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SWP 33/91 CHARTING COMPETITIVE STRATEGY

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CHARTING COMPETITIVE STRATEGY

Introduction

This article emerges from the author's attempts to teach practising managers about competitive strategy. The advantage of the approach outlined here is that it helps us to capture the essence of competitive strategy as a dynamic process.

The Chart

The North-South axis on the chart (Figure 1) is "perceived use-value", ie. what buyers perceive as valuable, not what management think is valuable. The East-West axis is relative price.

Assume all the firms are on the start line in Figure 1. That is, they are all perceived by buyers to be offering the same products/services, and they all charge the same price. In this situation we would expect all firms to have the same market share.

How can Firm A improve market share?

There are two basic options:

- * offer higher perceived value for the same price as the competition.
- * offer the same perceived value at a lower price.

These competitive moves could be dubbed the "Better" option, or the "Cheaper" option.

The "Cheaper" Option

So Firm A shifts to the left (Figure 2). What would the competition do about it? If the price cut pays Firm A dividends in market share terms, the competitors will be forced to match the lower prices. This they can do (overnight, if necessary).

So the "Cheaper" option can (and most likely, will) be imitated. In the short term a new average price will rule in this industry, to the left of the original one (Figure 3).

Can this option lead to sustainable advantage? Yes, it can, but only if Firm A has the lowest costs. This would enable it to sustain the lower price position longer

than the competition, and to continually drive prices down until most of the pursuers are shaken off.

Is it an attractive option? Well, probably not. If there are other players pursuing the same option life would be very uncomfortable for all competitors. Unless Firm A does achieve lowest costs, they, eventually, might be squeezed out by the lowest cost firm. Even if this does not happen margins are likely to be cut to the bone for all players.

However, if, having shaken off its rivals the lowest cost producer can move back East by raising prices, this could be a very profitable strategy. Until, that is, someone enters, or re-enters the market.

But, the biggest risk to this strategy is another player pursuing the "Better" option.

The "Better" Option

Here Firm A moves North, offering the buyers better perceived value for the same price (Figure 4). This could be done through branding, product innovation, improved service levels. However, what is critical to this option is the need to understand what buyers value. The big danger is that management assume they know what buyers want, because they are so experienced in the industry. This is a dangerous assumption to make.

The "Better" option improves market share so long as a significant proportion of buyers value the extra benefits Firm A offers. If all the buyers do, then we have a homogeneous, non-segmented market, and Firm A can sell everything it makes (and more!). This is not likely, though. The odds are that, as an industry moves north subtle differences in wants emerge which provide opportunities for niche strategies to exploit segments.

What would be the competitors' response to Firm A moving north? It depends on the nature of the original improved offer to the buyer. For example, take the banking industry. One bank moves north by opening longer hours. This persuades some customers to shift their accounts to Bank A, thereby increasing their share of the market. However, in a very short space of time, other banks match Bank A's opening hours, and maybe market shares settle back to where they were before Bank A's move. The net result would be a ratcheting up of acceptable ("average") perceived value in the industry, so a new average results at a higher level of value (Figure 5).

Over time competitor moves northward that are imitated have the effect of continually increasing the minimum acceptable standards in the industry. In the car industry, anti-corrosion warranties conferred advantage 10 years ago, now they are the norm. This means that firms left behind face a competitive disadvantage. If

they can't follow suit, they are likely to be forced to cut prices, as they are perceived to be offering inferior value to the rest of the industry.

Some moves North lead to a more sustainable competitive advantage, because they are less easy to imitate. Returning to the banking industry, improving customer service, making staff friendlier, more attentive, knowledgeable and helpful is difficult to achieve. The Bank that gets it right first may be able to stay out ahead as the rivals struggle to improve staff performance. Other "Better" strategies involve the firm being continually one step ahead, through constant product/service innovation.

