

Chapter 4 – Competitive Advantage – Cost and Differentiation

In this chapter 4, after analysing the environment and the internal resources and capabilities, we focus on the source of C.A. and its types (reading: **chapter 8 GRANT 2011** book).

Three parts:

- The emergence of competitive advantage
- Sustaining C.A.
- Types of C.A.: Cost and Differentiation

The Stan Shih Smile Curve (I)

VA

Value Added

Higher

The STAN SHIH SMILE CURVE

Lower

Business Activity can be brokendown into...

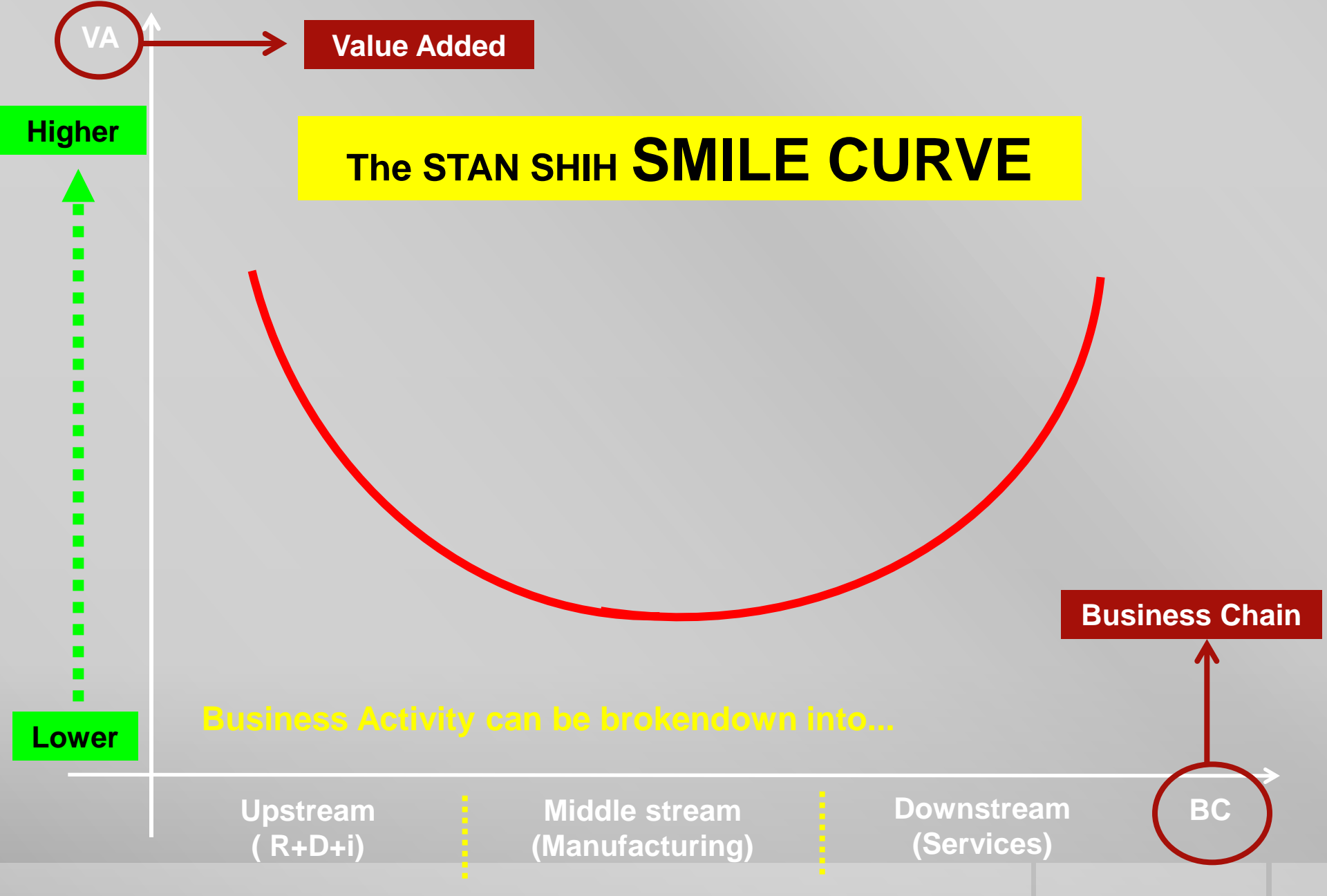
Upstream
(R+D+i)

Middle stream
(Manufacturing)

