few, if any, rivals are attempting to specialize in the same target segment.

The Risks of a Focused Low-Cost or Focused Differentiation Strategy

Focusing carries several risks. The *first major risk* is the chance that competitors will find effective ways to match the focused firm's capabilities in serving the target niche. In the lodging business, large chains such as Marriott and Hilton have launched multibrand strategies that allow them to compete effectively in several lodging segments simultaneously. Marriott has flagship hotels with a full complement of services and amenities that allow it to attract travelers and vacationers going to major resorts; it has J.W. Marriott, Ritz-Carlton, and Renaissance hotels that provide deluxe comfort and service to business and leisure travelers; it has Courtyard by Marriott and SpringHill Suites brands for business travelers looking for moderately priced lodging; it has Marriott Residence Inns and TownePlace Suites designed as a "home away from home" for travelers staying five or more nights; and it has more than 700 Fairfield Inn locations that cater to travelers looking for quality lodging at an "affordable" price. Marriott has also added Edition, AC Hotels by Marriott, and Autograph Collection hotels that offer stylish, distinctive decors and personalized services that appeal to young professionals seeking distinctive lodging alternatives. Multibrand strategies are attractive to large companies such as Marriott precisely because they enable a company to enter a market niche and siphon business away from companies that employ a focus strategy.

A *second risk* of employing a focus strategy is the potential for the preferences and needs of niche members to shift over time toward the product attributes desired by the majority of buyers. An erosion of the differences across buyer segments lowers entry barriers into a focuser's market niche and provides an open invitation for rivals in adjacent segments to begin competing for the focuser's customers. A *third risk* is that the segment may become so attractive it is soon inundated with competitors, intensifying rivalry and splintering segment profits.

LO4 Recognize the required conditions for delivering superior value to customers through the use of a hybrid of low-cost provider and differentiation strategies.

Best-Cost Provider Strategies

As Figure 5.1 indicates, **best-cost provider strategies** are a *hybrid* of low-cost provider and differentiation strategies that aim at satisfying buyer expectations on key quality/features/performance/service attributes and beating customer expectations on price. Companies pursuing best-cost strategies aim squarely at the sometimes great mass of value-conscious buyers looking for a good-to-very-good product or service at an economical price. The essence of a best-cost provider strategy is giving customers *more value for the money* by satisfying buyer desires for appealing features/performance/quality/service and charging a lower price for these attributes compared to that of rivals with similar-caliber product offerings.[3]

CORE CONCEPT

Best-cost provider strategies are a *hybrid* of low-cost provider and differentiation strategies that aim at satisfying buyer expectations on key quality/features/performance/ service attributes and beating customer expectations on price.

To profitably employ a best-cost provider strategy, a company *must have the capability to incorporate attractive or upscale attributes at a lower cost than rivals.* This capability is contingent on (1) a superior value chain configuration that eliminates or minimizes activities that do not add value, (2) unmatched efficiency in managing essential value chain activities, and (3) core competencies that allow differentiating attributes to be incorporated at a low cost. When a company can incorporate appealing features, good-to-excellent product performance or quality, or more satisfying customer service into its product offering *at a lower cost than that of rivals,* then it enjoys "best-cost" status—it is the low-cost provider of a product or service with *upscale attributes.* A best-cost provider can use its low-cost advantage to underprice rivals whose products or services have similar upscale attributes and still earn attractive profits.

Concepts & Connections 5.4 describes how American Giant has applied the principles of a best-cost provider strategy in producing and marketing its hoodie sweatshirts.

When a Best-Cost Provider Strategy Works Best

A best-cost provider strategy works best in markets where product differentiation is the norm and attractively large numbers of value-conscious buyers can be induced to purchase midrange products rather than the basic products of low-cost producers or the expensive products of top-of-the-line differentiators. A best-cost provider usually needs to position itself near the middle of the market with either a medium-quality product at a below-average price or a high-quality product at an average or slightly higher-than-average price. Best-cost provider strategies also work well in recessionary times when great masses of buyers become value-conscious and are attracted to economically priced products and services with especially appealing attributes.

