

chapter 7

Business Unit Strategies

After a firm's top managers have settled on a corporate-level strategy, focus shifts to how the firm's business unit(s) should compete. A **business unit** is an organizational entity with its own unique mission, set of competitors, and industry. While the corporate strategy concerns the basic thrust of the firm—*where* top managers would like to lead the firm—the **business strategy**, or competitive strategy, addresses the competitive aspect—*who* the business should serve, *what* needs should be satisfied, and *how* core competencies can be developed and the business can be positioned.

Another way of addressing the task of formulating a business strategy is to consider whether a business should concentrate on *exploiting* current opportunities, *exploring* new ones, or attempting to balance the two. Exploitation generates returns in the short term whereas exploration can create forms of sustainable **competitive advantage** for the long term. The business strategy developed for an organization seeks, among other things, to resolve this challenge.¹

A business unit is an organizational entity with its own mission, set of competitors, and industry. A firm that operates within only one industry is also considered a business unit. Strategic managers craft competitive strategies for each business unit to attain and sustain competitive advantage, a state whereby its successful strategies cannot be duplicated easily by rivals.² In most industries, a number of different competitive approaches can be successful, depending on the business unit's resources.

Each business competes with a unique competitive strategy, but attempting to analyze all of the different strategies in a large industry can be quite cumbersome. In the interest of parsimony, it is useful to categorize different strategies into a limited number of **generic strategies** based on their similarities. Businesses adopting the same generic strategy comprise a **strategic group**.³ In the airline industry, for example, one strategic group may comprise carriers such as Southwest Airlines and Frontier that maintain low costs by offering low fares and no frills on a limited number of domestic routes. A second strategic group may comprise many traditional carriers such as Delta, United, and American that serve both domestic and international routes and offer extra services such as meals and movies on extended flights.

Because industry definitions and strategy assessments are not always clear, identifying strategic groups within an industry is often difficult. Even when the definition of an industry is clear, its business units may be categorized into any number of strategic groups depending on the level of specificity desired. There may also be one or two competitors that seem to be functioning between groups and are difficult to classify. Hence, the concept of strategic groups can be used as a means of understanding and illustrating competition within an industry, but applying it is neither easy nor precise.

The challenging task of formulating and implementing a generic strategy is based on a number of internal and external factors. Because generic strategies by definition are overly simplistic, selecting a generic approach is only the first step in formulating a business strategy.⁴ It is also necessary to fine-tune the strategy and accentuate the organization's unique set of resource strengths.⁵ Two generic strategy frameworks—one developed by Porter and another by Miles and Snow—can serve as good starting points for developing business strategies.

Porter's Generic Strategies

Michael Porter developed the most commonly cited generic strategy framework.⁶ According to Porter's typology, a business unit must address two basic competitive concerns. First, managers must determine whether the business unit should focus its efforts on an identifiable subset of the industry in which it operates or seek to serve the entire market as a whole. For example, specialty clothing stores in shopping malls adopt the focus concept and concentrate their efforts on limited product lines primarily intended for a small market niche. In contrast, many chain grocery stores seek to serve the mass market—or at least most of it—by selecting an array of products and services that appeal to the general public as a whole. The smaller the business, the more desirable a focus strategy tends to be—although this is not always the case.

Second, managers must determine whether the business unit should compete primarily by minimizing its costs relative to those of its competitors (i.e., a **low-cost strategy**) or by seeking to offer unique and/or unusual products and services (i.e., a **differentiation strategy**). Porter views these two alternatives as mutually exclusive because differentiation efforts tend to erode a low-cost structure by raising production, promotional, and other expenses. In fact, Porter labeled business units attempting to emphasize both cost leadership and differentiation simultaneously as “stuck in the middle.”⁷ However, this is not necessarily the case, and the **low-cost–differentiation strategy** is a viable alternative for some businesses. Combining the two strategies is difficult, but businesses able to do so can perform exceptionally well.

Emphasis on Entire Market or Niche	Emphasis on Low Costs	Emphasis on Differentiation	Emphasis on Low Costs and Differentiation
Entire Market	Low-Cost Strategy	Differentiation Strategy	Low-Cost–Differentiation Strategy
Niche	Focus–Low-Cost Strategy	Focus-Differentiation Strategy	Focus–Low-Cost–Differentiation Strategy

Table 7.1 Generic Strategies Based on Porter's Typology

Depending on the way strategic managers in a business unit address the first (i.e., focus or not) and second (low-cost, differentiation, or low-cost–differentiation) questions, six configurations are possible. A seventh approach—**multiple strategies**—involves the simultaneous deployment of more than one of the six configurations (see Table 7.1). Only the low-cost and differentiation strategies with and without focus were included in Porter’s original framework.

Low-Cost (Cost Leadership) Strategy (Without Focus)

Businesses that compete with a low-cost strategy tend to produce basic, no-frills products and services for a mass market composed of price-sensitive customers. Because they attempt to satisfy most or all of the market, these businesses tend to be large and established. Low-cost businesses often succeed by building market share through low prices although some charge prices comparable to rivals and enjoy a greater margin. Because customers generally are willing to pay only low to average prices for “basic” products or services, it is essential that businesses using this strategy keep their overall costs as low as possible. Efficiency is a key to such businesses, as has been demonstrated by mega-retailer Wal-Mart in the past two decades.