Staying Put

Is there an option to stay put, to pursue neither the Better, nor the Cheaper options? The answer is yes, and it will work as long as everyone else stays put too. But the risks are twofold:

- * clearly, as soon as one firm breaks ranks, the strategy won't work.
- * the 'staying put' option is often linked with the pursuit of 'cost efficiency', which can be dangerous.
- * a sleepy industry may encourage new, more vigorous firms to enter.

Cost Efficiency

The pursuit of cost efficiency is clearly vital to either the Better or Cheaper options. Neither option will improve profit performance unless the firm is an efficient (relative to competitors) user of resources. Certainly, these options will improve market share, but in order to translate the share improvements into profit improvements, the management must focus attention on efficiency. Efficiency is not, therefore, just important for the "Cheaper" option.

However, 'staying put' seems to encourage an inward-looking, efficiency - orientated management. The pursuit of cost efficiency becomes an end in itself; it is not combined with a competitive strategy. A strong efficiency orientation can lead to a lack of flexibility in the organisation.

The reasons why efficiency is an attractive option are clear. It avoids management having to look outside the firm. It does not require the consideration of, or measurement of such qualitative and difficult areas like customer satisfaction, changing needs, competitor actions etc. Cost efficiency lends itself to measurement, and there are a whole bunch of well understood management

"routines" that can be applied to cut costs. But, on its own, it is not a competitive strategy. It plays a role in sustaining either the 'Better' or the 'Cheaper' options.

Moving North East

If Firm A shifts North East (Figure 6) it is supplying higher perceived value, and charging premium prices (Porter's "Differentiation" Strategy). This strategy could work, but it depends on two conditions: Firstly, that there is a segment out there that values these attributes, and is willing to pay premium prices to get them. And secondly, that there is no-one else already up there in the North East corner. If there is someone there, does your offering provide something better at the same prices, or can you offer the same perceived value at lower (relative) prices? In other words, moving North East forces us to re-draw our diagram (see Figure 7). We can now assess the effectiveness of this move with respect to the other firms perceived by the buyers as offering equivalent products or services. In this sense it is crazy to suggest, for example, that Mercedes has a competitive advantage over Hyundai; they are not perceived by their respective buyer segments as offering competing products.

Moving North West

Better and Cheaper at the same time might prove to be a powerful combination. There are problems, however, if buyers use price as a proxy measure of quality. This could mean your buyers would not acknowledge the added value you offer, meaning that your attempt to move North West ends up as a shift Westwards (Figure 2).

But it is conceivable that a move North may result in significant increases in share. And if there were scale or experience curve effects available, those volume increases could help to drive unit costs down. So, when the pack finally catches up, Firm A could cut prices (see Figure 9), or it could add product features to move them further North.

Moving South West - 'Cheap 'n' Cheerful'

In the same way that the move North East required a group of buyers willing to pay for the added perceived value, there may well be buyers who don't require the requirements continually being added in to the product/service, or buyers who can't afford to enter the market place with the existing price/value offerings available. If such a group exists, a shift South-West might be viable (Figure 8). Stripping out the frills should enable the firm to make profits at the lower price levels. But, just like in the North East example, we need to re-draw the chart to acknowledge that we have shifted 'down-market'. Here there may well be a whole different set of

players vying for these customers' businesses. This is why it is vital to conceive of these "industries" as trying to satisfy needs, not trying to sell a product/service.

