CHAPTER 5

BUSINESS LEVEL STRATEGIES

1. PORTER'S FIVE FORCES MODEL- COMPETITIVE ANALYSIS

- Every business operates in the competitive environment.

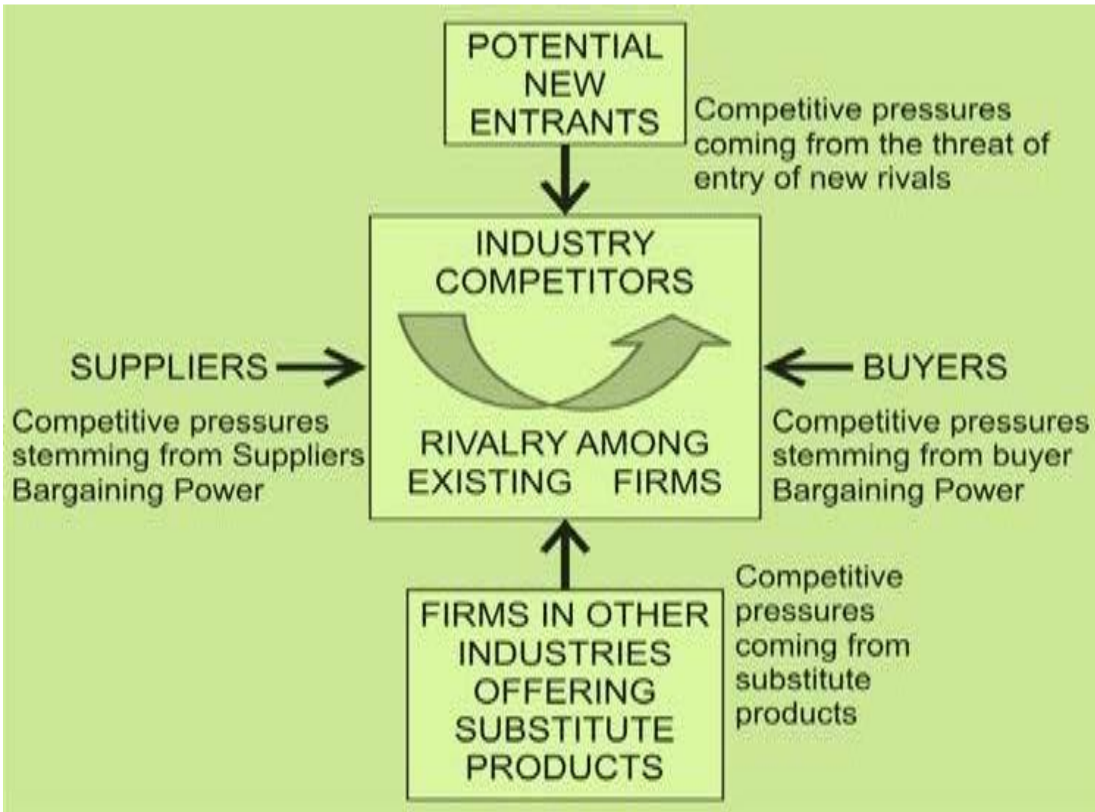
- Competitive state of an industry applies a strong influence on how firms develop their strategies. Michael Porter believes that the basic unit of analysis for understanding is a group of competitors producing goods or services that compete directly with each other.

- It is the industry where competitive advantage is ultimately won or lost. It is through competitive strategy that the organisation attempts to adopt an approach to compete in the industry.

- The character, mix, and intricacies of competitive forces are never the same from one industry to another.

- A powerful and widely used tool for systematically diagnosing the significant competitive pressures in a market and assessing the strength and importance of each is the Porter's five-forces model of competition.

- This model holds that the state of competition in an industry is a composite of competitive pressures operating in five areas of the overall market.



- The strategists can use the five-forces model to determine what competition is like in a given industry by undertaking the following steps:

Step 1: Identify the specific competitive pressures associated with each of the five forces.

