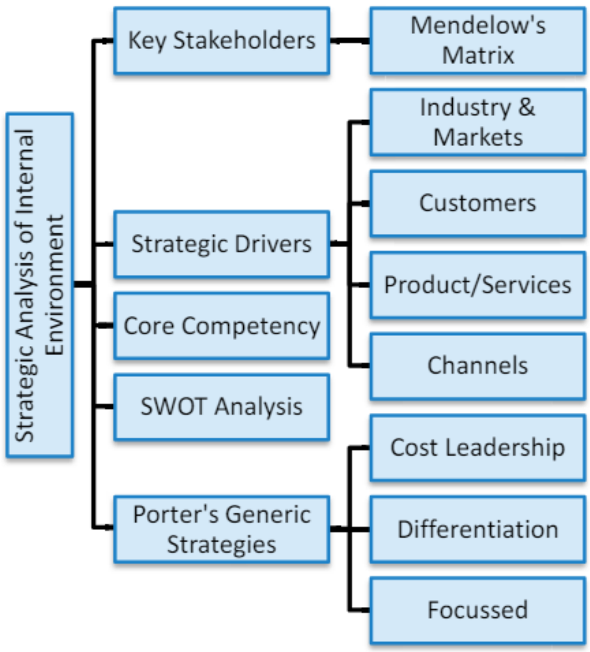
CHAPTER 3

STRATEGIC ANALYSIS: Internal Environment

OVERVIEW



INTRODUCTION

- Internal refers to sum total of people – individuals & groups, stakeholders, processes – input –throughput – output, physical, infrastructure –space, equipment & physical conditions of work, lines of authority, responsibility, accountability & organizational culture – intangible aspects of working – relationships, philosophy, values, ethics that shape an organization's identity.
- Internal is specific to each organization. It is based on its structure & business model & includes all stakeholders like top management, investors, employees, board of directors etc.

1.KEY STAKEHOLDERS

Who are Stakeholders and how do we identify them?

Stakeholders can be defined as any person/group of individuals, internal or external, that has an interest in, or impact on the business or corporate strategy of the organisation. They have the power to influence the strategy or performance of that organization.

It is important to first identify the key stakeholders. Each stakeholder exerts a different level of influence and can have differing levels of interest in the organisation. The expectations of key stakeholders can influence the organisation's strategy, a clash of objectives may have unfavourable consequences for the organisation.

EXAMPLE of Key Stakeholders and their requirements for an OTT Platform

Stakeholders	Requirements
Shareholders	♦ Innovation and continuous creative content ♦ Total shareholder return (RoI) ♦ Corporate social responsibility ♦ Top rankings of the organization ♦ Highest market share
CEO and Board of Directors	♦ Prestige ♦ Market share ♦ Revenue and profit growth ♦ Market rankings
Major Vendors (Production Houses)	♦ Growth ♦ Stability of ordering ♦ Stable margins
Consumers (Viewers)	♦ New content - Innovation ♦ Better deals - Pricing Benefits ♦ Value for money ♦ Continuous supply
Employees	♦ Wages and benefits ♦ Stability of employment ♦ Pride of working for a reputed organization

1.1 MENDELOW'S MATRIX

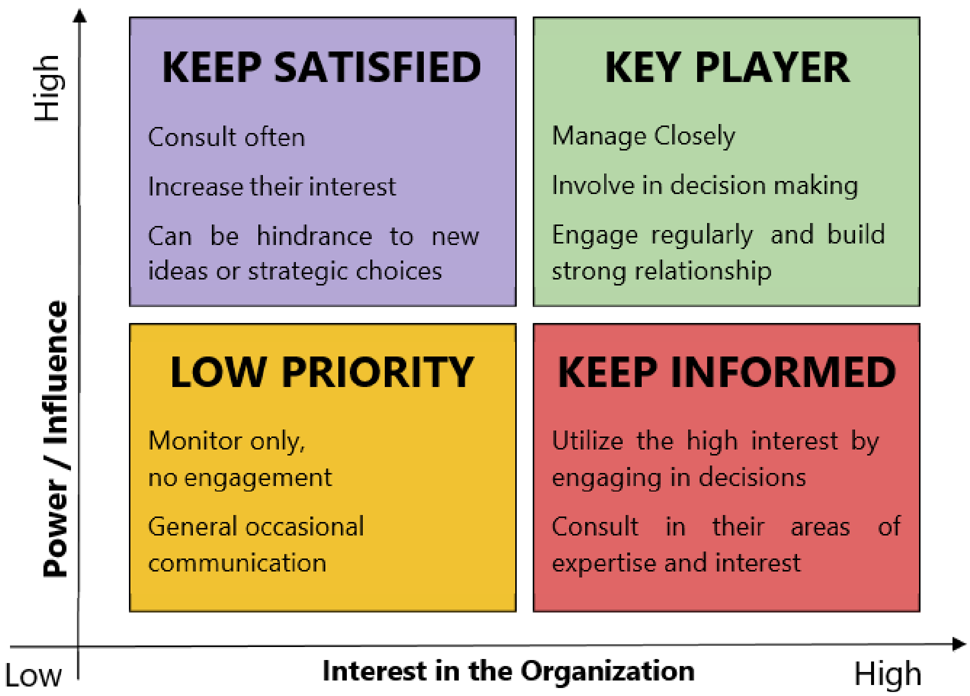
The Mendelow Stakeholder matrix (also known as the Stakeholder Analysis matrix and the Power-Interest matrix) is a simple framework to help manage key stakeholders

Mendelow suggests that one should analyse stakeholder groups based on Power (the ability to influence organisation strategy or resources) and Interest (how interested they are in the organisation succeeding).