Low-cost businesses tend to emphasize a low initial investment and low operating costs. Such organizations tend to purchase from suppliers who offer the lowest prices within a basic **quality** standard. Research and development (R & D) efforts are directed at improving operational efficiency, and attempts are made to enhance logistical and distribution efficiencies. Such businesses often—but not always—deemphasize the development of new and/or improved products or services that might raise costs, and advertising and promotional expenditures will be minimized (see Strategy at Work 7.1).

Strategy at Work 7.1. The Low-Cost Strategy at Kola Real⁸

Coca-Cola and PepsiCo enjoy substantial profit margins on their soft drinks in Mexico’s \$15 billion market, where the two have waged intense battles for market share during the past decade. Although Coke usually came out on top, the two collectively controlled sales and distribution in almost all of the country’s major markets. In 2003, Coke had more than 70% of Mexican sales, while Pepsi had 21%. Consumers in Mexico drink more Coke per capita than those in any other nation.

In the early 2000s, both well-known colas were challenged by an unlikely upstart from Peru known as Kola Real (pronounced RAY-AL). Introduced in Peru in 1988 and launched in Mexico in 2001, Kola Real captured 4% of the Mexican market in its first 2 years and amassed 17% by 2011.

Bottled by the Ananos family from Peru, Kola Real lacks all of the frills and endorsements associated with Coke and Pepsi. The strategy is simple: Eliminate all possible costs and offer large sizes at low prices. Whereas Coke and Pepsi spend nearly 20% of revenues on concentrates, the Ananos family makes its own. And while Coke and Pepsi spend millions on promotion and manage their own fleets of attractive trucks, the Ananos family hires third parties for deliveries—even individuals with dented pickup trucks—and relies primarily on word-of-mouth advertising.

Central to Kola Real’s success is the fact that most Mexican cola drinkers are relatively poor and consider price to be a major factor in their purchase decisions. In Brazil, so-called “B-brands” (i.e., low-cost generic or store brands) now account for almost one-third of the country’s cola sales. Fearing this could happen in Mexico, Coke and Pepsi have fought back with price cuts as well, although they will not be able to challenge Kola Real’s low-cost position on a large-scale basis.



A cost leader may be more likely than other businesses to outsource or offshore a number of its production activities if costs are reduced as a result—even if modest amounts of control over quality are lost in the process. In addition, the most efficient means of distribution is sought, even if it is not the fastest or easiest to manage. It is worth noting that successful low-cost businesses do not emphasize cost minimization to the degree that quality and service decline excessively. In other words, cost leadership taken to an extreme can result in the production of “cheap” goods and services that few customers are willing to purchase.



Outsourcing and offshoring can be a complex component in a low-cost strategy, however. Many American apparel retailers relocated production activities to China in the 1990s and 2000s. Labor costs began to increase in China in the late 2000s, and by 2010, Ann Taylor Stores, Coach, Guess, and others began to consider lower cost countries such as Bangladesh and Vietnam. Because the transportation infrastructure in these nations is not as developed, total costs could actually increase instead of decrease.⁹

Low-cost leaders depend on unique capabilities not available to others in the industry such as access to scarce raw materials, large market share, or a high degree of capitalization.¹⁰ However, manufacturers who employ a low-cost strategy are vulnerable to intense price competition that drives profit margins down and limits their ability to improve outputs, augment their products with superior services, or spend more on advertising and promotion.¹¹ The prospect of being caught in price wars keeps many manufacturers from adopting the low-cost strategy, although it can affect other businesses as well. Other low-cost leaders have bought their suppliers to control quality and distribution. Price cutting in the airline industry led to the demise of a number of upstarts even before the events of 9/11 and made it even more difficult to raise fares shortly thereafter.¹²



Although low costs do not necessarily lead to low prices, they usually do. Global retail giants like Wal-Mart and Carrefour have cut costs through economies of scale so that they can offer lower prices. Wal-Mart increasingly integrates its distribution network and emphasizes common sourcing throughout the world to shave costs and improve margins.¹³ Carrefour strayed from its low-cost, low price strategy in the late 2000s, however. This shift, in concert with the economic downturn, resulted in an \$85.3 million loss in 2008, a sharp decline from 2008's \$1.1 billion profit. Lars Olofsson joined Carrefour as chief executive officer (CEO) in 2009 and embarked on a return to a low-cost approach for the world's second largest retailer.¹⁴

Occasionally, smaller rivals will join in an effort to generate collective scale economies to battle an industry leader. This occurred in a cooperative effort called ShopRunner in the 2010 Christmas shopping season. Online stores like Babies“R”Us, Rockport, RadioShack, and others teamed up to battle Amazon.com by offering a \$79 loyalty program that includes unlimited 2-day shipping and free returns. These retailers understand that high-volume online shoppers account for most of the \$140 billion U.S. consumers spend online each year. They also recognize that the ongoing competitive threat from rival Amazon requires innovative and collective action that can lessen the advantage it enjoys from its massive size and scope.¹⁵ In the 2011 Christmas shopping season, even traditional retailers like Toys“R”Us, Wal-Mart, Best Buy, and Kohl's offered free shipping to compete more effectively with Amazon, Newegg.com, and other online retailers.¹⁶ Best Buy added deep discounts—particularly on Black Friday (the day after Thanksgiving)—and achieved a 20% increase in web sales and the first increase in overall revenues in six quarters. The massive price cuts hurt margins, however, as the sales *increase* was accompanied by a 29% *decrease* in earnings.¹⁷ This example illustrates the advantage that low-cost firms like Amazon have when attacked on price.