Step 2: Evaluate how strong the pressures comprising each of the five forces are (fierce, strong, moderate to normal, or weak).

Step 3: Determine whether the collective strength of the five competitive forces is conducive to learning attractive profits.

- Porter's five forces model is one of the most effective and enduring conceptual frameworks used to assess the nature of the competitive environment and to describe an industry's structure.

- The interrelationship among these five forces gives each industry its own particular competitive environment.

- By applying Porter's five forces model of industry attractiveness to their own industries, the manager can gauge their own firm's strengths, weaknesses, and future opportunities.

- **Threat of New Entrants**

  - New entrants can reduce industry profitability because they add new production capacity leading to increase supply of the product even at a lower price and can substantially erode existing firm's market share position.

  - New entrants are always a powerful source of competition. The new capacity and product range they bring in throw up new competitive pressure.

  - And the bigger the new entrant, the more severe the competitive effect. New entrants also place a limit on prices and affect the profitability of existing players.

  - A firm's profitability tends to be higher when other firms are blocked from entering the industry.

- To discourage new entrants, existing firms can try to raise barriers to entry. Barriers to entry represent economic forces (or 'hurdles') that slow down or impede entry by other firms. Common barriers to entry include:
    - Capital requirements
    - Economies of scale
    - Product differentiation
    - Switching costs
    - Brand identity
    - Access to distribution channels
    - Possibility of aggressive retaliation by existing players

a) Capital requirements

- When a large amount of capital is required to enter an industry, firms lacking funds are effectively barred from the industry, thus enhancing the profitability of existing firms in the industry.

b) Economies of scale

- Many industries are characterized by economic activities driven by economies of scale.
- Economies of scale refer to the decline in the per-unit cost of production (or other activity) as volume grows.

- A large firm that enjoys economies of scale can produce high volumes of goods at successively lower costs.
- This tends to discourage new entrants.

c) Product Differentiation:

- Product differentiation refers to the physical or perceptual differences, or enhancements, that make a product special or unique in the eyes of customers.
- Firms in the personal care products and cosmetics industries actively engage in product differentiation to enhance their products' features.
- Differentiation works to reinforce entry barriers because the cost of creating genuine product differences may be too high for the new entrants.

d) Switching Costs:

- To succeed in an industry, new entrant must be able to persuade existing customers of other companies to switch to its products.
- To make a switch, buyers may need to test a new firm's product, negotiate new purchase contracts, and train personnel to use the equipment, or modify facilities for product use.
- Buyers often incur substantial financial (and psychological) costs in switching between firms. When such switching costs are high, buyers are often reluctant to change.

e) Brand Identity:

- The brand identity of products or services offered by existing firms can serve as another entry barrier.
- Brand identity is particularly important for infrequently purchased products that carry a high unit cost to the buyer.
- New entrants often encounter significant difficulties in building up the brand identity, because to do so they must commit substantial resources over a long period.

f) Access to Distribution Channels:

- The unavailability of distribution channels for new entrants poses another significant entry barrier.
- Despite the growing power of the internet, many firms may continue to rely on their control of physical distribution channels to sustain a barrier to entry to rivals.
- Often, existing firms have significant influence over the distribution channels and can retard or impede their use by new firms.

g) Possibility of Aggressive Retaliation:

- Sometimes the mere threat of aggressive retaliation by incumbents can deter entry by other firms into an existing industry.

- For example, introduction of products by a new firm may lead incumbents' firms to reduce their product prices and increase their advertising budgets.

- **Bargaining Power of Buyers**

  - This is another force that influences the competitive condition of the industry.

  - This force will become heavier depending on the possibilities of the buyers forming groups or cartels. Mostly, this is a phenomenon seen in industrial products.

  - Quite often, users of industrial products come together formally or informally and exert pressure on the producer.

  - The bargaining power of the buyers influences not only the prices that the producer can charge but also influences in many cases, costs and investments of the producer because powerful buyers usually bargain for better services which involve costs and investment on the part of the producer.