Developing a Grid of Stakeholders

Mendelow's Matrix is based on Power and Interest. It suggests to identify which stakeholders are incredibly important. Metrics to define the importance being High Power and High Interest which management would need to manage closely, while investing a lot of time and resources.

EXAMPLE: The CEO is likely to have more Power to influence the work and also high interest in it being successful. Keeping them informed almost daily should be a priority.



1In the above figure, we see categorisation of stakeholders into four groups by Mendelow's;

1. **KEEP SATISFIED Stakeholders**: High power, less interested people - Organisation should put in enough work with these people to keep them satisfied with their intended information on a regular basis.

   EXAMPLE: banks, government, customers, etc.

2. **KEY PLAYERS Stakeholders**: High power, highly interested people - Organisation's aim should be to fully engage this group of stakeholders, making the greatest efforts to satisfy them, take their advice, build actions and keep them informed with all information on a regular basis. For EXAMPLE, Shareholders, CEO, Board of Directors, etc

3. **LOW PRIORITY Stakeholders**: Low power, less interested people - Organisation should only monitor them with no actions to satisfy their expectations. Strategically, minimal efforts should be spent on this group of stakeholders while keeping an eye to check if their levels of interest or power change.

   EXAMPLE: business magazines, media houses, etc.

4. **KEEP INFORMED Stakeholders**: Low power, highly interested people - Organisation should adequately inform this group of people and communicate with them to ensure that no major issues arise. This audiences can also help with real time feedbacks and areas of improvement for an organisation.

   EXAMPLE: employees, vendors, suppliers, legal experts, etc.

An important thing that strategists should be aware of, is the importance to remember that environment is highly dynamic and certain things might happen that can cause stakeholders to suddenly move between quadrants.

EXAMPLE: An organisation might inadvertently contravene a regulation, say GST compliance which would cause the regulatory body i.e. the Indirect Taxes Department to move from High Power, Low Interest to High Power, High Interest. This would then require a different way of managing and communicating with this stakeholder. Equally, the media houses would also move from Low Power, Low interest, to Low Power, High Interest.

So, it's always worth re-analysing the Mendelow's grid for one's organisation in the event of a change in the environment.

2.STRATEGIC DRIVERS

What are strategic drivers and their impact?

An important aspect of internal analysis is assessing the current performance of the business and in assessing current performance, the **strategic drivers** consider what differentiates an organisation from its competitors.

It involves analysis of the key markets in which the organisation operates, as well as its key customers, the products and services it provides, the channels in which the products or services are delivered, and the organisation's competitive advantage.

But in general, the key strategic drivers of an organisation include:

- Industry and markets
- Customers
- products/services
- Channels

2.1 INDUSTRY AND MARKETS

A **market** is defined as the sum total of all the buyers and sellers in the area or region under consideration. The value, cost and price of items traded are as per forces of supply and demand in a market. The **market** may be a physical entity or may be virtual like e-commerce websites and applications. It may further be local or global, depending on which all countries the business sells its products in.

In terms of the internal environment, it is very important for an organisation to understand it's relative position in the industry and in the market in which it operates. Similar companies are grouped together into industries. Basically, industry grouping is based on the primary product that a company makes or sells.

EXAMPLE: Maruti, Mahindra, Tata Motors, TVS, Bajaj Auto, are all selling automotives as their primary product and thus categorised into Automotive Industry.

Analysing industry and markets

Industry and market analysis is extremely important to identify one's position as compared to the competitors, who can be of equal size and value, or bigger in size and value or even smaller and newer. A tool used for this is called - **STRATEGIC GROUP MAPPING.**

A **strategic group** consists of those rival firms which have similar competitive approaches and positions in the market. Companies in the same strategic group can resemble one another in any of the several ways:

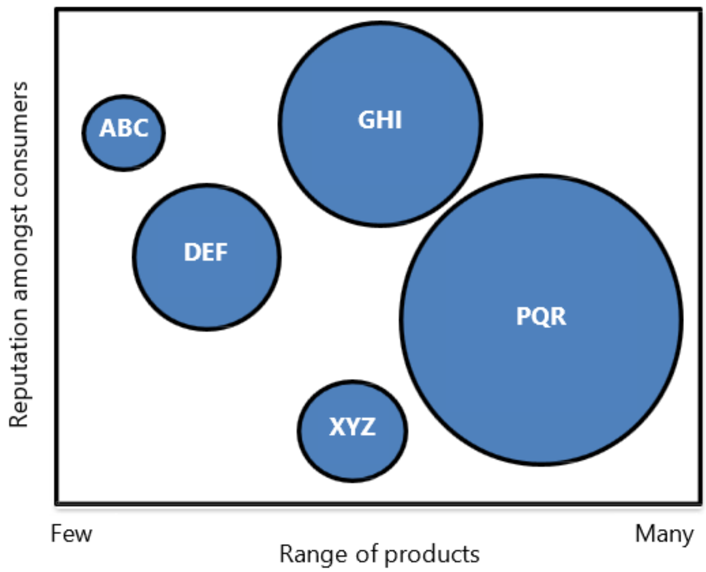
- comparable product-line breadth,
- sell in the same price/quality range
- same distribution channels,
- same product attributes to appeal to similar types of buyers,
- identical technological approaches,
- offer buyers similar services and technical assistance

Construction of strategic group

The procedure for constructing a strategic group map and deciding which firms belong in which strategic group is straightforward:

1. Identify the competitive characteristics that differentiate firms in the industry typical variables are price/quality range (high, medium, low); geographic coverage (local, regional, national, global); degree of vertical integration (none, partial, full); product-line breadth (wide, narrow); use of distribution channels (one, some, all); and degree of service offered (no-frills, limited, full)
2. Plot the firms on a two-variable map using pairs of these differentiating characteristics.
3. Assign firms that fall in about the same strategy space to the same strategic group.
4. Draw circles around each strategic group making the circles proportional to the size of the group's respective share of total industry sales revenues.