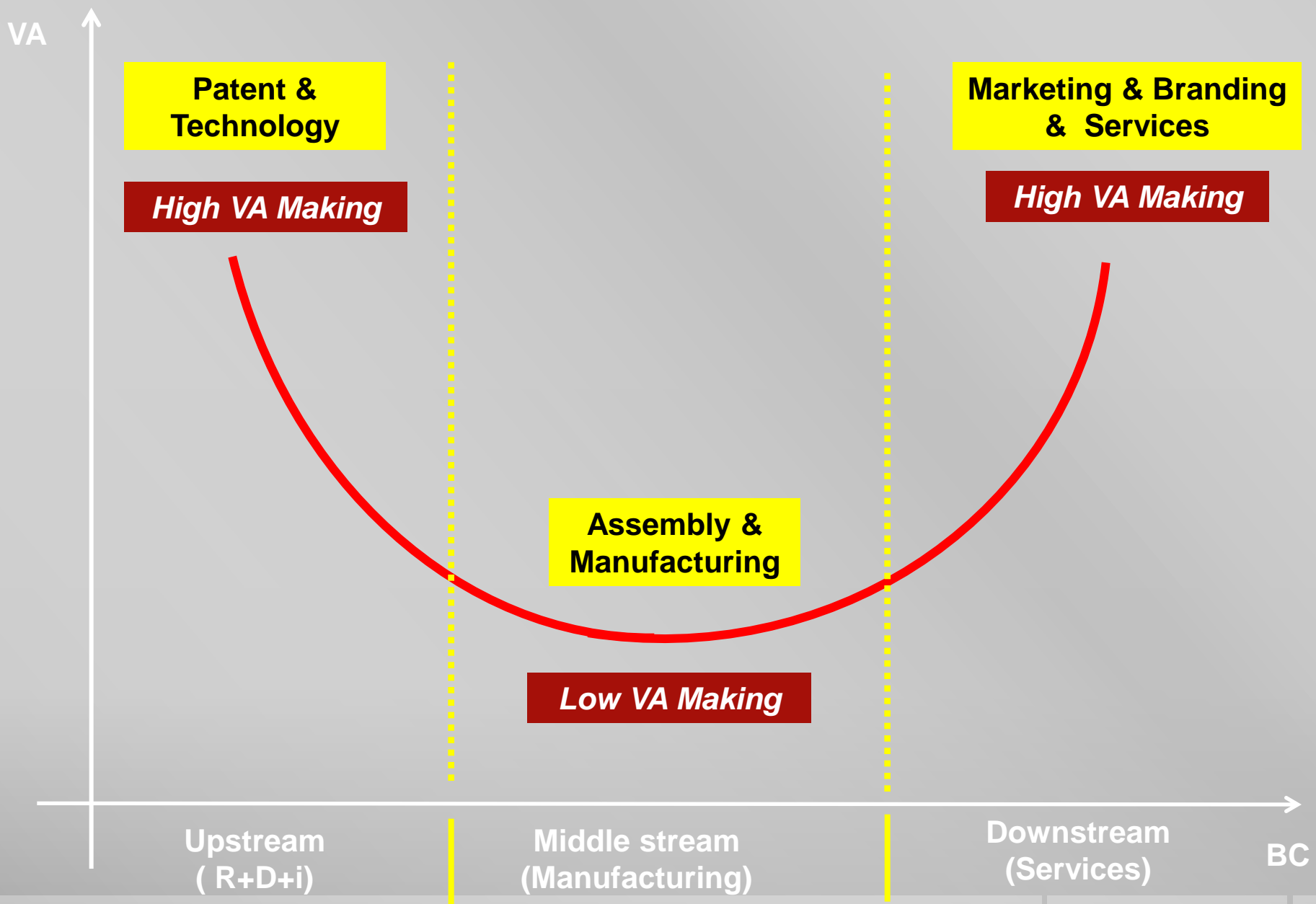
Downstream
(Services)

