JWI 540: Strategy

Week Six Lecture Notes

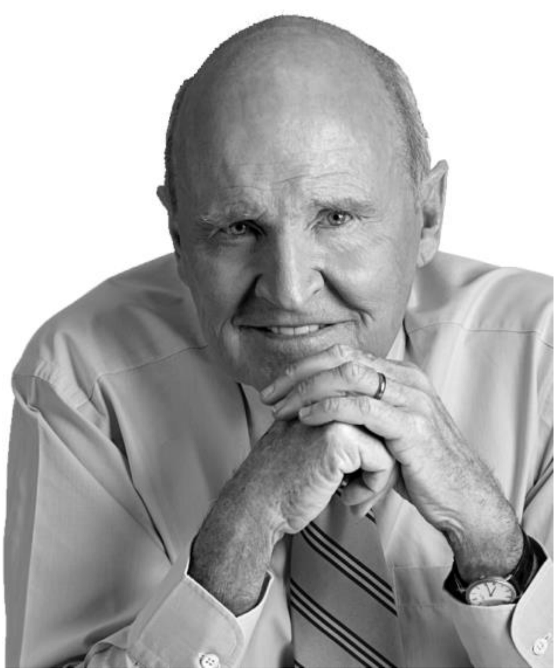
CREATING MEANINGFUL DIFFERENTIATION

What it Means

Failure to create a value proposition that is meaningfully different from those of your competitors will reduce your business model to a commodity play often with a race to the bottom on pricing. When thinking about meaningful differentiation, however, not every winning move requires a breakthrough invention like the iPhone. There are plenty of companies that make money in sectors that are commoditized (think of the retail gasoline business, for example). However, even in highly commoditized and mature industries, there are still opportunities for meaningful differentiation.

Why it Matters

- If your self-assessment shows that your organization is not focused on making dynamic, game-changing moves, then this is a significant warning sign that whatever competitive advantage you currently hold is vulnerable to erosion.
- It's easy to underestimate the power and capabilities of competitors. Too often, the assumption is that rivals aren't getting faster, better and more innovative. This is how a company can lose its competitive edge in a short timeframe.
- The future of your business must always be at the top of a leader's mind: it enables organizations to make smart moves faster than their competition.



"Getting the right strategy means you have to assume your competitors are damn good, or at the very least as good as you are, and that they are moving just as fast or faster."

"If the rate of change outside exceeds the rate of change on the inside, the end is near."

Jack Welch

WHAT IS "MEANINGFUL" DIFFERENTIATION?

For differentiation to be *meaningful*, it must be something that makes your offering stand out, AND it must be something that matters enough to customers that they are willing actually buy it. Any strategic move aimed at creating meaningful differentiation must increase your competitiveness in the market and improve your customer loyalty.

There are plenty of engineers and designers who are passionate about the products they create and support who will advocate for ides that make the products *better*, but that's not really what's at the heart of this. The real question is whether the move to make something better results in an offering that matters to your customers and is a something that is not easily copied.

The real question in the pursuit of meaningful differentiation is the one that was introduced last week: *"What can you do to change the playing field?"*

7 WAYS TO WIN

Below is a brief outline of SEVEN of the most common (and proven) ways that organizations can create competitive advantages and secure a dominant place in the market.

The list is not exhaustive, and you may discover that some strategists divide things up little differently. That's fine. The purpose is not to force potential strategic moves into overly rigid categories. It is to make use of groupings as a way to help you create and evaluate a checklist of options that *might* point to the right growth paths for your business.

Few strategic moves are undertaken in isolation. While many will be centered on a single core focus area, most will have other elements (such as branding) working together to support the initiative.

When considering any strategic move, you will have to assess not just whether the idea could be a money maker, but also whether it could actually backfire by distracting your organization from its core business. You also have to assess what it would take to implement the move. Is it simple or complex? Is the cost high cost or low? Is it risky or relatively safe? Does it align with the mission or does it require the organization to redefine why it is in business?

As you review the following, keep in mind that the best moves are those that actually expand the market by bringing in new customers rather than just finding ways to get a larger share of an existing pie.

Geographic Expansion

One of the most straightforward ways to grow your business is to expand geographically. You can think of plenty of examples of such growth including Target stores expanding into Mexico or a local or regional company expanding nationally. The logic is that if something is working well in one market, then reproducing the success elsewhere should be an obvious path to growth – just keep repeating what worked.

However, to say that this type of move is “straightforward” is not to say it is easy. The factors that have led to success in a particular city, region or country may be quite different than those in the new geography. Further, expansion of any sort takes resources. Attempting aggressive geographic growth without adequate funding and a good plan is an almost guaranteed recipe for failure.