Strategic Group Mapping



ABC, DEF, GHI, XYZ AND PQR are companies operating in the same industry. Let us assume these all are companies selling Laptops.

Now on the Y-Axis (vertical) is the reputation of the company and on the X-Axis (horizontal) is the range of their products.

The Reputation is depicted through the size of the bubble of the company along with how high it is on the Y-Axis. While on the X-Axis, we can see how huge their product range is, whether they have few models or they have many models on offer for the customers.

A simple glance of the mapping chart shows us that even though ABC has few models, but it has great reputation in the market. Similarly, GHI has a good range of products and is the most reputed company in laptops. Another view is that XYZ and GHI have the same number of models as both are on the same place on X-Axis, but GHI has much greater reputation than XYZ, as it has a bigger bubble and is higher on the Y-Axis.

This analysis helps a business understand its competition in terms of two or more factor in a single graphical representation.

2.2 CUSTOMERS

Understanding the different types of customers to whom the organisation's products/services are sold or provided, is not only important but also the first step in deciding the product/service. Different customers may have different needs and require different sales models or distribution channels

As **customers** are often responsible for the generation of profits obtained by an organisation, it is important to be able to collect and display data in order to show customer trends and profitability. Issues with customers can be identified, and target areas for growth can be pursued based on the findings.

CUSTOMER AND CONSUMER

while a **customer** is the one buys a product/service, the consumer is the one who finally uses/consumes the bought product or service.

EXAMPLE - A parent buying stationery products for their kids might be the customers, but consumers of stationery are the kids who would actually use it. Thus, understanding both is important for the marketers.

From a pricing perspective - the customer is of more importance and from value creation and design/usability, consumer needs to be the kept at the center of decision making.

Customer versus Consumer
A simple bifurcation yet extremely important for strategy build up. Consumers are the ones who finally use a product/service, while customers are the buyers of that product. A customer can be a consumer and vice versa. But for strategy teams especially marketing teams it is important to understand the customer and consumer separately. **For EXAMPLE**, baby diapers are bought by parents (customers) who are willing to pay higher price for higher quality, while the real consumers are the babies, who are more concerned about the comfort and easiness of the diaper. If babies do not accept the product i.e. if consumers aren't satisfied, it is difficult to retain the buyer i.e. customers as well.

2.3 PRODUCTS/SERVICES

Product stands for the combination of **"goods-and-services"** that the company offers to the target market. Strategies are needed for managing existing product over time, adding new ones and dropping failed products. Strategic decisions must also be made regarding branding, packaging and other product features such as warranties.

In this component of the strategic drivers' analysis, business identifies the key products/ services that the organisation offers and how those products/services are performing.

It attempts to answer the general question: What business are we in and what should be done to win over competition in each product/service we serve.

- There are products that have wide range of quality and workmanship and these also change over time since products and markets are infinitely dynamic. An organization has to capture such dynamics through a set of policies and strategies.
- Products can also be differentiated on the basis of size, shape, colour, packaging, brand names, after-sales service and so on.
- Quite often the differentiation is psychological rather than physical. It is enough if customers are persuaded to believe that the marketer's product is different from others.

> EXAMPLE-Shampoos with different branding namely Head & Shoulders, Olay, Old Spice, Pantene are all produced by the same company P&G.

- Organizations formalize product differentiation through designating 'brand names' to their respective products. These are generally reinforced with legal sanction and protection. Brands enable customers to identify the product and the organization behind it. The products and even firms' image is built around brands through advertising and other promotional strategies. Customers tend to develop strong brand loyalty for a particular product over a period of time
- For a new product, pricing strategies for entering a market need to be designed and for that matter at least **three objectives** must be kept in mind:
  - Have customer-centric approach while making a product.
  - Produce sufficient returns through a reasonable margin over cost.
  - Increasing market share.
- Products and services need heavy investment in reaching out to customers. Over the years, a number of marketing strategies have been evolved, which are given to handle marketing strategically and fight the competition in the market.

1. **Social Marketing**: It refers to the design, implementation, and control of programs seeking to increase the acceptability of a social ideas, cause, or practice among a target group to bring in a social change.

   EXAMPLE- the publicity campaign for prohibition of smoking in Delhi explained the place where one can and can't smoke and also indicates that smoking is injurious to health.

2. **Augmented Marketing**: This type of marketing includes additional customer services and benefits that a product can offer besides the core and actual product that is being offered. It can be in the form of introduction of hi-tech services like movies on demand, online computer repair services, secretarial services, etc. Such innovative offerings provide a set of benefits that promise to elevate customer service to unprecedented levels.

3. **Direct Marketing**: Marketing through various advertising media that interact directly with consumers, generally calling for the consumer to make a direct response. Direct marketing includes catalogue selling, e-mail, telecomputing, electronic marketing, shopping, and TV shopping.

4. **Relationship Marketing**: The process of creating, maintaining, and enhancing strong, value-laden relationships with customers and other stakeholders.

   EXAMPLE- Airlines offer special lounges at major airports for frequent flyers. Thus, providing special benefits to select customers to strengthen bonds. It can go a long way in building relationships.

5. **Services Marketing**: It is applying the concepts, tools, and techniques, of marketing to services. Services is any activity or benefit that one party can offer to another that is essentially intangible. This marketing requires different marketing strategies since it has peculiar characteristics of its own such as inseparability, variability etc.

6. **Person Marketing**: People can also be marketed. Person marketing consists of activities undertaken to create, maintain or change attitudes and behaviour towards particular person.