Success with the low-cost strategy can be short-lived, however. Low-cost airline AirTran (acquired by Southwest in 2011), for example, boasted a 2003 profit of \$101 million while Delta and its pilots were unable to agree on a cost reduction plan. The following year, however, Delta finally made headway and began cutting both costs and many of its fares, some by as much as

50%. By 2005, AirTran, along with other low-cost airlines, began to feel the squeeze as major airlines like Delta became more price competitive.

A key problem with the low-cost strategy is that cutting costs is not easy to accomplish. During the recession of the late 2000s, for example, low-cost restaurant Church's Chicken began filtering the shortening used for frying so that a batch could last for 14 days instead of 10, resulting in an estimated savings of \$1 million per year. Shrinking the scoop size of its biscuits from 3 tablespoons to 2 saves about \$1.8 million per year. Replacing the cardboard French-fry packaging with paper generates an estimated \$700,000 in annual savings.¹⁸ Of course, these savings assume that customers will not respond by altering their purchase behavior.

Although low-cost competitors like Church's tend to be better positioned for economic slowdowns, all businesses become more concerned about costs when industry revenues decline. During this same time, Ohio-based Marco's Pizza worked with vendors to lock in transportation costs and began contracting with manufacturers located closer to distribution centers to reduce freight costs. Small pizza boxes were eliminated at its more than 170 stores; placing small pizzas in CheezyBread boxes saves \$164,000 per year. Kentucky-based Tumbleweed Restaurants shifted lower priced and lower cost items like tacos and burritos to the front and center of the menu, enabling patrons to spend less but to do so on higher margin items.¹⁹

Trimming costs can also create other challenges for low-cost businesses. For example, regional or commuter airlines typically pay lower wages than their national and international counterparts. Pilots at United and other major airlines are required to log 5,000 to 7,000 flight hours before stepping into the cockpit. Smaller airlines like JetBlue Airways require 4,000, but some commuter airlines hire pilots with less than 1,000. Relaxing this requirement creates a cost advantage for commuter airlines but can also create safety concerns.²⁰

Imitation by competitors can also be a concern when the basis for low-cost leadership is not proprietary and can be easily duplicated. Lego discovered this when Canadian upstart Mega Blocks began to steal market share by making colorful blocks that not only look like Legos but also snap into them and sell for a lower price. Lego responded by launching the Quatro line of oversized blocks aimed at the preschool market and carrying lower prices than traditional Lego playsets.²¹

Low-cost businesses are also particularly vulnerable to technological obsolescence. Manufacturers that emphasize technological stability and do not respond to new product and market opportunities may eventually find that their products have become obsolete.

Focus–Low-Cost Strategy

The **focus–low-cost strategy** emphasizes low overall costs while serving a narrow segment of the market, producing no-frills products or services for price-sensitive customers in a market niche. Ideally, the small business unit that adopts the focus–low-cost strategy competes only in distinct market niches where it enjoys a cost advantage relative to large, low-cost competitors.

The focus concept is clear in theory but sometimes confusing in practice. In general, a business rejects a focus approach when it attempts to serve *most* of the market. In practice, however, virtually every business focuses its efforts—at least to some extent. Because *most* is a subjective term, scholars sometimes disagree on whether a particular business should be classified as focus or not.

Aldi is a clear example of a business that pursues a focus–low-cost strategy. Aldi is an international retailer that offers a limited assortment of groceries and related items at the lowest possible prices. In 2011, Aldi operated over 1,000 stores in over 31 states in the United States alone. Functional operations are focused on a single strategic objective: minimal costs. Efforts are targeted to consumers with low to moderate incomes.

Aldi minimizes costs in a number of ways. Most products are private label, allowing Aldi to negotiate rock-bottom prices from its suppliers. Stores are modest in size, much smaller than



that of a typical chain grocer. Aldi only stocks common food and related products, maximizing inventory turnover. The retailer does not accept credit cards, eliminating the 2% to 4% fee typically charged by banks to process the transaction. Customers bag their own groceries and must either bring their own bags or purchase them from Aldi for a nominal charge. Aldi also takes an innovative approach to the use of its shopping carts. Customers insert a quarter to unlock a cart from the interlocked row of carts located outside the store entrance. The quarter is returned with the cart when it is locked back into the group. As a result, no employee time is required to collect stray carts unless a customer is willing to forgo the quarter by not returning the cart!

