Organisational Strategy

BMA6104

Strategic Choices(1): Business Unit Options

Learning outcomes

- Identify ***strategic business units*** (SBUs) in organisations.
- Assess business strategy in terms of the generic strategies of ***cost leadership***, ***differentiation*** and ***focus***.
- Identify business strategies suited to ***hypercompetitive*** conditions.
- Assess the benefits of ***cooperation*** in business strategy.
- Apply principles of ***game theory*** to business strategy.

Strategic business units (SBUs)

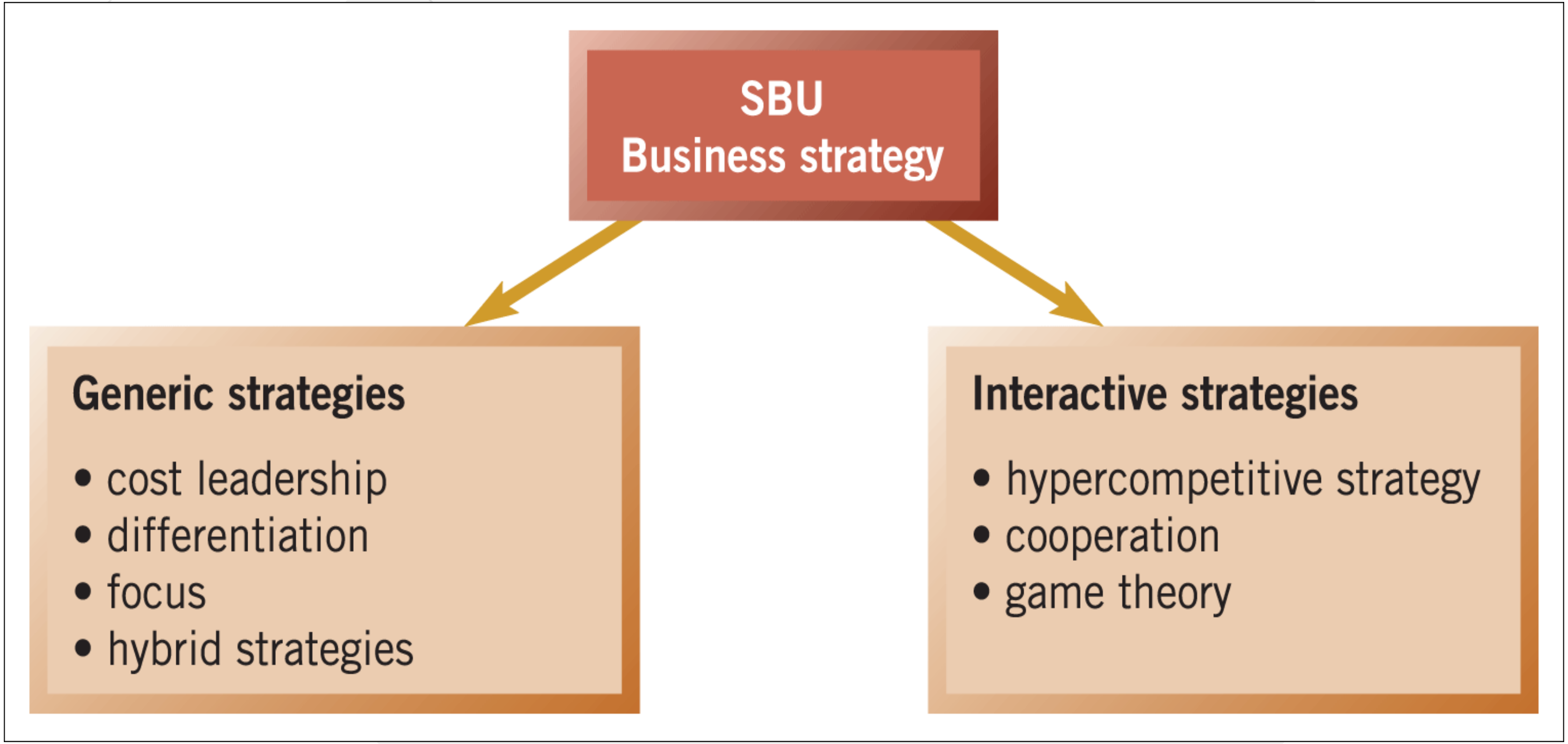
A strategic business unit (SBU) supplies goods or services for a distinct domain of activity.