  - Buyers of an industry's products or services can sometimes exert considerable pressure on existing firms to secure lower prices or better services. This leverage is particularly evident when

(i) Buyers have full knowledge of the sources of products and their substitutes.

(ii) They spend a lot of money on the industry's products i.e. they are big buyers.

(iii) The industry's product is not perceived as critical to the buyer's needs and buyers are more concentrated than firms supplying the product. They can easily switch to the substitutes available.

- **Bargaining Power of Suppliers**

  - Quite often suppliers, too, exercise considerable bargaining power over companies. The more specialized the offering from the supplier, greater is his clout.

  - And, if the suppliers are also limited in number, they stand a still better chance to exhibit their bargaining power.

  - The bargaining power of suppliers determines the cost of raw materials and other inputs of the industry and, therefore, industry attractiveness and profitability.

  - Suppliers can influence the profitability of an industry in a number of ways. Suppliers can command bargaining power over a firm when:

(i) Their products are crucial to the buyer and substitutes are not available.

(ii) They can erect high switching costs.

(iii) They are more concentrated than their buyers.

- **The Nature of Rivalry in the Industry**

  - The rivalry among existing players is quite obvious. This is what is normally understood as competition.

  - For any player, the competitors influence strategic decisions at different strategic levels. The impact is evident more at functional level in the prices being charged, advertising, and pressures on costs, product and so on.

  - The intensity of rivalry in an industry is a significant determinant of industry attractiveness and profitability.

  - The intensity of rivalry can influence the costs of suppliers, distribution, and of attracting customers and thus directly affect the profitability.

  - The more intensive the rivalry, the less attractive is the industry.

- **Industry Leader:**
  - A strong industry leader can discourage price wars by disciplining initiators of such activity.
  - Because of its greater financial resources, a leader can generally outlast smaller rivals in a price war.
  - Knowing this, smaller rivals often avoid initiating such a contest.
- **Number of Competitors:**
  - Even when an industry leader exists, the leader's ability to exert pricing discipline diminishes with the increased number of rivals in the industry as communicating expectations to players becomes more difficult.
- **Fixed Costs:**
  - When rivals operate with high fixed costs, they feel strong motivation to utilize their capacity and therefore are inclined to cut prices when they have excess capacity.
  - Price cutting causes profitability to fall for all firms in the industry as firms seek to produce more to cover costs that must be paid regardless of industry demand.

- For this reason, profitability tends to be lower in industries (for example, airline, telecommunications) characterized by high fixed costs.

❖ **Exit Barriers:**

- Rivalry among competitors declines if some competitors leave an industry.
- Profitability therefore tends to be higher in industries with few exit barriers.
- Exit barriers come in many forms.
- Assets of a firm considering exit may be highly specialized and therefore of little value to any other firm.
- Such a firm can thus find no buyer for its assets. This discourages exit. When barriers to exit are powerful, competitors desiring exit may refrain from leaving.
- Their continued presence in an industry exerts downward pressure on the profitability of all competitors.

❖ **Product Differentiation:**

- Firms can sometimes insulate themselves from price wars by differentiating their products from those of rivals.

- As a consequence, profitability tends to be higher in industries that offer opportunity for differentiation. Profitability tends to be lower in industries involving undifferentiated commodities such as, memory chips, natural resources, processed metals and railroads.

- **Slow Growth:**

  - Industries whose growth is slowing down tend to face more intense rivalry.

  - As industry growth slows, rivals must often fight harder to grow or even to keep their existing market share.

  - The resulting intensive rivalry tends to reduce profitability for all.

- **Threat of Substitutes**

  - Substitute products are a latent source of competition in an industry.

  - In many cases they become a major constituent of competition. Substitute products offering a price advantage and/or performance improvement to the consumer can drastically alter the competitive character of an industry.

  - And they can bring it about all of a sudden.

  - For example, coir suffered at the hands of synthetic fiber.