Adding a focus orientation to cost leadership can enable a firm to avoid direct competition with a mass-market cost leader. In this manner, grocer Save-A-Lot has found a way to compete successfully against Wal-Mart Supercenters. The grocery store pursues locations in urban areas that were rejected by Wal-Mart and offers prices competitive with the big-box store. Save-A-Lot generates profits by opening small, inexpensive stores catering to U.S. households earning less than \$35,000 a year. Save-A-Lot stocks mostly its own brand of high-turnover goods to minimize costs and eschews cost-inducing pharmacies, bakeries, and baggers.²²

Sharp Shopper is a no-frills discount store that sells surplus food items. Although targeted to low-income consumers, many middle-income earners began to frequent the store during the recession of the late 2000s. Sharp Shopper cuts costs by purchasing large quantities of discontinued products and those past the “best if eaten by” date at large discounts and passing the savings along to consumers. The surplus food retail segment has grown in recent years, but its size is not known because most of the companies—like Sharp Shopper—are privately held and independent.²³



Like low-cost businesses, those adopting the focus–low-cost strategy are vulnerable to intense price competition that periodically occurs in markets with no-frills outputs. To deter price competition, businesses employing the focus–low-cost strategy must continuously search for new ways to trim costs. The Irish no-frills air carrier Ryanair has surpassed Southwest in this regard. Passengers are required to pay for all food, drinks, newspapers, and even blankets, and they pay extra fees to check in at the airport instead of doing so online. Employees pay for their own training and uniforms. The airline even incorporates a strict no-refund policy, even if the airline cancels a flight. Even with an average ticket price of about \$50, Ryanair faces constant pressure from its larger rivals.²⁴



Other low-cost airlines have focused their efforts on limited geographical regions. With operations in Hungary, Bulgaria, and the Ukraine, Wizz Air specializes in transporting Central and Eastern Europeans to Britain and Ireland where many seek and find better paying jobs. CEO Jozsef Varadi sees buses—not other airlines—as their primary competition. Sparked by recent expansion of the European Union, Wizz Air makes economic sense for its customer base when considering fares and travel time.²⁵

Like low-cost businesses that do not adopt a focus approach, focus–low-cost businesses are particularly vulnerable to technological obsolescence. Businesses that value technological stability and do not respond to new product and market opportunities may eventually find that their products have become obsolete and are no longer desired by their customers.

Differentiation Strategy (Without Focus)

Businesses that employ the differentiation strategy (without a focus orientation) produce and market to the entire industry products or services that can be readily distinguished from those of their competitors. Because they attempt to satisfy most or all of the market, these businesses tend to be large and established. Differentiated businesses often attempt to create new product and market opportunities and have access to the latest scientific breakthroughs because technology and flexibility are key factors if firms are to initiate or keep pace with new developments in their industries.

The potential for differentiation is to some extent a function of its physical characteristics. Tangibly speaking, it is easier to differentiate an automobile than bottled water. However,

intangible differentiation can extend beyond the physical characteristics of a product or service to encompass everything associated with the value perceived by customers. Because such businesses' customers *perceive* significant differences in their products or services, they are willing to pay average to high prices for them.

There are a number of prospective bases for differentiation, the most obvious of which is features of the product (or the mix of products offered), including the objective and subjective differences in product attributes. Although many of the vehicles are similar to Toyotas, Lexus automobiles have been differentiated on product features and are well known for their attention to detail, quality, and luxury feel. United and other airlines have attempted to differentiate their businesses by offering in-flight satellite telephone and e-mail services.²⁶

Speed can also be a key differentiator in terms of product development cycles, customer responsiveness, and product delivery. For example, surveys suggest that about two-thirds of Americans consider speed of service when they decide where to dine out. Speed has been an essential part of Starbucks' competitive strategy but became a key concern when service slowed after breakfast sandwiches were added to their product line in the mid-2000s. Adding these food items broadened Starbucks' appeal but slowed service in a segment of the market where seconds count. Starbucks has deemphasized speed in recent years, focusing more on product quality and a superior experience. Starbucks even acquired upscale juice maker Evolution Fresh in 2011 in an effort to expand its reach beyond coffee. In contrast, rival Caribou Coffee still emphasizes speed, producing a small coffee of the day in only 6 seconds.²⁷



Strategy at Work 7.2. The Differentiation Strategy in Residential Real Estate²⁹

Implementing a differentiation strategy can be difficult in a highly regulated industry in which competitors are "forced to follow the rules" and even work together. Residential real estate is an example of such an industry. In most cases, a real estate agent who lists a home for a seller must work with agents from other firms who represent prospective buyers. Buyers and sellers are interested in working only with agents who can negotiate successfully with other agents to complete the transaction. When one also considers the myriad of federal, state, and local regulations concerning property disclosure, confidentiality, and the like, one can easily see why it is difficult for an agent or real estate firm to differentiate service.

Differentiation in such an industry is possible, however. Boyd Williams Real Estate Company (www.boydwilliams.com) operates in the southeastern Mississippi community of Meridian, a city of about 40,000. To distinguish himself from his rivals, Boyd brings his mobile office to clients' homes, offices, hotel lobbies, and even restaurants over lunch break. Prospective buyers can view full-color pictures of virtually every home in the market from the mobile office. This approach seeks to provide maximum efficiency and convenience to the buyer.

Commissions available to Boyd Williams are the same as those available to other agents who do not offer the same amenities. Clearly, Williams seeks to finance his additional investment in the mobile office by allowing consumers to move through the buying process more efficiently—saving him time as well—and by increasing his volume.