Reference

Porter M
"Competitive Advantage" Free Press New York 1985

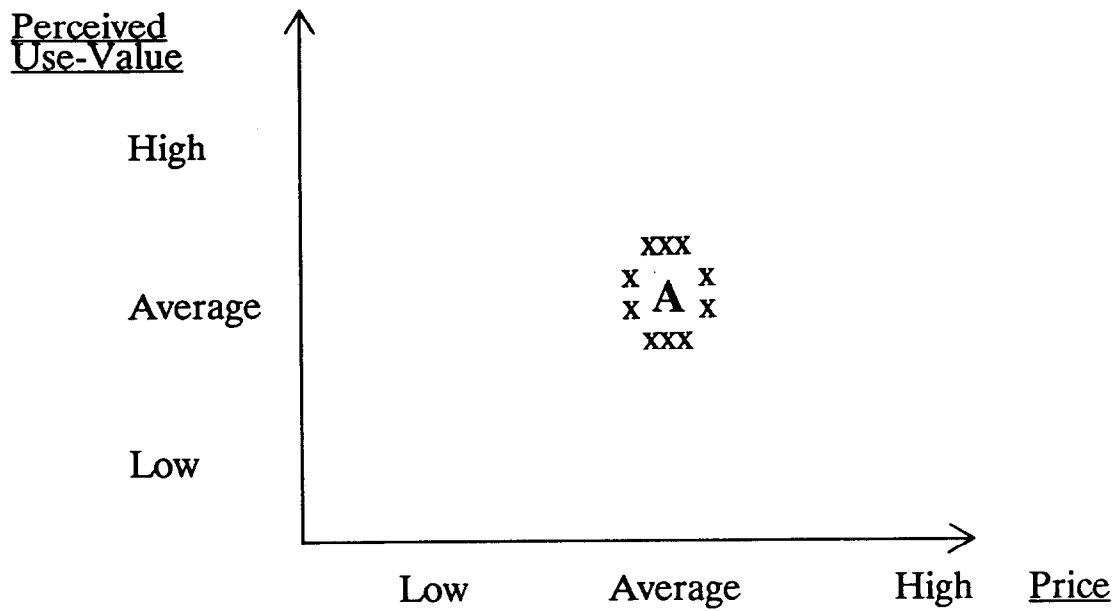


Fig 1

The Competitive Strategy Chart