   EXAMPLE-politicians, sports stars, film stars, etc. i.e., market themselves to get votes, or to promote their careers.

7. **Organization Marketing**: It consists of activities undertaken to create, maintain, or change attitudes and behaviour of target audiences towards an organization. Both profit and non-profit organizations practice organization marketing.

8. **Place Marketing**: Place marketing involves activities undertaken to create, maintain, or change attitudes and behaviour towards particular places say, marketing of business sites, tourism marketing.
9. **Enlightened Marketing**: It is a marketing philosophy holding that a company's marketing should support the best long-run performance of the marketing system that is beyond the prevailing mindset; its **five principles** include customer-oriented marketing, innovative marketing, value marketing, sense-of-mission marketing, and societal marketing.
10. **Differential Marketing**: It is a market-coverage strategy in which a firm decides to target several market segments and designs separate offer for each.

    EXAMPLE-Hindustan Unilever Limited has Lifebuoy, Lux and Rexona in popular segment and Dove and Pears in premium segment.

11. **Synchro-marketing:** When the demand for a product is irregular due to season, some parts of the day, or on hour basis, causing idle capacity or overworked capacities, **synchro-marketing** can be used to find ways to alter the pattern of demand through flexible pricing, promotion, and other incentives.

    EXAMPLE-products such as movie tickets can be sold at lower price over weekdays to generate demand.

12. **Concentrated Marketing**: It is a market-coverage strategy in which a firm goes after a large share of one or few sub-markets. It can also take the form of Niche marketing.
13. **Demarketing:** It includes marketing strategies to reduce demand temporarily or permanently. The aim is not to destroy demand, but only to reduce or shift it. This happens when there is overfull demand.

    EXAMPLE-buses are overloaded in the morning and evening, roads are busy for most of times, zoological parks are over-crowded on Saturdays, Sundays and holidays. Here demarketing can be applied to regulate demand.

2.4 CHANNELS

Channels are the distribution system by which an organisation distributes its product or provides its service.

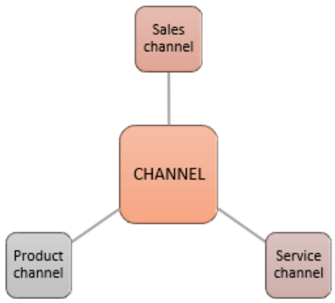
EXAMPLEs of how the following companies distribute their products and services;

- Lakme - sells its products via retail stores, intermediary stores (like Nykaa, Westside, Reliance Trends), as well as online mode like amazon, Flipkart, nykaa online and its own website.

- Boat Headphones - only online via e-commerce platforms like Flipkart and amazon.
- Coca Cola - retail shops across the nation, in each district, each town as well as online mode via dunzo, blinkit, etc.

The wider and stronger the channel the better position a business has to fight and win over competition. Also, having robust channels of business distribution help keep new players away from entering the industry, thus acting as barriers to entry.

There are typically three channels that should be considered: sales channel, product channel and service channel.



1. **<u>The sales channel</u>** - These are the intermediaries involved in selling the product through each channel and ultimately to the end user. The key question is: Who needs to sell to whom for your product to be sold to your end user?

   EXAMPLE-many fashion designers use agencies to sell their products to retail organisations, so that consumers can access them.

2. **<u>The product channel</u>** - The product channel focuses on the series of intermediaries who physically handle the product on its path from its producer to the end user.

   This is true of Australia Post, who delivers and distributes many online purchases between the seller and purchaser when using eBay and other online stores.

3. **<u>The service channel</u>** - The service channel refers to the entities that provide necessary services to support the product, as it moves through the sales channel and after purchase by the end user. The service channel is an important consideration for products that are complex in terms of installation or customer assistance.

   EXAMPLE-a Bosch dishwasher may be sold in a Bosch showroom, and then once sold it is installed by a Bosch contracted plumber.

Channel analysis is important when the business strategy is to scale up and expand beyond the current geographies and markets. When a business plans to grow to newer markets, they need to develop or leverage existing channels to get to new customers. Thus, analysis of channels that suit one's products and customers is of utmost importance.

EXAMPLE - if a healthcare brand wants to reach out to elderly customers - they need to be more focused on offline mode of business where agents reach out physically to the elderly as most of their potential customers (i.e. the old aged) are not active on smartphones.

3.CORE COMPETENCIES

What is core competency and how it is identified?

Core competency is defined as the collective learning in the organization, especially coordinating diverse production skills and integrating multiple streams of technologies. An organization's combination of technological and managerial know-how, wisdom and experience are a complex set of capabilities and resources that can lead to a competitive advantage compared to a competitor.

By C.K. Prahalad and Gary Hamel

Competency is defined as a combination of skills and techniques rather than individual skill or separate technique. The optimal way to define core competence is to consider it as sum of 5- 15 areas of developed expertise. For **core competencies**, it is characteristic to have a combination of skills and techniques, which makes the whole organization utilize these several separate individual capabilities.

According to C.K. Prahalad and Gary Hamel, major core competencies are identified in three areas -

1) competitor differentiation,
2) customer value, and
3) application to other markets

1. **Competitor differentiation**: The company can consider having a core competence if the competence is unique and it is difficult for competitors to imitate. This can provide a company an edge compared to competitors. It allows the company to provide better products or services to market with no fear that competitors can copy it. The company has to keep on improving these skills in order to sustain its competitive position. Although all companies operating in the same market would have the equal skills and resources, if one company can perform this significantly better; the company has obtained a core competence.

EXAMPLE, it is quite difficult to imitate patented innovation, like Tesla has been winning over competition in electric vehicles.