Business Chain

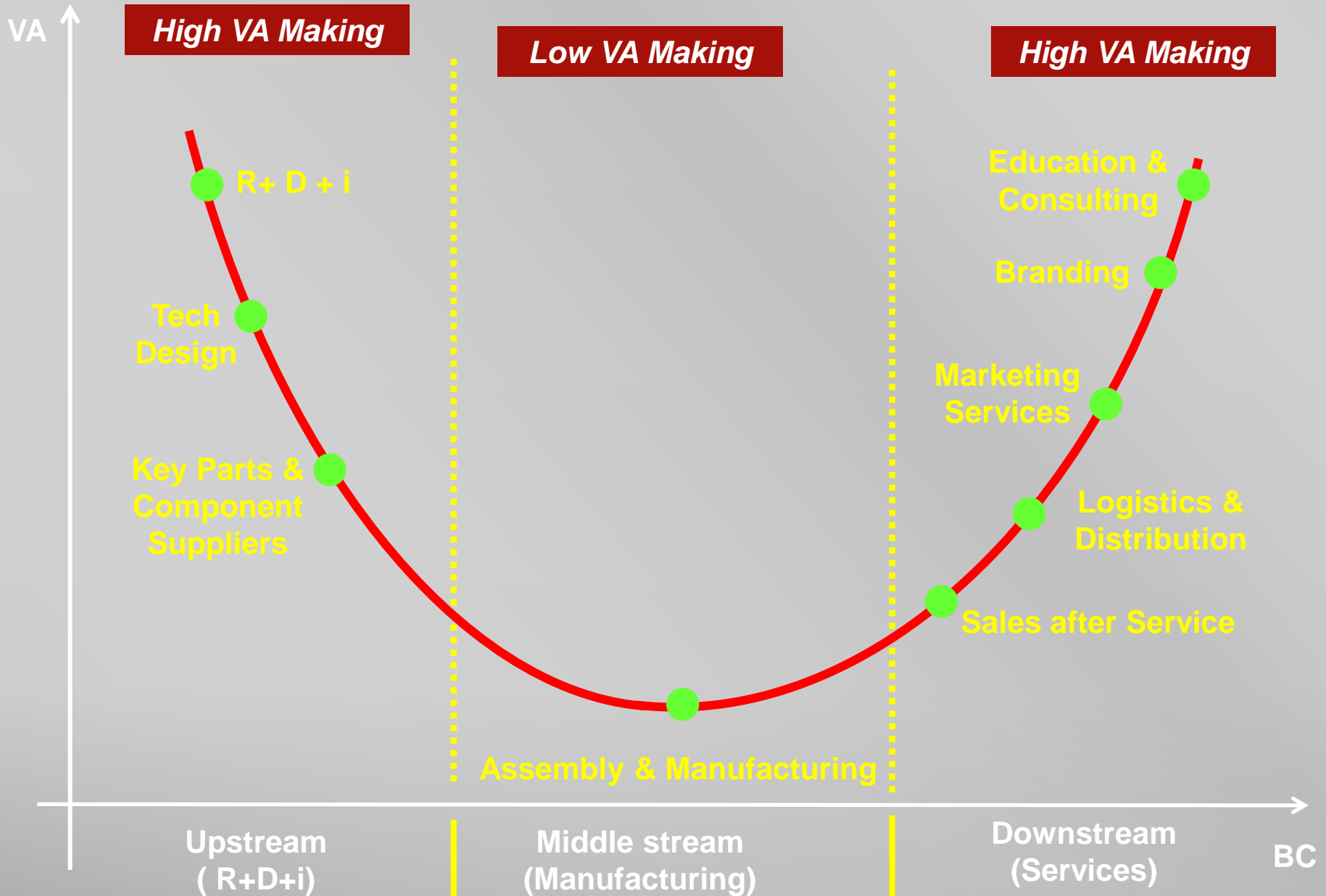
BC



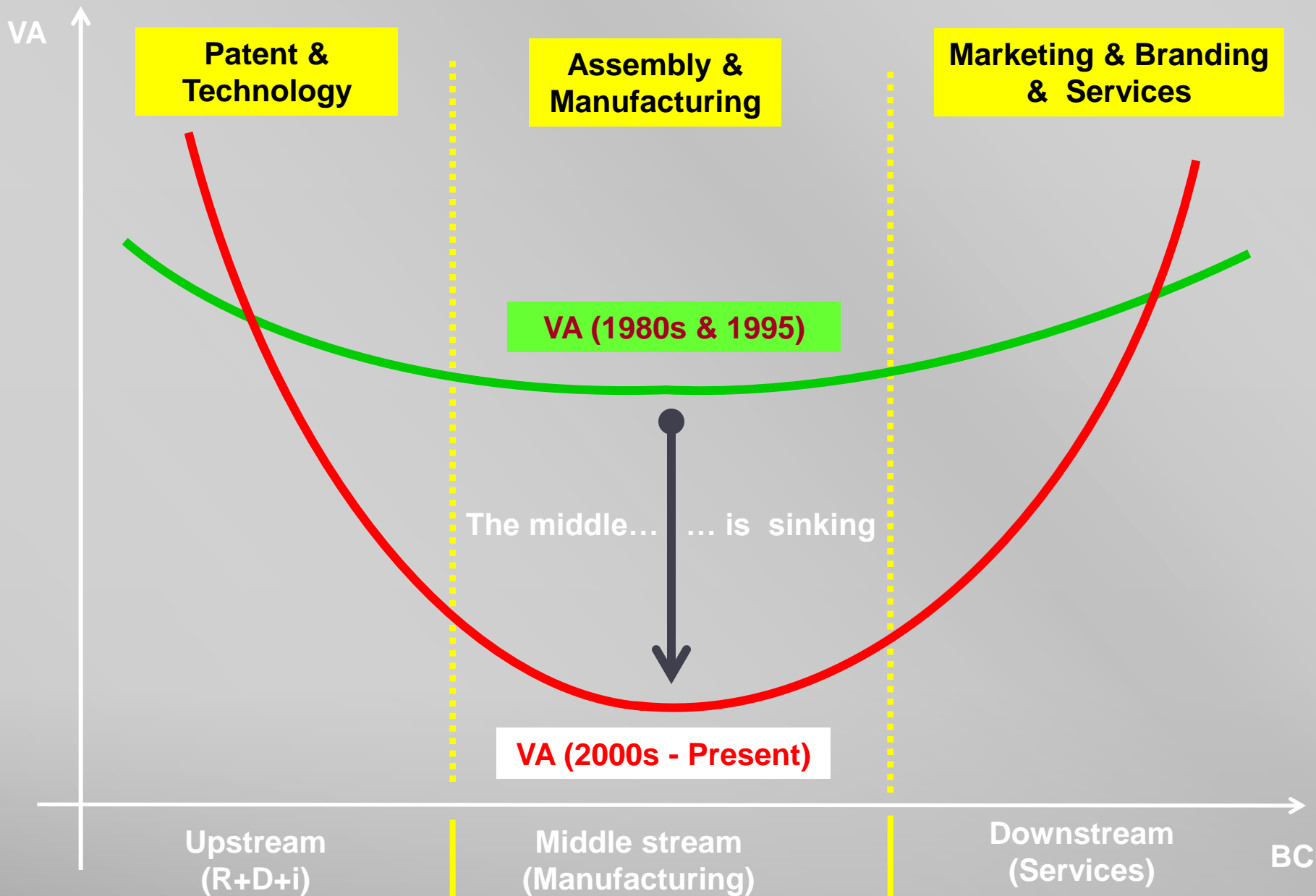
The Smile Curve: Breaking down Business Chain...



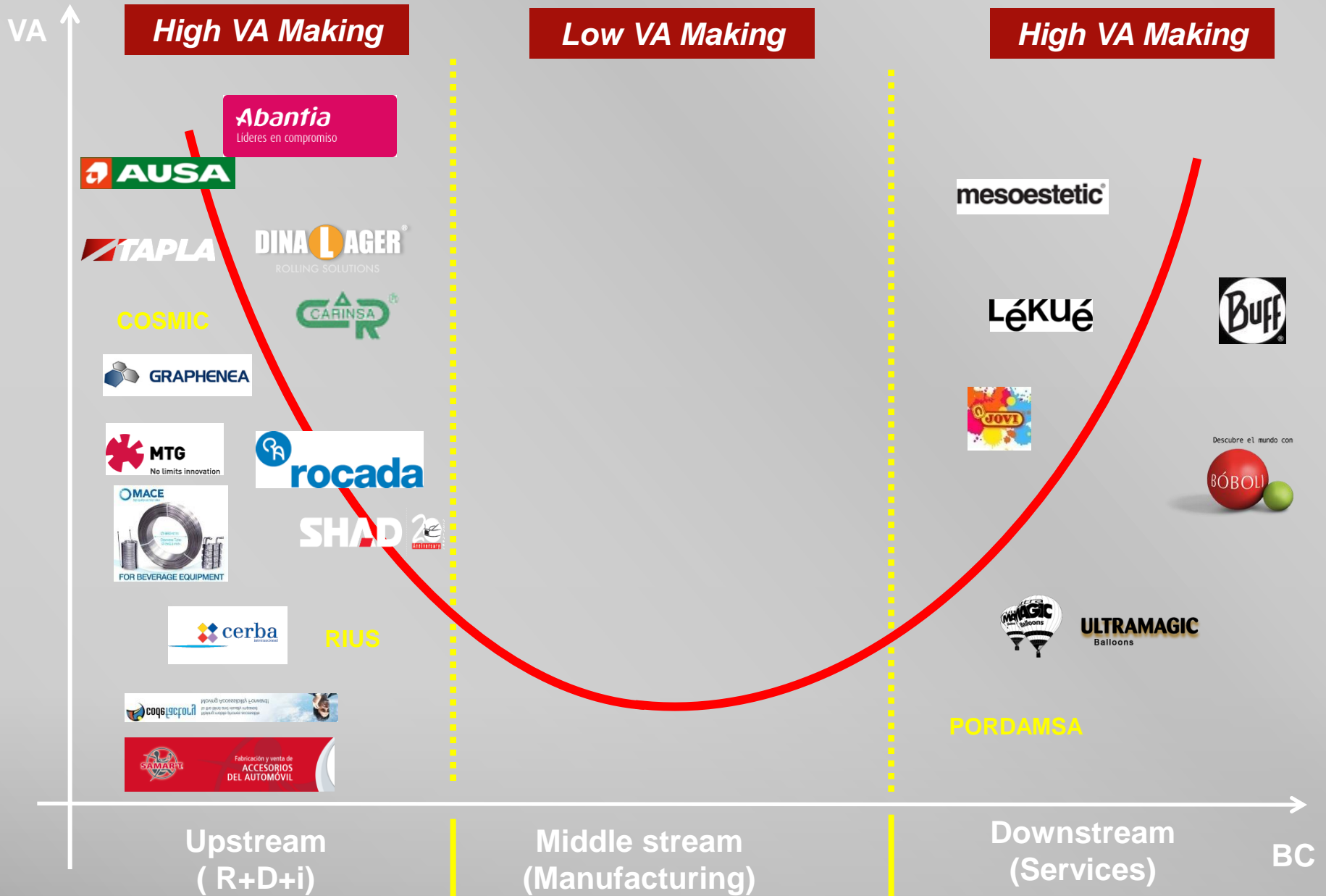
The Smile Curve: Breaking down Business Chain...



