Business Unit Strategies

CHAPTER 7

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Chapter Outline

After developing a corporate-level strategy, focus shifts to how the firm's business unit(s) should compete. While the corporate strategy concerns the primary thrust of the firm—*where* top managers would like to lead it—the **business or competitive strategy** addresses the competitive aspect—*who* the business should serve, *what* needs should be satisfied, and *how* core competencies can be developed.

Another way of thinking about a business strategy is to consider whether a business should concentrate on *exploiting* current opportunities, *exploring* new ones, or attempt to balance the two. Exploitation generates returns in the short-term, whereas exploration can create forms of sustainable competitive advantage over the long run. The business strategy developed for an organization addresses this challenge.[1]

A **business unit** is an organizational entity with a mission, set of competitors, and industry. A firm that operates within only one industry is also considered a business unit. Strategic managers craft competitive strategies for each business unit to attain and sustain a competitive advantage.[2] In most industries, multiple competitive approaches can be successful, depending on the resources and capabilities.

Each business competes with a unique competitive strategy. To simplify the analysis, it helps to categorize different strategies based on their similarities into a limited number of **generic strategies**. Businesses adopting the same generic approach comprise a **strategic group**.[3] In the airline industry, for example, one strategic group might comprise carriers such as Spirit, Southwest

Business strategy A strategy delineating how a business unit competes with its rivals, also called *competitive strategy*.

Business unit An organizational entity with a unique mission, set of competitors, and industry.

Generic strategies Strategies that can be adopted by business units to guide their organizations.

Strategic group A select group of direct competitors who have similar strategic profiles.

Airlines, and Frontier that maintain low costs and offer low fares on a limited number of routes. A second strategic group might include traditional carriers such as Delta, United, and American that serve both domestic and international routes and offer extra services such as meals and first or business class options.

There can be multiple valid approaches to identifying an industry's strategic groups. Moreover, there could be one or two competitors that appear to be functioning between groups and are difficult to classify. Hence, the concept of strategic groups can help illustrate competition within an industry, but applying it is neither easy nor precise.

The challenging task of formulating and implementing a generic strategy depends on various internal and external factors. Because generic strategies are simplistic, selecting a generic approach is only the first step in formulating a business strategy.[4] Managers should fine-tune the generic strategy to accentuate the organization's unique set of resources and capabilities.[5] Two generic strategy frameworks—one developed by Porter and another by Miles and Snow—are good starting points for developing business strategies.

Porter's Generic Strategies

Michael Porter's generic strategy typology has been widely cited for four decades.[6] According to Porter's typology, a business unit must address two fundamental competitive concerns. First, managers must determine whether the business unit should focus on an identifiable subset of the industry in which it operates or serve the entire market. For example, specialty clothing stores in shopping malls adopt the focus concept and concentrate their efforts on limited product lines primarily intended for a small market niche. In contrast, many chain grocery stores seek to serve the "mass market"—or at least most of it—by selecting an array of products and services that appeal to almost everyone. The smaller the business, the more desirable a focus strategy tends to be, although this is not always the case.

Second, managers must determine whether the business unit should compete primarily by minimizing its costs relative to those of its competitors (i.e., a low-cost strategy) or by seeking to offer unique or unusual products and services (i.e., a differentiation strategy). Porter views these two alternatives as mutually exclusive because differentiation efforts tend to erode a low-cost structure by raising production, promotional, and other expenses. Porter referred to business units attempting to emphasize both cost leadership and differentiation simultaneously as "stuck in the middle."[7] While businesses capable of combining cost leadership and differentiation strategies can perform well, many fail and end up squeezed between both ends of the market.

Six configurations are possible, depending on how strategic managers in a business unit address Porter's first (i.e., focus or not) and second (low-cost, differentiation, or low-cost–differentiation) questions. A seventh approach—multiple strategies—involves the simultaneous deployment of more than one of the six configurations (see Table 7-1). Porter's original framework included only four options, the low-cost and differentiation strategies with and without focus.

TABLE 7-1 Generic Strategies Based on Porter's Typology

Emphasis on the Entire Market or Niche	Emphasis on Low Costs	Emphasis on Differentiation	Emphasis on Low Costs & Differentiation	Emphasis on Various Factors Depending on Market
Entire Market	Low-Cost Strategy	Differentiation Strategy	Low-Cost–Differentiation Strategy*	
Niche	Focus–Low-Cost Strategy	Focus-Differentiation Strategy	Focus–Low-Cost–Differentiation Strategy*	Multiple Strategies*

*These strategies have been added to Porter's typology.

Low-Cost (Cost Leadership) Strategy (*Without Focus*)

Businesses that compete with a **low-cost strategy** tend to produce basic, no-frills products and services for a mass-market composed of price-sensitive customers. Because they attempt to satisfy most or all the market, these businesses tend to be large and established. Low-cost businesses often succeed by building market share through low prices, although some charge prices comparable to rivals and enjoy a higher margin. Because customers insist on low prices for "basic" products or services, businesses using this strategy should keep their overall costs as low as possible. Efficiency is essential, as has been demonstrated by mega-retailer Walmart in the last two decades.

Low-cost strategy A generic business unit strategy in which a larger business produces, at the lowest cost possible, no-frills products and services industry-wide for a large market with relatively elastic demand.

Low-cost businesses tend to emphasize a low initial investment and low operating costs. They tend to purchase from suppliers who offer the lowest prices within a basic quality standard. Their research and development (R&D) efforts seek to enhance operational, logistical, and distribution efficiencies. Such businesses often—but not always—de-emphasize the development of new or enhanced products or services that might raise costs, and advertising and promotional expenditures will be minimized (see Strategy at Work 7-1).

Planet Fitness provides an excellent example of a low-cost strategy. Revenue in the US health-club sector increased by 44% between 2013 and 2018, reaching $32.3 billion in 2018 with a forecast to reach $43 billion by 2023. While other gyms pursue differentiation through juice bars and workout classes, Planet Fitness quadrupled its valuation between 2015 and 2019 by pursuing a low-cost strategy that includes a $10 monthly membership fee and a no-frills atmosphere. Planet Fitness had amassed over 12 million members and over 1,600 locations by 2019.[8]

Cost leaders may be more likely than other businesses to outsource or offshore production if doing so reduced costs, even if some quality control is lost as a result. They also seek the most efficient means of distribution. Successful low-cost businesses do not emphasize cost minimization to the degree that quality and service decline excessively. Extreme cost leadership can result in the production of "cheap" goods and services that customers are unwilling to purchase.

Outsourcing and offshoring can be an intricate component in a low-cost strategy, however. Many American apparel retailers relocated production activities to China in the 1990s and 2000s. Labor costs began to increase in China in the late 2000s, and by the early 2010s, Ann Taylor Stores, Coach, Guess, and others began shifting production to

Strategy at Work 7-1

The Low-Cost Strategy at Kola Real[9]

Coca-Cola and PepsiCo enjoy substantial profit margins on their soft drinks in Mexico's $15 billion market, where the two have waged intense battles for market share during the past decade. Although Coke usually came out on top, the two collectively controlled sales and distribution in almost all the country's major markets. In 2003, Coke had more than 70% of Mexican sales, compared to 21% for Pepsi. Historically, consumers in Mexico drink more Coke per capita than those in any other nation.

In the early 2000s, both well-known colas were challenged by an unlikely upstart, Kola Real (pronounced RAY-AL). Introduced in Peru in 1988 and launched in Mexico in 2001, Kola Real captured 4% of the Mexican market in its first two years and about 20% by 2015.

Bottled by the Añaños family from Peru, Kola Real lacks all the frills and endorsements associated with Coke and Pepsi. The strategy is simple—eliminate all possible costs and offer large sizes at low prices. While Coke and Pepsi spend nearly 20% of revenues on concentrates, the Añaños family makes its own. And while Coke and Pepsi spend millions on promotion and manage their fleets of attractive trucks, the Añaños family hires third parties for deliveries—even individuals with dented pick-up trucks—and relies primarily on word-of-mouth advertising. Central to Kola Real's success is the fact that price drives the purchase decisions of most Mexican cola drinkers.