  - Wherever substantial investment in R&D is taking place, threats from substitute products can be expected. Substitutes, too, usually limit the prices and profits in an industry.

- A final force that can influence industry profitability is the availability of substitutes for an industry's product.

- To predict profit pressure from this source, firms must search for products that perform the same, or nearly the same, function as their existing products.

- Real estate, insurance, bonds and bank deposits for example are clear substitutes for common stocks, because they represent alternate ways to invest funds.

- The threat of substitutes is great in many high-tech industries as well.

- For example, introduction of digital filmless cameras virtually replaces the film cameras and threatened the existence of Eastman Kodak and Fuji Film.

- Further, the introduction of smart phones has replaced cameras to a great extent.

2. BUSINESS LEVEL STRATEGIES

- An organization's core competencies should be focused on satisfying customer needs or wants in order to achieve above average returns.

- This is done through Business-level strategies. Business level strategies detail actions taken to provide value to customers and gain a competitive advantage by exploiting core competencies in specific, individual product or service markets. Business-level strategy is concerned with a firm's position in an industry, relative to competitors and to the five forces of competition.

- Customers are the foundation of an organization's business-level strategies. Who will be served, what needs have to be met, and how those needs will be satisfied are determined by the senior management?

- **Who are the customers?**

  - Knowing one's customers is very important in obtaining and sustaining a competitive advantage.

  - Being able to successfully predict and satisfy future customer needs is important. Perhaps one of the Tata's mistake in manufacturing Name was understanding who was their real customer and what they wanted.

- **How to satisfy customer needs?**
  - Organizations must determine how to bundle resources and capabilities to form core competencies and then use these core competencies to satisfy customer needs or create value for them.

  - Business level strategies detail actions to be taken to provide value to customers and gain a competitive advantage by exploiting core competencies in specific individual product or service markets.

  - Having selected a market, the organization must develop a plan to be successful in that market. Business strategy therefore looks at how the organization can compete successfully in the individual markets that it chooses to operate within.

- Business level strategy is concerned with issues such as:
  - Meeting the needs of key customers.
  - Achieving advantage over competitors.
  - Avoiding competitive disadvantage.

3. MICHAEL PORTER'S GENERIC STRATEGIES

- According to Porter, strategies allow organizations to gain competitive advantage from three different bases: cost leadership, differentiation, and focus.

- Porter called these base generic strategies.

- These strategies have been termed generic because they can be pursued by any type or size of business firm and even by not-for-profit organisations.

- Cost leadership emphasizes producing standardized products at a very low per-unit cost for consumers who are price-sensitive.

- Differentiation is a strategy aimed at producing products and services considered unique industry wide and directed at consumers who are relatively price-insensitive.

- Focus means producing products and services that fulfill the needs of small groups of consumers.

- Porter's strategies imply different organizational arrangements, control procedures, and incentive systems.

- Larger firms with greater access to resources typically compete on a cost leadership and/or differentiation basis, whereas smaller firms often compete on a focus basis.

- **Cost Leadership Strategy**

  - It is a low-cost competitive strategy that aims at broad mass market.

  - It requires vigorous pursuit of cost reduction in the areas of procurement, production, storage and distribution of product or service and also economies in overhead costs.

  - Because of its lower costs, the cost leader is able to charge a lower price for its products than its competitors and still make satisfactory profits.

- For example, McDonald's fast-food restaurants have successfully followed low cost leadership strategy.

- Striving to be the low-cost producer in an industry can be especially effective when the market is composed of many price-sensitive buyers, when there are few ways to achieve product differentiation, when buyers do not care much about differences from brand to brand, or when there are a large number of buyers with significant bargaining power.

- The basic idea is to under-price competitors and thereby gain market share and sales, driving some competitors out of the market entirely.

- A successful cost leadership strategy usually permeates the entire firm, as evidenced by high efficiency, low overhead, limited perks, intolerance of waste, intensive screening of budget requests, wide spans of control, rewards linked to cost containment, and broad employee participation in cost control efforts.