The Smile Curve: The Sinking in the middle...



Mapping Spanish Hidden Champions & Brand Champions



Chapter 4 – Competitive Advantage – Cost and Differentiation

1. The emergence of competitive advantage

But first, what is competitive advantage?

“When two or more firms compete within the same market, one firm possesses a competitive advantage over its rivals when it earns a persistent higher rate of **profit**”

(Are we talking about superior profitability? Almost... but the firm may delay current profit in favour of investment in market share, technology, customer loyalty, executive perks...)

Competitive Advantage

What are the main characteristics of a C.A?

- It must be something difficult to match – difícil de igualar.
- It has to be unique
- It must be possible to sustain it in time
- It must be superior to the competitors´

Examples of C.A.:

- Superior product quality
- Patents
- Brand, reputation
- Employees´ skills
- Location
- Customer knowledge

Chapter 4 – Competitive Advantage (C.A.)–

How does C.A. emerge?

□ External sources of change:

- changing customer demand
- changing prices
- technological change

□ Internal sources of change

- some firms have greater creative and innovative capability. Hibridación, xej.

Chapter 4 – Competitive Advantage (C.A.)–

Rule of thumb: more turbulent environment + greater differences in firms' resources and capabilities = greater dispersion of profitability

Example:

- Tobacco industry: stable external environment + similar leading firms = small profit differences.
- Toy industry: unpredictable changes in demand, technology and fashion + leading firms diff strategies = huge profit differences.

Chapter 4 – Competitive Advantage (C.A.)–

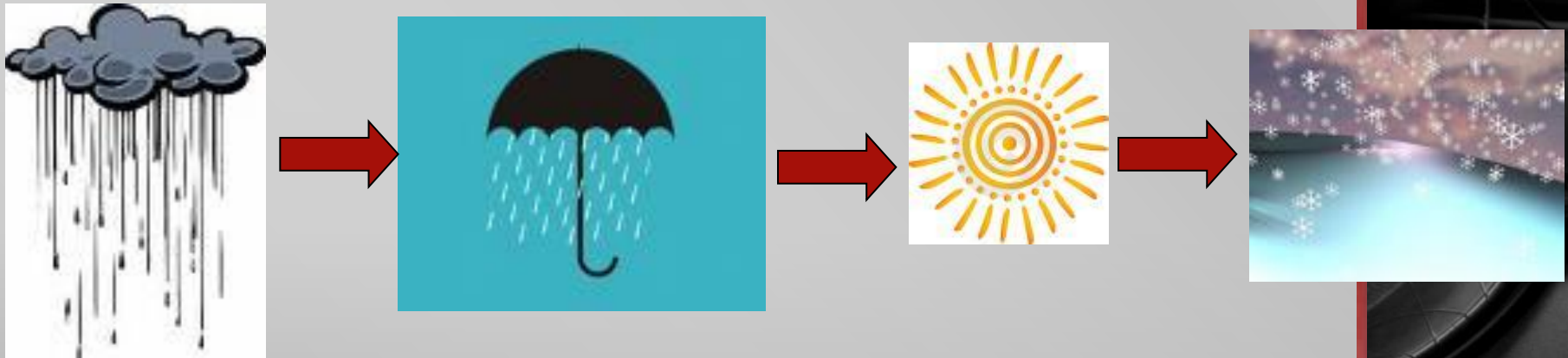
Any external change creates an opportunity for profit.

- Who will benefit from it? The firm able to respond to change the fastest: ***speed of response*** is critical to exploit a new business opportunity.



Chapter 4 – Competitive Advantage (C.A.)–

As markets become increasingly turbulent,
responsiveness to external change becomes
+ important as a source of C.A.



Chapter 4 – Competitive Advantage (C.A.)–

Example:

- Wal-Mart: business system that responds quickly to changes in demand. Decisions are taken at the store level. That means: low inventories, few stock-outs, few forced markdowns. That is their C.A.
- But what else? There has to be an internal reason. Initiative is rewarded and encouraged at all levels.

Ex. Conference on innovation...

Chapter 4 – Competitive Advantage (C.A.)–

Responsiveness means anticipated changes:

- One key resource: **information**.
- One key capability: **flexibility**.