The Añaños family business is known as Ajegroup and is headquartered in Lima, Peru. Ajegroup produces several other brands, including the popular caffeine-free Big Cola and Caral beer. The low-cost emphasis transcends all Ajegroup brands, enabling the company to compete on price.

lower-cost countries such as Bangladesh and Viet Nam. Developing nations often lack infrastructure, so it is essential to consider the *total* cost of producing a product, not just labor costs.[10]

Low-cost leaders depend on unique capabilities not available to rivals, such as access to scarce raw materials or a high degree of capitalization.[11] However, manufacturers that employ a low-cost strategy are vulnerable to intense price competition that drives profit margins down and limits their ability to improve outputs, augment their products with superior services, or spend more on advertising and promotion.[12] The prospect of being caught in price wars keeps many manufacturers from adopting a low-cost strategy, although it can affect other businesses as well. Other cost leaders have bought their suppliers to control quality and distribution. Price cutting in the airline industry has led to the demise of many upstarts over the years.[13]

Low costs usually, but do not always lead to low prices. Global retail giants like Walmart and Carrefour have cut costs through economies of scale to reduce prices. Walmart increasingly integrates its distribution network and emphasizes common sourcing throughout the world to shave costs and improve margins.[14] Carrefour strayed from its low-cost, low price strategy in the late 2000s, however. This shift, in concert with the economic downturn, resulted in losses for the company. Lars Olofsson joined Carrefour as CEO in 2009 and shifted the strategy back to cost containment.[15]

Occasionally, smaller rivals collaborate to generate collective scale economies to battle an industry leader. Consider the ShopRunner cooperative effort during the 2010 Christmas shopping season. Online stores like Babies 'R' Us, Rockport, RadioShack, and others teamed up to battle Amazon by offering a $79 loyalty program that includes unlimited two-day shipping and free returns. These retailers understand that high volume online shoppers account for most of the $140 billion US consumers spend online each year. They also recognize that the ongoing competitive threat from rival Amazon requires innovative and collective action that can lessen the advantage it enjoys from its massive size and scope.[16] In the Christmas shopping season, even traditional retailers like Walmart, Best Buy, and Kohl's offer free shipping to compete more with Amazon, Newegg.com, and other online retailers.[17] Best Buy adds deep discounts—particularly on Black Friday (the day after Thanksgiving)—and achieves substantial web traffic during the season. The massive price cuts hurt margins, however, as revenue *increase*s can result in a *decrease* in earnings.[18] Today, many small retailers sell their products through Amazon rather than attempting to compete directly with the behemoth. This example illustrates the advantage that low-cost firms like Amazon have when attacked on price.

Retailers in the United States Enjoy Huge Revenues on Black Friday

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Cost-cutting is not always a straightforward process, however. During the economic downturn of the late 2000s and early 2010s, low-cost restaurant Church's Chicken began filtering the shortening used for frying so that a batch could last for 14 days instead of 10, resulting in an estimated savings of $1 million per year. Shrinking the scoop size of its biscuits from three tablespoons to two saves about $1.8 million per year. Replacing the cardboard packaging for French fries with paper generates an estimated $700,000 in annual savings.[19] Of course, these savings assume that customers will not respond to these cost-cutting moves by altering their purchase behavior.

Although low-cost competitors like Church's tend to be positioned more effectively for economic slowdowns, all businesses become more concerned about costs when industry revenues decline. During this same time, Ohio-based Marco's Pizza worked with vendors to lock in transportation costs and contracted with manufacturers located closer to distribution centers to reduce freight costs. Marco's eliminated small pizza boxes at its more than 170 stores; by using CheezyBread boxes instead, Marco's saved $164,000 in one year. Kentucky-based

Strategy at Work 7-2

Walmart in India

After India relaxed its foreign investment rules in late 2012, Walmart announced it would open its first two stores in the country in 2013 and 2014. India's $490 billion retail sector was attractive, but Walmart faced several significant obstacles to success. India lacked a reliable infrastructure, making the transportation of goods throughout the country quite cumbersome and—according to government officials—causing the spoilage of about one-third of India's produce each year. Plagued by a plethora of unpaved and poor-quality roads, delivery trucks drive an average of 186 miles each day in India compared to about 500 in the United States. Regulation is more intense as well and is executed by an extensive bureaucracy financed by fees along the way. Hence, the factors that have allowed Walmart to implement a supply-chain–driven low-cost strategy in other parts of the world were lacking in India. As analyst Natalie Berg put it, "Foreign retailers in general need to be prepared to sustain losses in India for years to come. India will be quite a slow-burner for them."[20]

In 2013, Walmart ended its joint venture with Indian firm Bharti Enterprises amid difficulties working through the country's complex foreign investment regulations. At the time, international retailers in India were required to source 30% of their products from local small businesses. Walmart was unable to do so, prompting the company to leave India altogether.[21]

Walmart had planned to open 22 stores in 2012 and to become India's largest retailer by 2015, but the giant retailer only opened 5 stores. India has also been a difficult market for other international retailers. In 2001, 96% of the retailers in India were independent, local establishments. This percentage has declined but is still estimated to be 80% by 2021.[22]

Tumbleweed Restaurants shifted lower-priced and lower-cost items like tacos and burritos to the front and center of the menu, enabling patrons to spend less, but do so on higher-margin items.[23]

Trimming costs can also create other challenges for low-cost businesses (see Strategy at Work 7-2). For example, regional or commuter airlines typically pay much lower wages than their national and international counterparts. Pilots at United and other major airlines are required to log more flight hours than those at commuter airlines before stepping into the cockpit. Relaxing this requirement creates a cost advantage for commuter airlines but can also create safety concerns.[24]

Imitation by competitors often follows when the basis for low-cost leadership is not proprietary. Lego discovered this when Canadian upstart Mega Blocks began to steal market share by making colorful blocks that not only look like Legos but also snap into them and sell for a lower price. Lego responded by launching the "Quatro" line of oversize blocks aimed at the preschool market and carrying lower prices than traditional Lego playsets.[25]

Low-cost businesses are also particularly vulnerable to technological obsolescence. Manufacturers that emphasize technological stability and do not respond to new product and market opportunities may eventually find that their products have become obsolete.

Focus–Low-Cost Strategy

The **focus–low-cost strategy** emphasizes low overall costs while serving a narrow segment of the market, producing no-frills products or services for price-sensitive customers in a market niche. Ideally, the small business unit that adopts the focus–low-cost strategy competes only in distinct market niches where it enjoys a cost advantage relative to large, low-cost competitors.

Focus–low-cost strategy A generic business unit strategy in which a smaller business keeps overall costs low while producing no-frills products or services for a market niche with elastic demand.

The focus concept is not complicated but can be confusing in practice. In general, a business rejects a focus approach when it attempts to serve *most* of the market. In practice, virtually every company "focuses" efforts to some extent. Because *most* is a subjective term, scholars sometimes disagree on whether a specific business is pursuing a focus strategy.

Sharp Shopper is a small, no-frills grocery outlet that sells surplus food items. Although targeted to low-income consumers, many middle-income earners shopped there during the economic downturn of the late 2000s and early 2010s. Sharp Shopper cuts costs by purchasing large quantities of discontinued products and those past the "best if eaten by" date at substantial discounts and passing the savings along to consumers. The surplus-food retail segment has grown in recent years, but its size is not known because most competitors in the sector—like Sharp Shoppers—are privately held and independent.[26] In 2020, Sharp Shopper operated six stores in Pennsylvania and three in Virginia.

Dollar stores and other deep-discount retailers performed relatively well in the late 2000s and early 2010s because low prices were attractive to low-income consumers. Price competition among discounters is fierce, however. For example, more than half of Family Dollar's customers receive government assistance, and many of them are experiencing higher payroll taxes and wage stagnation. As a result, Family Dollar and other retailers are under pressure to cut costs and lower prices constantly.[27]

Global shippers like UPS and FedEx are facing a growing threat from small, regional shippers like LaserShip Inc., Pitt Ohio, and OnTrac that emphasize cost reductions. Regional shippers contract with large customers like Amazon to deliver packages in limited areas for 20% to 40% less than national shippers charge. These shippers form networks, with two or more often working together to deliver a package. They concentrate on high volume in select geographical areas to cut costs below those of the delivery giants. Regional shippers account for only a small percentage of the delivery market, but they are on the rise.[28]

Like low-cost businesses, focus–low-cost businesses are vulnerable to the intense price competition that frequently occurs in markets with no-frills outputs. To deter price competition, they must continuously search for new ways to trim costs. The Irish no-frills air carrier Ryanair has surpassed Southwest in this regard. Passengers are required to pay for all food, drinks, newspapers, and even blankets, and they pay extra fees to check in at the airport instead of doing so online. Employees pay for their training and uniforms. The airline also enforces a strict no-refund policy, even if the airline cancels a flight. Even with very low costs, Ryanair faces constant pressure from other low-cost airlines and traditional carriers alike.[29]

Frontier Airlines has employed a focus–low-cost strategy as part of a turnaround (corporate) strategy. After being purchased by an investment firm, the troubled discount carrier implemented a host of cost-cutting measures, such as outsourcing over a quarter

Ryanair Is One of Europe's Successful Low-Cost Airlines

Source: Alla Greeg/shutterstock.com

of its workforce; adding more seats to its aircraft; and charging extra for seat reservations, carry-on bags, and soft drinks. Frontier turned a loss into a $129 million profit in 2014 and has continued to grow. The US Department of Transportation has received numerous customer complaints about Frontier over the years. Frontier executive Barry Biffle laments the service issues but believes customers are starting to understand the realities of cost-cutting and keeping fares as low as possible.[30]

Other low-cost airlines have focused their efforts on limited geographical regions. With operations in Hungary, Bulgaria, and Ukraine, Wizz Air specializes in transporting Central and Eastern Europeans to Britain and Ireland, where many seek and find better-paying jobs. CEO Jozsef Varadi sees buses—not other airlines—as their primary competition.[31]

Like low-cost businesses that do not adopt a focus approach, focus–low-cost businesses are particularly vulnerable to technological obsolescence. Those that seek technological stability and do not respond to new product and market opportunities may eventually find that their products have become obsolete.

