

Foundations of Planning



Financial Planning. Photo credit.

Chapter sections

5.1 SWOT Analysis

5.2 Strategy formulation

5.2.1 Corporate strategy

5.2.2 Business unit or competitive strategy

Learning Objectives:

Upon completion of studying this chapter, *Foundations of Planning*, learners should be able to:

- Describe the constraints and challenges facing managers in today's external environment
- Conduct a SWOT analysis for a company
- Apply concepts of environmental analysis and strategy formulation to a company such as the one selected for your checkpoint assignment

“By failing to prepare, you are preparing to fail.”

—Benjamin Franklin

“You can't plow a field simply by turning it over in your mind.”

—Gordon B. Hinckley

“A good plan is like a road map: it shows the final destination and usually the best way to get there.”

—H. Stanely Judd

“If we could first know where we are, and whither we are tending, we could better judge what to do, and how to do it.”

—Abraham Lincoln

Recall from Chapter 1 that the field of management is an ongoing process composed of four functions: (1) planning, (2) organizing, (3) leading, and (4) controlling. The preceding three chapters dealt with the planning function. This chapter will continue the discussion in even greater detail.

Figure 5.1 shows the main components of planning at the organizational level, which is also called strategic management because it is done at the highest level of the company, as opposed to the planning that goes on within a business unit, a functional area, or even a committee.

Steps in Organizational Planning



Steps: Who are we? Where do we want to be?

These questions were discussed in the previous three chapters. Specifically, they look at the mission, values, organizational culture, and vision of the organization.

Where are we now?

At this stage, managers are concerned with analyzing both the external and internal environments, staying aware of general conditions of the environments where the business operates, like labor market conditions; awareness of competitors and how they are performing; what the demographics the company serves are; and the political, legal, economic, and technological trends present.

Doing an internal analysis is the second part of finding out where the company is, and it provides important information about an organization's specific resources, capabilities, core competencies, and finally its competitive advantage(s). The combined external and internal analyses are called the SWOT analysis because it is an analysis of the organization's **strengths**, **weaknesses**, **opportunities**, and **threats**. This topic is to be discussed shortly.



Figure 5-2

How will we get there? How will we know when we are there?

Once a picture of where the company stands becomes clear, the formulation of appropriate strategies follows, which aids in an organization achieving its goals. These strategies will be based on exploiting strengths and opportunities, protecting the firm from external threats, or correcting any weaknesses. The

final step in the strategic management process is evaluating the implementation of the strategies based on their effectiveness.

5.1 SWOT Analysis

The SWOT analysis is the appraisal of the company's internal strengths, weaknesses, external opportunities, and threats.

Strengths & weaknesses

Strengths refer to those resources that the firm has and does well with, whereas weaknesses are those assets it does not do well with or lacks. Again, the goal is to take advantage of strengths and minimize the disadvantages posed by any weaknesses.

Resources, capabilities, and core competencies

Some of the firm's resources are tangible while others are intangible. **Tangible resources** are assets that can be seen and quantified such as personnel, machinery, computers and desks, production equipment, manufacturing plants, cash, physical buildings, and reports. In general, tangible resources can be financial, organizational, physical, and technological. **Intangible resources**, on the other hand, are not readily observed and are therefore harder to analyze and duplicate by competitors, being an important source of competitive advantage to a company. Typically, they include assets that are rooted deeply in the firm's history and have accumulated over time. Intangible resources can be classified into:

1. **Human:** the sharing of employees knowledge, talents, design skills, trust, ability to envision the future, motivation, and commitment

2. **Innovation:** research and development of new products and services, unique ways people work together and combine talents, and scientific capabilities
3. **Reputation:** perceived superior marketplace competence, the degree the firm is held in high esteem, well known and valuable brand name(s), social capital, and relationship(s) with other organizations

A combination of both resources could be a distribution facility, which is assigned a monetary value on the firm's balance sheet under tangible assets. The real value of the facility, however, is grounded in a variety of factors, such as its proximity to raw materials and customers, but also in intangible factors, such as the manner in which workers integrate their actions internally and with other stakeholders, such as suppliers and customers.'



