

Porter's Generic Strategies

Choosing Your Route to Success

Which do you prefer when you fly: a cheap, no-frills airline, or a more expensive operator with fantastic service levels and maximum comfort? And would you ever consider going with a small company which focuses on just a few routes?

The choice is up to you, of course. But the point we're making here is that when you come to book a flight, there are some very different options available.

Why is this so? The answer is that each of these airlines has chosen a different way of achieving competitive advantage in a crowded marketplace.

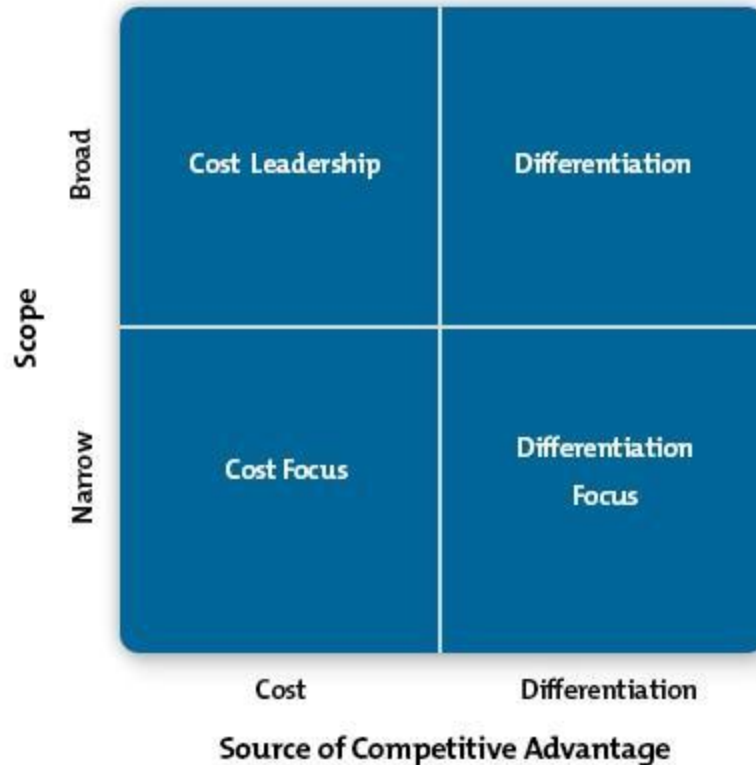
The no-frills operators have opted to cut costs to a minimum and pass their savings on to customers in lower prices. This helps them grab market share and ensure their planes are as full as possible, further driving down cost. The luxury airlines, on the other hand, focus their efforts on making their service as wonderful as possible, and the higher prices they can command as a result make up for their higher costs.

Meanwhile, smaller airlines try to make the most of their detailed knowledge of just a few routes to provide better or cheaper services than their larger, international rivals.

Generic Strategies

These three approaches are examples of "generic strategies," because they can be applied to products or services in all industries, and to organizations of all sizes. They were first set out by Michael Porter in 1985 in his book "**Competitive Advantage: Creating and Sustaining Superior Performance.**"

Porter called the generic strategies "Cost Leadership" (no frills), "Differentiation" (creating uniquely desirable products and services) and "Focus" (offering a specialized service in a niche market). He then subdivided the Focus strategy into two parts: "Cost Focus" and "Differentiation Focus". These are shown in Figure 1 below.



Tip:

The terms "Cost Focus" and "Differentiation Focus" can be a little confusing, as they could be interpreted as meaning "a focus on cost" or "a focus on differentiation." Remember that Cost Focus means emphasizing cost-minimization **within a focused market**, and Differentiation Focus means pursuing strategic differentiation **within a focused market**.

The Cost Leadership Strategy

Porter's generic strategies are ways of gaining competitive advantage – in other words, developing the "edge" that gets you the sale and takes it away from your competitors. There are two main ways of achieving this within a Cost Leadership strategy:

- Increasing profits by reducing costs, while charging industry-average prices.
- Increasing market share through charging lower prices, while still making a reasonable profit on each sale because you've reduced costs.

Tip:

Remember that Cost Leadership is about minimizing the cost to the organization of delivering products and services. The cost or price paid by the customer is a separate issue!

The Cost Leadership strategy is exactly that – it involves being the leader in terms of cost in your industry or market. Simply being amongst the lowest-cost producers is not good enough,

as you leave yourself wide open to attack by other low-cost producers who may undercut your prices and therefore block your attempts to increase market share.

You therefore need to be confident that you can achieve and maintain the number one position before choosing the Cost Leadership route. Companies that are successful in achieving Cost Leadership usually have:

- Access to the capital needed to invest in technology that will bring costs down.
- Very efficient logistics.
- A low-cost base (labor, materials, facilities), and a way of sustainably cutting costs below those of other competitors.

The greatest risk in pursuing a Cost Leadership strategy is that these sources of cost reduction are not unique to you, and that other competitors copy your cost reduction strategies. This is why it's important to continuously find ways of reducing every cost. One successful way of doing this is by adopting the Japanese **Kaizen** philosophy of "continuous improvement."