Differentiation Strategy (*Without Focus*)

Businesses that employ the **differentiation strategy** (without a focus orientation) produce and market to the entire industry products or services that can be readily distinguished from those of their competitors. Because they attempt to satisfy most buyers, these businesses tend to be large and established. Differentiated businesses often try to create new product and market opportunities and have access to the latest scientific breakthroughs because technology and flexibility help companies keep pace with new developments in their industries.

Differentiation strategy A generic business unit strategy in which a larger business produces and markets to the entire industry products or services that can be readily distinguished from those of its competitors.

The potential for differentiation is often a function of a product's physical characteristics. Tangibly speaking, it is easier to differentiate an automobile than bottled water. However, intangible differentiation can extend beyond the physical attributes of a product or service to encompass everything associated with the value perceived by customers. Because customers *perceive* significant differences in their products or services, they are willing to pay average to high prices for them.

There are many prospective bases for differentiation. The most common basis is the product. The Toyota and Lexus business units are owned by the same firm (Toyota), and many of their vehicles share common parts and designed. However, Lexus automobiles have been differentiated on product features and are known for their attention to detail, quality, and luxury feel. Different dealer networks also reinforce the distinctions.

United and other airlines have attempted to differentiate their businesses by offering services like in-flight Internet access and online baggage tracking.[32] However, an analysis of policies of the big three airlines in the United States—American, Delta, and United—reveals strategic similarities. The three have all but have abandoned international first-class service. Their aircraft, frequent flier programs, seats, legroom, and snacks are strikingly similar. When fares change at one of the three airlines, the other two usually follow.[33]

Speed can also be a key differentiator in terms of product development cycles, customer responsiveness, and product delivery. For example, surveys suggest that about two-thirds of Americans consider the speed of service when they decide where to dine out. Speed has been an essential part of Starbucks' competitive strategy but became a problem when service slowed after breakfast sandwiches were added to its product line in the mid-2000s. Adding these food items broadened Starbucks' appeal but slowed service in a segment of the market where seconds count. Starbucks has deemphasized speed in recent years, focusing more on product quality and a superior experience. In contrast, rival Caribou Coffee still emphasizes speed, producing a small coffee-of-the day in only six seconds.[34]

Timing can also be a key factor because first movers are more able to establish themselves in the market than those who come later, as was seen for many years with Domino's widespread introduction of pizza delivery.[35] Of course, pizza delivery is standard today, with few consumers aware that Domino's pioneered the approach on a large scale. Other factors, such as partnerships with other firms, location(s), and a reputation for service quality, can also be necessary (see Strategy at Work 7-3).

Strategy at Work 7-3

First-Mover Status at Radio Shack

First-mover status can contribute to differentiation but is not always an advantage. When the environment changes, first movers may struggle to shed an outdated business model while customers perceive them as stodgy or old-fashioned. Radio Shack has struggled with this reality for the last decade. Founded in 1921, Radio Shack was the first national chain of its kind, specializing in consumer electronics mostly geared toward enthusiasts.

Today, the consumer electronics industry is dominated by the likes of Best Buy, Amazon, and even Walmart. Although Radio Shack has attempted to refocus its efforts on mobile phones and everyday end users, many consumers still believe they must go elsewhere to find trendy and innovative products. As one franchisor put it, "The perception is that we carry nothing up-to-date and it is for people who build their own transistor radios."[36] Radio Shack declared bankruptcy multiple times in the 2010s. The once-dominant retailer operated about 500 stores in 2020.

Industry leadership is a fluid concept. When a first mover is surpassed in terms of technology, performance, or service, its leaders must devise a strategy to reclaim industry prominence or survive as a smaller, niche-oriented business. BlackBerry faced this dilemma in the early 2010s after the development of Apple and Android operating systems decimated BlackBerry's market share among smartphones. Losses mounted, however, and it was apparent that BlackBerry would not regain its industry prominence. In 2013, newly elected BlackBerry director Bert Nordberg began divesting nonessential assets and concentrating on the enterprise business niche. "But being a niche company means deciding to be a niche company," Nordberg explained. "Historically, BlackBerry has had larger ambitions. But battling giants like Apple, Google, and Samsung is tough."[37] BlackBerry still operates today but no longer produces smartphones. A Chinese company (TCL) uses the BlackBerry name, however.

Manufacturers and retailers are always seeking to tap into more sophisticated markets where customers are less price conscious and more willing to pay extra for products and services of perceived higher quality. Examples abound in the fast-food industry. Retailers typically trade down over time by offering lower-quality products and services at lower prices. In the late 2000s and early 2010s, McDonald's demonstrated that trading up is possible by introducing upscale coffee, smoothies, oatmeal, and salads in remodeled restaurants containing leather chairs, couches, and flat-screen TVs. Other fast-food restaurants have also borrowed concepts from Chipotle Mexican Grill, Panera Bread, and some of the other players in the more upscale "fast-casual" segment of the market. Yum Brand's Taco Bell introduced a "Cantina Bell" line of chef-inspired Chipotle-like burritos and salad bowls. Wendy's launched a bacon cheeseburger made with sautéed (not canned) mushrooms. Arby's introduced deli sandwiches featuring meats carved fresh in the store. These chains hope that their higher-end offerings can wean customers away from low-margin value menus toward their higher-priced, higher-margin offerings.[38]

When customers are relatively price insensitive, a business may select a differentiation strategy and emphasize quality throughout its functional areas. The purchasing department emphasizes the quality and appropriateness of supplies and raw materials over their per-unit costs. The R&D department emphasizes new-product development, not cost-cutting.

Differentiation can be a difficult challenge in many industries and product lines. Consider toothpaste. Proctor & Gamble's Crest brand was easily distinguished from its rivals when it became the only fluoride toothpaste in 1960. Today, hundreds of brands are sold worldwide, including many Crest variations. Hence, highlighting the distinctiveness of a given brand can be very difficult to accomplish. Many firms like P&G are seeking to reduce the number of different brands and types to reduce buyer confusion, a problem reminiscent of the commoditization phenomenon discussed in Chapter 4.[39] However, more brands often result in more shelf space, so these manufacturers have an incentive to keep introducing new brands.

Differentiated businesses are vulnerable to low-cost competitors offering similar products at lower prices, especially when the basis for differentiation is not well defined, or customers do not value it. This vulnerability is especially acute during economic downturns when buyers are more aware of prices. Private-label or store-branded items—from food to consumer electronics—increased in popularity during the economic decline of the late 2000s and early 2010s. Sales at food producers like Kraft, Heinz, and ConAgra declined approximately 4–6% at the peak of the recession, while private-label producers enjoyed an increase of about 10%.[40] Even Best Buy expanded its production of house brands for products such as televisions, flash drives, and cables.[41]

Focus-Differentiation Strategy

Firms employing the **focus-differentiation strategy** produce highly differentiated products or services for the specialized needs of a market niche. At first glance, the focus-differentiation approach may appear to be a less attractive strategy than the differentiation strategy without focus because the former consciously limits the set of customers it seeks to target. In some cases, however, large business units are not interested in serving smaller, highly defined niches. Unique market segments often require distinct approaches.[42]

Focus-differentiation strategy A generic business unit strategy in which a smaller business produces highly differentiated products or services for the specialized needs of a market niche.

Firms can focus their efforts in different ways. Popular retailer Cabela's has even successfully targeted its efforts to men who do not like shopping. The Cabela's in Michigan draws an estimated six million visitors to its retail store each year, mixing its outdoorsman-oriented merchandise with an aquarium, an indoor waterfall stocked with trout, and realistic nature scenes. As a result, Cabela's has secured a customer base primarily ignored by other retailers.[43]

Employing a focus-differentiation strategy can mean bucking a broad trend to satisfy a market segment with distinct preferences. Some retailers in the United States sell only American-made products, a difficult challenge in today's global marketplace. The Made in America Store, which opened in 2010, sells a variety of products online and in five stores in New York. Claiming "American made" is not good enough for head merchandise buyer Rob Whalen, who requires suppliers to sign letters attesting to their domestic purity.[44]

The cost leadership strategy at Planet Fitness—documented earlier in this chapter—has been mostly successful for the fitness club. Launched in 2012, New York–based Peloton has also generated success with a niche-differentiation strategy that focuses on consumers willing to spend thousands of dollars on exercise machines and monthly access fees required to stream videos of classes at home.[45]

Viking Range Corporation refused to depart the United States in search of lower production costs. Viking operates four plants in Mississippi that produce gas ranges, refrigerators, wine coolers, outdoor grills, and dishwashers. Its products sell at high prices but satisfy a quality-oriented consumer. Viking sees itself more as a culinary company than as an appliance manufacturer.[46]

In the service sector, the number of attorneys focusing on specialized clients continues to increase. One such group targets husbands who fear reprisals and legal hurdles in divorce battles over child custody, property, and finances. Some in the "divorce for men" niche have struggled to find attorneys with expertise on the types of issues they could face in a bitter separation. A small number of attorneys began serving this clientele in select markets in the 1970s and 1980s. Today, firms like Cordell & Cordell promote their services exclusively to male clients throughout the United States.[47]

The focus-differentiation approach can be appropriate for retailers battling big boxes like Walmart that enjoy economies of scale. Instead of trying to be like Walmart, grocers like Kroger, Publix, and Whole Foods Market offer less hectic stores, better selections of certain food products, and greater convenience, competitive factors Walmart cannot easily duplicate.[48]

Many stores target consumers who do not enjoy grocery shopping or lack time to do so by emphasizing online grocery sales. The concept has enjoyed success in the United Kingdom, where an estimated 7% of customers shop for groceries online. Only 3% of grocery sales in the United States are online, but the percentage is increasing.[49]

As mentioned earlier, categorizing a business strategy as focus-oriented can be difficult, as all businesses—large and small—seem to tailor their offerings to various groups of prospective buyers. The high prices that often accompany a focus-differentiation approach are acceptable to specific customers who need product performance, prestige, safety, or security, primarily when only one or a few businesses cater to their needs. As such, focus-differentiation is most appropriate when market demand is inelastic because high-cost products are often required to support the specialized efforts to serve a limited market niche. As a result, cost reduction efforts, while always desirable, are not emphasized.[50]

A strong niche or focus orientation can create challenges, however. The market size is limited. In a down economy, buyers may opt for less expensive mainstream offerings.

