Strategy and Competitive Advantage

Competing in the marketplace is like war. You have injuries and casualties, and the best strategy wins.
John Collins

Competitive advantage is at the heart of a firm’s performance in competitive markets.
Michael E. Porter

Winning business strategies are grounded in sustainable competitive advantage. A company has competitive advantage whenever it has an edge over rivals in securing customers and defending against competitive forces. There are many sources of competitive advantage: making the highest-quality product, providing superior customer service, achieving lower costs than rivals, having a more convenient geographic location, designing a product that performs better than competing brands, making a more reliable and longer-lasting product, and providing buyers more value for the money (a combination of good quality, good service, and acceptable price). To succeed in building a competitive advantage, a firm must try to provide what buyers will perceive as “superior value” — either a good product at a low price or a “better” product that is worth paying more for.

This chapter focuses on how a company can achieve or defend a competitive advantage.¹ We begin by describing the basic types of competitive strategies and then examine how these approaches rely on offensive moves to build competitive advantage and defensive moves to protect competitive advantage.

¹The definitive work on this subject is Michael E. Porter, Competitive Advantage (New York: Free Press, 1985). The treatment in this chapter draws heavily on Porter’s pioneering effort.
In the concluding two sections, we survey the pros and cons of a vertical integration strategy and look at the competitive importance of timing strategic moves—when it is advantageous to be a first-mover or a late-mover.

THE THREE GENERIC TYPES OF COMPETITIVE STRATEGY

Competitive strategy consists of all the moves and approaches a firm has taken and is taking to attract buyers, withstand competitive pressures, and improve its market position. In plainer terms, competitive strategy concerns what a firm is doing to try to knock the socks off rival companies and gain competitive advantage. A firm's strategy can be mostly offensive or mostly defensive, shifting from one to the other as market conditions warrant.

Companies the world over have tried every conceivable approach to outcompeting rivals and winning an edge in the marketplace. And because managers tailor strategy to fit the specifics of their own company's situation and market environment, there are countless variations. In this sense, there are as many competitive strategies as there are companies trying to compete. However, beneath all the nuances, the approaches to competitive strategy fall into three categories:

1. Striving to be the overall low-cost producer in the industry (a low-cost leadership strategy).
2. Seeking to differentiate one's product offering from rivals' products (a differentiation strategy).
3. Focusing on a narrow portion of the market rather than the whole market (a focus or niche strategy).²

Table 5-1 highlights the distinctive features of these three generic competitive strategy approaches.

Striving to Be the Low-Cost Producer

Striving to be the low-cost producer is a powerful competitive approach in markets where many buyers are price-sensitive. The aim is to open up a sustainable cost advantage over competitors and then use lower cost as a basis for either underpricing competitors and gaining market share at their expense or earning a higher profit margin selling at the going price. A cost advantage will generate superior profitability unless it is used up in aggressive price-cutting efforts to win sales from rivals. Firms that achieve low-cost leadership typically make low cost relative to competitors the theme of their entire business strategy—though they must be careful not to pursue low cost so zealously that their products end up being too stripped down and cheaply made to generate buyer appeal.

# Table 5-1: Distinctive Features of the Generic Competitive Strategies

<table>
<thead>
<tr>
<th>Type of Feature</th>
<th>Low-Cost Leadership</th>
<th>Differentiation</th>
<th>Focus</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Strategic target</strong></td>
<td>• A broad cross-section of the market.</td>
<td>• A broad cross-section of the market.</td>
<td>• A narrow market niche where buyer needs and preferences are distinctively different from the rest of the market.</td>
</tr>
<tr>
<td><strong>Basis of competitive advantage</strong></td>
<td>• Lower costs than competitors.</td>
<td>• An ability to offer buyers something different from competitors.</td>
<td>• Lower cost in serving the niche or an ability to offer niche buyers something customized to their requirements and tastes.</td>
</tr>
<tr>
<td><strong>Product line</strong></td>
<td>• A good basic product with few frills (acceptable quality and limited selection).</td>
<td>• Many product variations, wide selection, strong emphasis on the chosen differentiating features.</td>
<td>• Customized to fit the specialized needs of the target segment.</td>
</tr>
<tr>
<td><strong>Production emphasis</strong></td>
<td>• A continuous search for cost reduction without sacrificing acceptable quality and essential features.</td>
<td>• Invent ways to create value for buyers.</td>
<td>• Tailor-made for the niche.</td>
</tr>
<tr>
<td><strong>Marketing emphasis</strong></td>
<td>• Try to make a virtue out of product features that lead to low cost.</td>
<td>• Build in whatever features buyers are willing to pay for.</td>
<td>• Communicate the focuser's unique ability to satisfy the buyer's specialized requirements.</td>
</tr>
<tr>
<td><strong>Sustaining the strategy</strong></td>
<td>• Economical prices/good value</td>
<td>• Charge a premium price to cover the extra costs of differentiating features.</td>
<td>• Remain totally dedicated to serving the niche better than other competitors; don't blunt the firm's image and efforts by entering other segments and adding other product categories to widen market appeal.</td>
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- **Low-Cost Leadership**: Focus on economic prices and good value, with an emphasis on offering a broad cross-section of the market and maintaining lower costs than competitors. Strategies include offering a good basic product with limited frills, continuously searching for cost reduction without sacrificing quality and essential features, and trying to make a virtue out of product features that lead to low costs. Sustaining the strategy involves economical prices and good value, with all elements of the strategy aimed at contributing to a sustainable cost advantage by managing costs down, year after year, in every area of the business.

- **Differentiation**: Focus on offering something different from competitors, with a broad cross-section of the market. Strategies include offering many product variations, wide selection, strong emphasis on chosen differentiating features, and inventing ways to create value for buyers. Another strategy is building in whatever features buyers are willing to pay for, charging a premium price to cover the extra costs of differentiating features, communicating the points of difference in credible ways, and emphasizing constant improvement and use innovation to stay ahead of imitative competitors. Sustaining the strategy involves concentrating on a few key differentiating features, using them to create a reputation and brand image.