Figure 5-3

Capabilities refer to the firm's power and ability to integrate and bind together tangible and intangible resources over time through complex interactions that lead to core competencies. Capabilities represent a distinctive, superior, and sustainable way to allocate resources.

Dave Ulrich and Norm Smallwood assert that “[c]apabilities —the collective skills, abilities, and expertise of an organization— are the outcome of investment in staffing, training, compensation,

communication and other human resources areas. They represent the ways that people and resources are brought together to accomplish work. They form the identity and personality of the organization by defining what it is good at

doing and, in the end, what it is."²

Examples of capabilities include Walmart's effective use of the logistics management technique; Starbuck's ability to motivate, empower, and retain employees; Nordstrom's effective

SWOT Analysis: Internal Assessment of the Organization

Figure 5-4



customer service; Dyson's development of sophisticated, small, and powerful engines; Google's creation of proprietary algorithms to develop its search engines that, coupled with talented and good pay, motivate its workforce; and IKEA's design of modern, DIY furniture at affordable prices.

Finally, let us take a closer look at **core competencies**. These are the combination of synergistic capabilities embedded deep within a firm that allow it to differentiate its products and services from those of its rivals. For example, what has made Walmart so good at what it does? The unique combination of logistic management techniques, sophisticated inventory monitoring and control system, efficient supplier relations, economies of scale, and a low-cost value proposition have. Once a company is able to identify and develop its core competencies, then it must be sustained over time in order for it to become competitively advantaged.

Why is McDonald's so successful? It was able to capitalize and implement a quick service restaurant experience at competitive prices coupled with consistent, quality production of food and use of raw materials. The important point here is that strategy formulation—to be studied in the next section—is built upon competitive advantages, and competitive advantages are built upon core competencies.

Opportunities & threats

When appraising the external environment, the organization will typically start with its **general environment**. But what does this mean? The general environment is composed of dimensions in the broader society that influence an industry and the firms within it. Opportunities, or attractive factors, represent the reasons for a business to exist and prosper. They should be

leveraged. Threats are risk factors beyond the firm's control that could impact the firm negatively. They should be managed or eliminated. While there are many different ways for a company to study the general external environment, the primary tool is the PESTEL analysis. PESTEL is an acronym that stands for **political, environmental, sociocultural, technological, economic, and legal** environments.

Political factors entail to what degree the government intervenes in the economy in areas such as tax policy, labor law, environmental law, trade restrictions, tariffs, and political stability. Furthermore, governments have great influence on the health, education, and infrastructure of a nation. Trade agreements between nations are established to reduce trade restrictions. In the case of the North America Trade Agreement (NAFTA), companies and consumers in all three countries—Canada, the United States, Mexico—mutually benefit. But if a company is in a country very close to Mexico with similar climate and industries, and is not part of a treaty with the United States, it would be negatively impacted by NAFTA. Similarly, with renegotiations and proposed changes to increase tariffs, those companies relying on imports from Mexico—like Chipotle buying avocados, or Walmart purchasing cheap t-shirts from maquiladoras—will be negatively affected. However, if we are discussing an avocado producer in California, the changes would be welcome.

Environmental factors include ecological and environmental aspects, such as weather, natural disaster, and climate change, which have been increasingly important and may particularly affect industries like tourism, farming, and insurance. The drought in California, for instance, which affected the state for the better part of a decade, hit the agriculture industry hard; especially those in beekeeping and almond growing.³

Furthermore, climate change concerns and the move toward increasing sustainability are affecting how companies operate and the products that they offer, both creating new markets and diminishing existing ones. Chapter 4 discussed how consumers are demanding that the products they buy are sourced ethically, and this is further evidence of that notion.

Socio-cultural factors relate, for the most part, to demographics and attitudes of the population. Demographics include gender, age, ethnicity, knowledge of languages, disabilities, mobility, home ownership, employment status, religious belief or practice, culture and tradition, living standards, and income level. Trends in social factors affect the demand for a company's products and how that company operates. These factors are of particular interest to marketers who need to understand consumers and what drives them.