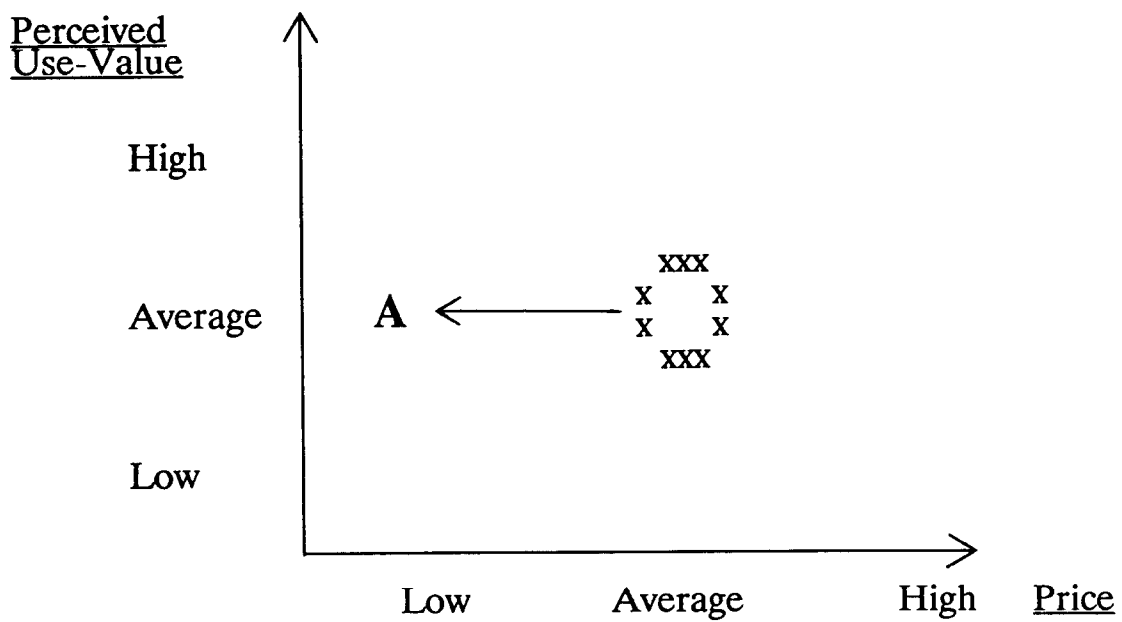


Fig 2

The "Cheaper" Option

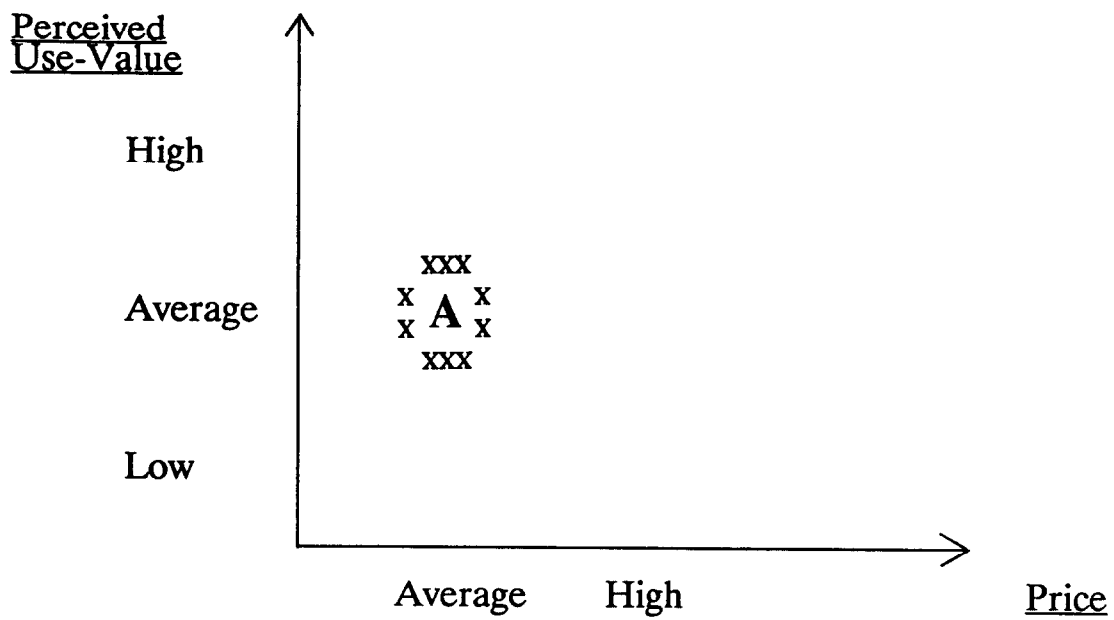


Fig 3 Competitor Response to the Cheaper Option