Low-Cost–Differentiation Strategy

Low-cost-differentiation strategy A generic business unit strategy in which a larger business unit maintains low costs while producing distinct products or services industry-wide for a large market with a relatively inelastic demand.

Scholars and practitioners debate the feasibility of pursuing low-cost and differentiation strategies simultaneously. Porter initially suggested that implementing a **low-cost–differentiation strategy** leaves a business "stuck in the middle" because actions designed to support one strategy tend to work against the other. Because differentiating a product can be costly, it can erode a firm's basis for cost leadership. Also, many cost-cutting measures may be directly related to quality or other bases of differentiation. Following this logic, a business should choose *either* low-cost *or* differentiation, but not both.[51]

Others contend that cost leadership and differentiation are not necessarily mutually exclusive.[52] For example, some businesses begin with a differentiation strategy and integrate low costs as they grow, developing economies of scale along the way. Other businesses seek forms of differentiation that also provide cost advantages (see Strategy at Work 7-4).

Competing solely on differentiation or focus-differentiation can be challenging over the long term. Whole Foods grew into a *Fortune 500* company with such a strategy but shifted gears as mainstream grocery stores and wholesale clubs entered the organic food segment with more modest costs and prices. A group of activist investors amassed an 8.8% stake of the company in early 2017, prompting Whole Foods to adopt standard practices such as loyalty cards to track customer buying habits, centralized product purchasing to improve efficiency and lower costs, and promotional sales and discounts.[53] Whole Foods was acquired by cost-conscious Amazon later in the year, and price cuts followed.

JetBlue Airways, launched in 2000 to provide economical air service among a limited number of cities, has minimized costs by such measures as squeezing more seats into its

Strategy at Work 7-4

The Low-Cost–Differentiation Strategy at McDonald's[54]

McDonald's has combined cost leadership and differentiation successfully over the years. The fast-food giant was known initially for consistency across stores, friendly service, and cleanliness. These bases for differentiation catapulted McDonald's to market-share leader, allowing the firm to negotiate for beef, potatoes, and other critical materials at the lowest possible cost. This unique combination of resources and strategic attributes has placed McDonald's in an enviable position as an undisputed industry leader. It faces constant competitive pressure from differentiated competitors emphasizing Mexican, healthy, or other distinct product lines. Its McCafé products are less expensive than those at upscale rival Starbucks. McDonald's has continued to emphasize its value menu while developing new, higher-margin items and selling breakfast 24 hours a day.

McDonald's has undergone many changes since the early 2010s. In 2017, the firm announced a shift away from menu expansion and back to a focus on its identity as an affordable fast-food chain. The transformation included the introduction of fresh (i.e., not frozen) beef for its Quarter Pounder sandwich. The strategic change was triggered by a customer survey that showed McDonald's was losing customers to other fast-food chains, not to fast-casual restaurants as previously believed. As the senior vice president of corporate strategy and business development put it, "We don't need to be a different McDonald's, but a better McDonald's.[55]

planes, selling its tickets directly to customers, and shortening ground delays. Although commonly seen as a discount airline, JetBlue has also distinguished itself by providing new planes, satellite television on board, and leather seating. Hence, JetBlue's differentiation efforts increased its load factor (i.e., the average percentage of filled seats), reducing its per-passenger flight costs.[56]

Evidence of the combination strategy can be seen throughout the world. Traditionally, the automobile market in China was divided into two distinct categories. Local low-cost producers such as Chery Automobile, Zhejiang Geely, and BYD produced inexpensive vehicles for frugal customers, while foreign producers like Nissan and General Motors have targeted elite customers. As the Chinese middle class expanded, however, low-cost producers have developed more distinctive, higher-quality offerings, while enticing foreign firms to produce more less-expensive models. Prompted by market changes, many carmakers have shifted to a combination strategy.[57]

While a low-cost–differentiation strategy can prove effective, Porter's point is valid because implementing a combination strategy is generally more difficult than either cost leadership or differentiation. A combination strategy often begins with differentiation based on high-quality products or services. Lots of satisfied customers can result in a larger market share, providing economies of scale that permit lower per-unit costs in purchasing, manufacturing, financing, research and development, and marketing (see Strategy at Work 7-5).

The failure of the $2000 Tata Nano illustrates a potential pitfall of the low-cost strategy and a reason why combining cost leadership and differentiation—at least to some extent—is often a good idea. India's fourth-largest automaker Tata Motors introduced the stripped-down Nano in 2009 as a highly economical solution for new entrants in developing nations seeking a car. As it turns out, the Nano kept costs *too low*. Customers in India and other countries may demand low prices, but they do not want a "cheap" car. After sluggish sales, Tata responded in 2013 with a $2500 version that contains a four-speaker stereo with Bluetooth connectivity, hubcaps, and chrome trim. The Nano sold for about $3400 in 2020. Tata hopes that customers seeking a low-priced car will be more willing to pay a little more for one that does not feel as much like one.[58]

Combining low cost and differentiation can be a challenge, however. Cheap-chic discounter Target has found a comfortable balance, offering higher quality than Walmart at operational costs and prices below those of traditional department stores. In the early 2010s—prompted by a weak economy—Target placed a greater emphasis on food items and low prices. Customers did not respond positively, and sales growth during this period

Strategy at Work 7-5

Competitive Strategy in the Fast-Food Industry[59]

Although fast food in the United States has long been considered an economical lunch or dinner option, restaurants have attempted to differentiate their products and create brand loyalty among consumers over the years, with varying degrees of success. "Value menus" and "dollar menus" were introduced in the 1990s, whereby restaurants offered a limited number of its sandwiches and other items at special prices for cost-conscious consumers. Initially, this move was a necessary means of serving consumers during an economic downturn.

While offering some sandwiches at or near the one- and two-dollar price points, many restaurants also offer—and heavily promote—highly differentiated products that cost much more. Managers hope that consumers lured in for the special prices will "move up" to the higher-priced items when it is time to order.

Value menus jeopardize margins, however. Fast-food chains have attempted to wean their customers away from value menus for decades but to little avail. High-end sandwich chains like Chipotle and Panera Bread Company avoid value menus, emphasizing fresh bread and ingredients to an increasingly health-conscious market. These restaurants were a "spin-off" from the fast food industry and are commonly known today as "fast-casual." The strategies implemented by different, successful fast-food and fast-casual players demonstrate the full range of viable approaches in the restaurant sector.

TABLE 7-2 Pursuing Low Costs and Differentiation Simultaneously

1. Commitment to quality
2. Differentiation on low price
3. Process innovations
4. Product innovations
5. Value innovations

lagged behind that of both department stores and discount rivals. Some retail analysts suggested that Target's cool image suffered when promotional efforts accentuated low prices, driving customers interested in quality to department stores and those interested in low prices to other discounters. As the economy rebounded, Target began to grow at a faster pace and consistently beat sales expectations in the late 2010s.[60]

A business can pursue low costs and differentiation simultaneously through five primary means: commitment to quality, differentiation on low price, process innovations, product innovations, and value innovations (see Table 7-2). First, a commitment to quality throughout the business organization not only improves outputs but also reduces costs involved in scrap, warranty, and service after the sale. **Quality** refers to the features and characteristics of a product or service that enable it to satisfy stated or implied needs.[61] Hence, a high-quality product or service conforms to a predetermined set of specifications and satisfies the needs of its users. In this sense, quality is based on *perceptions* and is a measure of customer satisfaction with a product over its lifetime, relative to customer satisfaction with competitors' product offerings.[62]

Quality The features and characteristics of a product or service that allow it to satisfy stated or implied needs.

Building quality into a product does not necessarily increase total costs because the costs of rework, scrap, and servicing the product after the sale may decline, and the business benefits from increased customer satisfaction and repeat sales, which can improve economies of scale. The emphasis on quality improvement programs initiated in the 1990s sought to enhance product and service quality and increase customer satisfaction by implementing a holistic commitment to quality, as seen through the eyes of the customer. When properly applied, an emphasis on quality can improve customer satisfaction while lowering costs.[63]

Second, a below-average price can also be a basis for differentiation. Here, low prices should be distinguished from low *costs*. *Price* refers to the transaction between the company and its customers, while *cost* refers to the expenses incurred when a company produces a good or service. Firms with low production costs do not always translate these low costs into low prices. Anheuser-Busch InBev, for example, maintains one of the lowest per-unit production costs in the beer industry but does not offer its beers at a low price. However, many firms that achieve low-cost positions also lower their prices because many of their competitors may not be able to afford to match their price level. These firms are combining low costs with a differentiation based on price.