Technological factors are at the heart of innovation and include aspects such as R&D activity, automation, technology incentives, and the rate of technological change. They can determine barriers to entry, impact the labor market, increase productivity and influence outsourcing/resourcing decisions. In

America, the use of robotics has increased productivity and reduced factories' need for human labor. General Motors employs barely a third of the 600,000 workers it had in the 1970s, yet it churns out more cars and trucks than ever; similarly, 265,000 jobs have been lost in the production of primary metals—a 42% plunge at a time when such production in the U.S. has surged to 38%.⁴



Figure 5-5

Economic factors include economic growth, interest rates, exchange rates, inflation rate, disposable income of consumers, and so on. These factors have major impacts on how businesses operate and make decisions. For example, interest rates affect a firm's cost of capital and therefore affect what extent a business grows and expands. Exchange rates affect the costs of exporting goods and the supply and demand of imported goods in an economy.

Legal factors include discrimination law, consumer law, antitrust law, intellectual property law, contract law, and health and safety law. Laws and regulations—from a marketing perspective—affect how a product is priced, promoted, and labeled. They are also in place to protect consumers from corporate abuses, like in the case of Wells Fargo when millions of accounts were opened without customers' consent, or when Mylan, the maker of EpiPen, boosted the price of the lifesaving allergy medication by 500%.⁵

In both cases, lawsuits were filed against the companies and became a real threat.

Because firms cannot directly control the general environment, successful companies audit it to gather the information required to understand the implication and seek a strategy that would minimize the impact, or that would take advantage of it. For example, the referendum on Brexit, whereby the British citizens voted to exit the European Union, surprised businesses throughout the world. Companies around the globe are challenged to understand the effects of this significant decision on their current and future strategies in terms of immigration policies, the labor market, international trade, political and legal stability of the region, the future of economic unions, and anti-globalization sentiments.

It is also important to note that a threat can be converted into an opportunity. Consider the situation that Spain's best selling newspaper, *El Pais*, had to confront in 2016. The daily had been reporting a steady decline in readership since 2008 due to the economic crisis of the country and changing habits of its readership. At the same time, the company was working to build an online version of the paper. When the print circulation finally shrunk by 15% and the online version started rising, the company made the decision to end its print edition—the Internet, in this case, was a threat for the company but also an opportunity, and when the time came to close the print edition, the company was already well positioned to go digital.⁶

Now we are ready to put together the individual components of the SWOT analysis with two examples. The first one is for a small company and the second one is for McDonalds, representing a large corporation. A small start-up consultancy business might draw up a SWOT Analysis as shown in Figure 5.6.

As a result of it, the consultancy may decide to specialize in rapid response and good value services to local businesses. Marketing would be in selected local publications to get the greatest possible presence for a set advertising budget, and the consultancy should remain up-to-date with changes in technology where possible.⁷

Figure 5.6

STRENGTHS	WEAKNESSES
We are able to respond very quickly as we have no red tape, and no need for higher management approval.	Our company has little market presence or reputation.
We are able to give really good customer care, as the current small amount of work means we have plenty of time to devote to customers.	We have a small staff, with shallow base skills in many areas.
Our lead consultant has a strong reputation in the market.	We are vulnerable to vital staff being sick, and leaving.
We can change direction quickly if we find that our marketing is not working.	Our cash flow will be unreliable in the early stages.
We have low overheads, so we can offer good value to customers.	

OPPORTUNITIES	THREATS
Our business sector is expanding, with many future opportunities for success.	Developments in technology may change this market beyond our capability to adopt.
Local governments want to encourage local businesses.	A small change in the focus of a large competitor might wipe out many market positions we achieve.
Our competitors may be slow to adopt new technologies.	

Suggested SWOT analysis of McDonald's (2013), developed by Jurvelcius & Ovidijus'

Strengths

- Largest fast food marketshare in the world
- Brand recognition valued at \$40 billion
- \$2 billion advertising budget
- Locally adapted food menus
- Partnerships with best brands
- More than 80% of restaurants owned by independent franchisees

5.2 Strategy formulation

Strategies need to be formulated for all levels in an organization: corporate, business, and functional (see Figure 5.3). Let us look closer at each of these types of strategies in this next section.