- A small business has just one SBU.
- A large diversified corporation is made up of multiple businesses (SBUs).
- SBUs can be called 'divisions' or 'profit centres'.
- SBUs can be identified by:
  - Market-based criteria (similar customers, channels and competitors)
  - Capabilities-based criteria (similar strategic capabilities).

The purpose of SBUs

- ***To decentralise initiative*** to smaller units within the corporation so SBUs can pursue their own distinct strategy
- To allow large corporations to ***vary their business strategies*** according to the different needs of external markets
- ***To encourage accountability*** – each SBU can be held responsible for the success or failure of its own strategy.

Business strategy

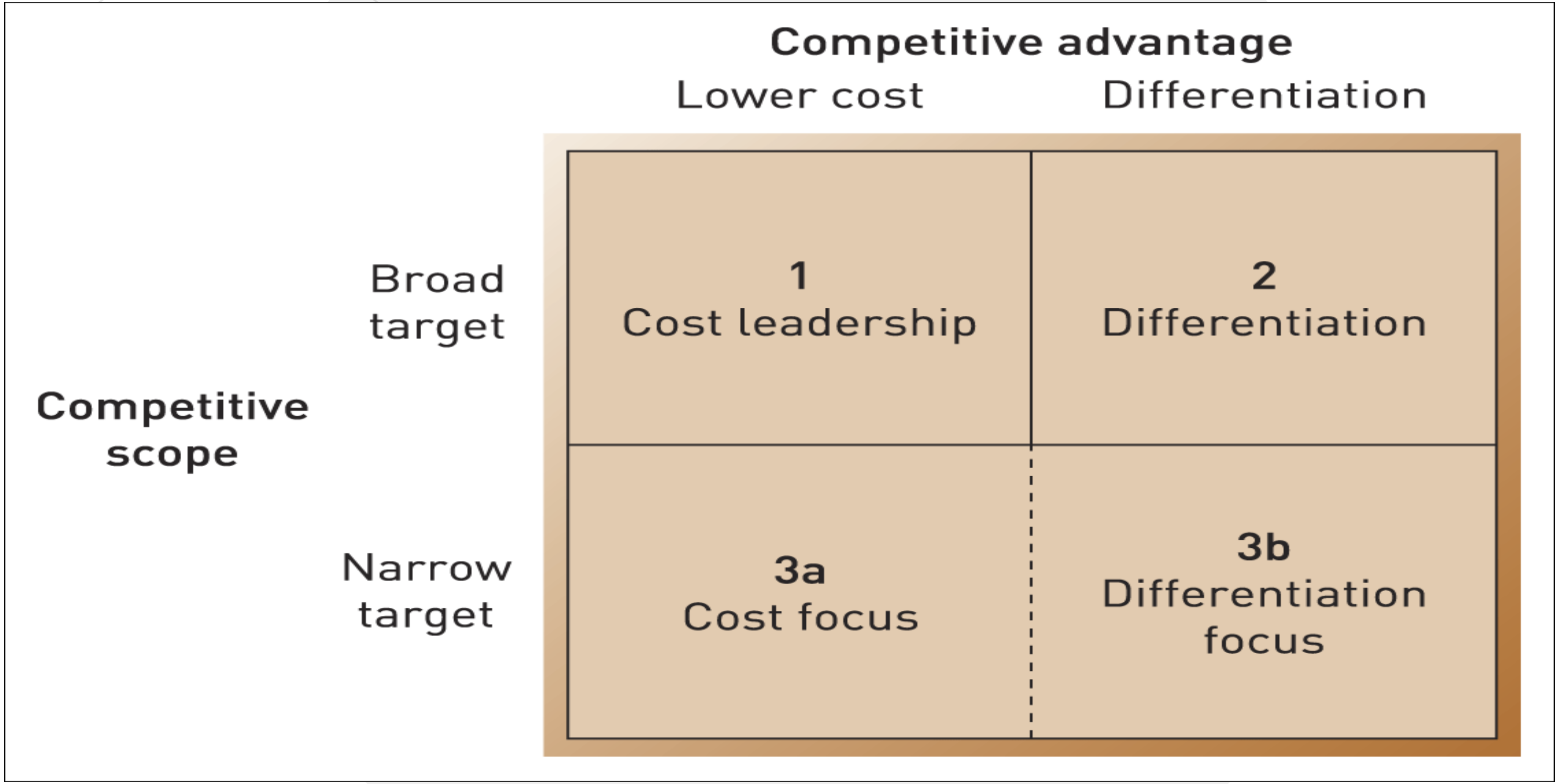


Generic strategies

Michael Porter introduced the term ***'generic strategy'*** to mean basic types of competitive strategy that hold across many kinds of business situations.