2. **Customer value**: When purchasing a product or service it has to deliver a fundamental benefit for the end customer in order to be a core competence. It will include all the skills needed to provide fundamental benefits. The service or the product has to have real impact on the customer as the reason to choose to purchase them. If customer has chosen the company without this impact, then competence is not a core competence, and it will not affect the company's market position. The essence is that the consumer should value the differentiation offered. Without it, the core competency does not make sense.

3. **Application of competencies**: Core competence must be applicable to the whole organization; it cannot be only one particular skill or specified area of expertise. Therefore, although some special capability would be essential or crucial for the success of business activity, it will not be considered as core competence if it is not fundamental from the whole organization's point of view. Thus, a **core competence** is a unique set of skills and expertise, which will be used throughout the organisation to open up potential markets to be exploited.

If the three above-mentioned conditions are met, then the company can regard it competence as core competency.

Core Competence-based diversification reduces risk and investment and increases the opportunities for transferring learning and best practice across business units.

Core competencies are often visible in the form of organizational functions.

EXAMPLE- Marketing and Sales is a core competence of Hindustan Unilever Limited (HUL) This means that HUL has used its resources to form marketing related capabilities that in turn allow it to market its products in ways that are superior those of competitors. Because of this core competence, HUL is capable of launching new brands in the market successfully.

3.1 CRITERIA FOR BUILDING CORE COMPETENCIES

Four specific criteria of sustainable competitive advantage that firms can use to determine those capabilities that are core competencies.

1. **Valuable**: **Valuable capabilities** are the ones that allow the firm to exploit opportunities or avert the threats in its external environment. A firm creates value for customers by effectively using capabilities to exploit opportunities. Finance companies build a valuable competence in financial services. In addition, to make such competencies as financial services highly successful require placing the right people in the right jobs. Human capital is important in creating value for customers.

2. **Rare**: Core competencies are very **rare capabilities** and very few of the competitors possess this. Capabilities possessed by many rivals are unlikely to be sources of competitive advantage for any one of them. Competitive advantage results only when firms develop and exploit valuable capabilities that differ from those shared with competitors.

3. **Costly to imitate**: **Costly to imitate** means such capabilities that competing firms are unable to develop easily.

   EXAMPLE: Intel has enjoyed a first-mover advantage more than once because of its rare fast R&D cycle time capability that brought SRAM and DRAM integrated circuit technology and brought microprocessors to market well ahead of the competitor. The product could be imitated in due course of time, but it was much more difficult to imitate the R&D cycle time capability.

4. **Non-substitutable:** Capabilities that do not have strategic equivalents are called **non-substitutable capabilities**. This final criterion for a capability to be a source of competitive advantage is that there must be no strategically equivalent valuable resources that are themselves either not rare or imitable.

   EXAMPLE-for years, firms tried to imitate Tata's low-cost strategy, but most have been unable to duplicate Tata's success. They did not realize that Tata has a unique culture and attracts some of the top talent in the industry. The culture and excellent human capital worked together in implementing Tata's strategy and are the basis for its competitive advantage.

   The strategic value of capabilities increases as they become more difficult to substitute.

   EXAMPLE-Competitors are deeply aware about Apple's operating system's (iOS) successful model. However, to date, no competitor has been able to imitate Apple's capabilities. These are also protected through copyrights.

When a capability is valuable, rare, costly to imitate, and non-substitutable, it is a core competence and a source of competitive advantage. Core competencies are a source of competitive advantage only when they allow the firm to create value by exploiting opportunities in its external environment

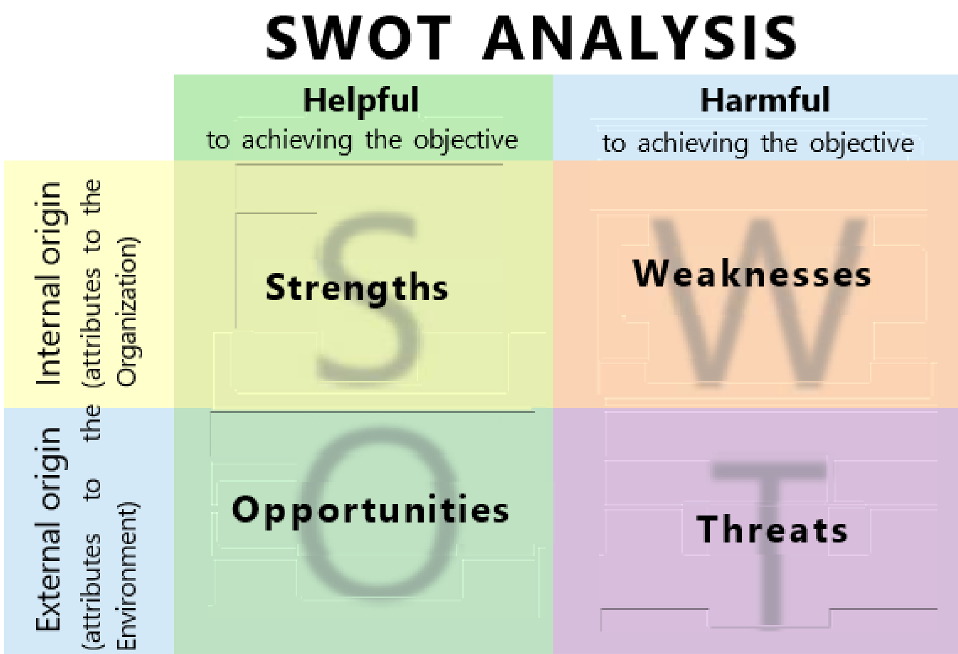
4.SWOT ANALYSIS-Combining internal and external analysis

What do you mean by swot analysis and how it is implemented?

SWOT analysis is the analysis of a business's **strengths**, **weaknesses**, **opportunities** and **threats**. The primary objective of a SWOT analysis is to help organizations develop a full awareness of all the factors (external as well as internal), involved in making a business decision.