➢ Achieving Cost Leadership Strategy

- To achieve cost leadership, following are the actions that could be taken:
  - a) Forecast the demand of a product or service promptly.
  - b) Optimum utilization of the resources to get cost advantages.
  - c) Achieving economies of scale leads to lower per unit cost of product/service.
  - d) Standardisation of products for mass production to yield lower cost per unit.
  - e) Invest in cost saving technologies and try using advance technology for smart working.
  - f) Resistance to differentiation till it becomes essential.

➢ Advantages of Cost Leadership Strategy

(i) **Rivalry –** Competitors are likely to avoid a price war, since the low-cost firm will continue to earn profits after competitors compete away their profits.

(ii) **Buyers –** Powerful buyers/customers would not be able to exploit the cost leader firm and will continue to buy its product.

(iii) **Suppliers –** Cost leaders are able to absorb greater price increases before it must raise price to customers.

(iv) **Entrants –** Low cost leaders create barriers to market entry through its continuous focus on efficiency and reducing costs.

(v) **Substitutes –** Low cost leaders are more likely to lower costs to induce customers to stay with their product, invest to develop substitutes, purchase patents.

- **Disadvantages of Cost Leadership Strategy**

(i) Cost advantage may not be remaining for long as competitors may also follow cost reduction technique.

(ii) Cost leadership can succeed only if the firm can achieve higher sales volume.

(iii) Cost leaders tend to keep their costs low by minimizing advertising, market research, and research and development, but this approach can prove to be expensive in the long run.

(iv) Technology changes are a great threat to the cost leader.

- **Differentiation Strategy**
  - This strategy is aimed at broad mass market and involves the creation of a product or service that is perceived by the customers as unique.
  - The uniqueness can be associated with product design, brand image, features, technology, dealer network or customer service.

- Because of differentiation, the business can charge a premium for its product.

- Differentiation strategy should be pursued only after a careful study of buyers' needs and preferences to determine the feasibility of incorporating one or more differentiating features into a unique product that features the desired attributes.

- A successful differentiation strategy allows a firm to charge a higher price for its product and to gain customer loyalty because consumers may become strongly attached to the differentiation features.

- Special features that differentiate one's product can include superior service, spare parts availability, engineering design, product performance, useful life, gas mileage, or ease of use.

Basis of Differentiation

- **Product:**
  - Innovative products that meet customer needs can be an area where a company has an advantage over competitors.
  - The pursuit of new product offerings can be costly – research and development, as well as production and marketing costs can all add to the cost of production and distribution.
  - The payoff, however, can be great as customer's flock to be among the first to have the new product.

❖ **Pricing:**

- It can fluctuate based on its supply and demand, and also be influence by the customer's ideal value for the product.

- Companies that differentiate based on product price can either determine to offer the lowest price, or can attempt to establish superiority through higher prices.

❖ **Organisation:**

- Organisational differentiation is yet another form of differentiation. Maximizing the power of a brand, or using the specific advantages that an organization possesses can be instrumental to a company's success.

- Location advantage, name recognition and customer loyalty can all provide additional ways for a company differentiate itself from the competition.

❖ **Achieving Differentiation Strategy**

- To achieve differentiation, following are the measures that could be adopted by an organization to incorporate:

(i) Offer utility for the customers and match the products with their tastes and preferences.

(ii) Elevate the performance of the product.

(iii) Offer the promise of high-quality product/service for buyer satisfaction.

(iv) Rapid product innovation.

(v) Taking steps for enhancing image and its brand value.

(vi) Fixing product prices based on the unique features of the product and buying capacity of the customer.

➢ Advantages of Differentiation Strategy

❖ A differentiation strategy may help to remain profitable even with: rivalry, new entrants, suppliers' power, substitute products, and buyers' power.

(i) **Rivalry**

- Brand loyalty acts as a safeguard against competitors.
- It means that customers will be less sensitive to price increases, as long as the firm can satisfy the needs of its customers.