The Danger of an Unsound Best-Cost Provider Strategy

A company's biggest vulnerability in employing a best-cost provider strategy is not having the requisite core competencies and efficiencies in managing value chain activities to support the addition of differentiating features without significantly increasing costs. A company with a modest degree of differentiation and no real cost advantage will most likely find itself squeezed between the firms using low-cost strategies and those using differentiation strategies. Low-cost providers may be able to siphon customers away with the appeal of a lower price (despite having marginally less appealing

Concepts & Connections 5.4

AMERICAN GIANT'S BEST-COST PROVIDER STRATEGY

Bayard Winthrop, founder and owner of American Giant, set out to make a hoodie like the soft, ultra-thick Navy sweatshirts his dad used to wear in the 1950s. But he also had two other aims: He wanted it to have a more updated look with a tailored fit, and he wanted it produced cost-effectively so that it could be sold at a great price. To accomplish these aims, he designed the sweatshirt with the help of a former industrial engineer from Apple and an internationally renowned pattern maker, rethinking every aspect of sweatshirt design and production along the way. The result was a hoodie differentiated from others on the basis of extreme attention to fabric, fit, construction, and durability. The hoodie is made from heavy-duty cotton that is run through a machine that carefully picks loops of thread out of the fabric to create a thick, combed, ring-spun fleece fabric that feels three times thicker than most sweatshirts. A small amount of spandex paneling along the shoulders and sides creates the fitted look and maintains the shape, keeping the sweatshirt from looking slouchy or sloppy. It has double stitching with strong thread on critical seams to avoid deterioration and boost durability. The zippers and draw cord are customized to match the sweatshirt's color—an uncommon practice in the business.

American Giant sources yarn from Parkdale, South Carolina, and turns it into cloth at the nearby Carolina Cotton Works. This reduces transport costs, creates a more dependable, durable product that American Giant can easily quality-check, and shortens product turnaround to about a month, lowering inventory costs. This process also enables the company to use a genuine "Made in the U.S.A" label, a perceived quality driver.

American Giant disrupts the traditional, expensive distribution models by having no stores or resellers. Instead, it sells directly to customers from its website, with free two-day shipping and returns. Much of the company's growth comes from word of mouth and a strong public relations effort that promotes the brand in magazines, newspapers, and key business-oriented television programs. American Giant has a robust refer-a-friend program that offers a discount to friends of, and a credit to, current owners. Articles in popular media proclaiming its product "the greatest hoodie ever made" have made demand for its sweatshirts skyrocket.

At $79 for the original men's hoodie, American Giant is not cheap but offers customers value in terms of both price and quality. The price is higher than what one would pay at The Gap or American Apparel and comparable to Levi's, J.Crew, or Banana Republic. But its quality is more on par with high-priced designer brands, while its price is far more affordable.

Note: Developed with Sarah Boole.
Sources: www.nytimes.com/2013/09/20/business/us-textile-factories-return.html?emc=eta1&_r=0; www.american-giant.com; www.slate.com/articles/technology/technology/2012/12/american_giant_hoodie_this_is_the_greatest_sweatshirt_known_to_man.html; www.businessinsider.com/this-hoodie-is-so-insanely-popular-you-have-to-wait-months-to-get-it-2013-12.

product attributes). High-end differentiators may be able to steal customers away with the appeal of appreciably better product attributes (even though their products carry a somewhat higher price tag). Thus, a successful best-cost provider must offer buyers *significantly* better product attributes to justify a price above what low-cost leaders are charging. Likewise, it has to achieve significantly lower costs in providing upscale features so that it can outcompete high-end differentiators on the basis of a *significantly* lower price.