Third, **process innovations** increase the efficiency of operations and distribution. Although these improvements often lower costs, they can also enhance product or service differentiation. For example, the recent emphasis on eliminating processes that do not add value has not only cut costs for many businesses but has also increased production and delivery speed, a critical form of differentiation.

Process innovations A business unit's activities that increase the efficiency of operations and distribution.

An emphasis on sustainable production can be viewed as a form of process innovation. Some argue that an emphasis on environmental friendliness creates competitive problems by driving up costs, but this is not always true. While sustainable production practices can be costly at the outset, they can also save energy, eliminate waste, and improve packaging efficiency over the long term, depending on the situation. By embracing the notion of sustainable development where economically feasible, top managers can position their firms for long term cost reductions and competitive advantage.[64]

Discussed earlier in this chapter, speed of service can be part of a successful combination strategy. Restaurant customers waiting for their food utilize seating that could be used by other customers. In this respect, restaurants seeking to develop economies of scale and higher volume (i.e., a low-cost strategy) can benefit by serving patrons more quickly and freeing up tables. High-end restaurants typically promote a relaxed dining experience, so emphasizing service speed is not best for all competitors.

Fourth, **product innovations** are typically presumed to enhance differentiation but can also lower costs. For instance, over the years, Philip Morris developed a filtered cigarette and, later, cigarettes with low tar and nicotine levels. These innovations not only differentiated its products but also allowed the company to use less tobacco per cigarette to produce a higher-quality product at a dramatic reduction in per-unit costs.[65]

Product innovations A business unit's activities that enhance the differentiation of its products or services.

The introduction of Boeing's new 787 Dreamliner in the early 2010s enabled airlines to cut costs while enhancing differentiation. Boeing touted comfort improvements with the upgraded aircraft. Still, American, Air France-KLM, Air Canada, and other airlines selected nine-abreast seating in coach instead of eight-abreast seating. Doing so reduced the width of each seat to 16.7 inches and triggered greater competition for overhead bin space for carry-on luggage. For full, long flights, this means that nine passengers fill the space previously occupied by eight.[66]

More customers have begun taking notice of the aircraft configuration before purchasing their tickets. Many airlines have attempted to compensate for narrower seats by adding amenities. Large video movie screens with hundreds of channels, movie options, and interactive games have become more common. From a cost perspective, part of the revenue increase associated with adding a seat to each row has been allocated to enhanced service.[67]

Innovation is not always good for revenues, however. For example, Proctor & Gamble and other detergent manufacturers developed premeasured pods in the early 2010s. A pod contains a fixed amount of detergent so that consumers can easily use the proper amount with each load. Although pods cost more than the same quantity of detergent in bulk—20 cents versus 25 cents per load of Tide—total sales of laundry detergent in the United States declined 5.1% between 2009 and 2012, the first three years pods were marketed widely. The reason is simple; without pods, consumers tend to use more detergent than necessary, so even more expensive pods result in lower revenue from detergent sales.[68]

Many companies claim to be innovative, but not all follow through. A survey of quarterly and annual reports filed with the US Securities and Exchange Commission (SEC) found 33,528 uses of the word *innovation* in 2011, a 64% increase from 2006. Innovation infers newness, but the term has multiple connotations. To Sealed Air Corporation, innovation means inventing a (new) product, such as packing material that inflates on delivery. To Ocean Spray Cranberries Inc., it means transforming an overlooked commodity like leftover cranberry skins into a snack like Craisins. To Pfizer, it includes product extensions that expand the applicability of existing drugs. Other companies use the term loosely, however, describing all their ordinary and mundane products, services, and processes as innovative. Hence, an organization's strategy should be tagged as innovative only if its behavior is consistent with the true meaning of the word.[69]

Fifth, firms may engage in **value innovations**, modifying products, services, and activities to maximize the value delivered to customers.[70] Such firms seek to provide maximum value by differentiating products and services only to the extent that any associated cost hikes are justified by increases in overall value *and* by pursuing cost reductions that result in minimal, if any, reductions in value. By concentrating on value instead of low cost or differentiation, a firm can offer the overall combination of cost minimization and differentiation in an industry.

Value innovations Modifying products, services, and activities to maximize the value delivered to customers.

Toyota employed value innovations throughout the 1990s and 2000s during its quest for leadership in the automobile industry. Before its recall crisis in late 2009 and early 2010, Toyota was known for delivering high value in the industry. Although its products were neither the cheapest nor the most advanced, Toyota's customers typically received a combination of quality construction, the most popular features, good performance, and competitive prices.[71]

Since 2009, Hyundai has joined Toyota as a value leader in the industry. Traditionally a low-cost producer anchored by the midsize Sonata, the Korean carmaker earned accolades for increasing quality throughout the 2000s and began introducing higher-priced vehicles late in the decade. In 2008, Hyundai introduced the Genesis at a price of about $38,000. In 2010, Hyundai introduced the Equus in the $55,000–60,000 range, a moderately high price for the US market but still below upscale rivals like Mercedes. Throughout the 2010s, the Hyundai Sonata developed a reputation as a high-value, reliable vehicle. Hyundai now defines its brand as "modern premium," a strategy aimed at selling cars with high-end features, but at prices low enough to attract mass-market consumers. Hyundai's success hinges on its ability to convince customers that a traditional cost-oriented carmaker can deliver exceptional quality and high value in the higher-priced segment.[72]

Focus–Low-Cost–Differentiation Strategy

Focus-low-cost-differentiation strategy A generic business unit strategy in which a smaller business produces highly differentiated products or services for the specialized needs of a select group of customers while keeping its costs low.

Structural innovations Modifying the structure of the organization and/or the business model to improve competitiveness.

Business units that adopt a **focus–low-cost–differentiation strategy** produce highly differentiated products or services for the specialized needs of a select group of customers while keeping their costs low. Businesses employing this strategy share all the characteristics of the previous strategies. The focus–low-cost–differentiation approach is difficult to implement because the niche orientation limits economies of scale and opportunities for **structural innovations**. Many small, independent restaurants, such as those specializing in ethnic or international cuisine, adopt this approach, seeking a balance of cost reductions and uniqueness targeted at a specific group of consumers. For example, many university towns have small eateries that emphasize a unique specialty—such as Garibaldi's barbeque pizza in Memphis, Tennessee—while also minimizing costs to remain affordable to the price-conscious college student. In the auto insurance industry, SafeAuto employs the focus–low-cost–differentiation strategy by targeting low-income drivers with affordable coverage designed to meet the minimum requirements in their respective states. SafeAuto's slogan says it all: "Drive safe, spend less."

Innovative car rental company Car2Go employs a focus–low-cost–differentiation strategy. With locations in select US and European cities, Car2Go offers small two-seat electric vehicles for rent by reserve or on demand, by the minute, hour, or day. Customers use a member card to access a car and are permitted to drive it and leave it anywhere in the local service area. Prices include insurance, parking, and maintenance, and a credit or debit card is charged automatically. Car2Go *differentiates* its offering by providing (very) short-term rentals on demand, emphasizes *cost leadership* by allowing multiple customers to rent a vehicle on the same day, and *focuses* on customers who need access to a vehicle for short trips.

Adding a focus orientation to cost leadership can enable a firm to avoid direct competition with a mass-market cost leader. In this manner, grocer Save-A-Lot has found a way to compete successfully against Walmart Supercenters. The grocery store pursues locations in urban areas that were rejected by Walmart and offers prices competitive with the Big Box. Save-A-Lot generates profits by opening small, inexpensive stores catering to low-income US households. Save-A-Lot stocks its brand of high-turnover goods to minimize costs and avoids cost-inducing pharmacies, bakeries, and baggers.

Walmart—the corporation—employed the focus–low-cost–differentiation strategy with The Más Club, introduced in Houston in 2009. Anchored by Walmart's corporate obsession with cost containment, The Más Club focused on the Hispanic niche by providing a differentiated array of products and services, including many typically offered only in Mexico.[73] The Más Club struggled, however, and was closed in 2014.

Doing Business in Mexico

Walmart's experience in Mexico illustrates the complexity of operating in multiple global markets.

Source: Rawpixel/Shutterstock.com.

Multiple Strategies

In some cases, business units employ **multiple strategies**, or more than one of the six strategies identified in this chapter, simultaneously. Unlike the *combination* low-cost–differentiation strategy, multiple strategies involve the *simultaneous* execution of two or more different generic strategies, each tailored to the needs of a distinct market or class of customer. For this reason, large businesses are more likely than small ones to adopt this approach. Hotels, for example, utilize multiple strategies when they offer basic rooms to most guests but reserve suites on the top floor for others.

Multiple strategies A strategic alternative for a larger business unit in which the organization simultaneously employs more than one of the generic business strategies.