- **Focus**: This strategy involves targeting a narrow market niche where buyer needs and preferences are distinctively different from the rest of the market. The focus is on lower cost in serving the niche or offering niche buyers something customized to their requirements and tastes. The strategy involves being customized to fit the specialized needs of the target segment, being tailored-made for the niche, and communicating the focuser's unique ability to satisfy the buyer's specialized requirements. Sustaining the strategy involves remaining totally dedicated to serving the niche better than other competitors; not blunting the firm's image and efforts by entering other segments and adding other product categories to widen market appeal.
Iowa Beef Packers and Federal Express have been able to win strong competitive positions by restructuring the traditional activity-cost chains in their industries. In beef packing, the traditional cost chain involved raising cattle on scattered farms and ranches, shipping them live to labor-intensive, unionized slaughtering plants, and then transporting whole sides of beef to grocery retailers whose butcher departments cut them into smaller pieces and package them for sale to grocery shoppers.

Iowa Beef Packers revamped the traditional chain with a radically different strategy—large automated plants employing nonunion labor were built near economically transportable supplies of cattle, and the meat was partially butchered at the processing plant into smaller high-yield cuts (sometimes sealed in plastic casing ready for purchase), boxed, and shipped to retailers. IBP's inbound cattle transportation expenses, traditionally a major cost item, were cut significantly by avoiding the weight losses that occurred when live animals were shipped long distances; major outbound shipping cost savings were achieved by not having to ship whole sides of beef with their high waste factor. Iowa Beef's strategy was so successful that it was, in 1985, the largest U.S. meatpacker, surpassing the former industry leaders, Swift, Wilson, and Armour.

Federal Express innovatively redefined the activity-cost chain for rapid delivery of small parcels. Traditional firms like Emery and Airborne Express operated by collecting freight packages of varying sizes, shipping them to their destination points via air freight and commercial airlines, and then delivering them to the addressee. Federal Express opted to focus only on the market for overnight delivery of small packages and documents. These were collected at local drop points during the late afternoon hours, flown on company-owned planes during early evening hours to a central hub in Memphis where from 11 P.M. to 3 A.M., each night, all parcels were sorted, then reloaded on company planes, and flown during the early morning hours to their destination points, where they were delivered the next morning by company personnel using company trucks. The cost structure so achieved by Federal Express was low enough to permit it to guarantee overnight delivery of a small parcel anywhere in the United States for a price as low as $11. In 1986, Federal Express had a 58 percent market share of the air-express package delivery market versus a 15 percent share for UPS, 11 percent for Airborne Express, and 10 percent for Emery/Purolator.


**Opening up a Cost Advantage** To achieve a cost advantage, a firm's cumulative costs across its activity-cost chain must be lower than competitors' cumulative costs. There are two ways to accomplish this:

- Do a better job of improving efficiency and controlling costs along the existing activity-cost chain.
- Revamp the firm's activity-cost chain to bypass some cost-producing activities altogether.

Both approaches can be used simultaneously. Successful low-cost producers usually achieve their cost advantages by exhaustively pursuing cost savings throughout the activity-cost chain. No area is overlooked. Normally, low-cost producers have a very cost-conscious organizational culture symbolically reinforced by spartan facilities, limited perks for executives, intolerance of waste, intensive screening of budget requests, and broad employee participation in
cost control efforts. But while low-cost producers are champions of frugality, they tend to commit funds aggressively to cost-saving improvements.

A firm intent on being a low-cost producer has to scrutinize each cost-creating activity and identify what drives the cost of the activity. Then it has to use its knowledge about the cost drivers to manage the costs of each activity down further year after year. Where possible, whole activities are eliminated from the activity-cost chain entirely. Companies can achieve dramatic cost advantages from restructuring the cost-chain and eliminating unnecessary cost-producing activities. Illustration Capsule 12 describes how two companies won strong competitive positions by revamping the makeup of their industry’s traditional activity-cost chain.

Firms well known for their low-cost leadership strategies include: Lincoln Electric in arc welding equipment, Briggs and Stratton in small horsepower gasoline engines, BIC in ballpoint pens, Black and Decker in tools, Design and Manufacturing in dishwashers (marketed under Sears’ Kenmore brand), Beaird-Poulan in chain saws, Ford in heavy-duty trucks, General Electric in major home appliances, Wal-Mart in discount retailing, and Southwest Airlines in commercial airline travel.

The Appeal of Being a Low-Cost Producer  Being the low-cost producer in an industry provides some attractive defenses against the five competitive forces:

- As concerns rival competitors, the low-cost company is in the best position to compete offensively on the basis of price, to defend against price war conditions, to use the appeal of a lower price to win sales (and market share) from rivals, and to earn above-average profits (based on bigger profit margins or greater sales volume) in markets where price competition thrives.

- As concerns buyers, the low-cost company has partial profit margin protection from powerful customers, since such customers are rarely able to bargain price down past the survival level of the next most cost-efficient seller.

- As concerns suppliers, the low-cost producer is more insulated than competitors from powerful suppliers if greater internal efficiency is the primary source of its cost advantage.

- As concerns potential entrants, the low-cost producer can use price-cutting to make it harder for a new rival to win customers; the pricing power of the low-cost producer acts as a barrier for a new entrant.

- As concerns substitutes, a low-cost producer is better positioned than higher-cost rivals to use low price as a defense against substitutes trying to gain market inroads.

A low-cost producer’s ability to set the industry’s price floor and still earn a profit erects barriers around its market position. Anytime price competition becomes a major market force, less efficient rivals get squeezed the most. Firms in a low-cost position relative to rivals have a significant edge in appealing to buyers who base their purchase decision on low price.

A competitive strategy based on low-cost leadership is particularly powerful when:

1. Price competition among rival sellers is a dominant competitive force.
2. The industry's product is an essentially standardized, commodity-type item readily available from a variety of sellers (a condition that allows buyers to shop for price).
3. There are few ways to achieve product differentiation that have value to buyers (put another way, the differences from brand to brand don't matter much to buyers).
4. Most buyers use the product in the same ways—with common user requirements, a standardized product can fully satisfy the needs of all buyers, in which case price, not features or quality, becomes the dominant competitive force.
5. Buyers incur low switching costs in changing from one seller to another, thus giving them flexibility to shop for the best price.
6. Buyers are large and have significant power to bargain down prices.