- ***Competitive strategy*** is concerned with how a strategic business unit achieves competitive advantage in its domain of activity.
- ***Competitive advantage*** is about how an SBU creates value for its users, both greater than the costs of supplying them and superior to that of rival SBUs.

Three generic strategies



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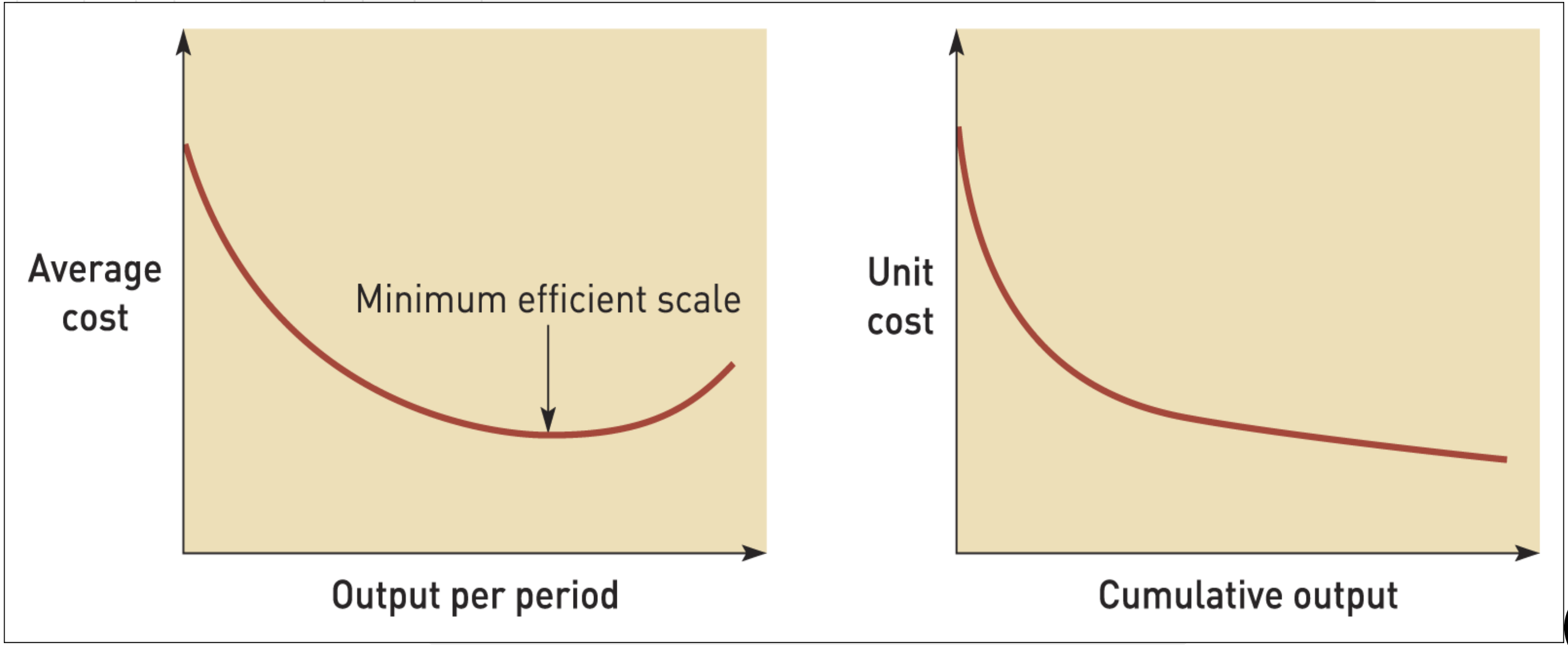
Cost-leadership

Cost-leadership strategy involves becoming the lowest-cost organisation in a domain of activity.