Timing can also be a key factor, because first movers are more able to establish themselves in the market than those who come later, as was seen for a number of years with Domino's widespread introduction of pizza delivery.²⁸ Of course, pizza delivery is common today, with few consumers aware that Domino's pioneered the approach on a large scale. Other factors such as partnerships with other firms, location(s), and a reputation for service quality can also be important (see Strategy at Work 7.2 on the previous page).

When customers are relatively price insensitive, a business may select a differentiation strategy and emphasize quality throughout its functional areas. Marketing materials may be printed on high-quality paper. The purchasing department emphasizes the quality and appropriateness of supplies and raw materials over their per-unit costs. The R & D department emphasizes new product development (as opposed to cost-cutting measures).

Differentiation can be a difficult challenge in many industries and product lines. Consider toothpaste. Procter & Gamble's (P&G) Crest brand was easily distinguished from its rivals when it became the only fluoride toothpaste in 1960. In 2010—over 50 years later—69 new varieties were introduced. In January 2011, 352 distinct types of toothpaste were sold. Hence, highlighting the distinctiveness of a given brand can be very difficult to accomplish. Many firms like P&G are seeking to reduce the number of different brands and types to reduce buyer confusion, a problem reminiscent of the commoditization phenomenon discussed in Chapter 4.³⁰

Differentiated businesses are vulnerable to low-cost competitors offering similar products at lower prices—especially when the basis for differentiation is not well defined or it is not valued by customers. For example, a grocer may emphasize fast checkout, assuming that customers are willing to pay a little more for additional cashiers and checkout lanes. If customers tend to be more concerned with product assortments and prices than with waiting times, they may shop at other stores instead.

This vulnerability to low-cost rivals is especially acute during economic downturns when buyers are more cognizant of prices. Private-label or store-branded items—from food to consumer electronics—increased in popularity during the recession of the late 2000s. Sales at food producers like Kraft, Heinz, and ConAgra declined approximately 4% to 6% during this time, while private-label producers enjoyed an increase of about 10%.³¹ Even Best Buy expanded its production of house brands for products such as televisions, flash drives, and cables.³²

Focus-Differentiation Strategy

Firms employing the **focus-differentiation strategy** produce highly differentiated products or services for the specialized needs of a market niche. At first glance, the focus-differentiation strategy may appear to be a less attractive strategy than the differentiation strategy without focus because the former consciously limits the set of customers it seeks to target. In some cases, however, large business units are simply not interested in serving smaller, highly defined niches. Unique market segments often require distinct approaches.

Firms can focus their efforts in a number of ways. Popular retailer Cabela's has even successfully targeted its efforts to men who do not like shopping. The Cabela's in Michigan draws an estimated 6 million visitors to its retail store each year, mixing its outdoorsman-oriented merchandise with an aquarium, an indoor waterfall stocked with trout, and realistic nature scenes. As a result, Cabela's has secured a customer base largely ignored by other retailers.³³

Employing a focus differentiation can mean bucking a broad trend to satisfy a market segment with distinct preferences. Viking Range Corporation refused to depart the United States in search of lower production costs. Viking operates four plants in Mississippi that produce gas ranges, refrigerators, wine coolers, outdoor grills, and dishwashers. Its products are made to order—reducing inventory costs but sell at high prices—but satisfy a quality-oriented consumer. Viking sees itself more as a culinary company than as an appliance manufacturer.³⁴

The focus-differentiation approach can be appropriate for retailers battling big boxes like Wal-Mart that enjoy economies of scale. Instead of trying to be like Wal-Mart, grocers like

Kroger, SuperValu, and Whole Foods Market emphasize key points of distinction. These grocers tend to offer less-hecktic stores, better selections of certain food products, greater convenience, and competitive factors Wal-Mart cannot easily duplicate.³⁵

Many stores have attempted to target consumers who do not enjoy grocery shopping or lack the time to do so by emphasizing online grocery sales. The concept has enjoyed more success in Europe—a 4% market share in the United Kingdom—than in the United States. With only a 2% market share in the United States, the online grocery store remains a niche business serviced by relatively few grocers in select urban markets. Traditional low cost and differentiated businesses like Wal-Mart, Kmart, and Publix continue to experiment with online sales, however, hoping to secure a strong market position if American interest piques in the future.³⁶

As mentioned earlier, categorizing a business strategy as focus-oriented can be difficult as all businesses—large and small—seem to tailor their offerings to various groups of prospective buyers. Even big-box store Home Depot embraced a focus approach—at least to some extent. After taking over as CEO in 2007, Frank Blake noticed that centralized merchandising resulted in too many riding lawn mowers in Arizona, where lush lawns are uncommon, and too few Makita power tools on the West Coast, where they sell quite well. Blake instituted a shift away from a uniform purchasing system in favor of one that gives managers the flexibility to stock their stores based on local tastes.³⁷

The high prices that often accompany a focus-differentiation approach are acceptable to certain customers who need product performance, prestige, safety, or security especially when only one or a few businesses cater to their needs. As such, focus differentiation is most appropriate when market demand is inelastic because high-cost products are often required to support the specialized efforts to serve a limited market niche. As a result, cost reduction efforts, while always desirable, are not emphasized.³⁸