The Risks of a Low-Cost Producer Strategy A low-cost competitive approach has its drawbacks. Technological breakthroughs can open up cost reductions for rivals that nullify a low-cost producer's past investments and hard-won gains in efficiency. Rival firms may find it easy and/or inexpensive to imitate the leader's low-cost methods, thus making any advantage short-lived. A company driving hard to push its costs down can become so fixated on cost reduction that it fails to pick up on such significant market changes as growing buyer preference for added quality or service, subtle shifts in how buyers use the product, or declining buyer sensitivity to price and thus gets left behind as buyer interest swings to quality, performance, service, and other differentiating features. In sum, heavy investments in cost reduction can lock a firm into both its present technology and its present strategy, leaving it vulnerable to new technologies and to growing customer interest in something other than a cheaper price.

Differentiation Strategies

Differentiation strategies come into play whenever buyers' needs and preferences are too diverse to be satisfied by a standardized product. A successful differentiator studies buyers' needs and behavior carefully to learn what they consider important and valuable. Then the differentiator incorporates one or several of those features into its product offering to encourage buyer preferences for its brand over the brands of rivals. Competitive advantage results when enough buyers become strongly attached to the attributes of a differentiator's product offering. Successful differentiation allows a firm to

- command a premium price for its product, and/or
- sell more units (because additional buyers are won over by the differentiating features), and/or
- gain greater buyer loyalty to its brand (because some buyers are strongly attracted to the differentiating features).

Differentiation enhances profitability whenever the extra price the product commands outweighs the added costs of achieving differentiation. Differentiation is unsuccessful when buyers don't value the additional features highly enough to buy the product in profitable quantities. And differentiation is
unprofitable when the price premium buyers are willing to pay won’t cover the extra costs of achieving brand distinctiveness.

The approaches to differentiating a product take many forms: a different taste (Dr Pepper and Listerine), special features (Jenn Air’s indoor cooking tops with a vented built-in grill for barbecuing), superior service (Federal Express in overnight package delivery), spare parts availability (Caterpillar guarantees 48-hour spare parts delivery to any customer anywhere in the world or else the part is furnished free), overall value to the customer (McDonald's), engineering design and performance (Mercedes), prestige and distinctiveness (Rolex), product reliability (Johnson & Johnson baby products), quality manufacture (Honda), technological leadership (3M in bonding and coating products), a full range of services (Merrill Lynch), a complete line of products (Campbell soups), and top-of-the-line image and reputation (Brooks Brothers and Ralph Lauren in menswear, Kitchen Aid in dishwashers, and Cross in writing instruments).

Achieving Differentiation  Anything a firm can do to create buyer value represents a potential basis for differentiation. Once a firm finds good sources of buyer value, it must build the value-creating attributes into its product at an acceptable cost. A differentiator can incorporate attributes that raise the product’s performance or make it more economical to use. Or a firm can incorporate features that enhance buyer satisfaction in tangible or intangible ways during use. Differentiation possibilities can grow out of activities performed anywhere in the activity-cost chain. McDonald's gets high ratings on its french fries partly because it has very strict specifications on the potatoes it purchases from its supplier. The quality of Japanese cars stems primarily from Japanese auto-makers' skills in manufacturing and quality control. IBM boosts buyer value by providing its customers with an extensive array of services and technical support. L. L. Bean makes its mail-order customers feel secure by providing an unconditional guarantee with no time limit: “All of our products are guaranteed to give 100 percent satisfaction in every way. Return anything purchased from us at anytime if it proves otherwise. We will replace it, refund your purchase price, or credit your credit card, as you wish.” Commercial airlines use their empty seats during off-peak travel periods (i.e., their excess capacity) as the basis for awarding free travel to frequent flyers.

What Makes Differentiation Attractive  Differentiation provides some buffer against rivals' strategies because buyers become loyal to the brand or model they like best and often are willing to pay a little (perhaps a lot!) more for it. In addition, successful differentiation (1) erects entry barriers in the form of customer loyalty and uniqueness that newcomers find hard to overcome, (2) mitigates the bargaining power of large buyers since rivals’ products are less attractive to them, and (3) helps a firm fend off threats from substitutes. If differentiation allows a firm to charge a higher price and boost profit margins, it will be in a stronger position to withstand powerful suppliers’ efforts to raise their prices. Thus, as with cost leadership, successful differentiation creates lines of defense for dealing with the five competitive forces.

As a rule, differentiation strategies work best in situations where (1) there are many ways to differentiate the product or service and many buyers perceive these differences as valuable, (2) buyer needs and uses of the item
are diverse, and (3) few rival firms are following a similar differentiation approach.

The most appealing types of differentiation strategies are those least subject to quick or inexpensive imitation. Here is where having core competences becomes a major competitive asset. When a firm has skills and expertise that competitors cannot match easily, it can use them as a basis for successful differentiation. Differentiation is most likely to produce an attractive, longer-lasting competitive edge if it is based on:

- Technical superiority.
- Quality.
- More customer support services.
- More value for the money.

Such differentiating attributes tend to be harder for rivals to copy quickly and profitably.

**Real Value, Perceived Value, and Signals of Value**  Buyers seldom pay for value they don’t perceive, no matter how real the unique features may be. Thus the price premium a differentiation strategy commands reflects the value actually delivered to the buyer and the value the buyer perceives (even if it is not actually delivered). Actual and perceived value can differ whenever buyers have trouble assessing in advance what their experience with the product will be. Buyers with incomplete knowledge of the product often judge value based on such signals as seller’s word-of-mouth reputation, attractive packaging, extensive ad campaigns (i.e., how “well known” the product is), ad content and image, brochures and sales presentations, the seller’s facilities, the seller’s list of customers, the firm’s market share, length of time the firm has been in business, price (where price connotes “quality”), and the professionalism, appearance, and personality of the seller’s employees. Such signals of value may be as important as actual value (1) when the nature of differentiation is subjective or hard to quantify, (2) when buyers are making a first-time purchase, (3) when repurchase is infrequent, and (4) when buyers are unsophisticated.

**Keeping the Cost of Differentiation in Line**  Attempts to achieve differentiation usually raise costs. The trick to profitable differentiation is either to keep the costs of achieving differentiation below the price premium the differentiating attributes can command in the marketplace (thus increasing the profit margin per unit sold) or to offset thinner profit margins with enough added volume to increase total profits (larger volume can make up for smaller margins provided differentiation adds enough extra sales). In pursuing differentiation, a firm must be careful not to get its overall unit costs so far out of line with competitors that it has to charge a higher price than buyers are willing to pay. There may also be good reason to add extra differentiating features that are not costly but add to buyer satisfaction—fine restaurants typically provide such extras as a slice of lemon in the water glass, valet parking, and complimentary after-dinner mints.