SWOT analysis shall be implemented before all company actions, whether it is exploring new initiatives, revamping internal policies, considering opportunities to grow or alter a plan midway. One shall also use SWOT analysis to discover recommendations and strategies, with a focus on leveraging strengths and opportunities to overcome weaknesses and threats.

Since its creation, SWOT has been the most widely used tools for business owners to grow their companies. The analysis can show areas where an organization is performing well, as well as areas that need improvement.



SWOT Analysis Example

EXAMPLE of a law firm - what could its SWOT analysis help understand about its business.

STRENGTH	WEAKNESS
Multiple Partners with varied expertise Long Term contractual service agreements 70 years of brand value Services spread across 20 states of India 400+ employee strength to deliver work	Run by old methods No automation of work and documentation Not very employee friendly culture
OPPORTUNITY	**THREAT**
Automation driven advancement.	Online players entering market.
Startups can be supported with experienced partners. Investment in technology can multiply returns.	AI based solutions and applications. Price point of online being very competitive Speed of work becoming faster by the day.

The benefit of this analysis is that it identifies the complex issues for an organisation and puts them into a simple framework. While on the other hand, one of the major criticisms of this tool is that it does not generally provide for evaluation of strengths, weaknesses, opportunities and threats in the competitive context.

Therefore, an organisation while using this tool, SWOT analysis, should consider relative competitors, and external factors affecting the organisation. Although a simple tool, it is a useful starting point for analysis.

SWOT Analysis for Internal or External Environment?
SWOT stands for Strengths, Weaknesses, Opportunities and Threats. Internal analysis is more focused on understanding the existing structure and competencies of the business, thus highlighting the Strengths and Weaknesses, while External Analysis is about identifying and preparing for uncontrollable which can either be Opportunities or threats. Therefore, SWOT Analysis is a tool which is used for both Internal and External Analysis.

5.COMPETITIVE ADVANTAGE (using MICHAEL PORTER'S GENERIC STRATERGIES)

What is a competitive advantage?

If a company's strategies result in superior performance, it is said to have a **competitive advantage.**

Strategic management involves development of competencies that managers can use to achieve better performance and a competitive advantage for their organization. Competitive advantage allows a firm to gain an edge over rivals when competing. **'It is a set of unique features of a company and its products that are perceived by the target market as significant and superior to the competition.'**

The **competitive advantage** is the achieved advantage over rivals when a company's profitability is greater than the average profitability of firms in its industry. It is achieved when the firm successfully formulates and implements the value creation strategy and other firms are unable to duplicate it or find it too costly to imitate.

5.1 SUSTAINABILITY OF COMPETITIVE ADVANTAGE

The **sustainability of competitive advantage** and a firm's ability to earn profits from its competitive advantage depends upon four major characteristics of resources and capabilities:

1. **Durability**: The period over which a **competitive advantage** is sustained depends in part on the rate at which a firm's resources and capabilities deteriorate. In industries where the rate of product innovation is fast, product patents are quite likely to become obsolete.

   Similarly, capabilities which are the result of the management expertise of the CEO are also vulnerable to his or her retirement or departure. On the other hand, many consumer brand names have a highly durable appeal.

2. **Transferability:** Even if the resources and capabilities on which a competitive advantage is based are durable, it is likely to be eroded by competition from rivals. The ability of rivals to attack position of competitive advantage relies on their gaining access to the necessary resources and capabilities. The easier it is to transfer resources and capabilities between companies, the less sustainable will be the competitive advantage which is based on them.

3. **Imitability**: If resources and capabilities cannot be purchased by a would-be imitator, then they must be built from scratch. How easily and quickly can the competitors build the resources and capabilities on which a firm's competitive advantage is based? This is the true test of imitability.

EXAMPLE- In financial services, innovations lack legal protection and are easily copied. Here again the complexity of many organizational capabilities can provide a degree of competitive defence. Where capabilities require networks of organizational routines, whose effectiveness depends on the corporate culture, imitation is difficult.

4. **Appropriability:** **Appropriability** refers to the ability of the firm's owners to appropriate the returns on its resource base. Even where resources and capabilities are capable of offering sustainable advantage, there is an issue as to who receives the returns on these resources. This means, that rewards are directed to from where the funds were invested, rather than creating an advantage with no actual reward to people to invested capital.

5.2 MICHAEL PORTER'S GENERIC STRATEGY

According to Porter, strategies allow organizations to gain competitive advantage from three different bases: cost leadership, differentiation, and focus. Porter called these base generic strategies. These strategies have been termed generic, because they can be pursued by any type or size of business firm and even by not-for-profit organisations.

COMPETITIVE SCOPE		Low-Cost products/services	Differentiated products/services
	Broad Target	Cost Leadership	Differentiation
	Narrow Target	Focussed Cost Leadership	Focussed Differentiation

COMPETITIVE ADVANTAGE

1. **Cost leadership** emphasizes on producing standardized products at a very low per-unit cost for consumers who are price-sensitive.
2. **Differentiation** is a strategy aimed at producing products and services considered unique industry-wide and directed at consumers who are relatively price-insensitive.
3. **Focus** means producing products and services that fulfil the needs of small groups of consumers with very specific taste

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

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

Porter stresses the need for strategists to perform **cost-benefit analysis** to evaluate "sharing opportunities" among the firm's existing and potential business units. Sharing activities and resources enhances competitive advantage by lowering costs or raising differentiation.

Porter stresses the need for firms to "transfer" skills and expertise among autonomous business units effectively in order to gain competitive advantage.

Depending upon factors such as type of industry, size of firm and nature of competition, various strategies could yield advantages in cost leadership differentiation, and focus.