If you are considering a geographic expansion for your business, you will need to carefully assess a wide range of questions including:

- How do the competitive dynamics in your new market compare to your current one?
- How will the expansion be managed?
- Are there supply chain or quality-control challenges that could surface with the new geography that are not present in your current market?
- Is the customer base different in the new geography?
- What will the management and ownership structure look like? Is franchising a way to go?
- If you are considering an international expansion, a whole additional set of issues comes into play including taxation, regulation, cultural and legal differences, etc.

Still, despite all this, geographic expansion (when properly managed) is one of the most proven pathways to generating growth, and one worthy of consideration for any business that has the potential for scalability.

New Price Tiers

Outside of commodity sales or products that have very tightly defined performance requirements (think about any products that have very strict safety standards), nearly all businesses will position their offerings along a price-performance or price-quality continuum. Typically there will be groups of customers who, given a range of choices, will self-select the price-performance intersection that is right for them. The automotive industry is a classic example of this.

Toyota built a successful business selling reasonably priced cars that were reliable. Believing there was an opportunity in the luxury segment, they developed the Lexus brand which has been hugely successful for them.

Price tier moves can go in the other direction also. Mercedes and other German automotive brands that were historically known (at least in the U.S.) for top-of-the-line cars, started making entry-level models. The objective with these moves was not just to sell more cars into a segment that was not part of their current market, but to build loyalty by getting younger, less affluent customers into the brand earlier and then moving them up into their more premium models as they got older and their income rose. In reality, this is exactly what General Motors was doing back in its prime with its suite of offerings from Chevy to Pontiac to Oldsmobile, to Buick and eventually to Cadillac. While not every customer had the means to move all the way to the top, the ability for GM to deliver a wide range of solutions to the same group customers was (at least for a while) a successful example of levering pricing tiers to drive brand loyalty.

As you consider the potential of developing a new pricing tier for your offerings, you will need to assess:

- Whether you can actually deliver a higher or lower tier of offerings. There may be certain minimum performance demands that (presently) cannot be met at a lower price point, or there might be performance limits that cannot be surpassed at any price point, or if they can be surpassed, the cost is beyond what the market is willing to pay.

- How an up-market or down-market offering will be perceived. A mid-level brand seeking to enter into a premium-tier space will typically have a lot of work to do to build the reputation and status needed to succeed. Conversely, premium brands considering a less expensive offering have to assess whether such a move will jeopardize the brand. Think about ultra-premium brands. What might happen if Rolls Royce or Bentley started offering modestly priced entry-level cars? What if Rolex started marketing a $500 wristwatch?

Vertical Integration

Vertical integration refers to supply chain moves in which companies take over additional parts of the production (and potentially, distribution) process.

As you evaluate your supply chain, and how your product is created and delivered to the customer, think about ways of eliminating interim steps or completely changing how your customer purchases or receives your product. This tactic can be one of the most powerful ways of changing the playing field.

Supply chain optimization became a hot topic in the mid-seventies through the 80's and a whole consulting specialization was built around this, but the principles are at least as old as the Industrial Revolution. In the early 20th century, companies like Ford owned almost the entire production chain from raw materials to finished products. At one point, Ford even owned the land and harvested the rubber that went into tires. But one doesn't have to look nearly that far back. There are plenty of more modern examples such as Apple deciding to make their own chips instead of buying from Intel.

Vertical integration strategies are about improving business alignment in ways that allow profits generated from previously outsourced (or inefficient) production to be realized internally. These operational efficiencies result in improvements in pricing, speed or quality. Such efficiencies, if properly exploited, can create value that is meaningful if passed on to your customers.

Additionally, vertical integration can increase supply chain control and security. Most suppliers sell to a more than one single buyer. That means that buyers (even ones with a lot of power like Wal-Mart or Apple) still have to purchase from vendors who have other customers. These competing demands on the seller can lead to delays and risks including quality control issues.

The opposite of vertical integration is outsourcing – taking a part of the production process that is currently done in-house and finding an external provider to take over the task. Specialized providers are often more efficient at performing these tasks since that is all they do. It is their core competency and they have developed tools and expertise that would take non-specialists years to replicate.

If you are considering a vertical integration (or an outsourcing) move for your business, you'll have to assess some important questions:

- What evidence do you have that you have (or could efficiently develop) the expertise and capacity to take over a production phase currently handled by a supplier?
- Even if you can (profitably) take it over, *should you*? If the profit margins are lower than those of your core business or if taking it over creates a distraction that draws resources and focus away from your core business, then a move that looks good on paper could actually hurt the business.
- If you do make the move, what will it allow you to do now that we couldn't do before, and what would stop your competitors from making a similar move thus negating any advantage you had gained?

Moving into Adjacent Product Segments

Expanding into adjacent product groups can be a winning move for companies whose products are closely associated with other functions. Think about Nike expanding from clothes/shoes into making golf clubs/golf balls.