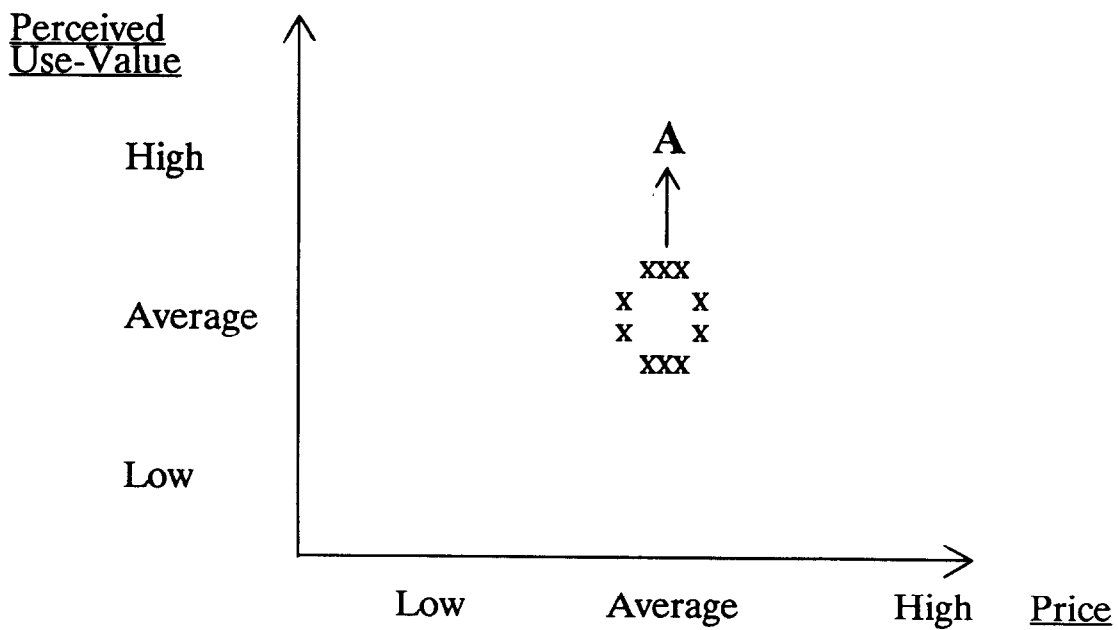


Fig 4 The "Better" Option

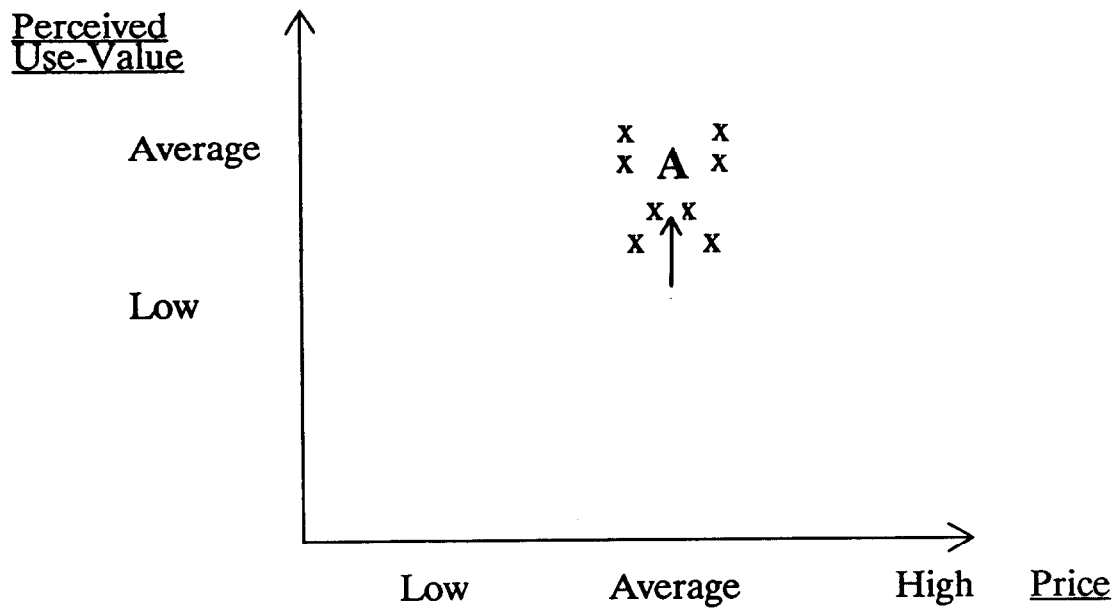


Fig 5 Competitor Response to the "Better" Option