A strong niche or focus orientation can create challenges, however. The market size is limited by definition. In a down economy, buyers may opt for less expensive mainstream offerings. Restaurant chain Quiznos—known for its submarine sandwiches, salads, and soups—suffered during the recession of the late 2000s and early 2010s as consumers migrated to McDonald's and elsewhere. Quiznos responded by expanding its reach through partnerships with convenience stores and service stations. Quiznos hopes to control quality and increase revenues while maintaining its focus-differentiation strategy. The company risks a diluted image, however, and could drift away from its niche concentration toward a more mass-market orientation.³⁹

Low-Cost–Differentiation Strategy

Debate is widespread among scholars and practitioners as to the feasibility of pursuing low-cost and differentiation strategies simultaneously. Porter suggests that implementing a low-cost–differentiation strategy is not advisable and leaves a business “stuck in the middle” because actions designed to support one strategy could actually work against the other. Simply stated, differentiating a product can be costly, thereby eroding a firm's cost leadership basis. In addition, a number of cost-cutting measures may be directly related to quality and/or other bases of differentiation. Following this logic, a business should choose *either* low-cost *or* differentiation but not both.⁴⁰

Others contend that the two approaches are not necessarily mutually exclusive.⁴¹ For example, some businesses begin with a differentiation strategy and integrate low costs as they grow, developing economies of scale along the way. Other businesses seek forms of differentiation that also provide cost advantages, such as enhancing and enlarging the filter on a cigarette, which reduces the amount of costly tobacco required to manufacture the product.

Perhaps the best example of a business that has successfully combined the two approaches is McDonald's. The fast-food giant was originally known for consistency from store to store, friendly service, and cleanliness. These bases for differentiation catapulted McDonald's to



market share leader, allowing the firm to negotiate for beef, potatoes, and other key materials at the lowest possible cost. This unique combination of resources and strategic attributes has placed McDonald's in an enviable position as undisputed industry leader. It faces constant competitive pressure from differentiated competitors emphasizing Mexican, "fresh and healthy," or other distinct product lines, but the fast-food giant went on the attack in late 2008 by installing coffee bars featuring cappuccinos, lattes, and gourmet coffee in a direct attack on high-end Starbucks.⁴² The move proved successful, prompting McDonald's to expand its number of McCafés in Europe to more than 1,200 in 2010.⁴³

A more recent example of the combination strategy is JetBlue Airways, launched in 2000 to provide economical air service among a limited number of cities. JetBlue has minimized costs by such measures as squeezing more seats into its planes, selling its tickets directly to customers, and shortening ground delays. Although commonly thought of as a discount airline, JetBlue has also distinguished itself by providing new planes, SiriusXM and satellite television on board, and leather seating. Hence, JetBlue's differentiation efforts increased its load factor (i.e., the average percentage of filled seats), reducing its per-passenger flight costs.⁴⁴



Evidence of the combination strategy can be seen throughout the world. Traditionally, the automobile market in China was divided into two distinct categories. Local low-cost producers such as Chery Automobile, Zhejiang Geely, and BYD produced inexpensive vehicles for frugal customers while foreign producers like Nissan and General Motors (GM) have targeted elite customers. However, the number of families with an income sufficient to purchase a vehicle is expected to double between 2010 and 2014. This transition has prompted low-cost producers to develop more distinctive, high-quality offerings while enticing foreign firms to produce more less expensive models. Hence, many low-cost and differentiated carmakers have shifted to a combination strategy.⁴⁵

Revenue declines within an industry may cause some of its differentiated businesses to cut costs to remain competitive. In the years following the events of 9/11, for example, British Air embarked on an aggressive cost-cutting campaign, ordering replacement jets devoid of the customary special features, trimming the total number of jets in its fleet, cutting fees to travel agents, eliminating 13,000 jobs, and even limiting menu choices for customers. Ticket prices were also reduced so that the airline could become more competitive with low-fare carriers. As a result, British Air has integrated an emphasis on low costs into its traditional differentiation emphasis.⁴⁶ Indeed, the low-cost–differentiation strategy is possible to attain and can be quite effective. Porter's point is well taken, however, because implementing the combination strategy is generally more difficult than either the low-cost or the differentiation strategy alone. This strategy begins with an organizational commitment to quality products or services, thereby differentiating itself from its competitors. Because customers may be drawn to high quality, demand may rise, resulting in a larger market share, providing economies of scale that permit lower per-unit costs in purchasing, manufacturing, financing, R & D, and marketing (see Strategy at Work 7.3).

Strategy at Work 7.3. Competitive Strategy in the Fast-Food Industry⁴⁷

Although fast food in the United States has long been considered an economical lunch or dinner option, restaurants over the years have attempted to differentiate their products and create brand loyalty among consumers with varying degrees of success. "Value menus" and "dollar menus" were introduced in the 1990s, whereby restaurants offered a limited number of its sandwich and other items at special prices for cost-conscious consumers. Initially, this move was seen as a necessary means of serving consumers during down economic times.

While offering some sandwiches at or near the \$1 price point, many restaurants also offer—and heavily promote—highly differentiated products in the \$2 to \$3 range. Managers hope that

many consumers will be lured in for the special prices, only to “move up” to the higher priced items when it is time to order. McDonald’s, Burger King, and Wendy’s all follow this approach to some degree on a national level. In 2002, Hardee’s even introduced the “six dollar burger,” a sandwich designed to compete with those offered in the \$6 range at full-service restaurants such as Applebee’s but for only about \$4 at Hardee’s.