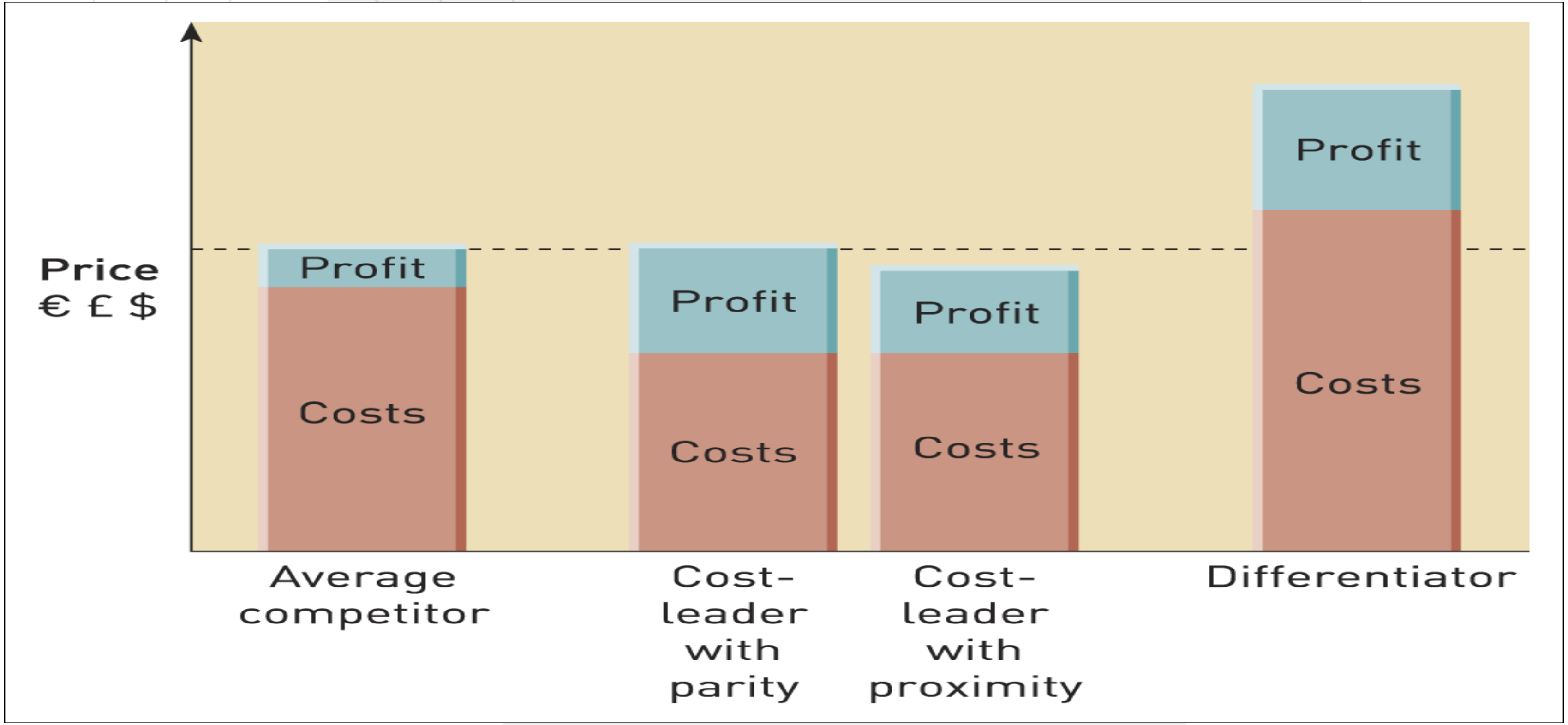
Four key cost drivers that can help deliver cost leadership:

- ***Lower input costs***
- ***Economies of scale***
- ***Experience***
- ***Product/process design.***