A multiple-strategy approach can be challenging to implement and confusing to customers. Many airlines have been engaging in a sophisticated multiple-strategy approach that emphasizes cost leadership, differentiation, and various combinations of the two. Most large airlines have eliminated first-class seating in favor of an upscale and slightly less costly business class. Most charge extra for coach seats that are favorably located in the aircraft or have a few more inches of legroom, offering passengers an opportunity to select a middle level of cost/price and comfort.[74]

Although first-class seating has all but disappeared in major airlines, many have turned to a new hybrid seating class, sometimes called premium economy. The length and width of traditional seating are about 31 to 34 inches and 17 to 18.5 inches, respectively, in economy class but increase to about 38 to 42 inches and as much as 20 inches, respectively, in premium economy. A premium economy seat might also come with other amenities, like better food. Higher-quality seating comes at a price and can be very profitable for airlines. Airlines typically do not reveal pricing data. Still, travel website TripAdvisor estimates that premium economy fares range from two to four times the lowest economy fare, whereas business-class fares can be as high as 10 times the lowest economy fare. Some see premium economy seating as a reasonable compromise for business travelers whose travel policies do not permit business class.[75]

The Miles and Snow Strategy Framework

A second commonly used framework introduced by Miles and Snow includes four strategic types: prospectors, defenders, analyzers, and reactors.[76] The Miles and Snow typology is an alternative to Porter's approach to generic strategy.

Prospectors perceive a dynamic, uncertain environment and maintain flexibility to combat environmental change. They introduce new products and new services and design the industry. Prospectors tend to possess a loose structure, a low division of labor, and low formalization and centralization. While a prospector identifies and exploits new product and market opportunities, it accepts the risk associated with new ideas. For example, Amazon's initial launch of its web-based bookstore was a significant risk, one that has been successful ever since.

Prospectors typically seek **first-mover advantages** derived from being first to market. First-mover advantages can be substantial, as demonstrated by products widely known by their original brand names, such as Kleenex and Chapstick. Being first, however, can be a risky proposition, and research has shown that competitors may be able to catch up quickly and effectively.[77] Altria Group's Philip Morris USA failed in its attempts to develop safer alternatives to traditional cigarettes, including its high-technology filtered Marlboro Ultra Smooth, its battery-heated Accord, and its "spit-free" smokeless tobacco.[78] General Motors' launch of the Chevy Volt in 2010 was not a strategic move devoid of risk.[79] As a result, prospectors must develop expertise in innovation and evaluate risk scenarios effectively.

First-mover advantages Benefits derived from being the first firm to offer a new or modified product or service.

The cutting edge sought by prospectors can quickly become a bleeding edge. Consider 3-D Systems, a leading developer of 3-D printers. The company enjoyed initial growth in the early 2010s, but sales declined precipitously in 2015, turning a $2.1 million profit into a $13.7 million loss. With printers in the $5,000 range and the printers' initial quality and reliability problems, many prospective buyers began to wait for the next generation of faster, higher-quality, less expensive machines from Hewlett-Packard (HP) and other more established manufacturers.[80] In this instance, 3-D Systems played the role of a prospector, investing heavily at the outset but enjoying first-mover advantages. HP played the role of an analyzer, entering the market in the second round with less initial investment (at least on the per-unit basis) and a more advanced product.

Intrapreneurship The creation of new business ventures within an existing firm.

Prospectors typically focus on **intrapreneurship** (i.e., corporate entrepreneurship). Whereas entrepreneurship focuses on the development of new business ventures as a means of launching an organization, intrapreneurship involves the creation of new business ventures within an existing firm. Established firms seeking to foster a culture that encourages the type of innovative activity often seen in upstarts must provide time, resources, and rewards to employees who develop new venture opportunities for the organization.

Defenders are almost the opposite of prospectors. They perceive the environment to be stable and predictable, seeking stability and control in their operations to achieve maximum efficiency. Defenders incorporate an extensive division of labor, high formalization, and high centralization. The defender concentrates on only one segment of the market. Whereas prospectors pursue first-mover advantages, defenders avoid early market entry. Being the first mover can be costly and risky, and savvy rivals can often leapfrog first movers with better designs and more efficient production processes. Defenders wait until markets are more predictable. *Analyzers* stress stability and flexibility and attempt to capitalize on the best of the prospector and defender strategy types. They exert tight control over existing operations and loose control for new undertakings. The strength of the analyzer is the ability to respond to prospectors (or imitate them) while maintaining efficiency in operations. An analyzer may follow a prospector's successful lead, modify the product or service offered by the prospector, and market it more effectively. In effect, an analyzer is seeking a second-mover advantage.[81]

Reactors lack consistency in strategic choice and perform poorly. The reactor organization lacks an appropriate set of response mechanisms with which to confront environmental change. There is no strength in the reactor type.

There is a connection between strategies in the Miles and Snow typology and the industry life cycle discussed in Chapter 2. The prospector strategy is often appropriate when an industry is in the introduction or growth stages and there is a premium for new-product development. Successful businesses may shift to an analyzer approach during the shakeout stage and, ultimately, a defender approach during the maturity stage when markets tend to be well defined. These are generalizations, however. It is incorrect to suggest that a business *must* modify its strategy as its industry evolves. Nonetheless, strategic success at the business level depends on the product, customer, and competitive challenges that must be addressed at the industry level. Savvy executives understand this link and consider it when formulating competitive strategies.

In some respects, Porter's typology and Miles and Snow's typology are similar. For example, Miles and Snow's prospector business is likely to emphasize differentiation, whereas the defender business typically emphasizes low costs. However, fundamental differences exist between the typologies. Porter's approach is based on economic principles associated with the cost-differentiation dichotomy, whereas the Miles and Snow approach describes how a business approaches its environment (see Case Analysis 7-1).

Business Size, Strategy, and Performance

Studies have examined the relationship between a business unit's size and performance relative to those of its competitors. Interestingly, mid-sized business units often perform poorly in comparison with small or large competitors because they typically do not possess the advantages associated with being flexible like their small rivals or possessing substantial resources like their large rivals.[82] Specifically, small businesses enjoy flexibility in meeting specific market demands and a potentially quicker reaction to environmental changes. Because of their lower investments, they may be able to make strategic moves and pursue more limited revenue opportunities that would be unprofitable for mid-size or large businesses. Likewise, large companies can translate their economies of scale into lower costs per unit and may be better able to bargain with their suppliers or customers or to win industry price wars.

Case Analysis 7-1

Step 10: What Is the Current Business-Level Strategy?

The generic strategies for each business unit (if there is more than one) should be identified. *Both* strategy typologies (e.g., Porter, and Miles and Snow) should be applied, but additional support should also be provided. Each business employs a unique strategy based on its combination of resources. It is also essential to discuss how the competitive strategy differs from those of rivals that might share the same generic strategy. What makes the organization unique? Identifying the generic approach is not enough.

The notion of business-level strategy cannot be understood independent of industry definition because a business strategy is expressed in terms *relative* to rivals. For example, the competitive strategy for retailing giant Walmart might be considered that of differentiation or low-cost–differentiation if the industry is defined "discount retail." In contrast, it might be regarded as low-cost if the industry is defined more broadly as "department stores." Likewise, McDonald's strategy might be described as a combination approach when compared to other fast-food restaurants. If McDonald's is viewed as part of the broader restaurant industry, a low-cost strategy is a more accurate depiction.

A specific generic strategy may be common in an industry because of structural characteristics or demand patterns. For example, because the computer software industry tends to reward innovation, most competitors might be categorized as prospectors. However, it would be incorrect to classify *all* rivals as prospectors without a detailed assessment.

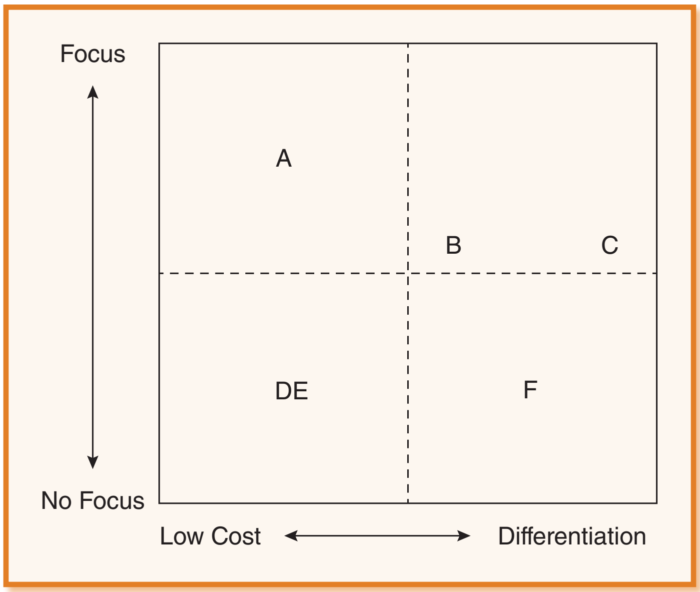
Because mid-size business units tend to lack the advantages of either small or large rivals, many choose to become larger or smaller to capitalize on some of the benefits of their competitors. Specifically, they may seek to expand their operations (i.e., increase their size) to take advantage of scale economies, or they may retrench (i.e., decrease their size) to avail themselves of the benefits possessed by small companies. Either option can be difficult and may not even be feasible, depending on various competitive and industry forces.[83] While not all mid-size businesses perform poorly and should aggressively attempt to increase or decrease size, the relationships between size and performance should be considered when evaluating the specific needs of their business units.