Fast-food chains have attempted to wean their customers away from the dollar items throughout the late 2000s and early 2010s but largely to no avail. Facing an ongoing recession, U.S. customers have demonstrated a distinct preference for stores with dollar items.

A new breed of fast-food restaurants is avoiding the value menu concept, however. High-end sandwich chains such as Panera Bread Company and Corner Bakery Café are sticking to a highly differentiated approach, emphasizing fresh bread and ingredients to an increasingly health-conscious market. The various strategies implemented by different, successful fast-food players demonstrate the number of viable market niches available in the industry.

Combining low cost and differentiation can be a challenge, however. In the 2000s, cheap-chic discounter Target found a comfortable balance, offering higher quality than Wal-Mart at operational costs and prices below those of traditional department stores. In 2011—prompted by a weak economy—Target placed a greater emphasis on food items and low prices. Customers did not respond positively, and sales growth during this period lagged behind that of both department stores and discount rivals. Some retail analysts suggested that Target’s cool image suffered when promotional efforts accentuated low prices, driving customers interested in quality to department stores and those interested in low prices to other discounters.⁴⁸

A business can pursue low costs and differentiation simultaneously through five primary means: (1) commitment to quality, (2) differentiation on low price, (3) **process innovations**, (4) **product innovations**, and (5) **value innovations** (see Table 7.2). First, commitment to quality throughout the business organization not only improves outputs but also reduces costs involved in scrap, warranty, and service after the sale. Quality refers to the features and characteristics of a product or service that enable it to satisfy stated or implied needs.⁴⁹ Hence, a high-quality product or service conforms to a predetermined set of specifications and satisfies the needs of its users. In this sense, quality is based on *perceptions* and is a measure of customer satisfaction with a product over its lifetime, relative to customer satisfaction with competitors’ product offerings.⁵⁰

Building quality into a product does not necessarily increase total costs because the costs of rework, scrap, and servicing the product after the sale may be reduced, and the business benefits from increased customer satisfaction and repeat sales, which can improve economies

1. Commitment to quality
2. Differentiation on low price
3. Process innovations
4. Product innovations
5. Value innovations

Table 7.2 Pursuing Low Costs and Differentiation Simultaneously

of scale. The emphasis on quality improvement programs initiated in the 1990s sought to improve product and service quality and increase customer satisfaction by implementing an holistic commitment to quality, as seen through the eyes of the customer. Studies suggest that when properly implemented, an emphasis on quality can improve customer satisfaction while lowering costs.⁵¹

Second, a below average price can also be a basis for differentiation. Here, it is important to distinguish low *prices* from low *costs*. Whereas *price* refers to the transaction between the firm and its customers, *cost* refers to the expenses incurred in the production of a good or service. Firms with low production costs do not always translate these low costs into low prices. Anheuser-Busch, for example, maintains one of the lowest per-unit production costs in the beer industry but does not offer its beers at a low price. However, many firms that achieve low-cost positions also lower their prices because many of their competitors may not be able to afford to match their price level. These firms are combining low costs with a differentiation based on price.

Third, process innovations increase the efficiency of operations and distribution. Although these improvements are normally thought of as lowering costs, they can also enhance product or service differentiation. For example, the recent emphasis on eliminating processes that do not add value to the end product has not only cut costs for many businesses but has also increased production and delivery speed, a key form of differentiation.

An emphasis on sustainable production can be viewed as a form of process innovation. Some argue that an emphasis on environmental friendliness creates competitive problems by driving up costs, but this is not always true. While sustainable production practices can be costly at the outset, they can also save energy, eliminate waste, and improve packaging efficiency over the long term, depending on the situation. By embracing the notion of sustainable development where economically feasible, top managers can position their firms for long-term cost reductions and competitive advantage.⁵²

Fourth, product innovations are typically presumed to enhance differentiation but can also lower costs. For instance, over the years, Philip Morris developed a filter cigarette and, later, cigarettes with low-tar and nicotine levels. These innovations not only differentiated its products but also allowed the company to use less tobacco per cigarette to produce a higher-quality product at a dramatic reduction in per-unit costs.⁵³

Fifth, firms may engage in value innovations, modifying products, services, and activities in order to maximize the value delivered to customers.⁵⁴ Such firms seek to provide maximum value by differentiating products and services only to the extent that any associated cost hikes can be justified by increases in overall value *and* by pursuing cost reductions that result in minimal, if any, reductions in value. By focusing on value instead of low cost or differentiation, a firm can offer the overall combination of cost minimization and differentiation in an industry.