Economies of scale and the experience curve



Costs, prices and profits for generic strategies



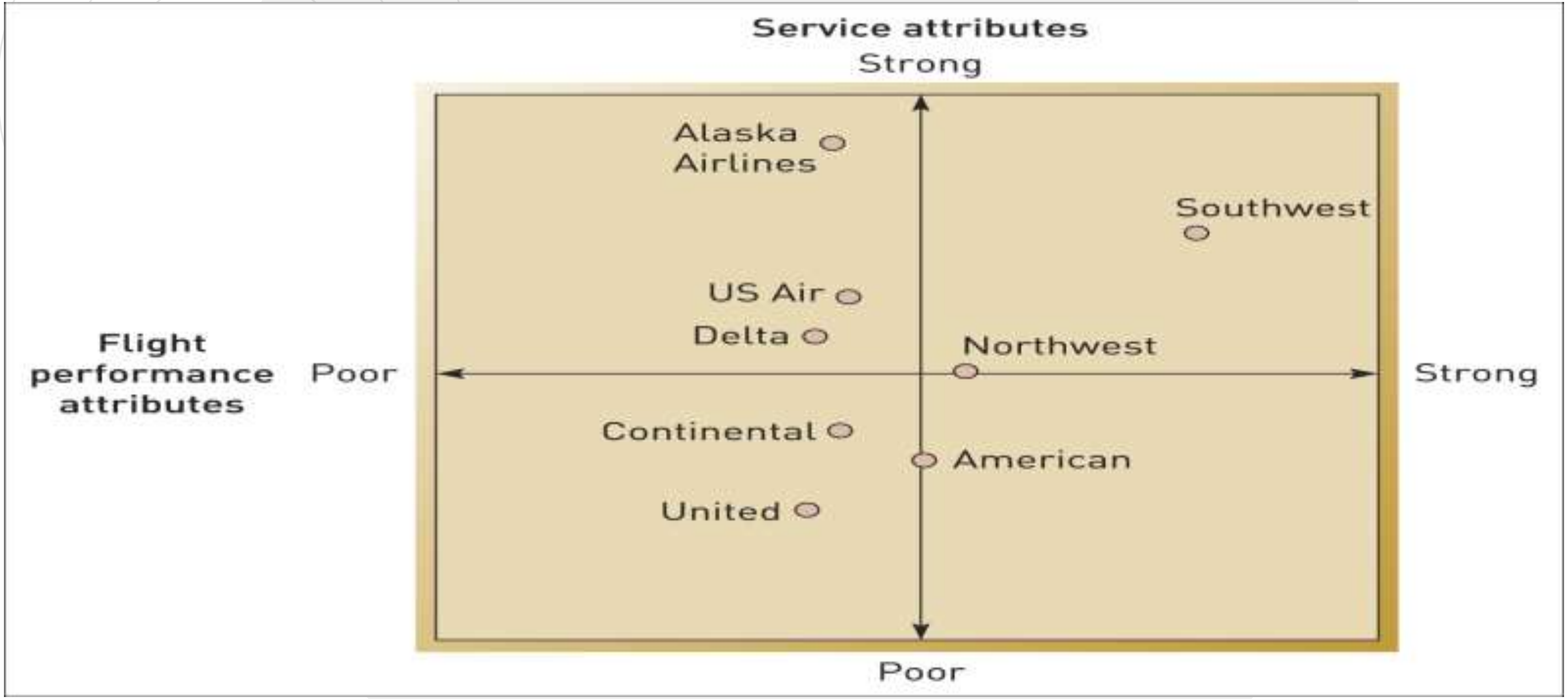
Differentiation strategies

Differentiation involves uniqueness along some dimension that is sufficiently valued by customers to allow a price premium.

Two key issues:

- The ***strategic customer*** on whose needs the differentiation is based
- ***Key competitors*** – who are the rivals and who may *become* a rival.

Differentiation in the US airline industry



Source: Simplified from Figure 1, in D. Gursoy, M. Chen and H. Kim (2005) 'The US airlines relative positioning', *Tourism Management*, 26, 5, 57–67: p. 62.

Focus strategies (1)

A ***focus strategy*** targets a narrow segment or domain of activity and tailors its products or services to the needs of that specific segment to the exclusion of others.

Two types of focus strategy:

- ***Cost-focus strategy*** (e.g. Iceland Foods)
- ***Differentiation focus strategy*** (e.g. ARM Holdings for mobile phone chips).