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3This discussion draws from Porter, *Competitive Advantage* pp. 138-42. Porter’s insights here are particularly important to formulating differentiating strategies because they highlight the relevance of “intangibles” and “signals.”
The Risks of a Differentiation Strategy  There are, of course, no guarantees that differentiation will produce a meaningful competitive advantage. If buyers see little value in uniqueness (i.e., a standard item meets their needs), a low-cost strategy can easily defeat a differentiation strategy. In addition, differentiation can be defeated from the outset if competitors can quickly copy the attempt at differentiating. Rapid imitation means that firms never achieve real differentiation because competing brands keep changing in like ways despite continued efforts to create uniqueness. Thus, to be successful at differentiation, a firm must search out durable sources of uniqueness that cannot be quickly or cheaply imitated. Aside from these considerations, other common pitfalls include:  

- Trying to differentiate on the basis of something that does not lower a buyer’s cost or enhance a buyer’s well-being (as perceived by the buyer).
- Overdifferentiating so that price is too high relative to competitors or product quality or service levels exceed buyers’ needs.
- Trying to charge too high a price premium (the bigger the premium, the more buyers can be lured away by lower-priced competitors).
- Ignoring the need to signal value and depending only on tangible product attributes to achieve differentiation.
- Not understanding or identifying what buyers consider as value.

The Strategy of Being a Best-Cost Producer  A differentiation strategy aimed at giving customers more value for the money usually means combining an emphasis on low-cost with an emphasis on more than minimally acceptable quality, service, features, and performance. The idea is to create superior value by meeting or exceeding buyer expectations on quality-service-features-performance attributes and beating their expectations on price. Strategy-wise, the aim is to be the low-cost producer of a product with good-to-excellent product attributes, then use the cost advantage to underprice brands with comparable attributes. Such a competitive approach is termed a best-cost producer strategy because the producer has the best (lowest) cost relative to producers whose brands are comparably positioned on the quality-service-features-performance scale. The competitive advantage of a best-cost producer comes from matching close rivals on key attributes and beating them on cost. To become a best-cost producer, a company must match quality at a lower cost than rivals, match features at a lower cost than rivals, match product performance at a lower cost than rivals, and so on. What distinguishes a successful best-cost producer is expertise in incorporating upscale product attributes at a low cost; or, to put it a bit differently, an ability to contain the costs of providing customers with a better product. The most successful best-cost producers have the skills to simultaneously manage unit costs down and product caliber up.

A best-cost producer strategy has great appeal from the standpoint of competitive positioning. It produces superior customer value by balancing strategic emphasis on low cost against strategic emphasis on differentiation. In effect, such a hybrid strategy allows a company to combine the competitive advantage appeals of both low-cost and differentiation. In markets where
buyer diversity makes product differentiation the norm and buyers are price and value sensitive, a best-cost producer strategy can be more advantageous than either a pure low-cost producer strategy or a pure differentiation strategy keyed to product superiority. This is because a best-cost producer can position itself near the middle of the market with either a medium-quality product at a below-average price or a very good product at a medium price. Many buyers prefer a mid-range product rather than the cheap, basic product of a low-cost producer or the expensive product of a top-of-the-line differentiator.

Focus and Specialization Strategies

Focusing starts by choosing a market niche where buyers have distinctive preferences or requirements. The niche can be defined by geographic uniqueness, by specialized requirements in using the product, or by special product attributes that appeal only to niche members. A focuser's basis for competitive advantage is either lower costs than competitors in serving the market niche or an ability to offer niche members something different from other competitors. A focus strategy based on low cost depends on there being a buyer segment whose needs are less costly to satisfy compared to the rest of the market. A focus strategy based on differentiation depends on there being a buyer segment that demands unique product attributes.

Examples of firms employing a focus strategy include Tandem Computers (a specialist in “nonstop” computers for customers who need a “fail-safe” system), Rolls Royce (in super luxury automobiles), Apple Computer in desktop publishing (Apple computers produce typeset-quality reports and graphics), Fort Howard Paper (specializing in paper products for industrial and commercial enterprises only), commuter airlines like Skywest and Atlantic Southeast (specializing in low-traffic, short-haul flights linking major airports with smaller cities 50 to 250 miles away), and Bandag (a specialist in truck tire recapping that promotes its recaps aggressively at over 1,000 truck stops).

Using a focus strategy to achieve a cost breakthrough is a fairly common technique. Budget-priced motel chains like Days Inn, Motel 6, and LaQuinta have lowered their investment and operating cost per room by using a no-frills approach and catering to price-conscious travelers. Discount stock brokerage houses have lowered costs by focusing on customers mainly interested in buy-sell transactions who are willing to forgo the investment research, investment advice, and financial services offered by full-service firms like Merrill Lynch. Pursuing a cost advantage via focusing works well when a firm can find ways to lower costs by limiting its customer base to a well-defined buyer segment.

When Focusing Is Attractive  A focus strategy becomes increasingly attractive as more of the following conditions are met:

- The segment is big enough to be profitable.
- The segment has good growth potential.
- The segment is not crucial to the success of major competitors.
- The focusing firm has the skills and resources to serve the segment effectively.

What sets a focus strategy apart is concentrated attention on a narrow piece of the total market.
1. The focuser can defend itself against challengers based on the customer goodwill it has built up and its superior ability to serve buyers in the segment.

A focuser's specialized skills in serving the target market niche provide a basis for defending against the five competitive forces. Multisegment rivals do not have the same competitive capability to serve the target clientele. The focused firm's competence in serving the market niche raises entry barriers, thus making it harder for companies outside the niche to enter. A focuser's unique capabilities in serving the niche also present a hurdle that makers of substitute products must overcome. The bargaining leverage of powerful customers is blunted somewhat by their own unwillingness to shift their business to rival firms less capable of serving their needs.