Assessing Strategies

Although the distinctions between such strategies as cost leadership and differentiation or prospectors and differentiators are clear in theory, they are not always easy to assign in practice. Considering Porter's typology, cost leadership and differentiation may be viewed as opposite extremes on a continuum. Likewise, focus and no-focus can also be viewed as opposite extremes. Figure 7-1 illustrates this approach with a hypothetical industry containing six rivals. Company A is the only focus-low cost competitor. Companies B and C—generally seen as part of the same strategic group—are slightly "less focused" than A. Both B and C are more differentiated than A, but C is more differentiated than B. Companies D and E—clearly members of the same strategic group—employ low cost (no focus) strategies. In contrast, company F follows a differentiation (no focus) approach. Viewing generic strategies as a matter of degree enables analysts to illustrate relatively minor distinctions between businesses employing the same generic strategy. This approach can also be applied to the Miles and Snow typology, with prospectors and defenders anchoring ends of a continuum and analyzers in the middle.[84]

Figure 7-1 does not include real companies because categorizing businesses in such a matrix is difficult, time-laden, and somewhat subjective. Consider Walmart as an example. Traditionally, the retailer passed on a focus approach in favor of a one-size-fits-all approach geared at selling to most consumers. Although this approach was successful for a while, sales growth in the United States began to decline in the early 2000s. In 2006, the retailer started modifying its product mixes in many of its US stores to target six groups: African Americans, the affluent, empty-nesters, Hispanics, suburbanites, and rural residents.[85] On the one hand, this move reflects an attempt by Walmart to concentrate its efforts on

FIGURE 7-1
Porter's Generic Strategy Matrix



specific markets, an approach consistent with Porter's focus strategy. On the other hand, the six groups identified together comprise the majority of the US population, suggesting that Walmart's competitive strategy does not qualify as a focus strategy but, rather, as a no-focus strategy, with some degree of tailoring each store to the needs of its clientele. Although it might not be appropriate to reclassify Walmart's strategy as a focus approach because of this strategic shift, a modest move toward the focus end of the continuum may be warranted.

Almost all businesses seek to reduce costs and distinguish their products or services from others in the market. Consider how changes to airline baggage policies in the 2010s reduced costs across the industry. Most airlines allow customers to bring one carry-on bag plus a small item that can fit under the seat in front of them. Additional bags can be checked for an additional charge, typically in the range of $25 to $35. This fee incentivizes fliers not to check bags but ultimately results in bottlenecks on many full flights. The Boeing 737-900 aircraft can accommodate 180 passengers, but its bins can only handle 125 roll-aboard bags. When bag demand exceeds supply, airlines typically check extras at the gate for no charge, resulting in delays and frustration among customers, especially those who paid to check bags when they could have been checked without charge at the gate. Some airlines even offer customers the opportunity to board the aircraft earlier (and secure coveted space for their bags) for an additional fee.[86]

Meanwhile, most airlines continuously seek ways to enhance service. In 2009, 13% of global airlines asked fliers to tag their bags for quick drop-off at the airport. This grew to about 35% in 2015 and was estimated to hit 75% in 2018. Some airlines have also introduced tracking devices stored inside the bag to allow customers to track their bags on their smartphones, and others are offering permanent bar tags for frequently used bags. The number of passengers grew by about a third between 2007 and 2014, but the number of checked bags dropped by about half. Airlines also trimmed the number of ticket agents and began charging fees for checked bags during this time.[87] By 2018, baggage fees in the United States totaled $4.9 billion annually.[88]

Positioning the business relative to its rivals is also essential. Consider Chipotle Mexican Grill. Chipotle's burritos are healthier than fast food but prepared more rapidly than those at traditional Mexican restaurants. Executives hoped to extend this approach to another American favorite, pizza. In 2013, Chipotle financed Pizzeria Locale, a Denver-based restaurant that prepares an 11-inch pizza to order in just a few minutes for less than $7. Customers at both restaurants pay at the counter and can watch their food being prepared. Pizzeria Locale has not been successful outside of Colorado, however.[89]

So-called "fast-casual" restaurants like Chipotle and Panera Bread are positioned between fast-food chains like McDonald's and sit-down chains like Olive Garden. Fast-casual chains have taken business from both sides because many consumers are willing to pay a few dollars more for a higher-quality eating experience than fast-food restaurants offer.[90]

Chick-fil-A's growth and success also illustrate strategic complexity. While staying true to a straightforward menu and excellent customer service, Chick-fil-A became the third-largest restaurant chain in the United States in 2019, behind McDonald's and Starbucks. The Atlanta-based company has expanded its base from the southeastern United States to other parts of the country, nearly doubling its store count between 2007 and 2019 to about 2,400. Chick-fil-A was the top-rated fast-food restaurant on the American Customer Satisfaction Index for every year between 2015 and 2018. Most Chick-fil-A franchisees run only one restaurant, whereas the typical McDonald's franchisee operates about six.[91]

Also, formulating an effective competitive strategy is almost impossible without a clear understanding of the primary competitors and their strategies. It is crucial to comprehend how rivals compete, what they are attempting to accomplish (i.e., their goals), what assumptions they hold concerning the industry, and what their unique strengths and weaknesses are relative to others in the industry. Developing this understanding not only helps formulate strategies to position a business in the industry but can also help them forecast any competitive responses that rivals might make if a significant strategic change is implemented (see Case Analysis 7-2).

Businesses often change strategies to take advantage of a competitor's misfortune, but this can be problematic. In a famous 2000 case, Bridgestone's Firestone unit was forced to recall 6.5 million tires linked to fatal accidents on Ford Explorers in a widely publicized challenge to its credibility. Goodyear, however, was unable to meet the sudden increase in demand for its tires and responded by raising prices. Although sales stabilized at Bridgestone in the early 2000s at a market share about 2% lower than before the recall, Goodyear's market share had declined back to its pre-recall levels by 2003. In this instance, Goodyear was unable to respond effectively to Bridgestone's woes.[92]

Global Concerns

Identifying the competitive strategy of a business operating in global markets can be challenging because of different strategies in different countries. Moreover, there is no simple formula for developing and implementing successful business strategies abroad. A popular approach to this global strategy challenge is to "think globally, but act locally." Following this logic, a business should emphasize the synergy created by serving multiple markets globally but formulate a distinct competitive strategy for each market. Others argue that consistency across global markets is critical, citing examples such as Coca-Cola, whose emphasis on quality, brand recognition, and a small world theme has been successful across global markets. These two approaches represent distinct perspectives on what it takes to be successful in foreign markets. Consider several examples.

Coca-Cola's global approach to marketing the popular soft drink has been relatively consistent across borders. Some product differences exist, however, due to availability

KFC has succeeded in China through localization, but other companies have struggled with the concept. Learn more at http://www.business2community.com/branding/kfc-china-localization-translation-tip-iceberg-0898020#DtKyMCUTzxKjETRW.97.

Case Analysis 7-2

Step 11: What Business-Level Strategies Are Being Employed by Competitors?

Understanding the competitive strategies of each rival is essential. Depending on the industry, obtaining detailed, public information on all competitors can be challenging and might require a lot of research. One of the business strategy typologies should be applied to the industry, with strategy designations and details for each competitor. It is essential to understand how different competitors in the industry employ similar and different strategies. This insight helps managers predict how competitors might respond to a change in strategy.

It might be necessary to refine step 10 after step 11 is completed. Because competitive strategy is a relative term, it cannot be fully understood without comprehending the range of strategic action present in an industry. For example, the extent to which McDonald's pursues cost leadership *relative* to its rivals (e.g., Burger King, KFC, etc.) becomes clearer *after* the strategic groups in the industry are identified.

and cost factors. In Mexico, for example, Coke contains readily available cane sugar. In the United States, where customers are not believed to perceive a significant difference in sweeteners, Coke changed to high-fructose corn syrup, a less expensive alternative.[93]

Starbucks also rejects the notion that localizing the product line is essential for success. Almost all its products are consistent across global markets. According to former COO Martin Coles, many retailers fail with a globalized product line because execution is inconsistent. Training and development efforts are essential, especially when employees in countries where coffee is not a strong tradition must follow specific procedures to produce a cappuccino indistinguishable from one served in the United States. For Starbucks, this is an ongoing challenge in many of its global markets, including China.[94]

In the United States, Sam's Club faces fierce competition from Costco and targets small businesses and budget-minded consumers with bulk items. In China, Sam's emphasizes high-quality, imported goods. By 2018, Sam's had opened 19 clubs in China. Its 1.9 million members in China are more affluent than their American counterparts. Nonetheless, Sam's has been successful in both countries.[95]