Focus strategies (2)

Successful focus strategies depend on at least one of three key factors:

- ***Distinct segment needs***
- ***Distinct segment value chains***
- ***Viable segment economics.***

‘Stuck in the middle’?

Porter argues:

- It is best to choose which generic strategy to adopt and then stick rigorously to it.
- Failure to do this leads to a danger of being ***‘stuck in the middle’*** – doing no strategy well.
- The argument for pure generic strategies is controversial. Porter acknowledges that the strategies can be combined (e.g. if being unique costs nothing).

Combining generic strategies

- A company can create separate strategic business units each pursuing different generic strategies and with different cost structures.
- Technological or managerial innovations where both cost efficiency and quality are improved.
- Competitive failures – if rivals are similarly ‘stuck in the middle’ or if there is no significant competition then ‘middle’ strategies may be OK.

Strategy clock (1)

The strategy clock provides an alternative approach to ***generic strategy*** which gives more scope for ***hybrid strategies***.

It has two distinct features:

- It is focused on the prices to customers rather than the costs to organisations.
- The circular design allows for incremental adjustments in strategy rather than stark choices.

Strategy clock: differentiation

- Strategies in this zone seeks to provide products that offer perceived benefits that differ from those offered by competitors.
- A range of alternative strategies from:
  - ***differentiation without price premium (12 o'clock)*** *– used to increase market share.*
  - ***differentiation with price premium (1 o'clock)*** *– used to increase profit margins.*
  - ***focused differentiation (2 o'clock)*** *– used for customers that demand top quality and will pay a big premium.*

Strategy clock: low price

Low price combined with low perceived value.

- ***A standard low price strategy (9 o'clock)***
- Low prices combined with similar quality to competitors aimed at increasing market share. Needs a cost advantage (such as economies of scale) to be sustainable, e.g. Asda/Walmart in grocery retailing.
- ***A 'no frills' strategy (7 o'clock)***
- Focusing on price sensitive market segments – typified by low-cost airlines like Ryanair.

Strategy clock: hybrid

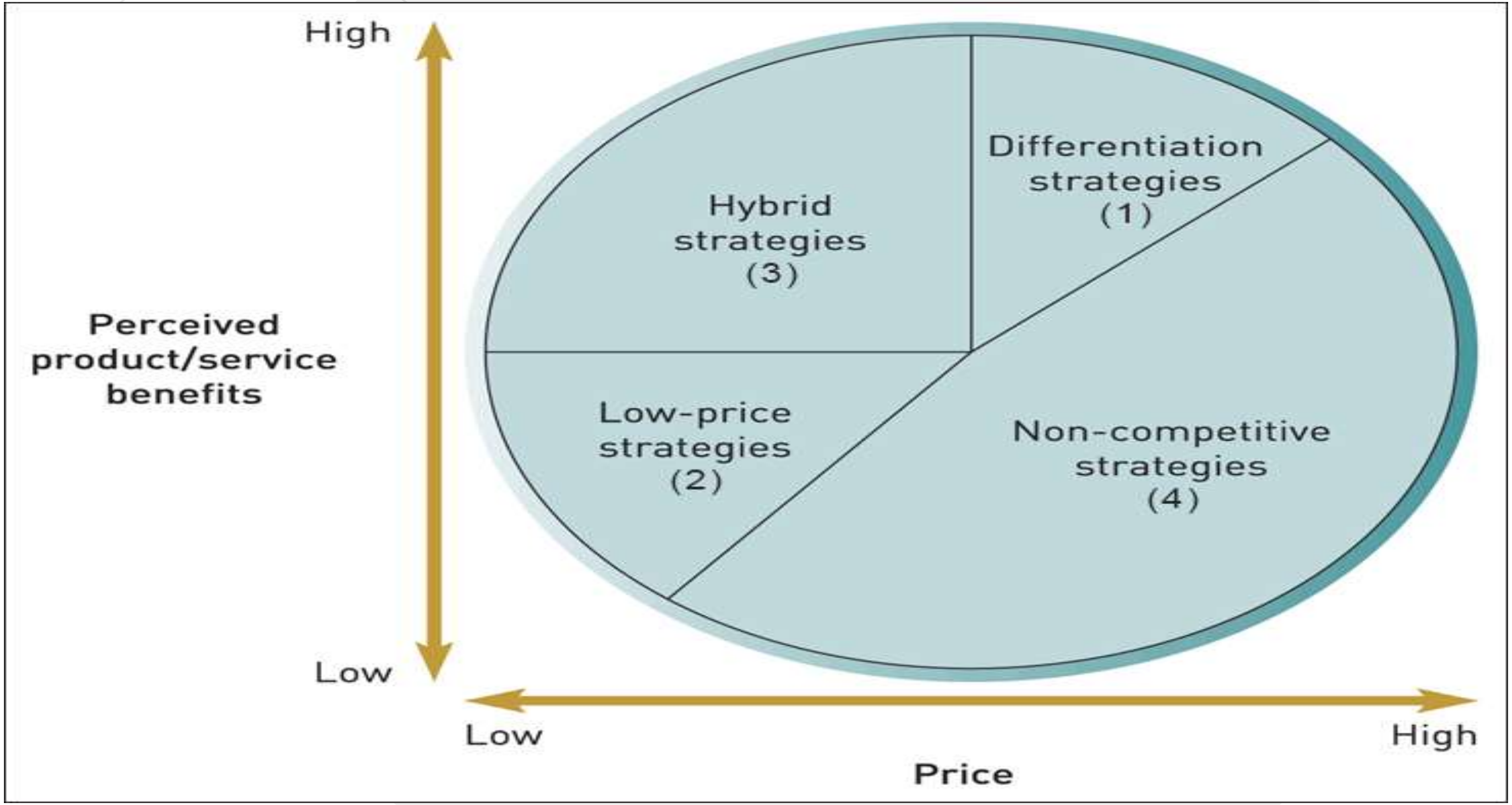
Seeks to simultaneously achieve higher benefits and lower prices relative to those of competitors.