Focusing works best (1) when it is costly or difficult for multisegment competitors to meet the specialized needs of the niche, (2) when no other rival is attempting to specialize in the same target segment; (3) when a firm doesn't have enough resources to pursue a wider part of the total market; and (4) when the industry has many different segments, thereby allowing a focuser to pick an attractive segment suited to its strengths and capabilities.

The Risks of a Focus Strategy Focusing carries several risks. One is the chance that competitors will find ways to match the focused firm in serving the narrow target market. Second is the potential for the niche buyer's preferences and needs to shift toward the product attributes desired by the market as a whole; such erosion opens the way for rivals with broad market appeal. Third is the chance that the segment will become so attractive that it becomes inundated with competitors, causing profits to be splintered.

USING OFFENSIVE STRATEGIES TO SECURE COMPETITIVE ADVANTAGE

An offensive strategy, if successful, can open up a competitive advantage over rivals. How long this process takes depends on the industry's competitive characteristics. The buildup period, shown in Figure 5-1, can be short as in service businesses which need little in the way of equipment and distribution support to implement a new offensive move. Or the buildup can take much longer, as in capital intensive and technologically sophisticated industries where firms may need several years to debug a new technology, bring new capacity on line, and win consumer acceptance of a new product. Ideally, an offensive move builds competitive advantage quickly; the longer it takes the more likely rivals will spot the move, see its potential, and begin responding. The size of the advantage (indicated on the vertical scale in Figure 5-1) can be large (as in pharmaceuticals where patents on new drugs produce a substantial advantage) or small (as in apparel where popular new designs can be imitated quickly).

Following a successful competitive offensive, there is a benefit period during which the fruits of competitive advantage can be enjoyed. The length of the

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benefit period depends on how much time it takes rivals to launch counteroffensives and begin closing the competitive gap. A lengthy benefit period gives a firm valuable time to earn above-average profits and recoup the investment made in creating the advantage. The best strategic offensives produce big competitive advantages and long benefit periods.

As competitors respond with counteroffensives, the erosion period begins. Any competitive advantage a firm currently holds will eventually be eroded by the actions of competent, resourceful competitors. Thus, to sustain its initial advantage, a firm must devise a second strategic offensive. The groundwork for the second offensive needs to be laid during the benefit period so that the firm is ready for launch when competitors respond to the earlier offensive. To successfully sustain a competitive advantage, a firm must stay a step ahead of rivals by mounting one creative strategic offensive after another.

There are six basic ways to mount strategic offensives:

- Attacks on competitor strengths.
- Attacks on competitor weaknesses.
- Simultaneous attack on many fronts.
- End-run offensives.
- Guerrilla offensives.
- Preemptive strikes.

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Attacking Competitor Strengths

There are two good reasons to go head-to-head against rivals, pitting one's own strengths against theirs, price for price, model for model, promotion tactic for promotion tactic, and geographic area by geographic area. The first is to try to gain market share by overpowering weaker rivals; challenging weaker rivals where they are strongest is attractive whenever a firm can win a decisive market victory and a commanding edge over struggling competitors. The other reason is to whittle away at a strong rival’s competitive advantage; here success is measured by how much the competitive gap is narrowed. The merits of a strength-against-strength offensive challenge, of course, depend on how much the offensive costs compared to its benefits. To succeed, the initiator needs enough competitive strength and resources to take at least some market share from the targeted rivals.

All-out attacks on competitor strengths can involve initiatives on any of several fronts—price-cutting, comparison ads, new features that appeal to a rival’s customers, new plant capacity in a rival’s backyard, or new models that match rivals. One of the best ploys is for the aggressor to attack with an equally good product offering and a lower price. This can produce market share gains if the targeted rival has strong reasons for not cutting its prices and if the challenger convinces buyers that its product is just as good. However, such a strategy will increase profits only if volume gains offset the impact of thinner margins per unit sold.

In another type of price-aggressive attack, firms first achieve a cost advantage and then attack competitors with a lower price. Price-cutting supported by a cost advantage is the strongest basis for launching and sustaining a price-aggressive offensive. Without a cost advantage, price-cutting works only if the aggressor has more financial resources and can outlast its rivals in a war of attrition.

Attacking Competitor Weaknesses

In this offensive approach, firms concentrate their competitive attention directly on the weaknesses of rivals. There are a number of weaknesses which can prove fruitful to challenge:

- Attack geographic regions where a rival has a weak market share or is exerting less competitive effort.
- Attack buyer segments that a rival is neglecting or is weakly equipped to serve.
- Attack rivals that lag on quality, features, or product performance; in such cases, a challenger with a better product can often convince the most performance-conscious customers of lagging rivals to switch to its brand.
- Attack rivals that have done a poor job of servicing customers; in such cases, a service-oriented challenger can win a rival’s disenchanted customers.

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9Ibid., p. 403.
- Attack rivals with weak advertising and brand recognition; a challenger with strong marketing skills and a good image can often move in on lesser-known rivals.
- Attack market leaders that have gaps in their product line; challengers can exploit opportunities to develop these gaps into strong, new market segments.
- Attack market leaders who are ignoring certain buyer needs by introducing product versions that satisfy these needs.

As a rule, attacks on competitor weaknesses have a better chance of succeeding than attacks on competitor strengths, provided the weaknesses represent important vulnerabilities and the rival is caught by surprise with no ready defense.\(^{10}\)

**Simultaneous Attack on Many Fronts**

Sometimes aggressors launch a grand competitive offensive involving several major initiatives in an effort to throw a rival off-balance, scatter its attention, and force it into channeling resources to protect all its sides simultaneously. Hunt's tried such an offensive several years ago in an attempt to wrest market share from Heinz ketchup. The attack began when Hunt's introduced two new ketchup flavors to disrupt consumers' taste preferences, try to create new product segments, and capture more shelf space in retail stores. Simultaneously, Hunt's lowered its price to 70 percent of Heinz's; it offered sizable trade allowances to retailers; and it raised its advertising budget to over twice that of Heinz's.\(^{11}\) The offensive failed because not enough Heinz users tried the Hunt's brands, and many of those who did soon switched back to Heinz.

Grand offensives have their best chance of success when a challenger, because of superior resources, can overpower its rivals by outspending them across-the-board long enough to buy its way into a position of market leadership and competitive advantage.

