Session 5

3. Strategy and Competitive Advantage

Businesses are always looking for a competitive advantage, a way to stand apart from the masses and to offer something that's just right for a specific target audience. Therein lies the secret. Competitive advantage requires identifying a specific target audience with a clearly defined need, developing and delivering a high-quality and appropriately priced product or service and doing it better than anybody else.

Target Audience with Clearly Defined Need

Effective business strategy begins with focusing on the particular needs of a target audience. Cooks who wanted a faster way to cook food welcomed the microwave. Busy people on the move wanting a fast, affordable way to communicate with others embraced the cell phone. Businesses that are able to identify an audience and meet their needs better than their competitors will find themselves with a clear competitive advantage.

Delivering a High-Quality Service

Competitive advantage means just that: being better than the other available alternatives that your target audience has and, in the process, achieving an advantage. It's not enough to be "just as good as" the competition. Successful strategic advantage falls to those who can deliver a product or service that is better in some way and that is more meaningful to the target audience, says Lin Grensing-Pophal, a marketing consultant and the author of "Marketing with the End in Mind." High-quality is defined differently by different people, she says, and encompasses all elements of the marketing mix—product, price, place (or access) and promotion.

An Appropriate Price

Determining an appropriate price depends on the market and the competitive strategy that the business has selected. Is a Starbucks coffee worth $4 to $5? It is if Starbucks customers are willing to pay that much. Starbucks caters to a different audience than McDonald's, for instance, which sells coffee for much less. Appropriate price will be determined by the competitive position that a company hopes to achieve relative to its competitors and the weight of its brand image.

Being the Best

Being the best—at whatever it is—is the key to achieving competitive advantage for a business. Whether that means the best price, the easiest access, the best quality or the best service, successful companies find a way to differentiate themselves from the masses.

3.1.1. Defensive

Competition is inevitable in the business world. The threat of competitors swooping in to steal your customers or your share of the market can sometimes seem overwhelming for a small-business owner. There are steps you can take, however, to defend your products and your share of the market from competition.

Understanding Strategy

Defensive strategies are management tools that can be used to fend off an attack from a potential competitor. Think of it as a battleground: You have to protect your share of the market in order to keep your customers happy and your profits stable. Defending your business strategically is about knowing the market you're best equipped to operate in and about knowing when to widen your appeal to enter into new markets. In contrast to offensive strategies -- which are aimed to attack your market competition --

defensive strategies are about holding onto what you have and about using your competitive advantage to keep competitors at bay.

Approaches to Defensive Strategy

There are two approaches to defensive strategy in strategic management. The first approach is aimed at blocking competitors who are attempting to take over part of your business's market share. Cutting the price of your products, adding incentives or discounts to encourage customers to buy from you or increasing your advertising and marketing campaigns are the best common ways of going about this. The second approach is more passive. Here, you announce new product innovations, plan a company expansion by opening a new chain or reconnect with old customers to encourage them to buy from you. This is still a method to prevent the competition from taking away your customers and earning, but it is done in a more relaxed and less-aggressive manner, whereas the first approach is active and direct.

Advantages of Defensive Strategy

Employing a defensive strategy in your business can have many perceived and real benefits. First, you are increasing your marketing and advertising, which can be an effective way of getting both old and new customers through the door. Second, defensive strategies are typically less risk-laden than offensive strategies. You have the option to take passive measures to ensure your share of the market and you don't have to necessarily feel threatened at every turn. The third benefit of defensive strategy is that you are working to enhance the value of your products or services. By emphasizing the benefits of your brand, you are simultaneously devaluing the value of your competitors. This can be an effective long-term strategy in securing a niche market for your products and services.

Disadvantages to Defensive Strategy

The biggest disadvantage to defensive strategy comes when a business does not understand its target market. All products and services should be aimed at particular demographics of the broader marketplace. If you sell children's bicycles, for instance, aim your marketing at the demographic most likely to buy from you: probably young to middle-aged adults with children. It wouldn't make sense to target your children's bicycles to older adults without children or to teenagers who are no longer interested in riding children's sized bikes. The key is to know your share of the market and to work hard to hold onto that piece of the pie. Along with this major disadvantage comes the risk that you may rest on your laurels when it comes to innovation and product development. Successful businesses also keep their eyes open for opportunities to engage in new markets, to sell cutting-edge products and to reach new customers. Thus any defensive strategy you employ should be balanced with a long-term strategy for growing your business.