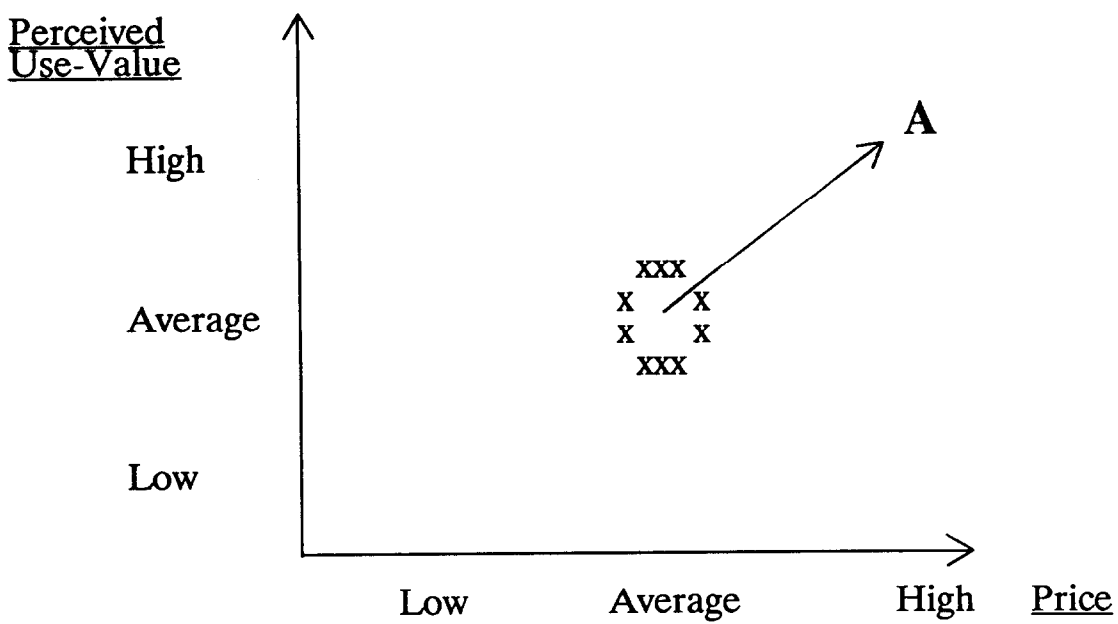


Fig 6 Higher Value/Higher Prices

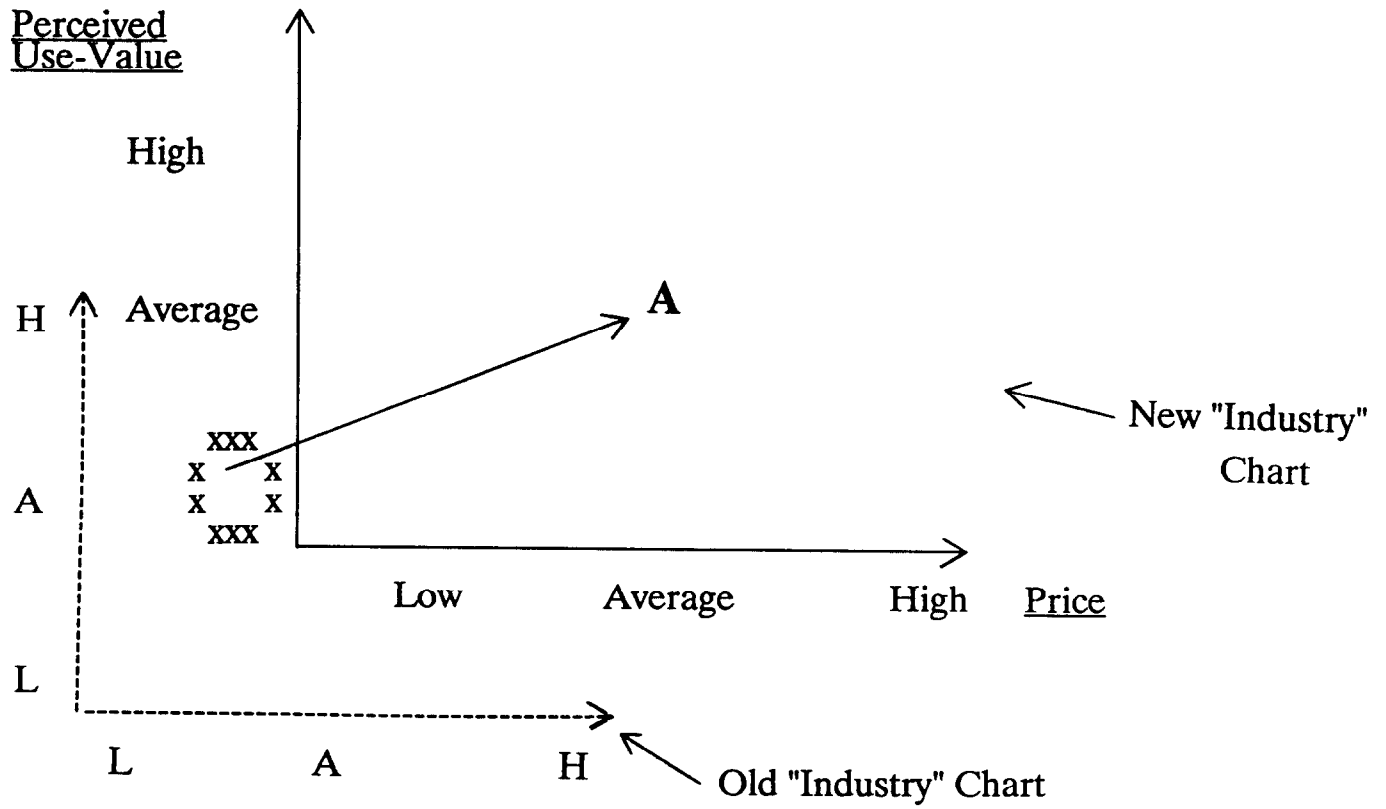


Fig 7

Re-drawing the Chart - Moving 'Up Market'