Hybrid strategies can be used:

- ***to enter markets and build position quickly***
- ***as an aggressive attempt to win market share***
- ***to build volume sales and gain from mass production.***

A classic example is IKEA. (Low price with differentiation strategies/ Swedish design)

Strategy clock (2)



Source: Adapted from D. Faulkner and C. Bowman, *The Essence of Competitive Strategy*, Prentice Hall, 1995.

Strategy clock – non-competitive strategies

Increased prices with low perceived product or service benefits.

- In competitive markets such strategies will be doomed to failure.
- Only feasible where there is strategic ‘lock-in’ or a near monopoly position.

Strategic lock-in

Strategic lock-in is where users become dependent on a supplier and are unable to use another supplier without substantial switching costs.

Lock-in can be achieved in two main ways:

- ***Controlling complementary products or services.*** An example is razors that only work with one type of blade.
- ***Creating a proprietary industry standard.*** Microsoft with its Windows operating system.

Hypercompetition

Hypercompetition describes markets with continuous disequilibrium and change, e.g. popular music or consumer electronics.

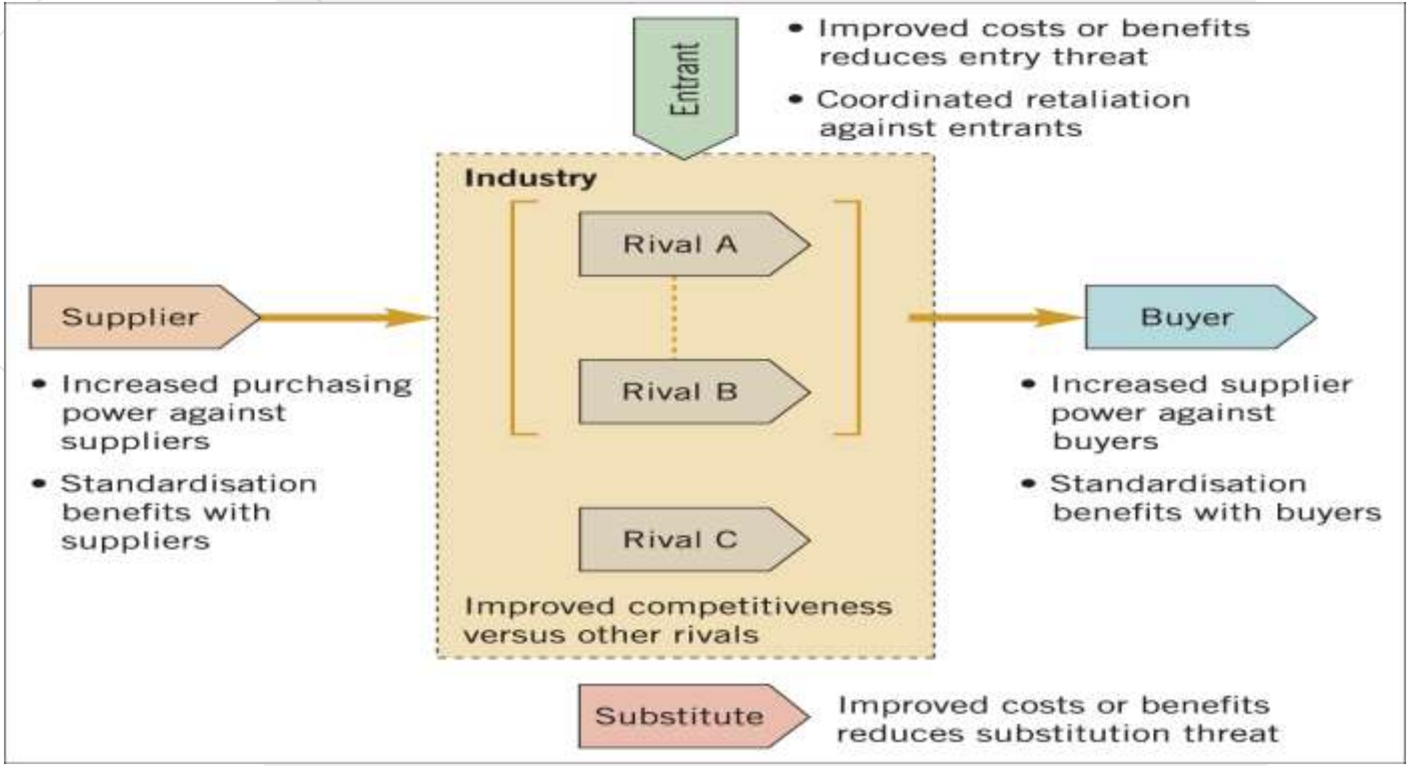
- It may be impossible to plan for long-term sustainable competitive advantage.
- Planning may actually destroy competitive advantage by slowing down responses.
- Successful hypercompetition demands ***speed and initiative*** rather than defensiveness.

Interactive strategies in hypercompetition

Four key principles:

- ***Cannibalise bases of success***
- ***Series of small moves rather than big moves***
- ***Be unpredictable***
- ***Mislead the competition.***

Cooperating with rivals