5.2.1 Corporate strategy

A **corporate strategy** is an organizational strategy that specifies "what businesses a company is in or wants to be in, and what it wants to do with those businesses. It is based on the mission and goals of the organization and the roles that each business unit of the organization will play."⁹ A business unit could be a division, facility, or department of an organization. We can see both of these aspects with Google, for instance. Its mission to organize the world's information and make it universally accessible and useful has been pursued with a corporate strategy that has organized different types of information from the various business units including Mobile Applications, Google+, YouTube, Google Maps, Google driverless cars, etc. Top managers decide what to do with those business units, and the choices are whether to grow them, keep them the same, or renew them. Therefore, there are three main types of corporate strategies: growth, stability, and renewal.

Growth strategy

Growth strategy is when an organization expands the number of markets served or products offered, either through its current business(es) or through new business(es).¹⁰ Because of its growth strategy, an organization may increase revenues, number of employees, or marketshare. Organizations can grow

by buying more companies in the same industry or offering more products, by vertical and horizontal value-chain integration or by getting into a different industry that its own. There are four ways in which the growth strategy can be used.

Concentration is when an organization grows by focusing on its primary line of business and increases the number of products offered or markets served in this primary business.¹¹ Yum! Brands, the parent company of Kentucky Fried Chicken, Taco Bell, and Pizza Hut, is expanding into new products in the same line of the fast food business. The company opened a new Asian sandwich chain in 2014—Banh Shop—to potentially expand into the Asian market. The menu includes grilled steak banh mi sandwiches, Vietnamese noodle salad, and grilled pork meatball banh mi sandwiches. The company also launched Super Chix, which sells chicken tenders and chicken sandwiches similar to Chick-fil-A's¹²

In 2016, Chipotle added chorizo—a spicy pork sausage—to its menu, which by design had changed very little the past 23 years. The company made the move because chorizo is a unique choice, fits within the menu concepts, and helped to revamp sluggish sales.¹³

A company might also choose to grow by vertical integration, either backward, forward, or both. In **backward vertical integration**, the organization becomes its own supplier so it can control its inputs. Starbucks is best known as a chain of coffee shops. However, in 2013, it got into the coffee bean

Figure 5-6



Figure 5-7 Types of strategies

business when it bought a farm in Costa Rica with plans to develop an agronomy center, expand its ethically sourced coffee initiative, and have more control over the sourcing process.¹⁴

Consider the case of Amazon, which started as an online bookstore. It has now become a publisher itself, creating its own content as well as its own digital and paper printing press, making the books cheaper and attracting its own cadre of well-known writers. After the Kindle debuted, the company established Amazon Publishing, which is now a profitable empire of digital works. Amazon has made it possible for thousands of writers to have their work read. And, by producing its own original work, Amazon can sell more devices and sign up more Prime members—a major source of revenue.¹⁵

In 2016, Walmart announced plans to build and operate its own dairy processing plant in Indiana to supply 600 stores in five midwest states with its own Walmart-brand milk.¹⁶

With **forward vertical integration**, the organization becomes its own distributor and is able to control its outputs. An example of such integration is Apple, with its more than 500 retail stores

around the globe to exclusively distribute its product. Critics felt that it was illogical for Apple to venture into retail at a time when tech retail stores were in decline, but Steve Jobs understood that even if you create products that are easy to use, the variety of things that people want to use technology for often creates complexity. Because of this, consumers at all levels may need some hand holding from time to time. Apple uses this

conundrum to its advantage. Because it keeps product SKUs simple, the salespeople inside the stores know the products very well. They go right to the heart of any technology user's question; a question that is always related to what they want to do with the technology in which the user is interested. Once the customer's needs are explained, Apple store employees take care of it on the spot.¹⁷

Another example is Amazon, which is reportedly considering buying an airport in Germany to build its own fleet of delivery airplanes. This acquisition would add to Amazon's efforts to build a full-fledged logistics and freight-transportation services to compete with FedEx and UPS, in essence, becoming its own shipper.¹⁸

With **horizontal integration**, a company grows by combining with its competitors. A corporation that implements this type of strategy usually merges with or acquires another company—usually a competitor that is in the same industry value chain.¹⁹ Some examples: Disney merging with Pixar—both companies are in movie production; Exxon with Mobile—oil production, refining, and distribution; Daimler Benz and Chrysler merger—car development, manufacturing, and retailing.