Firms are learning to be less dependent on “conventional data and market analysis” and more dependent on “*early warning systems*”: direct relations with customers, suppliers and competitors. Ex.this week Avery: tapes in car doors
Ex. Dell Computers (order 9am delivered 9 pm following day; 10 days inventory) and Zara (3 weeks time new model delivery).

Chapter 4 – Competitive Advantage (C.A.)–

Speed through:

- manufacturing
- sales and distribution
- innovation

This is the C.A. of most Japanese industries.

This increased speed has become possible only through internet, real-time data exchange and business processes reengineering



these changes have enabled companies to reduce cycle times drastically.

Chapter 4 – Competitive Advantage (C.A.)–

Competitive process as “creative destruction”



Strategic Innovation: new ideas and new knowledge that goes a lot further than just “product innovation” or “technology innovation”.

Gary Hamel, “Leading the revolution”

From the **age of continuity** to the **age of revolution**.

Chapter 4 – Competitive Advantage (C.A.)–

Gary Hamel, world's first "**Management Lab.**" The MLab is a pioneering attempt to create a setting in which progressive companies and world renowned management scholars work together to co-create "tomorrow's best practices" today.

Goal: to radically accelerate the evolution of management knowledge and practice.

Source: www.garyhamel.com

Video:

<http://www.youtube.com/watch?v=TVX8XhiR1UY&playnext=1&list=PLC267070423129E89>

Chapter 4 – Competitive Advantage (C.A.)–

BLUE OCEAN STRATEGY

<http://www.youtube.com/watch?v=7SQDGBSjty4&feature=related>

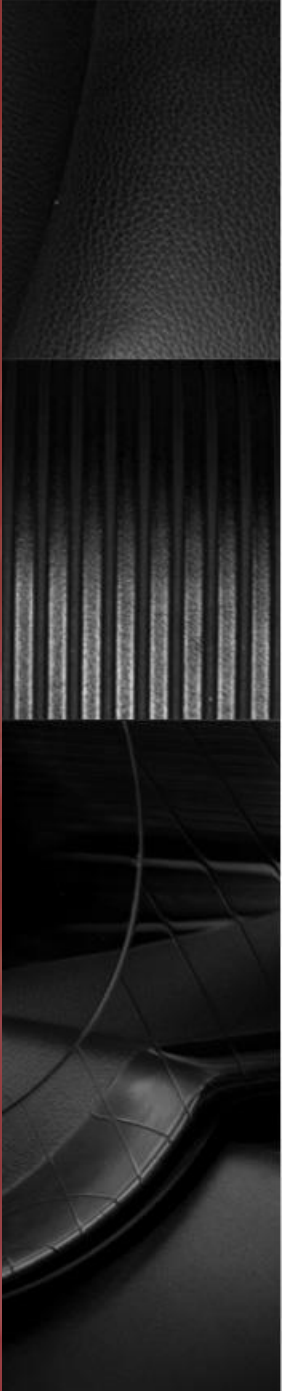
<http://www.youtube.com/watch?v=HJH0g-EPGDs>