Cost leadership strategy

It is a low-cost competitive strategy that aims at broad mass market. It requires vigorous pursuit of cost reduction in the areas of procurement, production, storage and distribution of product or service and also economies in overhead costs. Because of its lower costs, the cost leader is able to charge a lower price for its products than most of its competitors and still earn satisfactory profits

EXAMPLE-McDonald's fast-food restaurants have successfully followed low-cost leadership strategy. Decathlon Group's mega sports stores have been following low-cost leadership strategy to gain international recognition and also beat competition.

A primary reason for pursuing forward, backward, and horizontal integration strategies is to gain cost leadership benefits. A number of cost elements affect the relative attractiveness of generic strategies, including economies or diseconomies of scale achieved, learning and experience curve effects, the percentage of capacity utilization achieved, and linkages with suppliers and distributors. Other cost elements to consider while choosing among alternative generic strategies include the potential for sharing costs and knowledge within the organization, R&D costs associated with new product development or modification of existing products, labour costs, tax rates, energy costs, and shipping costs. This internal strategy of sharing resources to build a competitive advantage is called synergy benefit.

Striving to be a low-cost producer in an industry can especially be effective,

- when the market is composed of many price-sensitive buyers and
- when there are few ways to achieve product differentiation.

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

Some risks of pursuing cost leadership are;

1. that competitors may imitate the strategy, therefore driving overall industry profits down;
2. that technological breakthroughs in the industry may make the strategy ineffective; or that buyer interests may swing to other differentiating features besides price.

Achieving cost leadership strategy

1. Prompt forecasting of demand of a product or service.
2. Optimum utilization of the resources to achieve cost advantages.
3. Achieving economies of scale; thus, lower per unit cost of product/service.
4. Standardisation of products for mass production to yield lower cost per unit.

   EXAMPLE of McDonald's

5. Invest in cost saving technologies and using advance technology for smart efficient working.
6. Resistance to differentiation till it becomes essential.

Advantages of Cost Leadership Strategy

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

1. **Rivalry** – Competitors are likely to avoid a price war, since the low-cost firm will continue to earn profits even after competitors compete away their profits.
2. **Buyers** – Powerful buyers/customers would not be able to exploit the cost leader firm and will continue to buy its product.
3. **Suppliers** – Cost leaders are able to absorb greater price increases from suppliers

before they need to raise prices for customers.

4. **Entrants** – Low-cost leaders create barriers to market entry through their continuous focus on efficiency and cost reduction.

5. **Substitutes** – Low-cost leaders are more likely to lower the costs to induce existing customers to stay with their products, invest in developing substitutes, and even purchase patents.

Disadvantages of Cost Leadership Strategy

1. Cost advantage may not last long as competitors may imitate cost reduction techniques.

2. Cost leadership can succeed only if the firm can achieve higher sales volume.

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

4. Technological advancement areas a great threat to cost leaders.

Differentiation Strategy

This strategy is aimed at broad mass market and involves the creation of a product or service that is perceived by the customers as unique. The uniqueness can be associated with product design, brand image, features, technology, dealer network or customer service. Because of differentiation, the business can charge a premium for its product.

EXAMPLE-Domino's Pizza has been offering home delivery within 30 minutes or the order is free, is a unique selling point that differentiates if from its rivals.

Differentiation does not guarantee competitive advantage, especially if standard products sufficiently meet customer needs or if rapid imitation by competitors is possible.

Successful differentiation can mean greater product flexibility, greater compatibility, lower costs, improved service, less maintenance, greater convenience, or more features. A **successful differentiation strategy** allows a firm to charge a higher price for its product and to gain customer loyalty, because consumers may become strongly attached to the differentiated features.

Product development is an EXAMPLE of a strategy that offers the advantages of differentiation.

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

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

Some risks of pursuing differentiation strategy are that

1. The unique product may not be valued high enough by customers to justify the higher price. When this happens, a cost leadership strategy will easily defeat a differentiation strategy.
2. Competitors may develop ways to copy the differentiating features quickly. Firms must find durable sources of uniqueness that cannot be imitated quickly or cheaply by rival firms.

   Example -amazon prime offers deliver within two hours. This is quite difficult to imitate by its rivals, and thus this differentiating factor helps it to lead the market.

Basis of Differentiation

There are several bases of differentiation, major being: Product, Pricing and Organization.

1. **Product:** Innovative products that meet customer needs can be an area where a company has an advantage over competitors. However, the pursuit of a new product offering can be costly. The payoff, however, can be great as customer's flock to be among the first to have the new product.

   EXAMPLE-Apple iPhone, has invested huge amounts of money in R&D, and the customers' value that. They want to be among the first ones to try the new offerings from the company.

2. **Pricing:** It fluctuates based on its supply and demand and may also be influenced by the customer's ideal value for a product. Companies that differentiate based on product price can either determine to offer the lowest price or can attempt to establish superiority through higher prices.

   EXAMPLE-Apple iPhone dominates the smart phone segment by charging higher prices for its products.

3. **Organization:** Organizational differentiation is yet another form of differentiation. Maximizing the power of a brand or using the specific advantages that an organization possesses can be instrumental to a company's success. Location advantage, name recognition and customer loyalty can all provide additional ways for a company differentiate itself from the competition.

EXAMPLE-Apple has been building customer loyalty since years and has a fanbase of consumers that are called "Apple Fanboys/Fangirls".

Achieving Differentiation Strategy

To achieve differentiation, following strategies could be adopted by an organization:

1. Offer utility to the customers and match products with their tastes and preferences.
2. Elevate/Improve performance of the product.
3. Offer the high-quality product/service for buyer satisfaction.
4. Rapid product innovation to keep up with dynamic environment.
5. Taking steps for enhancing brand image and brand value.
6. Fixing product prices based on the unique features of product and buying capacity of the customer.