The retail drugstore Walgreens, which already owns Duane Reade, Boots, and Drugstore.com, acquired Rite Aid at the end of 2015 in a deal that united two of the largest drugstores chains in the U.S. In the press release about it, CEO Stefano Pessina wrote, “[t]oday's announcement is another step in Walgreens Boots

Alliance's global development and continues our profitable growth strategy. In both mature and newer markets across the world, our approach is to advance and broaden the delivery of retail health, wellbeing and beauty products and services.”²⁰

The following are some of the advantages of horizontal integration:²¹

1. Lower costs: There is one larger company, which produces higher outputs and takes advantage of greater economies of scale and higher efficiency.

2. Increased differentiation: The combined company can offer more products or service features.

3. Increased market power: The larger company has more power over its suppliers and distributors/customers.

4. Reduced competition: The results of industry consolidation are fewer companies operating in the industry and less intense competition.

5. Access to new markets: The integration operates in a different region or serves a different market segment.

In the case of Walgreens, for example, the company now has 18,000 stores globally and its presence is also online.²²

Finally, an organization can grow through diversification, either related or unrelated. **Related diversification** is when a company combines with other



Figure 5-8 Types of corporate strategies



Figure 5-9 Vertical and horizontal integration

companies through merging and acquisitions in different, but related, industries.

The general argument for a diversified approach is that it reduces risk. As one industry gets hit, another may rise. That is the approach that makers of sugary sodas, like Coca Cola and Pepsi, are moving into healthier beverages. Pepsi recently

acquired probiotic drink maker Kevita, whose beverage portfolio generally contains between five and 45 calories per serving, and are sweetened with stevia or very little sugar.²³ Compare that to the high caloric count of Pepsi's flagship carbonated soft drink.

Another advantage of diversifying is the synergy realized from the convergence of technology across businesses,

preferably within a single industry. At Johnson & Johnson (J&J), the company has diversified into three business groups: (1) consumer products like Tylenol, baby shampoo, Neutrogena; (2) medical devices like sutures or blood sugar testers for diabetes; and (3) pharmaceuticals like Concerta, Remicade, and Prezista. One of the earliest examples of this kind of innovation at J&J was a drug for cardiovascular disease that resulted from a meeting in the 1990s between engineers from the devices group and scientists from the pharmaceutical group. They posted their problem on the company's intranet, and that same day they heard from a scientist in another business group in a different location. He responded with the answer; it had been the focus of his Ph.D. work.²⁴

Yet, another benefit of diversification is cross-pollination. J&J acquired Omrix biopharmaceuticals, and is exploring the use of the company's biologic drugs in tandem with J&J's surgical dressings to help control soft tissue bleeding. Cross-pollination can also benefit consumer products. The company applied scientific advances in sunscreen technology from its research labs to its Neutrogena and Aveeno lines.²⁵

J.M. Smucker, the famous maker of coffee, peanut butter, jam, and frosting, bought Big Heart Pet Brands, the owner of MeowMix, Milk-Bone, and Kibbles 'N Bits—another industry related to grocery store consumer products. This acquisition was an attempt to diversify Smucker's portfolio and move away from relying solely on coffee sales that stood at 46% of the company's sales before purchase, and after the acquisition, overall revenues are divided roughly equally between pet food, coffee, peanut butter, oils, jams, and frostings.²⁶

Unrelated diversification is when a company combines with firms in different and unrelated industries. For instance, the

Indian, international conglomerate Tata Group focuses its acquisitions on six industries: steel, motor vehicles, power, telecoms, information technology, and hotels.²⁷ An odd mix with no strategic fit existing among its businesses; each is expected to compete and thrive on its own.

Stability strategy

During periods of economic uncertainty, like those in the wake of the 2008 recession, many companies choose to maintain things as they are. As an organization continues to do what it is currently doing, this is referred to as stability strategy. Examples of this strategy include continuing to serve the same clients by offering the same product or service, maintaining market share, and sustaining the organization's current business operations.²⁸ The organization does not grow, but does not fall behind, either. It simply survives.