(ii) **Buyers**

- They do not negotiate for price as they get special features and also, they have fewer options in the market.

(iii) **Suppliers**

- Because differentiators charge a premium price, they can afford to absorb higher costs of supplies and customers are willing to pay extra too.

(iv) Entrants

- Innovative features are an expensive offer.

- So, new entrants generally avoid these features because it is tough for them to provide the same product with special features at a comparable price.

(v) Substitutes

- Substitute products can't replace differentiated products which have high brand value and enjoy customer loyalty.

➢ Disadvantages of Differentiation Strategy

(i) In long term, uniqueness is difficult to sustain.

(ii) Charging too high a price for differentiated features may cause the customer to switch-off to another alternative.

(iii) Differentiation fails to work if its basis is something that is not valued by the customers.

Focus Strategies

- A successful focus strategy depends on an industry segment that is of sufficient size, has good growth potential, and is not crucial to the success of other major competitors.

- Strategies such as market penetration and market development offer substantial focusing advantages. Midsize and large firms can effectively pursue focus-based strategies only in conjunction with differentiation or cost leadership- based strategies.

- All firms in essence follow a differentiated strategy.

- Because only one firm can differentiate itself with the lowest cost, the remaining firms in the industry must find other ways to differentiate their products.

- Focus strategies are most effective when consumers have distinctive preferences or requirements and when rival firms are not attempting to specialize in the same target segment.

- An organization using a focus strategy may concentrate on a particular group of customers, geographic markets, or on particular product-line segments in order to serve a well-defined but narrow market better than competitors who serve a broader market.

- **Focused cost leadership:**

  - A focused cost leadership strategy requires competing based on price to target a narrow market.

  - A firm that follows this strategy does not necessarily charge the lowest prices in the industry.

  - Instead, it charges low prices relative to other firms that compete within the target market.

  - Firms that compete based on price and target a narrow market are following a focused cost leadership strategy.

- **Focused differentiation:**

  - A focused differentiation strategy requires offering unique features that fulfill the demands of a narrow market.

  - As with a focused low-cost strategy, narrow markets are defined in different ways in different settings.

  - Some firms using a focused differentiation strategy concentrate their efforts on a particular sales channel, such as selling over the internet only.

- Others target particular demographic groups.

- Firms that compete based on uniqueness and target a narrow market are following a focused differentiations strategy.

- For example, Rolls-Royce sells limited number of high-end, custom-built cars.

- **Achieving Focused Strategy**

  - To achieve focused cost leadership/differentiation, following are the measures that could be adopted by an organization:

    (i) Selecting specific niches which are not covered by cost leaders and differentiators.

    (ii) Creating superior skills for catering to such niche markets.

    (iii) Generating high efficiencies for serving such niche markets.

    (iv) Developing innovative ways in managing the value chain.

- **Advantages of Focused Strategy**

  (i) Premium prices can be charged by the organisations for their focused product/services.

  (ii) Due to the tremendous expertise about the goods and services that organisations following focus strategy offer, rivals and new entrants may find it difficult to compete.

- **Disadvantages of Focused Strategy**

  (i) The firms lacking in distinctive competencies may not be able to pursue focus strategy.

  (ii) Due to the limited demand of product/services, costs are high which can cause problems.

  (iii) In long run, the niche could disappear or be taken over by larger competitors by acquiring the same distinctive competencies.

4. BEST-COST PROVIDER STRATEGY

- The new model of best cost provider strategy is a further development of above three generic strategies.

- It is directed towards giving customers more value for the money by emphasizing both low cost and upscale differences.

- The objective is to keep costs and prices lower than those of other sellers of comparable products.

- Best-cost provider strategy involves providing customers more value for the money by emphasizing low cost and better-quality difference. It can be done:

  (a) through offering products at lower price than what is being offered by rivals for products with comparable quality and features or

  (b) charging similar price as by the rivals for products with much higher quality and better features.