Advantages of Differentiation Strategy

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

1. **Rivalry** - Brand loyalty acts as a safeguard against competitors. It means that customers will be less sensitive to price increases, as long as the firm can satisfy the needs of its customers.
2. **Buyers** – They do not negotiate for price as they get special features and they have fewer options in the market.
3. **Suppliers** – Because differentiators charge a premium price, they can afford to absorb higher costs of supplies as the customers are willing to pay extra too.
4. **Entrants** – Innovative features are an expensive offer. So, new entrants generally avoid these features because it is tough for them to provide the same product with special features at a comparable price.
5. **Substitutes** – Substitute products can't replace differentiated products which have

high brand value and enjoy customer loyalty.

Disadvantages of Differentiation Strategy

1. In the long term, uniqueness is difficult to sustain.
2. Charging too high a price for differentiated features may cause the customer to switch-off to another alternative. As we see a shift of iPhone users to other android flagship smart phones.
3. Differentiation fails to work if its basis is something that is not valued by the customers. Home delivery of packed snacks in 30 minutes would not even be a differentiator as the consumer wouldn't value such an offer.

Focus Strategies

A **successful focus strategy** depends on an industry segment that is of sufficient size, has good growth potential, and is not crucial to the success of other major competitors. Strategies such as market penetration and market development offer substantial focusing advantages.

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

Some Risks of pursuing a focus strategy include,

1. the possibility of numerous competitors recognizing the successful focus strategy and imitating it
2. that consumer preferences may drift towards the product attributes desired by the market as a whole.

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

EXAMPLE-Ferrari sports cars.

Focused cost leadership: A **focused cost leadership** strategy requires competing based on price to target a narrow market. A firm that follows this strategy does not necessarily charge the lowest prices in the industry. Instead, it charges low prices relative to other firms that compete within the target market. Firms that compete based on price and target a narrow market follow a **focused cost leadership strategy**.

Focused differentiation: A **focused differentiation** strategy requires offering unique features that fulfil the demands of a narrow market. Similar to focused low- cost strategy, narrow markets are defined in different ways in different settings. Some firms using a focused differentiation strategy concentrate their efforts on a particular sales channel, such as selling over the internet only, Others target particular demographic groups. Firms that compete based on uniqueness and target a narrow market are following a **focused differentiations strategy**.

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

Achieving Focused Strategy

To achieve focused cost leadership/differentiation, following strategies could be adopted by an organization:

1. Selecting specific niches which are not covered by cost leaders and differentiators.
2. Creating superior skills for catering such niche markets.
3. Generating high efficiencies for serving such niche markets.
4. Developing innovative ways in managing the value chain.

Advantages of Focused Strategy

1. Premium prices can be charged by the organizations for their focused product/services.
2. Due to the tremendous expertise in the goods and services that the organizations following focus strategy offer, rivals and new entrants may find it difficult to compete.

Disadvantages of Focused Strategy

1. The firms lacking in distinctive competencies may not be able to pursue focus strategy.
2. Due to the limited demand of product/services, costs are high, which can cause problems.
3. In the long run, the niche could disappear or be taken over by larger competitors by acquiring the same distinctive competencies.

Best-Cost Provider Strategy

The new model of **best cost provider strategy** is a further development of above three generic strategies. It is directed towards giving customers more value for the money by emphasizing on both, low cost and upscale differences.

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

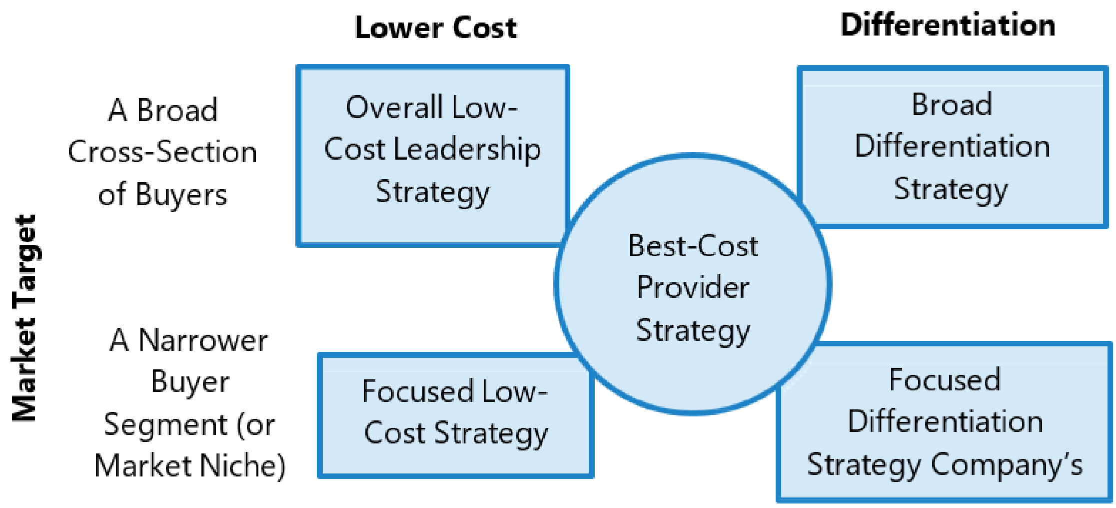


Figure: The Five Generic Competitive Strategies

Best-cost provider strategy involves providing customers more value for the money by emphasizing on lower cost and better-quality differences.

It can be done through:

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

Or

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

EXAMPLE-android flagship phones from OnePlus, Xiaomi, Oppo, Vivo, etc, are all rooting for giving better quality at lowest prices to the customers. They are following the best-cost provider strategy to penetrate market.