**End-Run Offensives**

End-run offensives seek to avoid head-on challenges tied to aggressive price-cutting, escalated advertising, or costly efforts to outdifferentiate rivals. Instead the idea is to maneuver around competitors and lead the way into unoccupied market territory. Examples of end-run offensives include moving aggressively into geographic areas where close rivals have no market presence, trying to create new segments by introducing products with different attributes and performance features to better meet the needs of selected buyers, and leapfrogging into next-generation technologies to supplant existing products and/or production processes. With an end-run offensive, a firm can gain a significant first-mover advantage in a new arena and force competitors to play catch-up. The most successful end-runs change the rules of the competitive game in the aggressor's favor.

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End-run offensives dodge head-to-head confrontations, concentrating instead on innovative product attributes, technological advances, and early entry into less contested geographic markets.

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Guerrilla Offensives

Guerrilla offensives are particularly well-suited to small challengers who have neither the resources nor the market visibility to mount a full-fledged attack on industry leaders. A guerrilla offensive uses the hit-and-run principle, selectively attacking where and when an underdog can temporarily exploit the situation to its own advantage. There are several ways to wage a guerrilla offensive:12

1. Attack a narrow, well-defined segment that is weakly defended by competitors.
2. Attack areas where rivals are overextended and have spread their resources most thinly (possibilities include going after their customers in less-populated geographic areas, enhancing delivery schedules at times when competitors’ deliveries are running behind, adding to quality when rivals have quality control problems, and boosting technical services when buyers are confused by the number of competitors’ models and features).
3. Make small, scattered, random raids on leaders with such tactics as occasional lowballing on price (to win a big order or steal a key account), intense bursts of promotional activity, and legal actions charging antitrust violations, patent infringement, and unfair advertising.

Preemptive Strategies

Preemptive strategies involve moving first to secure an advantageous position that rivals are foreclosed or discouraged from duplicating. There are several ways to win a prime strategic position with preemptive moves:13

- Expand production capacity ahead of market demand in hopes of discouraging rivals from following suit. When rivals are “bluffed” out of adding capacity by a fear of creating long-term excess supply and underutilized plants, the preemptor can win a bigger market share if market demand grows and its own plant capacity fills.
- Tie up the best (or the most) raw material sources and/or the most reliable, high-quality suppliers via long-term contracts or backward vertical integration. This move can relegate rivals to struggling for second-best supply positions.
- Secure the best geographic locations. An attractive first-mover advantage can often be locked up by moving to obtain the most favorable site along a heavily traveled thoroughfare, at a new interchange or intersection, in a new shopping mall, in a natural beauty spot, close to cheap transportation or raw material supplies or market outlets, and so on.
- Obtain the business of prestigious customers.

● Build a "psychological" image in the minds of consumers that is unique and hard to copy and that establishes a compelling appeal and rallying cry. Examples include Avis's well-known "We try harder" theme, Frito-Lay's guarantee to retailers of "99.5% service," Holiday Inn's assurance of "no surprises," and Prudential's "piece of the rock" image of safety and permanence.

● Secure exclusive or dominant access to the best distributors in an area.

Preemption has been used successfully by a number of companies. General Mills' Red Lobster restaurant chain has gained a prime position in the restaurant business by establishing strong relationships with very dependable seafood suppliers. De Beers became the dominant world distributor of diamonds by buying the production of most of the important diamond mines. Du Pont's aggressive capacity expansions in titanium dioxide, while not blocking all competitors from expanding, did discourage enough to give it a leadership position in the titanium dioxide industry.

To be successful, a preemptive move doesn’t have to totally block rivals from following or copying; it merely needs to give a firm a "prime" position. A prime position is one that puts rivals at a competitive disadvantage and is not easily circumvented.

Choosing Who to Attack

Aggressor firms need to analyze which of their rivals to attack as well as how to attack them. There are basically three types of firms that can be attacked offensively:14

1. Market leader(s). Waging an offensive against strong leader(s) risks squandering valuable resources in a futile effort and even precipitating a fierce and profitless industrywide battle for market share. Offensive attacks on a major competitor make the best sense when the leader in terms of size and market share is not the "true leader" in terms of serving the market well. Signs of leader vulnerability include unhappy buyers, sliding profits, strong emotional commitment to a technology the leader has pioneered, outdated plants and equipment, a preoccupation with diversification into other industries, a product line that is clearly not superior to rivals', and a competitive strategy that lacks real strength based on low-cost leadership or differentiation. Attacks on leaders can also succeed when the challenger is able to revamp its activity-cost chain or innovate to gain a fresh cost-based or differentiation-based competitive advantage.15 Attacks on leaders need not have the objective of making the aggressor the new leader; a challenger may "win" by simply wresting enough sales from the leader to make the aggressor a stronger runner-up.

2. Runner-up firms. Offensives against weaker, vulnerable runner-up firms entail relatively low risk. Attacking a runner-up is an especially attractive option when a challenger's competitive strengths match the runner-up's weaknesses.

3. *Struggling enterprises that are on the verge of going under.* Challenging a hard-pressed rival in ways that further sap its financial strength and competitive position can weaken its resolve enough to prompt its exit from the market.

4. *Small local and regional firms.* Because these firms typically have limited expertise, a challenger with broader capabilities is well-positioned to raid their biggest and best customers—particularly those who are growing rapidly, have increasingly sophisticated needs, and may already be thinking about switching to a supplier with more full-service capability.

As we have said, successful strategies are grounded in competitive advantage. This goes for offensive strategies too. The competitive advantage potentials that offer the strongest basis for a strategic offensive include: 16

- Developing a lower-cost product design.
- Making changes in production operations that lower costs or enhance differentiation.
- Developing product features that deliver superior performance or lower user costs.
- Giving buyers more responsive after-sale support.
- Escalating the marketing effort in an undermarketed industry.
- Pioneering a new distribution channel.
- Bypassing wholesale distributors and selling direct to the end-user.