Source: Adapted from *Competitive Strategy: Techniques for Analysing Industries and Competitors*, The Free Press, by Michael E. Porter. Copyright © 1980, 1998 by The Free Press. All rights reserved.

Game theory

Game theory encourages an organisation to consider competitors' likely moves and the implications of these moves for its own strategy.

- Game theory is particularly important where competitors are ***interdependent***.

- In these circumstances it is important to:

  - ***get in the mind of competitors.***

  - ***think forwards and reason backwards.***

Prisoner's dilemma

		Boeing	
		Hold prices	Cut prices
Airbus	Hold prices	500 500	700 100
	Cut prices	100 700	300 300

Hypothetical data constructed for illustration purposes only

Summary (1)

- Business strategy is concerned with seeking ***competitive advantage*** in markets at the ***business*** rather than **corporate** level.
- Business strategy needs to be considered and defined in terms of ***strategic business units (SBUs)***.
- Porter's framework and the Strategy Clock define various ***generic strategies***, including ***cost-leadership***, ***differentiation***, ***focus*** and ***hybrid*** strategies.
- Managers need to consider how business strategies can be ***sustained through strategic capabilities*** and/or the ability to achieve a 'lock-in' position with buyers.

Summary (2)

- In ***hypercompetitive conditions*** sustainable competitive advantage is difficult to achieve. Competitors need to be able to cannibalise, make small moves, be unpredictable and mislead their rivals.
- ***Cooperative strategies*** may offer alternatives to competitive strategies or may run in parallel.
- ***Game theory*** encourages managers to get in the mind of competitors and think forwards and reason backwards.

Thanks!