Renewal strategy

When an organization is in trouble, something needs to be done. Managers need strategies that address declining performance. These strategies are called renewal strategies, of which there are two main types. A **retrenchment strategy** is a short-run renewal strategy used for minor performance problems. Regular readers of business journals will find countless examples of companies making these types of corrective changes, like cutting costs and restructuring organizational operations. "This strategy helps organizations stabilize operations, revitalize organizational resources and capabilities, and prepare to compete once again."²⁹ Wal-Mart, for example, had announced a cut of over 100 jobs in China in late 2014 as part of its effort to lower costs in the midst of tough price competition. Wal-Mart has faced setbacks in China, including an embarrassing food safety

scandal in which its popular Five Spice donkey meat was found to have traces of fox meat.³⁰ In 2015, media entertainment giant Viacom set aside \$785 million for a reorganization to help boost its financial performance in the face of increasing competition.³¹

When an organization's problems are more serious, more drastic action—the **turnaround strategy**—is needed. Measures to cut costs and reorganize capabilities and personnel are more extensive and longer in duration than in a retrenchment strategy.

Examples of successful turnaround strategies include Apple's. The company was given a three-month life expectancy in the early 1990s due to poor performance and a drop in market share of the personal computing business. What came after that is the story of the century: Steve Jobs, Apple's founder and ousted CEO, returned to the company and with his vision came the best of Apple with the introduction of the iMac, iPods, iTunes, iPads, iPhones, and Apple Stores. Apple not only transformed itself but the personal computing, animation, music, phone, and mobile computing industries.

Another example of turnaround strategy success is Domino's Pizza. The company was founded in 1960 by two brothers who borrowed \$900 to pay for their first store and used a Volkswagen Beetle to deliver their first pizzas. Today, there are more than 9,000 stores around the world with more than 4,000 of them located abroad. However, in 2010, Domino's future looked bleak. Strong competition, harsh criticism over the taste of its pizzas, and low consumer satisfaction levels were playing against the company's revenue. Management decided to adopt a surprising market strategy: admit that its product was awful. The company spent millions in creating a new pizza from the crust up, expanding its menu offerings and advertising the process. The results have been amazing: Between 2010 and 2013, America's

customer satisfaction index score for Domino's Pizza increased from 69% to 81%. More importantly, the company's revenue has also improved significantly, beating the growth rate of competitors Pizza Hut and Papa John's Pizza.³²

Denny's turnaround strategy is another bright spot in the fast food industry, which has been plagued by declining traffic over the last several years. Here is what Denny's did to win back its customers:

1. The company remodeled restaurants to support a rebranding campaign. In the first three quarters of 2014, Denny's had completed 129 remodels. Within the next four years, 70% of Denny's 1,289 restaurants were updated.
2. Denny's simplified its menu and added healthier options. They rolled out a new core menu, which includes two premium sandwich entrees with new high quality, seven-grain bread, in addition to over 20 other menu changes for simplification and for margin improvement.
3. The company is rolling out a millennial-focused fast casual concept on college campuses, called The Den. The Den's menu, which is smaller than Denny's traditional menu, offers breakfast all day, gourmet burgers, burritos, sandwiches and salads. The company now has 11 The Den locations.³³

Divestiture, the selling of a division or part of an organization, can be part of an overall retrenchment or turnaround strategies to rid a company of businesses that are no longer profitable or do not fit the firm's other activities. Sometimes, a company may grow too fast through mergers and acquisitions only to later realize it needs to focus on its core strengths.

Bankruptcy & liquidation

A company that struggled for its survival but did not make it was RadioShack. Sales and shares had been tumbling for years. Their stores were outdated, with a format, merchandise mix, and physical presence that no longer registered with the American consuming public.³⁴ Nearly a century after it opened its first store, it declared bankruptcy in early 2015.

A company that many analysts think will not make it—as it passed the point of no return—is the iconic Sears. Robin Lewis and Michael Dart, in their book *The New rules of Retail*, assert that Sear's decline started decades ago due to spending too much time investing in side businesses and ignoring the competition, leaving it unable to respond to the needs of consumers and marketplace.³⁵

Finally, a company may have no other choice than to liquidate or sell off its assets for their tangible worth. This happens when renewal strategies had been pursued unsuccessfully and the company simply needs to cut its losses. Blockbuster was a movie rental company popular from the 1980s to the early 2000s with thousands of employees and stores in America and other countries. In 2011, it filed for bankruptcy protection, and finally liquidated in 2015. It was quite an emotional and difficult decision to make, but a necessary one.