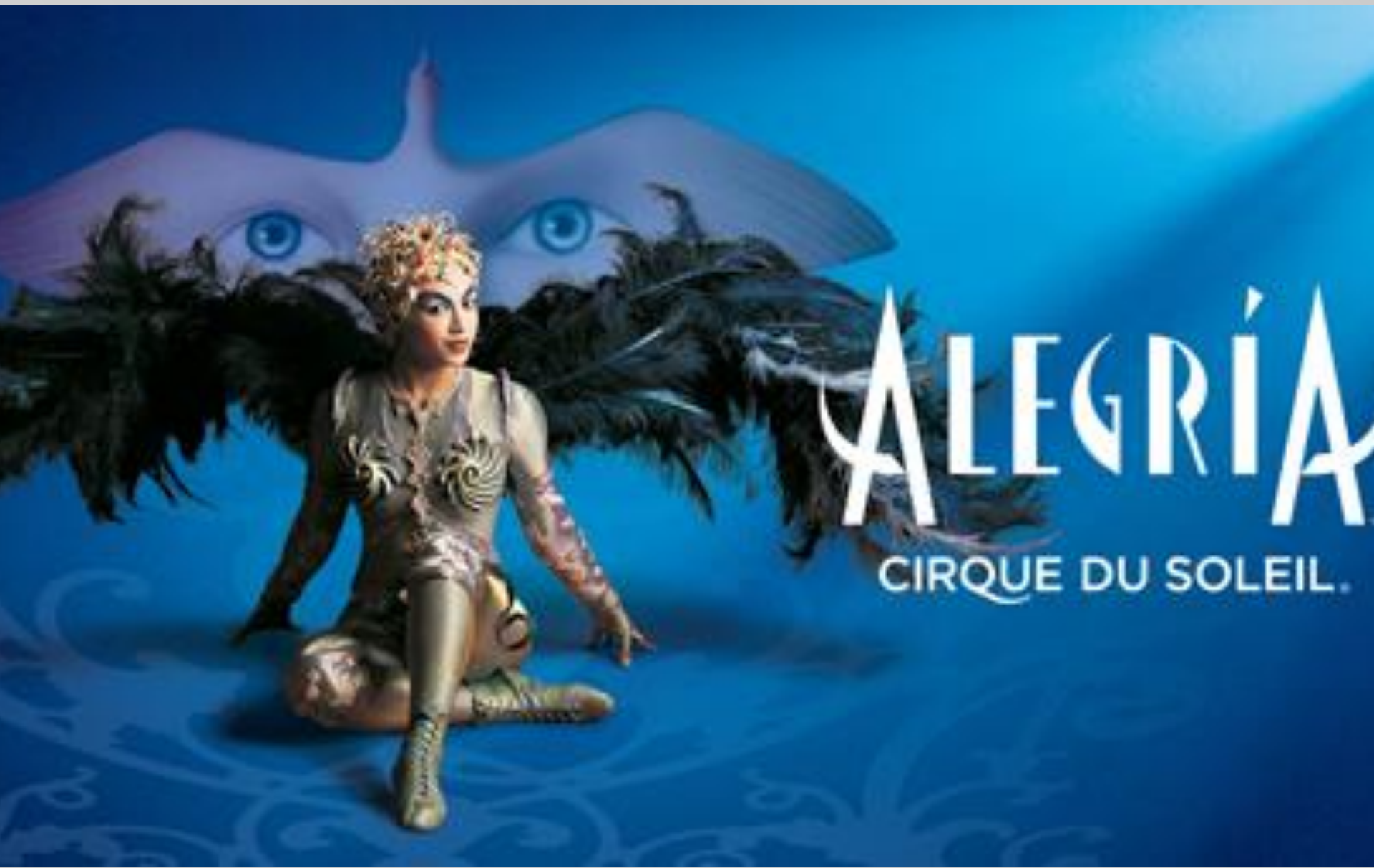
Five Forces vs Blue Ocean

<http://www.youtube.com/watch?v=V2b99iZviUk>

An aerial photograph of the ocean with vibrant turquoise and light blue waves. The water's surface is textured with small ripples and larger wave crests, creating a dynamic and colorful scene. The text is centered over the image.

Blue Ocean Strategy





Caso DACIA: http://www.lemonde.fr/economie/article/2012/09/24/avec-logan-renault-a-casse-les-codes_1764522_3234.html 5000€ 80%^{2ª} mano

- **CIRQUE DU SOLEIL**- Cirque du Soleil successfully created a new, highly-profitable market within the ailing circus industry. The company's management eliminated the main cost drivers of conventional circuses: the animals and the stars. At the same time they incorporated elements from opera, ballet and concerts.

- The result was a totally new entertainment concept targeting former non-customers: adults happy to pay for good entertainment.

Caso DACIA 5000€ 80%² a mano

Curves GYM: between Home exercise and a Traditional Women's Health Club (fun, affordable, easy to use, peer support)

Barnes & Noble

Yellow Tail Wines: Yellow Tail was developed around the year 2000, originally marketed to export countries and became the number one imported wine to the USA by 2003. Young consumers in particular tend to avoid what they consider to be confusing and pretentious [wine labels](#) characteristic of some Old World wine bottles

- **SOUTHWEST AIRLINES**

- Southwest Airlines, a US company, made history as the world's first low-cost carrier. Southwest Airlines analysed alternative industries and created new benefits for their non-customers: cost-sensitive travellers who rather drive.

The Body Shop: The Body Shop ignored most glamorous aspects of the industry. Instead The Body Shop designed its image around functionality, reduced prices and modest packaging. Increased value was given to natural ingredients, a healthy lifestyle and ethical concerns.

Chapter 4 – Competitive Advantage (C.A.)–

New concepts – new business models.

For ex. In retail- **Experiencia de compra**: Sephora (freedom, beauty and pleasure), bookstores (browsing, relaxing, coffee), traveling, *can you think of any other?*

Continual reinvention of the business model.... ... but be clear and stable with what your strategy is. *Blog: five business models... or more!*

Chapter 4 – Competitive Advantage (C.A.)–

New concepts – new business models.
For ex. In retail- **Shopping experience:**

Read Strategy Capsule 8.1
Urban Outfitters
p. 217



Chapter 4 – Competitive Advantage (C.A.)–

2. Sustaining C.A.

Once established, C.A. is subject to erosion by competition (by imitation or by innovation)

“**Barriers to imitation**” must exist. These barriers are also called *isolating mechanisms*: barriers that limit the re-balancing of the difference in profitability. According to studies, the destruction of C.A. is slow, over a decade.

It gives time to consolidate and bring up new concept B4 they copy you.

Chapter 4 – Competitive Advantage (C.A.)–

Some sectors are easier to imitate: services in general; financial services in particular.

First-mover advantage: the initial occupant of a strategic position gains access to resources and capabilities and others cannot follow. Ex. Have a patent, technology, product or design no one has (even better, legally do not have access to it).

“Success breeds success”.

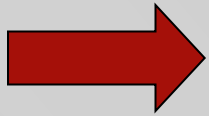
- Resources are scarce: establishment in Passeig Gracia, or highly specialised employees (Google)
- Patent license
- Reputation (W&F)
- Industry learning curve

Chapter 4 – Cost and Differentiation

Porter's two generic strategies:

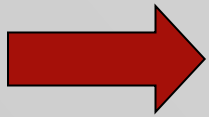
C.A. can be achieved in one of the following ways:

1. Supply identical product or service at a lower cost



Cost advantage

2. Supply a product or service that is differentiated in such a way that the customer is willing to pay a price premium (that exceeds the cost of the differentiation)



Differentiation advantage

Chapter 4 – Cost and Differentiation

similar product at lower cost → Cost advantage

C. A.

price premium from unique product → Differentiation adv.