The Differentiation Strategy

Differentiation involves making your products or services different from and more attractive than those of your competitors. How you do this depends on the exact nature of your industry and of the products and services themselves, but will typically involve features, functionality, durability, support and also brand image that your customers value.

To make a success of a Differentiation strategy, organizations need:

- Good research, development and innovation.
- The ability to deliver high-quality products or services.
- Effective sales and marketing, so that the market understands the benefits offered by the differentiated offerings.

Large organizations pursuing a differentiation strategy need to stay agile with their new product development processes. Otherwise, they risk attack on several fronts by competitors pursuing Focus Differentiation strategies in different market segments.

The Focus Strategy

Companies that use Focus strategies concentrate on particular niche markets and, by understanding the dynamics of that market and the unique needs of customers within it, develop uniquely low-cost or well-specified products for the market. Because they serve customers in their market uniquely well, they tend to build strong brand loyalty amongst their customers. This makes their particular market segment less attractive to competitors.

As with broad market strategies, it is still essential to decide whether you will pursue Cost Leadership or Differentiation once you have selected a Focus strategy as your main approach: Focus is not normally enough on its own.

But whether you use Cost Focus or Differentiation Focus, the key to making a success of a generic Focus strategy is to ensure that you are adding something extra as a result of serving only that market niche. It's simply not enough to focus on only one market segment because your organization is too small to serve a broader market (if you do, you risk competing against better-resourced broad market companies' offerings.)

The "something extra" that you add can contribute to reducing costs (perhaps through your knowledge of specialist suppliers) or to increasing differentiation (through your deep understanding of customers' needs).

Tip:

Generic strategies apply to not-for-profit organizations too.

A not-for-profit can use a Cost Leadership strategy to minimize the cost of getting donations and achieving more for their income, while one with pursuing a Differentiation strategy will be committed to the very best outcomes, even if the volume of work they do as a result is lower.

Local charities are great examples of organizations using Focus strategies to get donations and contribute to their communities.

Choosing the Right Generic Strategy

Your choice of which generic strategy to pursue underpins every other strategic decision you make, so it's worth spending time to get it right.

But you **do** need to make a decision: Porter specifically warns against trying to "hedge your bets" by following more than one strategy. One of the most important reasons why this is wise advice is that the things you need to do to make each type of strategy work appeal to different types of people. Cost Leadership requires a very detailed internal focus on processes. Differentiation, on the other hand, demands an outward-facing, highly creative approach.

So, when you come to choose which of the three generic strategies is for you, it's vital that you take your organization's competencies and strengths into account.

Use the following steps to help you choose.

Step 1:

For each generic strategy, carry out a **SWOT Analysis** of your strengths and weaknesses, and the opportunities and threats you would face, if you adopted that strategy.

Having done this, it may be clear that your organization is unlikely to be able to make a success of some of the generic strategies.

Step 2:

Use **Five Forces Analysis** to understand the nature of the industry you are in.

Step 3:

Compare the SWOT Analyses of the viable strategic options with the results of your Five Forces analysis. For each strategic option, ask yourself how you could use that strategy to:

- Reduce or manage supplier power.
- Reduce or manage buyer/customer power.
- Come out on top of the competitive rivalry.
- Reduce or eliminate the threat of substitution.
- Reduce or eliminate the threat of new entry.

Select the generic strategy that gives you the strongest set of options.

Tip:

Porter's Generic Strategies offer a great starting point for strategic decision-making.

Once you've made your basic choice, though, there are still many strategic options available.

Bowman's Strategy Clock helps you think at the next level of details, in that it splits Porter's options into eight sub-strategies. You can also use **USP Analysis** and **Core Competence Analysis** to identify the areas you should focus on to stand out in your marketplace.

Key Points

According to Porter's Generic Strategies model, there are three basic strategic options available to organizations for gaining competitive advantage. These are: Cost Leadership, Differentiation and Focus.

Organizations that achieve Cost Leadership can benefit either by gaining market share through lowering prices (whilst maintaining profitability) or by maintaining average prices and therefore increasing profits. All of this is achieved by reducing costs to a level below those of the organization's competitors.

Companies that pursue a Differentiation strategy win market share by offering unique features that are valued by their customers. Focus strategies involve achieving Cost Leadership or Differentiation within niche markets in ways that are not available to more broadly-focused players.

Apply This to Your Life

- Ask yourself what your organization's generic strategy is. How does this affect the choices you make in your job?
- If you're in an organization committed to achieving Cost Leadership, can you reduce costs by hiring less expensive staff and training them up, or by reducing staff turnover? Can you reduce training costs by devising in-house schemes for sharing skills and knowledge amongst team members? Can you reduce expenses by using technology such as video conferencing over the Internet?
- If your organization is pursuing a Differentiation strategy, can you improve customer service? **Customer Experience Mapping** may help here. Can you help to foster a culture of continuous improvement and innovation in your team?
- And if you're working for a company that has chosen a Focus strategy, what knowledge or expertise can you use or develop to add value for your customers that isn't available to broad market competitors?