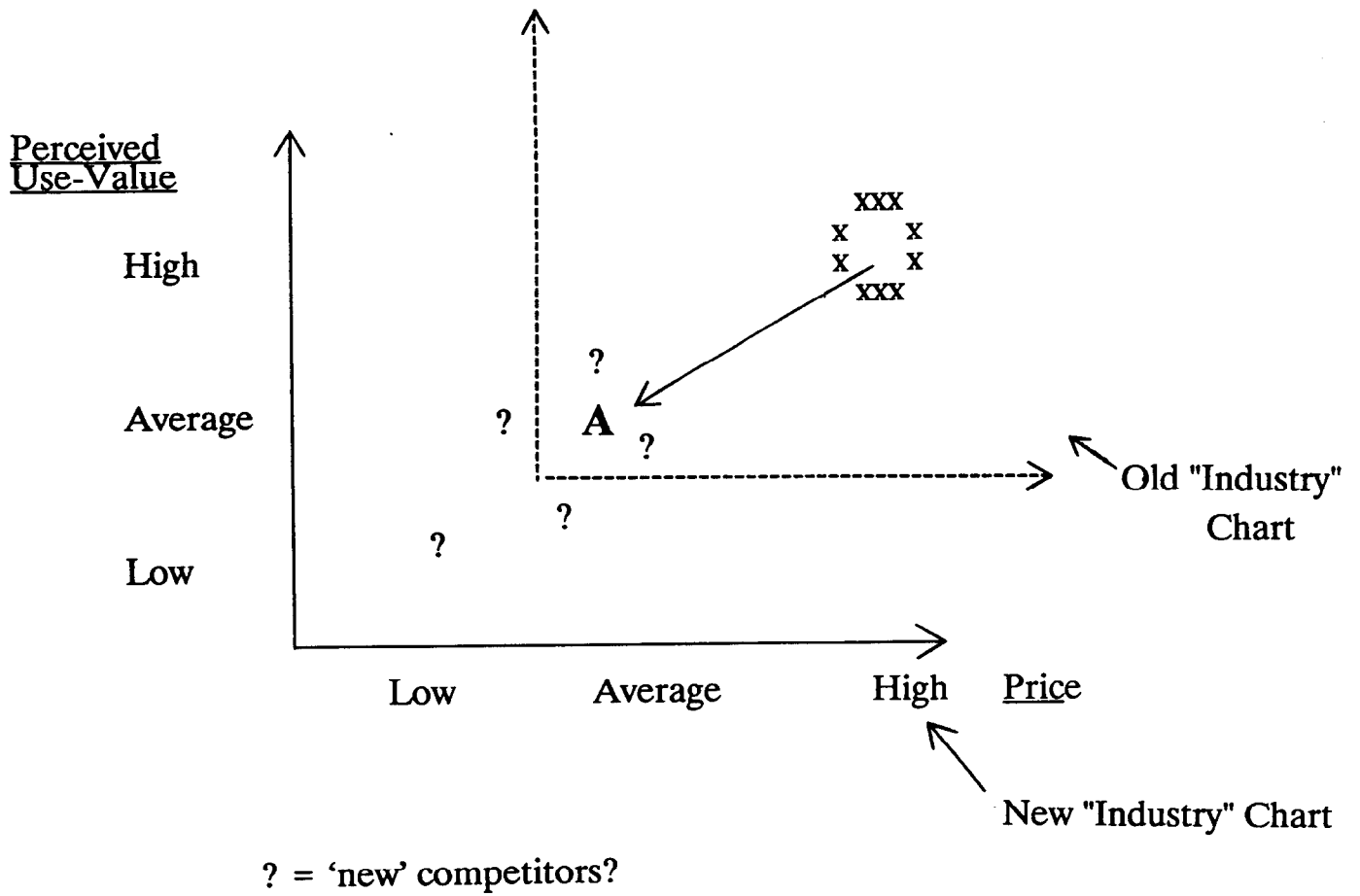


Fig 8

Re-drawing the Chart - Moving 'Down Market'