A strategic offensive *must* be tied to what a firm does best—its competitive strengths and capabilities. As a rule, these strengths take the form of a *key skill* (cost reduction capabilities, customer service skills, technical expertise) or a uniquely *strong functional competence* (engineering and product design, manufacturing expertise, advertising and promotion, marketing know-how). 17

**USING DEFENSIVE STRATEGIES TO PROTECT COMPETITIVE ADVANTAGE**

In a competitive market, all firms are subject to attacks from rivals. Offensive attacks can come both from new entrants and from established firms seeking to improve their market positions. The purpose of defensive strategy is to lower the risk of being attacked, weaken the impact of any attack that occurs, and influence challengers to aim their efforts at other rivals. While defensive strategy usually doesn’t enhance a firm’s competitive advantage, it should help fortify a firm’s competitive position and sustain whatever competitive advantage it has.

There are several basic ways for a firm to protect its competitive position. One approach involves trying to block challengers’ avenues for mounting an offensive; the options include: 18

16Ibid., pp. 520–22.
17For more details, see Macmillan, “Controlling Competitive Dynamics,” pp. 112–16.
• Broadening the firm’s product line to close off vacant niches and gaps to would-be challengers.
• Introducing models or brands that match the characteristics challengers’ models already have or might have.
• Keeping prices low on models that most closely match competitors’ offerings.
• Signing exclusive agreements with dealers and distributors to keep competitors from using the same ones.
• Granting dealers and distributors sizable volume discounts to discourage them from experimenting with other suppliers.
• Offering free or low-cost training to buyers’ personnel in the use of the firm’s product.
• Making it harder for competitors to get buyers to try their brands by (1) giving special price discounts to buyers who are considering trial use of rival brands, (2) resorting to high levels of couponing and sample giveaways to buyers most prone to experiment, and (3) making early announcements about impending new products or price changes so buyers postpone switching.
• Raising the amount of financing provided to dealers and/or buyers.
• Reducing delivery times for spare parts.
• Increasing warranty coverages.
• Patenting alternative technologies.
• Protecting proprietary know-how in products, production technologies, and other parts of the activity-cost chain.
• Signing exclusive contracts with the best suppliers to block access of aggressive rivals.
• Purchasing natural resource reserves ahead of present needs to keep them from competitors.
• Avoiding suppliers that also serve competitors.
• Challenging rivals’ products or practices in regulatory proceedings.

Moves such as these not only buttress a firm’s present position, they also present competitors with a moving target. It is not enough just to try to protect the status quo. A good defense entails adjusting quickly to changing industry conditions and, on occasion, being a first-mover to block or preempt moves by would-be aggressors. A mobile defense is always preferable to a stationary defense.

A second approach to defensive strategy entails signaling strong retaliation if a challenger attacks. The goal is to dissuade challengers from attacking at all (by raising their expectations that the resulting battle will be more costly than it is worth) or divert challengers to options less threatening to the defender. Would-be challengers can be signaled by:19

• Publicly announcing management’s commitment to maintain the firm’s present market share.

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19 Porter, *Competitive Advantage*, pp. 495–97. The listing here is selective; Porter offers a greater number of options.
Publicly announcing plans to construct adequate production capacity to meet forecast demand growth, and sometimes building ahead of demand.

Giving out advance information about a new product, technological breakthrough, or the planned introduction of important new brands or models, in hopes that challengers will be induced to delay moves of their own until they see if the signaled actions are true.

Publicly committing the firm to a policy of matching the prices or terms offered by competitors.

Maintaining a war chest of cash and marketable securities.

Making an occasional strong counterresponse to the moves of weak competitors to enhance the firm's image as a tough defender.

Another way to dissuade rivals involves trying to lower the profit inducement for challengers to launch an offensive. When a firm's or industry's profitability is enticingly high, challengers are more willing to tackle high defensive barriers and combat strong retaliation. A defender can deflect attacks, especially from new entrants, by deliberately forgoing some short-run profits and by using accounting methods that obscure profitability.

**VERTICAL INTEGRATION STRATEGIES**

Vertical integration strategies aim at extending a firm's competitive scope within the same industry. Firms can expand their range of activities backward into sources of supply and/or forward toward end-users. A manufacturer that builds a new plant to make component parts rather than purchase them from suppliers remains in essentially the same industry as before. The only change is that it has business units in two stages of production in the industry's total activity-chain. Similarly, if a personal computer manufacturer elects to integrate forward by opening retail stores to market its brands, it remains in the personal computer business even though its competitive scope extends further forward in the industry chain.

Moves to vertically integrate can aim at full integration (participating in all stages of the process of getting products in the hands of final-users) or partial integration (building positions in just some stages of the industry's total production-distribution chain). A firm can accomplish vertical integration by starting its own company in other stages of the industry's activity chain or by acquiring a company already positioned in the stage it wishes to integrate.

**The Appeal of Vertical Integration**

The only good reason for investing company resources in vertical integration is to strengthen the firm's competitive position. Unless vertical integration produces sufficient cost-savings to justify the extra investment or yields a competitive advantage, it has no real profit or strategic payoff.

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Integrating backward generates cost-savings only when the volume needed is big enough to capture the same scale economies suppliers have and when it can match or exceed suppliers' production efficiency. Backward integration usually generates the largest cost advantage when suppliers have sizable profit margins, when the item being supplied is a major cost component, and when the needed technological skills are easily mastered. Backward vertical integration can produce a differentiation-based competitive advantage when a company, by supplying its own parts, ends up with a better-quality part and thereby significantly enhances the performance of its final product.

Backward integration can also spare a firm the uncertainty of being dependent on suppliers of crucial raw materials or support services, and it can lessen the firm's vulnerability to powerful suppliers intent on raising prices at every opportunity. Stockpiling, fixed-price contracts, or the use of substitute inputs may not be attractive ways for dealing with uncertain supply conditions or economically powerful suppliers. When this is the case, backward integration can be an organization's most profitable and competitively secure option for accessing reliable supplies of essential materials and support services at favorable prices.

The strategic impetus for forward integration has much the same roots. Undependable sales and distribution channels can give rise to costly inventory pileups and frequent underutilization of capacity, thereby undermining the economies of a steady, near-capacity production operation. In such cases, it is often advantageous for a firm to set up its own wholesale-retail distribution network in order to gain dependable channels through which to push its products to end-users. Sometimes even a small percentage increase in the average rate of capacity utilization can boost manufacturing margins enough to make forward integration economical. On other occasions, forward integration into distribution and retailing is cheaper than dealing with independent distributors and retailers, thus providing a source of cost advantage.