3.1.2. Adaptive

In their approach to strategy, companies have sometimes emphasized scale and position and at other times capabilities and competencies. Despite these shifts in focus, some basic beliefs about the nature of competition have remained unchanged.

Strategists have generally assumed that there is durable advantage in well-defined and largely stable industries comprising a few relatively homogeneous competitors. The practice of strategy has also retained some constant features: for the most part, it has remained deductive, predictive, episodic, and top down.

Yet sweeping forces in the business environment over the past decade? Many of them complex and interrelated _ argue not just for a shift in focus among the primarily static elements of traditional strategy but also for a new way of acknowledging the dynamic qualities of competition.

We can distinguish three important dimensions of turbulence and change: volatility in market positions, unpredictability of outcomes, and the widening gap in performance between winners and losers. Most industries have experienced instability on at least one of these dimensions, but some — such as technology-driven industries and commercial banking — have been affected on all three. The hardest-hit industries are those that have been disproportionately affected by globalization, deregulation, digitalization, connectivity, deconstruction, and the shift from products to services.

We are not implying that classical strategy and strategic planning are no longer relevant. They still are. But they are providing increasingly limited in their ability to address these rapidly evolving trends, which have resulted in extremely fluid business systems.

We believe that companies can renew and sharpen their quest for sustainable competitive advantage by pursuing adaptive advantage. Organizations with adaptive advantage recognize the unpredictability of today's environment and the limits of deductive analysis.

They seek to develop the most favorable organizational context in which new approaches to new problems can continually emerge. Adaptive advantage thus enables them to unite reflection with execution and to balance deduction with experimentation.

A Virgin Group is a good model

A good example of a company that has developed adaptive advantage at the level of the business portfolio is the Virgin Group, which boldly enters scales up, and exits new businesses in diverse industries.

Virgin constantly launches offerings that challenge incumbents' business models to deliver greater value to consumers. It usually partners with others for assets and talent, and its highest governance body is an investment committee rather than the more traditional operating committee.

Virgin creates and maintains dynamic advantage in a fluid environment by sowing a broad range of portfolio seeds, setting the conditions of success, orchestrating the assets and capabilities required, and continually applying strict criteria for exiting investments.

Most companies, and especially those in industries characterized by both unpredictability and a high rate of change, need a more adaptive and dynamic approach to strategy — an approach that emphasizes iterative experimentation in order to overcome the limitations of deductive approaches and keep pace with incessant change.

With such an approach, organizations gain adaptive advantage: the ability to achieve superior outcomes in a turbulent environment by continuously reshaping the enterprise through a process of managed evolution. In this article, we explain how adaptive advantage can be harnessed in practice.

Elements of adaptive advantage

Three attributes are essential for survival in a changing environment: readiness, responsiveness, and resilience. They can be achieved by static measures such as improved forecasting, decentralized decision-making, and buffering with excess capacity, respectively. However, to gain a sustainable advantage in a turbulent environment, companies must employ a more dynamic, recursive approach in which better-fitting strategies continuously evolve in response to change.

Styles of Adaptive Strategy

There are many styles of adaptive strategy that can help companies achieve business sustainability during a turbulent environment. A company's optimal choices are mainly a function of the environment — especially the rate at which it is changing, the predictability of change, and the degree of change required. There are four broad styles of adaptive strategy.

The Sprinter: In environments with only a moderate degree of both turbulence and required change, companies can focus on rapidly optimizing and exploiting existing business models to track an increasingly volatile environment. The fashion retailer Zara, for example, focuses on building a fast feedback cycle between sales data from its stores and the design and manufacture of new products. This model allows the company to stay at the forefront of fashion trends without having to make big bets on where the trends are headed.

The Experimenter: In environments where turbulence is high but the degree of change required is low, companies whose business models are fundamentally sound must nevertheless modify their product mix or other low-level aspects of their business through a process of iterative experimentation. McDonald's, for example, uses a structured process to design, test, and introduce menu items while keeping its overarching business model unchanged. This enables it to evolve along with customer preferences and still preserve the well-honed efficiency of the kitchen model at the core of its operations.

The Migrator: In environments with moderate turbulence and a high degree of required change, companies must deliberately migrate their obsolescent business models or domains toward more attractive ones using a targeted and deliberate process. Virgin, for instance, systematically manages a diverse portfolio of challenger businesses by rapidly scaling up potential winners and cleanly divesting or shutting down losers.