Successful Competitive Strategies Are Resource Based

For a company's competitive strategy to succeed in delivering good performance and the intended competitive edge over rivals, it has to be well matched to a company's internal situation and underpinned by an appropriate set of resources, know-how, and competitive capabilities. To succeed in employing a low-cost provider strategy, a company has to have the resources and capabilities to keep its costs below those of its competitors; this means having the expertise to cost-effectively manage value chain activities better than rivals and/or the innovative capability to bypass certain value chain activities being performed by rivals. To succeed in strongly differentiating its product in ways that are appealing to buyers, a company must have the resources and capabilities (such as better technology, strong skills in product innovation, expertise in customer service) to incorporate unique attributes into its product offering that a broad range of buyers will find appealing and worth paying for. Strategies focusing on a narrow segment of the market require the capability to do an outstanding job of satisfying the needs and expectations of niche buyers. Success in employing a strategy keyed to a best-value offering requires the resources and capabilities to incorporate upscale product or service attributes at a lower cost than that of rivals.

A company's competitive strategy should be well matched to its internal situation and predicated on leveraging its collection of competitively valuable resources and competencies.

KEY POINTS

1. Early in the process of crafting a strategy, company managers have to decide which of the five basic competitive strategies to employ: overall low-cost, broad differentiation, focused low-cost, focused differentiation, or best-cost provider.
2. In employing a low-cost provider strategy, a company must do a better job than rivals of cost-effectively managing internal activities, and/or it must find innovative ways to eliminate or bypass cost-producing activities. Particular attention should be paid to cost drivers, which are factors having a strong effect on the cost of a company's value chain activities and cost structure. Low-cost provider strategies work particularly well when price competition is strong and the products of rival sellers are very weakly differentiated. Other conditions favoring a low-cost provider strategy are when supplies are readily available from eager sellers, when there are not many ways to differentiate that have value to buyers, when the majority of industry sales are made to a few large buyers, when buyer switching costs are low, and when industry newcomers are likely to use a low introductory price to build market share.
3. Broad differentiation strategies seek to produce a competitive edge by incorporating attributes and features that set a company's product/service offering apart from rivals in ways that buyers consider valuable and worth paying for. Such features and attributes are best integrated through the systematic management of uniqueness—value chain activities or factors that can have a strong effect on customer value and creating differentiation. Successful differentiation allows a firm to (1) command a premium price for its product, (2) increase unit sales (because additional buyers are won over by the differentiating features),

and/or (3) gain buyer loyalty to its brand (because some buyers are strongly attracted to the differentiating features and bond with the company and its products). Differentiation strategies work best in markets with diverse buyer preferences where there are big windows of opportunity to strongly differentiate a company's product offering from those of rival brands, in situations where few other rivals are pursuing a similar differentiation approach, and in circumstances where technological change is fast-paced and competition centers on rapidly evolving product features. A differentiation strategy is doomed when competitors are able to quickly copy most or all of the appealing product attributes a company comes up with, when a company's differentiation efforts meet with a ho-hum or so-what market reception, or when a company erodes profitability by overspending on efforts to differentiate its product offering.

4. A focused strategy delivers competitive advantage either by achieving lower costs than rivals' in serving buyers comprising the target market niche or by offering niche buyers an appealingly differentiated product or service that meets their needs better than rival brands. A focused strategy becomes increasingly attractive when the target market niche is big enough to be profitable and offers good growth potential, when it is costly or difficult for multisegment competitors to put capabilities in place to meet the specialized needs of the target market niche and at the same time satisfy the expectations of their mainstream customers, when there are one or more niches that present a good match with a focuser's resource strengths and capabilities, and when few other rivals are attempting to specialize in the same target segment.
5. Best-cost provider strategies stake out a middle ground between pursuing a low-cost advantage and a differentiation-based advantage and between appealing to the broad market as a whole and a narrow market niche. The aim is to create competitive advantage by giving buyers more value for the money—satisfying buyer expectations on key quality/features/performance/service attributes while beating customer expectations on price. To profitably employ a best-cost provider strategy, a company *must have the capability to incorporate attractive or upscale attributes at a lower cost than that of rivals.* This capability is contingent on (1) a superior value chain configuration, (2) unmatched efficiency in managing essential value chain activities, and (3) resource strengths and core competencies that allow differentiating attributes to be incorporated at a low cost. A best-cost provider strategy works best in markets where opportunities to differentiate exist and where many buyers are sensitive to price and value.
6. Deciding which generic strategy to employ is perhaps the most important strategic commitment a company makes—it tends to drive the rest of the strategic actions a company decides to undertake, and it sets the whole tone for the pursuit of a competitive advantage over rivals.