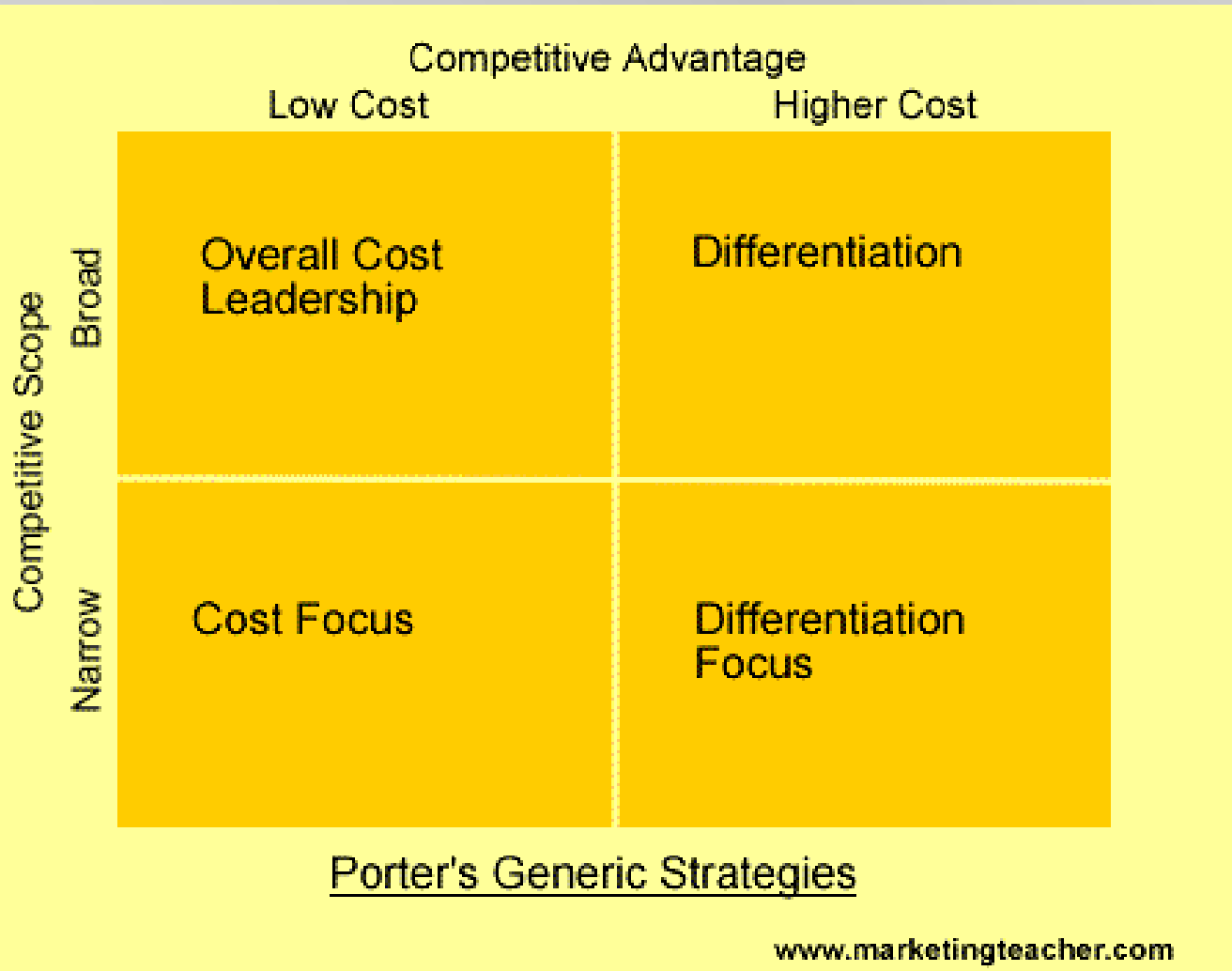
Chapter 4 – Cost and Differentiation

Cost leadership

the firm must find and exploit all sources of cost advantage and sell a standard, no-frills product.

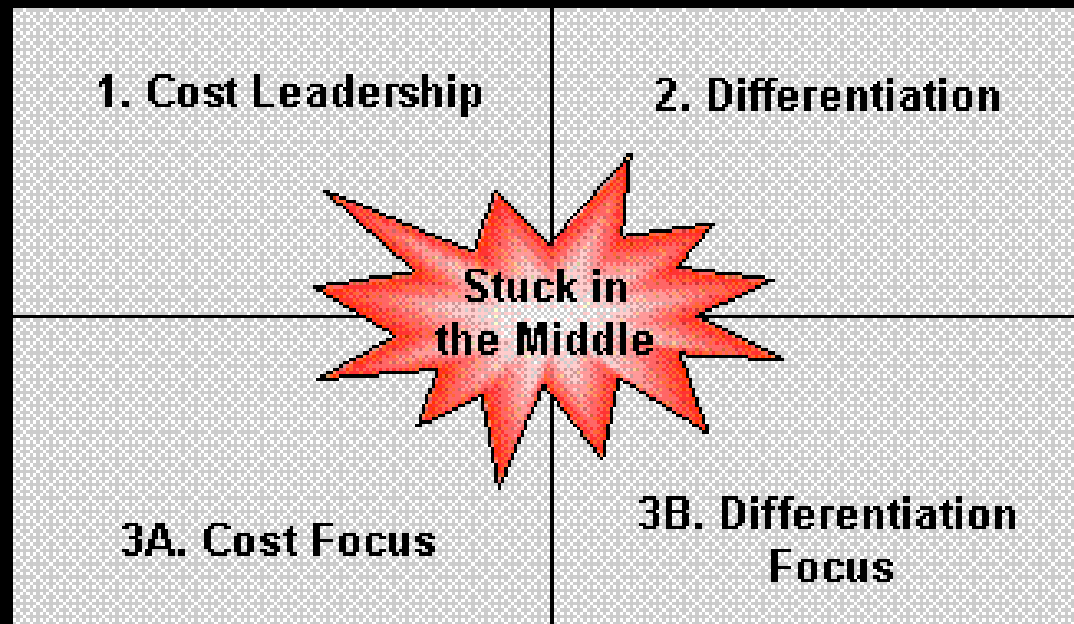
Differentiation

the firm provides sth unique beyond simply offering a low price



Porter generic strategies

© 12manage.com



Chapter 4 – Cost and Differentiation

Three generic strategies:

1. Cost leadership (Toyota, Ikea, Canon, Dell)
2. Differentiation (BA, Apple, Mercedes, Nike)
3. Focus (small companies, brand, innovation)

Important: need to define yourself. “Stuck in the middle” means for sure low profitability.

Very important: low cost does not mean your product is not differentiated.

Most industries:

- One market leader low-cost but also effectively differentiated (IKEA)
- Ability to balance low-cost with quality and technology
- Smaller rivals - focus

Focus examples

Focus Cost: “me too’s”, Bershka, low cost hairdresses, hotels on the motorway, Tata Nano (below €2,000)

Focus Differentiation: Ferrari, Singapore Airlines, luxurious goods

Chapter 4 – Cost and Differentiation

NEXT DAY:

1. Cost leadership
2. Differentiation
3. Focus A. Cost / B. Differentiation
4. Gary Hamel – “The age of revolution”
5. The strategy clock: Bowman’s strategic options

Chapter 4 – **Cost Advantage (book chapter 9)**

The experience curve: cost per unit 1980-2004, Japanese watches, UK refrigerators. P230.