Dunkin' Brands has also followed a primarily global approach, opening 20 stores in Moscow in 2010 after retreating in 1999. Coffee has become more popular in the country, but few Russians were familiar with donuts before the reentry of Dunkin' Donuts. Several unique fillings were developed for the Russian market, but the traditional coffee-and-donuts product mix typical in the United States was employed in Moscow with limited changes.[96] Dunkin' opened its first store in India in 2012 and once franchised as many as 77 there, but the company eliminated 40 stores in 2018. Dunkin' has faced the same challenges in India; although coffee consumption has increased during the past decade, most Indians are unfamiliar with doughnuts. To address local tastes, Dunkin' has tried spicy ciabatta sandwiches, mango doughnuts, and Alphonso mango smoothies.[97]

Yum Brands takes a localized approach with its KFC business unit. KFC emphasizes chicken in its host country—the United States—but has added fish sandwiches and other local favorites in its Asian stores. According to Toh Chun Wah, executive director and chief operating officer of KFC Holdings (Malaysia), "As much as our customers love our chicken products, they also want a greater variety of meat products at KFC. Our market

Localization at KFC

Source: aimpol buranet/shutterstock.com surveys show that our customers want more than just tasty, high quality, and affordable chicken but are also constantly on the lookout for new and interesting things to eat." This move reflects an apparent move to "localize" business strategies along the lines of taste.[98]

The localization perspective can be extended further to **micro-localization**, customizing products and services to suit the taste and needs of diverse consumers across a nation or region. Micro-localization is common in India because Indian tastes not only differ substantially from those in other markets but also vary throughout the nation. India's Barista Coffee chain sells south Indian filtered coffee on the Bangalore-Mysore highway but offers yogurt-based drinks in the north. Indian consumer products company Godrej alters the scents in its Godrej No. 1 soap from sandalwood to rose across regions of the country. LG microwaves in the south of India come with auto-cook options for regional rice-based breakfast foods like idli and upma, whereas those produced in the east are programmed for cooking Bengali fish curry or the mixed vegetable dish known as shukto.[99]

Micro-localization Customizing products and services to suit the taste and needs of diverse consumers across a nation or region.

There is wisdom in both global strategy perspectives—localizing and maintaining consistency across borders—although the most effective approach will depend on the mission, goals, and characteristics of the organization. Tailoring a business strategy to meet the unique demands of a different market can be especially challenging because it requires that top managers understand the similarities and differences between the markets from both industry and cultural perspectives. In practice, businesses rarely operate at one extreme or the other.

The opportunities available in developing and emerging economies are substantial. In Africa, however, much of the current development is in the nation of South Africa. McDonald's operates 200 restaurants in South Africa but has locations in only three other African countries. These restaurants face many challenges, including low or moderate incomes in most African nations, water shortages, and product costs. Many of the ingredients—including beef, cheese, lettuce, and tomatoes—must be imported. For this reason, a Johnny Rockets Single burger costing less than $6 in the United States sells for about $14 in Nigeria. US chains are seeking ways to overcome these difficulties and capitalize on the emerging African market.[100]

Summary

At the business level, top managers determine how the organization is to compete with its rivals. According to Porter's framework, managers must decide whether to focus on a segment of the market—a strategy often appropriate for small businesses—and whether to emphasize low costs or differentiation. Each approach has its own set of advantages and challenges. Business units may also seek to combine low-cost and differentiation strategies, although this approach can be challenging to implement effectively.

According to Miles and Snow's framework, managers may select a prospector, an analyzer, a defender, or a reactor strategy. Each of the first three approaches can be effective, but the reactor strategy cannot. Top managers should also consider the roles of business size, the strategies of rivals, and opportunities in emerging markets when seeking to develop business strategies.

Key Terms

Business strategy, p. 171
Business unit, p. 171
Differentiation strategy, p. 177
First-mover advantages, p. 185
Focus-differentiation strategy, p. 179
Focus-low-cost differentiation strategy, p. 184
Focus-low-cost-strategy, p. 175
Generic strategies, p. 171
Intrapreneurship, p. 186
Low-cost-differentiation strategy 180
Low-cost strategy, p. 173
Micro-localization, p. 191
Multiple strategies, p. 185
Process innovations, p. 182
Product innovations, p. 183
Quality, p. 182
Strategic group, p. 171
Structural innovations, p. 184
Value innovations, p. 183

Review Questions & Exercises

1. What is the difference between a corporate strategy and a business strategy?
2. Identify the generic business strategy configurations available to strategic managers, according to Porter's typology.
3. Is it possible for a business to differentiate its outputs and lower its costs simultaneously? Explain.
4. Identify the generic business strategy configurations available to strategic managers, according to Miles and Snow's typology.
5. How are the business strategy typologies by Porter and those by Miles and Snow similar? How are they different?
6. Why might one expect the performance level of mid-size business units to be lower than the performance level of either small or large business units?

Practice Quiz

True or False

1. The focus-differentiation strategy emphasizes low overall costs while serving a narrow segment of the market.
2. Businesses that employ the focus strategy produce and market to the entire industry products or services that can be readily distinguished from those of their competitors.
3. The combination strategy can also be referred to as multiple strategies.
4. There is no advantage to the reactor strategy type.
5. The generic strategy typologies developed by Porter and Miles & Snow possess both similarities and differences.
6. Mid-sized enterprises tend to be outperformed by their smaller and larger counterparts.

Multiple Choice

7. Businesses adopting the same generic strategy are referred to as
   A. low-cost businesses.
   B. differentiated businesses.
   C. a strategic group.
   D. none of the above
8. A no-frills product targeted at the market at large is consistent with the
   A. low-cost strategy.
   B. differentiation strategy.
   C. focus strategy.
   D. none of the above
9. Which of the following is not an important advantage of the low-cost–differentiation strategy?
   A. It enables the business to compete from a cost leadership position.
   B. It is easier to implement than either the low-cost or differentiation strategy.
   C. It allows the business to distinguish its products from the competition.
   D. It offers the prospects of high profitability.
10. Modifying the structure of the organization or the business model to improve competitiveness is consistent with
   A. the low-cost strategy.
   B. the focus strategy.
   C. the differentiation strategy.
   D. the low-cost–differentiation strategy.
11. Analyzers
   A. seek first-mover advantages.
   B. control a distinct segment of the market.
   C. display some of the characteristics of both prospectors and defenders.
   D. none of the above
12. Emerging markets are often more attractive than developed ones because
   A. competition is not as intense.
   B. consumer incomes in emerging markets are not a concern.
   C. the infrastructure in emerging markets is already developed.
   D. none of the above

Case 7: Aldi

The Albrecht family opened the first Aldi grocery store in Germany in 1961, and the company has grown rapidly since its inception. Headquartered in Essen, Germany, the international retailer offers a limited assortment of groceries and related items at the lowest possible prices. Functional operations focus on a single strategic objective, minimal costs. Aldi targets consumers with low to moderate incomes.

Aldi minimizes costs in many ways. About 90% of its products are exclusive brands (i.e., private label), allowing Aldi to negotiate high-volume, rock-bottom prices from its suppliers. Stores are modest in size, much smaller than that of a typical chain grocer. Aldi only stocks common food and related products, maximizing inventory turnover. Customers bag their groceries and must either bring their bags or purchase them from Aldi for a nominal charge. Aldi does not offer costly services like banking, check-cashing, and pharmacies.

Aldi also takes an innovative approach to the use of its shopping carts. Customers insert a quarter to unlock a cart from the interlocked row of carts located outside the store entrance. The quarter is returned with the cart when it is locked back into the group. As a result, no employee time is required to collect stray carts unless a customer is willing to forego the quarter by not returning the cart.

Aldi's US division is headquartered in Batavia, Illinois, and employs about 25,000 people. The company operates about 1,900 small, deep-discount stores in 36 states. Aldi operates stores in 19 other countries as well.

Case Challenges

1. How has Aldi succeeded in the United States amid intense low-cost pressure from Walmart?
2. Is Aldi's business model likely to be successful in the future? Why or why not?
3. Could Aldi succeed as a nongrocery retailer in the United States? Why or why not?

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Simulation 101: Competitive Positioning

No single chapter has a more significant bearing on success in a strategy simulation than this one. The market for products sold in your industry includes buyers with distinct interests and preferences. You must determine how your virtual firm will appeal to some or all buyers clearly and consistently. Some virtual firms fail to do this. Instead, they make incremental adjustments to strategic decisions across the board and hope to maintain the status quo. More times than not, the simulation's starting point (e.g., current pricing, advertising, production, and other levels) is not optimal, so staying the course usually represents a lack of strategy and is rarely a good option.

The business strategy should be crafted at the beginning of the simulation. The two questions inherent in Porter's typology represent the best place to start. First, should your firm attempt to sell to the entire market (e.g., no focus) or concentrate its efforts on a segment (e.g., focus)? If you choose not to focus, you will have a larger pool of potential customers but a more diverse array of competitors. If you choose to focus, your pool of potential customers is much smaller, but it is easier to address the needs of the selected segment.

Second, should you emphasize low costs or differentiate your products from those of your rivals? Cost containment is essential for all businesses but especially for cost leaders, most of which use their lower-cost position to lower their prices. Some buyers are willing to pay extra for demonstrably better products. Most simulations permit firms to improve criteria such as size, performance, and reliability, but doing so can be costly. Different buyers often value different things, so differentiators should align these investments with the preferences of the customer groups they seek to serve. As noted in the text, combining low cost and differentiation is an option, but doing both is not easy and can leave a business "stuck in the middle."

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