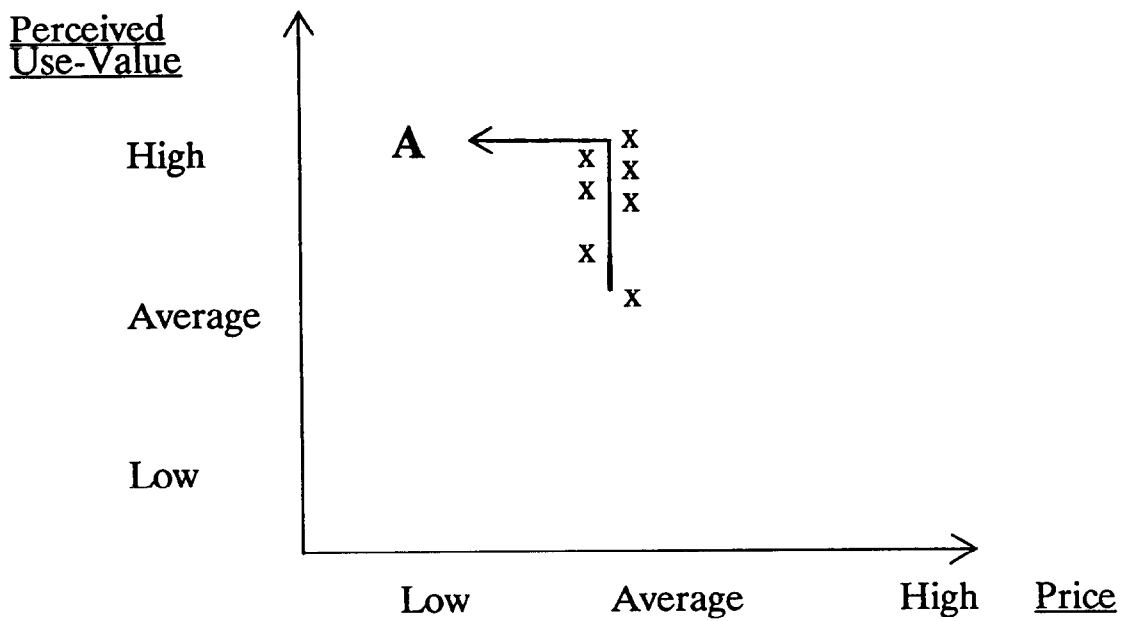


Fig 9

Escaping the Pack - The North → West Hook