The success of these sorts of moves typically depends on being able to capitalize on one or both of the following:

- Leveraging a strong brand connection. This occurs when customers like a brand so much for its core offerings that they are open to expanding their interaction with it into other areas.
- The second common way to move into an adjacent product segment is the "convenience play." Consider, for example, a company that only sold furniture but expands to also sell design services, or the gas station that adds a car wash. Is it the best car wash in town? Probably not. But if you can add the purchase of a car wash at the pump when you finish filling up and it's here and now, then why not? It's not so much about a strong brand connection. It's about the convenience. If a customer can buy two items from one supplier, it may just simply be easier than managing two separate buying processes.

New Distribution Channels

Another way companies create meaningful differentiation is through identifying a new way to distribute their products or services. Amazon and Netflix enjoyed tremendous growth by leveraging novel ways of distributing existing products and becoming experts in their fields.

Amazon accomplished this by offering a vast array of consumer products at lower prices and shipping directly to their customers' doorstep. In addition to the convenience of home shipping, Amazon eliminated the "middle man," local stores, and could offer cheaper prices.

Netflix accomplished a similar feat by making movies available first by mail and then through the internet through a variety of devices. This paradigm shift in how consumers could access movies stole huge market share from the largest vendor of movie rentals, Blockbuster, ultimately leading to its bankruptcy.

Building a winning move around opening new distribution channels is, in some ways, similar to moving into a new geography in that the core principle is to get your same product offerings in front of more buyers.

Another example of this is IAMS dog food expanding from specialty pet stores into mass market grocery stores. Originally a premium product, sold only through specialty stores, IAMS was well liked by its customers, but a significant number of pet owners wanted the convenience of being able to buy their dog food at the same time and place that they bought their (human) groceries and were unwilling to make a separate trip to specialized retailer.

Opening new distribution channels can enable businesses to gain access to new markets with little to no disruption to the current function. As such, this is often a lower-risk strategy. However, lower-risk does not mean no-risk. Opening new channels can take considerable work to not only identify viable channels, but negotiate distribution terms and then, once the new channel is operational, manage the channel.

There may be pricing concessions required that can negatively impact margins, and there is a possibility of a backlash from current distributors who feel your new sales channels are a threat to their business and an insult to their loyalty. But generally speaking (and despite these cautionary factors), the more ways you can get your products to qualified buyers, the better.

As you explore ideas to open new distribution channels for your business, you will want to look at all the ways that your current competitors get to market. You will also need to assess whether it is worth it to gain market share if your margins are reduced to the point that either your quality or ability to meet demand is threatened.

Discontinuous Innovation

Every once in a while, individuals and companies hit upon an idea that is so revolutionary it disrupts the way that business is done. Often these breakthroughs are technological in nature such as Tesla launching battery-powered autos, but other times, the breakthrough is less about a new technology than it is about creating value for customers through a different operating model, such as Southwest Airlines building a business around point-to-point flights, standardized planes and quick turnarounds at the gate.

It's well and good to always be on the lookout for innovations that have the potential to disrupt, but if you don't have any idea of what the breakthrough would look even like or the R&D budget needed to fund it, this may not be a viable winning move at this point in time. Discontinuous Innovation is a wonderful way to gain market share. Every company should spend some time thinking about what it can do differently to totally disrupt the market, but changes in the very way that products function (Apple's iPhone) or that customers buy (Amazon) are rare. Investing too much energy into seeking groundbreaking "eureka" moves can distract from continuous improvement and from being a good operator of the current business.

As you assess whether there is a potential for discontinuous innovation for your business, you have to:

- Identify the most fundamental problems that are just not getting addressed with the current solutions
- Determine whether, if you were to innovate and disrupt, how difficult it would be for your competitors to copy your move
- Look for ways to get more out of your team with brainstorming sessions or with incentive programs that reward new ideas
- Look outside your industry for ideas that could be transferable

Mergers & Acquisitions

Especially in crowded industries, one of the most dramatic and powerful ways to change the Playing Field is to acquire or merge with a competitor. Companies can benefit from economies of scale and by pooling resources together to increase efficiency. They can also broaden their product portfolio and possibly their geographical reach.

As you evaluate your possible strategic direction, give some serious thought to whether an acquisition or a merger may be the most effective way to gain competitive advantage. Don't let old biases and grudges blind you to the potential of what such a move could accomplish. The more commoditized your industry, the more likely your company's size may be important for success. In fact, M&A is such a significant pathway to market leadership that we will focus on it in Week 8 of our course.

There are numerous reasons why an M&A move can be a winning one, but the majority of these come down to one single thing – efficiency. This pursuit of efficiency typically falls into one of three categories:

- Economy-of-scale drivers where being larger enables companies to negotiate better deals with suppliers or distributors, or where manufacturing or selling in larger quantities creates better operating margins.

- Ending a futile competition in a market without a growing pie. Think about Sirius merging with XM Radio or about the numerous airline mergers that have taken place over the last two decades.

- Acquiring a capability (or access to a market segment) that would take longer or cost more to develop organically.