The importance of market share: if an industry can expand its output more than competitors, they can move down the experience curve: widening cost differential.

Firms should put prices not on the basis of current prices but of anticipated costs (not full-cost pricing but penetration pricing).

Maximising volume by (a) offering a broad product range and (b) expanding internationally rather than restricting sales to domestic market.

Chapter 4 – Cost Advantage

The sources of cost advantage

What are the factors that determine a firm's cost position?

Seven drivers of cost advantage:

1. Economies of scale
2. Economies of learning
3. Production techniques
4. Product design
5. Input costs
6. Capacity Utilization
7. Residual efficiency

Photocopy Figure 9.1- p231: drivers of cost advantage

Case: IBM – Process Reengineering

Chapter 4 – Cost Advantage

1. Economies of scale

More production, lower unit cost. Typically associated with manufacturing – but not necessarily. Minimum Efficiency Plant Size (MEPS). Fig. 9.2 – p232

- Technical input –output relationships
- Indivisibilities (advertising for ex). Fig. 9.3 -p233
- Specialization: more efficiency, more training, less time loss. Division of labour.

Ex. Marketing is the cause why consumer goods are dominated by a few giants.

Chapter 4 – Cost Advantage

2. Economies of learning

- ✓ Cost reduction is based on members of the organisation learning how to do things.
- ✓ Repetition develops skills and routines.
- ✓ The more complex the product or service, the greater the potential for learning.
- ✓ **Documenting solutions** as a base for learning.

Chapter 4 – Cost Advantage

3. Production techniques

Re-engineering of the business processes (BPR – Business Process Reengineering) – if we could start from afresh, how would we do it?

- Combining several jobs in one
- Allow workers to make decisions
- Performing steps of a process in a natural order
- Make sense of processes
- Reduce checks and controls
- Appoint a single point of contact in the org.
- Centralization vs. Decentralization – balance.

Chapter 4 – Cost Advantage

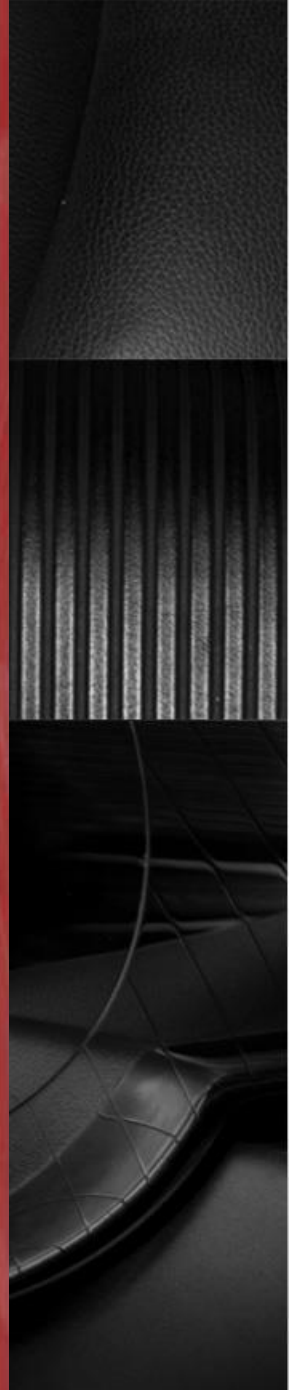
4. Product design

Cars are built in “platforms”.

Platforms can be re-used for other models.

Services can also be designed for efficiency of production...

ex. Budget Hotels in low-cost locations, identical furniture, cleaning and maintenance.



Chapter 4 – **Cost Advantage**

5. Input costs

The question is: how to lower input costs?

- Location differences (rent, labour, materials, etc)
- Ownership of low-cost supplies
- Non-union labour (?)
- Bargaining buying power (Wal Mart)

Chapter 4 – Cost Advantage

6. Capacity Utilization

What's the problem?

Underutilization in periods low demand: fixed costs have to be absorbed. Airlines, Theme Parks: all fixed costs

Overcapacity: shift work / outsourcing /

Ratio of fixed to variable costs

Fast and flexible capacity adjustment: ex. Caterpillar announced in Jan 2008 cutting 20 000 jobs. That very same day they declared sales had gone up.

Distinguish between cyclical and structural overcapacity.

Chapter 4 – Cost Advantage

7. Residual efficiency

Why an industry has a lower cost per unit than the competitor? Six reasons before plus ... *sth else*.

The “*organizational fat*” or “X-inefficiency” (inefficiency, organizational slack, institutionalised inefficiencies, demotivation, lack of management, micro-management, etc).

Eliminating excess costs is very difficult. Ex. Estevia firm.

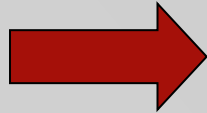
IBM case – exercise in class

Chapter 4 – Cost Advantage

In order to:

- ✓ Maximise shareholder wealth
- ✓ Divest poorly performing assets
- ✓ Boost financial performance
- ✓ Eliminate inefficiencies
- ✓ Increase accountability
- ✓ Increase speed in decision making

Some times, need to apply radical cost surgery-



1. Plant closures
2. Outsourcing components and services
3. Employment reductions (fire or lay off workers)
4. Delaying - reduce administrative overhead

Chapter 4 – Cost Advantage

Radical cost surgery- it requires normally:

Re-centralization of power

Radical cost reduction

Empowerment at high level

Avoid extensive negotiation

Sometimes through a high level *Task Force*



Chapter 4 – Differentiation

Differentiation: concerned with how a firm competes, the way in which it offers sth unique to customers.

BMW means quality. Volvo means safety.

Segmentation: a feature of the market.

Differentiation: the demand side – what our customers want

Differentiation: the supply side – our capability

Case Study, the *percolator*.