5.2.2 Business unit or competitive strategy

We have learned that a firm's distinctive resources and capabilities together form its core competencies. When a firm deploys core competencies and sustains profits that exceed the

average for its industry, the firm is said to possess a competitive advantage over its rivals.

Michael Porter, in his seminal work on competitive advantage, developed three generic strategies that, he argues, can be used either singly or in combination to create a defensible position and to outperform competitors, whether they are within an industry or across nations.³⁶



Michael Porter, 2012. Photo credit.

The goal of a business's strategy is to achieve a sustainable competitive advantage. These competencies enable innovation, efficiency, quality, and customer responsiveness, all of which can be leveraged to create a cost advantage or a differentiation advantage.

This decision is a central component of a firm's competitive strategy. The two basic types of competitive advantage combine with the scope of activities for which a firm seeks to achieve them, and leads to three generic strategies (see Figure 5-9) for achieving above average performance in an industry: cost leadership, differentiation, and focus.³⁷

Cost leadership sets out to deliver the same benefits as competitors, but at a lower cost due to a more efficient development, manufacturing, or distribution of products/services. The source of cost advantage can originate from restructuring, the pursuit of economies of scale, proprietary technology, the preferential access to raw materials, or a core competence that is hard to duplicate.

This strategy is particularly effective for organizations in industries where there is limited possibility of product differentiation and where buyers are very price sensitive.

One of the potential problems with this strategy is that two or more firms competing for cost leadership may engage in price wars that drive profits to very low levels. Another concern is that firms may become so concerned with maintaining low costs that they overlook needed changes in production or marketing—areas that they may need to invest in to remain competitive. Wal-Mart is by far the best example of a company using the cost leadership strategy.

In **differentiation strategy**, a firm seeks to deliver hard-to-copy, superior benefits that exceed those of competing products/services by being unique along some dimensions widely valued by buyers or consumers. This uniqueness is rewarded with a premium price based upon the product itself, the delivery system by which it is sold, or the marketing approach. The superiority arises from factors other than low cost, such as customer service, methods of distribution, product features and quality, product design, advertising, brand image, or unique style.

A company choosing this strategy must develop and maintain a product perceived as different enough from competitors' products to warrant the asking price. Apple is a



Figure 5-10 Generic strategies

good example of a company following this strategy in both the personal and mobile consumer markets.

Differentiation may lead to customer brand loyalty and result in reduced price elasticity. As long as the firm can increase the selling price by more than the marginal cost of adding the features, the profit margin is increased. Firms pursuing a differentiation strategy are vulnerable to more and varied competitive threats than firms pursuing a cost-leader strategy.

Another risk for firms pursuing a differentiation strategy is changing consumer tastes. The feature that customers like and find attractive about a product this year may not make the

product popular next year. Changes in customer tastes are especially obvious in the fashion industry.

The **focus** strategy defines the breadth of a company's target market. A company can have a broad (mass market) competitive scope, or a narrow (niche market) competitive scope. Therefore, there are two types of focus strategy: focus low-cost and focus differentiation.³⁸

Focus low-cost

A cost-focus strategy is a low-cost, narrowly focused market strategy. Firms employing this strategy may focus on a particular buyer segment or a particular geographic segment, and must locate a niche market that wants or needs an efficient product and is willing to forgo extras to pay a lower price for the product. A company's costs can be reduced by providing little or no service, providing a low-cost method of distribution, or producing a no-frills product.

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. Redbox, for example, uses vending machines placed outside grocery stores and other retail outlets to rent DVDs for \$1. There are ways to view movies even cheaper, such as through the flat-fee streaming video subscriptions offered by Netflix, but among firms that rent actual DVDs, Redbox offers unparalleled levels of low-price and high-convenience.