Integrating forward into manufacturing may help a raw materials producer achieve greater product differentiation and escape the price-oriented competition of a commodity business. Often, in the early phases of vertical product flow, intermediate goods are "commodities" in the sense that they have essentially identical technical specifications irrespective of producer (as is the case with crude oil, poultry, sheet steel, cement, and textile fibers). Competition in commodity or commodity-like markets is usually fiercely price-competitive, with shifting supply and demand conditions causing volatile profits. However, the closer the production stage to the ultimate consumer, the greater the opportunities for a firm to break out of a commodity-like competitive environment and differentiate its end-product via design, service, quality features, packaging, promotion, and so on. Product differentiation often reduces the importance of price in comparison with other product attributes and allows for improved profit margins.

For a manufacturer, integrating forward may mean building a chain of closely supervised dealer franchises or establishing company-owned and operated retail outlets. Or it may entail simply establishing a sales force instead of selling through manufacturer's agents or independent distributors.
The Strategic Disadvantages of Vertical Integration

Vertical integration has some potential weaknesses, however. First, it boosts a firm's capital investment in the industry, perhaps denying financial resources to more worthwhile pursuits. Second, integration introduces additional risks, since it extends the enterprise's scope of activity across the industry chain. Third, vertical integration increases a firm's interest in protecting its present technology and production facilities even though they are becoming obsolete. Because of the high cost of abandoning such investments before they are worn out, fully integrated firms are more vulnerable to new technologies and new products than partially integrated or nonintegrated firms.

Fourth, vertical integration can pose problems of balancing capacity at each stage in the activity-chain. The most efficient scale of operation at each step in the chain can vary substantially. Exact self-sufficiency at each interface is the exception not the rule. Where internal capacity is deficient to supply the next stage, the difference has to be bought externally. Where internal capacity is excessive, customers need to be found for the surplus. And if by-products are generated, they must be disposed of.

All in all, a strategy of vertical integration can have both strengths and weaknesses. Which direction the scales tip depends on (1) how compatible vertical integration is with the organization's long-term strategic interests and performance objectives, (2) how much it strengthens an organization's position in the overall industry, and (3) the extent to which it creates competitive advantage. Unless these considerations yield solid benefits, vertical integration is unlikely to be an attractive business strategy option.

FIRST-MOVER ADVANTAGES AND DISADVANTAGES

When to make a strategic move is often as crucial as what move to make. Timing is especially important when first-mover advantages or disadvantages exist. Being first to initiate a strategic move can have a high payoff when (1) pioneering helps build a firm's image and reputation with buyers, (2) early commitments to supplies of raw materials, new technologies, distribution channels, and so on can produce an absolute cost advantage over rivals, (3) first-time customers remain strongly loyal to pioneering firms in making repeat purchases, and (4) moving first constitutes a preemptive strike, making imitation extra hard or unlikely. The bigger the first-mover advantages, the more attractive that making the first move becomes.

However, a "wait and see" approach doesn't always carry a competitive penalty. Making the first move may carry greater risks than a late move. First-mover disadvantages (or late-mover advantages) arise when: (1) pioneering leadership is much more costly and only negligible experience curve effects accrue to the leader, (2) technological change is so rapid that early investments are soon obsolete (thus allowing following firms to gain the advantages of next-generation newest products and more efficient processes), (3) it is easy for late-

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22 Porter, Competitive Strategy, pp. 232–33.
comers to crack the market because customer loyalty to pioneering firms is weak, and (4) skills and know-how developed by the market leaders can be easily copied or even surpassed by late movers. Good timing, therefore, is an important ingredient in deciding whether to be aggressive or cautious.

The challenge of competitive strategy—low-cost, differentiation, or focus—is to create a competitive advantage for the firm. Competitive advantage comes from positioning a firm in the marketplace so it has an edge in coping with competitive forces and in attracting buyers.

A strategy of trying to be the low-cost producer works well in situations where

- The industry’s product is pretty much the same from seller to seller.
- The marketplace is dominated by price competition (buyers are prone to shop for the lowest price).
- There are only a few ways to achieve product differentiation that have much value to buyers.
- Most buyers use the product in the same ways and thus have common user requirements.
- Buyers’ costs in switching from one seller or brand to another are low (or even zero).
- Buyers are large and have significant bargaining power.

To achieve a low-cost advantage, a company must become more skilled than rivals in controlling cost drivers and/or it must find innovative cost-saving ways to revamp the activity-cost chain.

Differentiation strategies can produce a competitive edge based on technical superiority, quality, service, or more value for the money. Differentiation strategies work best when:

- There are many ways to differentiate the product/service that buyers think have value.
- Buyer needs or uses of the product/service are diverse.
- Not many rivals are following a similar differentiation strategy.

Anything a firm can do to create buyer value represents a potential basis for differentiation. Successful differentiation is usually keyed to lowering the buyer’s cost of using the item, raising the performance the buyer gets, giving the buyer more value for the money, or boosting a buyer’s psychological satisfaction. A best-cost producer strategy works especially well in market situations where product differentiation is the rule and buyers are price sensitive.

The competitive advantage of focusing comes from achieving lower costs in serving the target market niche or from offering niche buyers something different from rivals—in other words, the advantage a firm gains with a focus strategy is either cost-based or differentiation-based. Focusing works best when:

- Buyer needs or uses of the item are diverse.
- No other rival is attempting to specialize in the same target segment.
A firm lacks the ability to go after a wider part of the total market.

Buyer segments differ widely in size, growth rate, profitability, and intensity in the five competitive forces, making some segments more attractive than others.

A variety of offensive strategic moves can be used to secure a competitive advantage. Strategic offensives can be aimed at competitors' strengths or weaknesses; they can involve end-runs or grand offensives; they can be designed as guerrilla actions or as preemptive strikes; and the target of the offensive can be a market leader, a runner-up firm, or the smallest and/or weakest firms in the industry.

To defend its current position, a company can: (1) make moves that fortify its current position, (2) present competitors with a moving target to avoid "out-of-date" vulnerability, and (3) dissuade rivals from even trying to attack.

Vertical integration forward or backward makes strategic sense if it strengthens a company's position via either cost reduction or enhanced product differentiation.

The timing of strategic moves is important. First-movers sometimes gain strategic advantage; at other times, it is cheaper and easier to be a follower than a leader.

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**SUGGESTED READINGS**