ASSURANCE OF LEARNING EXERCISES

1. Best Buy is the largest consumer electronics retailer in the United States with 2015 sales of more than $40 billion. The company competes aggressively on price with rivals such as Costco Wholesale, Sam's Club, Walmart, and Target but is also known by consumers for its first-rate customer service. Best Buy customers have commented that the retailer's sales staff is exceptionally knowledgeable about products and can direct them to the exact location of difficult-to-find items. Best Buy customers also appreciate that demonstration models of PC monitors, digital media players, and other electronics are fully powered and ready for in-store use. Best Buy's Geek Squad tech support and installation services are additional customer service features valued by many customers. **LO1, LO2, LO3, LO4**

How would you characterize Best Buy's competitive strategy? Should it be classified as a low-cost provider strategy? A differentiation strategy? A best-cost strategy? Explain your answer.

connect

LO2

2. Concepts & Connections 5.1 discusses Walmart's low-cost advantage in the supermarket industry. Based on information provided in the illustration, explain how Walmart has built its low-cost advantage in the supermarket industry and why a low-cost provider strategy is well suited to the industry.

LO1, LO2, LO3, LO4

3. USAA is a Fortune 500 insurance and financial services company with 2014 annual sales exceeding $24 billion. The company was founded in 1922 by 25 Army officers who decided to insure each other's vehicles and continues to limit its membership to active-duty and retired military members, officer candidates, and adult children and spouses of military-affiliated USAA members. The company has received countless awards, including being listed among *Fortune*'s World's Most Admired Companies in 2014 and 2015 and 100 Best Companies to Work For in 2010 through 2015. USAA was also ranked as the number-one Bank, Credit Card and Insurance Company by Forrester Research from 2013 to 2015. You can read more about the company's history and strategy at www.usaa.com. How would you characterize USAA's competitive strategy? Should it be classified as a low-cost provider strategy? A differentiation strategy? A best-cost strategy? Also, has the company chosen to focus on a narrow piece of the market, or does it appear to pursue a broad market approach? Explain your answer.

connect

LO3

4. Explore lululemon athletica's website at info.lululemon.com and see if you can identify at least three ways in which the company seeks to differentiate itself from rival athletic apparel firms. Is there reason to believe that lululemon's differentiation strategy has been successful in producing a competitive advantage? Why or why not?

EXERCISES FOR SIMULATION PARTICIPANTS

LO1, LO2, LO3, LO4

1. Which one of the five generic competitive strategies best characterizes your company's strategic approach to competing successfully?
2. Which rival companies appear to be employing a low-cost provider strategy?
3. Which rival companies appear to be employing a broad differentiation strategy?
4. Which rival companies appear to be employing a best-cost provider strategy?
5. Which rival companies appear to be employing some type of focus strategy?
6. What is your company's action plan to achieve a sustainable competitive advantage over rival companies? List at least three (preferably, more than three) specific kinds of decision entries on specific decision screens that your company has made or intends to make to win this kind of competitive edge over rivals.

ENDNOTES

1. Michael E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York: Free Press, 1980), chap. 2, and Michael E. Porter, "What Is Strategy?" *Harvard Business Review* 74, no. 6 (November–December 1996).
2. Michael E. Porter, *Competitive Advantage* (New York: Free Press, 1985).
3. Peter J. Williamson and Ming Zeng, "Value-for-Money Strategies for Recessionary Times," *Harvard Business Review* 87, no. 3 (March 2009).