The Voyager: In environments with a high degree of both turbulence and required change, companies need to deploy an exploratory approach to the business model or system. This can involve "live" tests with a mixed portfolio of competing business models and strategies, some of which may even be mutually contradictory. Netflix, which has reinvented fundamental aspects of its business strategy and model several times in the extremely turbulent movie-rental business, is a good example of a voyager. It removed late fees (at one time a mainstay of industry profits) and is exploring video streaming on a variety of platforms, potentially cannibalizing its DVD-by-mail business in order to stay ahead of the competition. Netflix has succeeded in dominating and reshaping a chaotic industry in which less adaptive competitors have fared poorly.

Beginning the Journey

Adaptive advantage is a powerful concept for companies facing unstable environments. It involves not only different ways of operating but also very different ways of thinking about strategy. The first step in embracing adaptive advantage is therefore to create awareness of the challenges and opportunities presented by turbulence and unpredictability — and the adaptive choices available.

3.1.3. Survival

A strong business is one that can ride out the tough times. Your business plan should be able to account for a soft economy or an industry slump and should have the built-in flexibility you'll need in order to react quickly and nimbly in the face of change.

Take these business survival measures to insulate your company in the event of an unexpected downturn.

Maximize Your Cash Holdings

Remember that cash is king, and with it you can pay your suppliers and the bank. A quick way to boost your cash reserves is to sell off surplus inventory and then cut back your inventory orders until the situation improves. You can also push to improve your accounts receivables collection.

Diversify

Your infrastructure may allow you to quickly start selling alternative products that are unaffected by adverse market conditions. For example, during Prohibition, Anheuser-Busch Inc. sold malt syrup and a non-alcoholic beverage. When the ban on alcohol was lifted in 1933, the company had the resources in play to begin producing beer again.

Be Aggressive

If you can afford to do so, a slowdown can be the perfect time to introduce a new product or strike a strategic partnership. Surprise your competition while they're busy worrying about their own future.

Use Freelancers and Part-Timers

They can help build business at a lower cost because, unlike full-time workers, you typically don't have to provide benefits like health care and you can pay them at a lower rate than full-time employees.

Focus on Service

Good customer service will always help to differentiate you from your bigger competitors. In an economic slowdown, your clients may be looking to cut costs, too. If you boost your customer service efforts toward existing clients, it's more likely they'll stay you with during the slowdown -- and they may even expand their business with you once things pick up again.

Look for Substitute Materials

If your business is heavily dependent on raw materials, look for less expensive, substitute goods. The savings will go straight to your bottom line.

Revise Your Revenue Projections

Use the new projections to try and renegotiate the terms of your trade credit and bank debt.

Involve Your Employees

You may be surprised that your employees are willing to help come up with ways to cut costs. But smart workers realize their job status is tied to the overall health of the business.

Don't Abandon Development

The costliest mistake you can make during a rough period is to focus entirely on cutting costs to survive and abandon product development. New products can help differentiate you in a tough market. Also, when the market improves, you don't want to be caught with an empty development pipeline.

3.1.4 Offensive

Some business strategies can be seen as defensive, while others go on the offense. Defensive business strategies are reactionary and involve a wait-and-see approach, observing what competitors are doing and then responding. Offensive business strategies involve taking proactive, often aggressive action in the market. This action can be focused directly at competitors or aimed at securing market share regardless of the existing competition.

Direct Competition

A classic example of an offensive business strategy is direct, head-to-head competition. This type of direct competition could take the form of selling a product similar to a competitor's at a lower price or highlighting quality differences between one product and another. This type of offensive strategy can lead to destructive price wars that ultimately harm both organizations, however.

Aggressive Marketing

Direct competition strategies often involve an element of aggressive marketing. For example, one competitor might openly point out flaws in another competitor's product or service as a way to dissuade customers from doing business with the competitor. Such advertisements could be done with an objective price comparison or a more aggressive form of derision. Companies must be careful when using overly aggressive advertisements directed at competitors, as some customers may find these advertisements to be in poor taste.

Niche Market

Not all offensive strategies are directly aimed at a specific competitor. Some companies aggressively seek out new niches in the market that have not been tapped by the existing companies. For example, if the market for automobiles consisted primarily of large muscle cars, a company with an aggressive approach could offer a smaller, more fuel-efficient model to establish a new market. Similarly, a company's offensive strategy may target a new geographic market not presently being served with a particular type of product.

Innovation

Similar to establishing a new niche, many companies aggressively seek out new innovations to market to consumers. Innovation is not strictly limited to inventing a new product or a new process for creating a product. Innovation can also come in the form of inventive ways to run an existing business model more efficiently or more profitably.