Another important point is that the nature of the narrow target market varies across firms that use a focused cost leadership strategy. In some cases, the target market is defined by demographics. Claire's, for example, seeks to appeal to young

women by selling inexpensive jewelry, accessories, and ear piercings. Claire's use of a focused cost leadership strategy has been very successful; the firm has more than 3,000 locations and has stores in 95% of American shopping malls.³⁹

The German grocery chain Aldi offers drastically cheaper prices—even lower than Wal-Mart—in a limited number of basic grocery items. While a typical grocery store may carry 40,000 items, Aldi offers just 1,400, but at the best price. Aldi's strategies to sell groceries for so cheap includes private labels, no-frills design, and efficient layout and packaging.⁴⁰

A **focus-differentiation strategy** is the marketing of a differentiated product to a narrow market, often involving a unique product and a unique market. This strategy is viable for a company that can convince consumers that its narrow focus allows it to provide better goods and services than its competitors.

Consider the case of Nike. The inspiration for Nike Flyknit was born from the common runner's feedback, craving a shoe with the qualities of a sock: a snug fit that goes virtually unnoticed to the wearer. But all the features that make a sock desirable have proven to make them a bad choice for a running upper. An inherently dynamic material like yarn generally has no structure or durability. Nike embarked on a four-year mission of micro-engineering static properties into pliable materials. It required teams of programmers, engineers, and designers to create the proprietary technology needed to create the knit upper.

The next steps were to map out where the specific yarn and knit structures were needed. Applying 40 years of knowledge from working with runners, Nike refined the precise placement of support, flexibility and did so all in one layer, resulting in precision

engineering in its purest form: Every element had a purpose, resulting in one of the lightest, best fitting running shoes Nike had ever made.⁴¹

Firms using a narrow focus strategy can also tailor advertising and promotional efforts to a particular market niche. Many automobile dealers advertise that they are the largest volume dealer for a specific geographic area. Other car dealers advertise that they have the highest customer satisfaction scores within their defined market, or even the most awards for their service department.

For example, the dedication of Mercedes-Benz to cutting-edge technology, styling, and safety innovations has made the company's vehicles prized by those who are wealthy enough to afford them. At Build-A-Bear Workshop, customers enjoy an interactive process of designing and assembling teddy bears. Customers are willing to pay a premium price because they receive a unique, hands-on experience rather than simply buying a stuffed toy.⁴²

Functional strategy

The final type of strategy that managers use is functional strategy, which includes those strategies used by an organization's various functional departments, like marketing, finance, operations, etc., to support the competitive strategy. For instance, when Starbucks found itself facing increased competition from the likes of McDonald's and Dunkin' Donuts, it put additional emphasis on its marketing, product research and development, and customer service strategies.

Note: We do not cover specific functional strategies here since you will cover them in other business courses you will take.

Checkpoint assignment

The specific objective of this critical assignment is to conduct a managerial examination of a company. This exercise will provide students with the opportunity to integrate and implement theory into practice, and will also prepare them to develop comprehensive business plans in the capstone course of their final year of study.

For the purpose of this exercise, students will choose a company (from the list of companies provided by your professor —one per student), and will conduct the following analysis:

- Using information from news articles, company websites, library database searches, etc., analyze the company's internal environment as it relates to its **mission, values, and vision**. See Chapter 2 of this Multi-touch book for clarification.
- Using information from news articles, company websites, library database searches, etc., analyze the company's internal environment as it relates to its **organizational culture**. See Chapter 3 of this Multi-touch book for clarification.
- Using information from news articles, company websites, library database searches, etc., analyze the company's **internal environment as it relates to its strengths, weaknesses, opportunities, and threats**. See Chapter 5 of this Multi-touch book for clarification.
- Using information from news articles, company websites, library database searches, etc., identify the company's **corporate strategy**. See Chapter 5 of this Multi-touch book for clarification.

- Using information from news articles, company websites, library database searches, etc., identify the company's **competitive strategy**. See Chapter 5 of this Multi-touch book for clarification.

Format:

The written paper must be at least 2,000 words with one-inch margins using Times New Roman or similar 12-point font with correct spelling and grammar, organized headings, proper citations, references, and a cover page. APA Style formatting is required.

Note: The instructor's approval of the company selected is required.

Note: Check with the instructor for further information and assistance.

REVIEW 5.1

Question 1 of 5

The three different types of strategies that managers implement are _____.

- A. Corporate, private, functional**
- B. Corporate, competitive, functional**
- C. Long-term, short-term, public**
- D. Competitive, noncompetitive, corporate**

Check Answer