Toyota employed value innovations throughout the 1990s and 2000s during its quest for leadership of the automobile industry. Prior to its recall crisis in late 2009 and early 2010, Toyota was known for delivering high value in the industry. Although its products were neither the cheapest nor the most advanced, Toyota's customers typically received a combination of quality workmanship, the most popular features, good performance, and competitive prices.⁵⁵

In 2009 and 2010, Hyundai appeared to dethrone Toyota as value leader in the industry, however. Traditionally a low-cost producer anchored by the midsize Sonata, the Korean carmaker earned accolades for increasing quality throughout the 2000s and began introducing higher-priced vehicles late in the decade. In 2008, Hyundai introduced the Genesis at a price of about \$38,000. In 2010, Hyundai introduced the Equus in the \$55,000 to \$60,000 range, a moderately high price for the U.S. market but still below upscale rivals like Mercedes. Production at Hyundai and its sister brand Kia increased 20% between 2009 and 2010, making Hyundai the fifth largest automaker in the world. In 2011, Hyundai relaunched its brand as "modern premium," a strategy aimed at selling cars with high-end features but at prices low enough to attract mass-market consumers. Hyundai's success hinges on its ability to convince



customers that a traditional cost-oriented carmaker can deliver exceptional quality and high value in the higher-priced segment.⁵⁶

Focus–Low–Cost–Differentiation Strategy

Business units that adopt a **focus–low–cost–differentiation strategy** produce highly differentiated products or services for the specialized needs of a select group of customers while keeping their costs low. Businesses employing this strategy share all the characteristics of the previous strategies. The focus–low–cost–differentiation strategy is difficult to implement because the niche orientation limits prospects for economies of scale as well as opportunities for **structural innovations**. Many small, independent restaurants such as those specializing in ethnic or international cuisine adopt this approach, constantly seeking a balance of cost reductions and uniqueness targeted at a specific group of consumers. For example, many university towns have small eateries that emphasize a unique specialty—such as Garibaldi’s barbecue pizza in Memphis, Tennessee—while also minimizing costs to remain affordable to the price-conscious college student. In the auto insurance industry, SafeAuto employs the focus–low–cost–differentiation strategy by targeting low-income drivers with affordable coverage designed to meet the minimum requirements in their respective states. SafeAuto’s 2011 slogan says it all: “We keep you legal for less. That’s all we do.”

Innovative car rental company Car2Go employs a focus–low–cost–differentiation strategy. With locations in select U.S. and European cities, Car2Go offers small two-seat electric vehicles for rent by reserve or on demand by the minute, hour, or day. Customers use a member card to access a car and are permitted to drive and leave it anywhere in the local service area. Prices include insurance, parking, and maintenance, and a credit or debit card is charged automatically. Car2Go *differentiates* its offering by providing (very) short-term rentals on demand, emphasizes *cost leadership* by allowing multiple customers to rent a vehicle on the same day, and *focuses* on customers who need access to a vehicle for short trips.

Wal-Mart—the corporation—employed the focus–low–cost–differentiation strategy with its new business unit, Más Club, introduced in Houston in 2009. Anchored by Wal-Mart’s corporate obsession with cost containment, Más Club focuses on the Hispanic niche by providing a differentiated array of products and services, including many typically offered only in Mexico.⁵⁷



Multiple Strategies

In some cases, business units employ multiple strategies, or more than one of the six strategies identified previously, simultaneously. Unlike the *combination* low-cost–differentiation strategy, multiple strategies involve the *simultaneous* execution of two or more different generic strategies, each tailored to the needs of a distinct market or class of customer. For this reason, large businesses are more likely than small ones to adopt this approach. Hotels, for example, utilize multiple strategies when they offer basic rooms to most guests but reserve suites on the top floor for others.

A multiple strategy approach can be difficult to implement and confusing to customers. Many airlines utilize multiple strategies when they offer both highly differentiated (and high-priced) service via first-class seating and economical, limited-frills service in coach. To distinguish between these two classes of customers, airlines typically provide separate customer service counters, different boarding times and procedures, and better food for their first-class passengers. While this approach is not optimal in theory, it enables airlines to satisfy the needs of more than one traveling segment without flying additional aircraft.



The Miles and Snow Strategy Framework

A second commonly used framework introduced by Miles and Snow considers four strategic types: (1) *prospectors*, (2) *defenders*, (3) *analyzers*, and (4) *reactors*.⁵⁸ The Miles and Snow typology is an alternative to Porter's approach to generic strategy.

Prospectors perceive a dynamic, uncertain environment and maintain flexibility to combat environmental change. Prospectors introduce new products and new services and design the industry. Thus, prospectors tend to possess a loose structure, a low division of labor, and low formalization and centralization. While a prospector identifies and exploits new product and market opportunities, it accepts the risk associated with new ideas. For example, Amazon's initial launch of its web-based bookstore was a major risk, one that resulted in much greater success for the company than with literally hundreds of other Internet start-ups in the late 1990s.

Prospectors typically seek **first-mover advantages** derived from being first to market. First-mover advantages can be strong, as demonstrated by products widely known by their original brand names, such as Kleenex and ChapStick. Being first, however, can be a risky proposition, and research has shown that competitors may be able to catch up quickly and effectively.⁵⁹ Altria Group's Philip Morris USA failed in its attempts to develop alternatives to traditional cigarettes, including its high technology filtered Marlboro Ultra Smooth, its battery heated Accord, and its "spit-free" smokeless tobacco.⁶⁰ GM's launch of the Chevy Volt in 2010 was not a strategic move devoid of risk.⁶¹ As a result, prospectors must develop expertise in innovation and evaluate risk scenarios effectively.

Prospectors are typically focused on corporate entrepreneurship, or **intrapreneurship**. Whereas entrepreneurship focuses on the development of new business ventures as a means of launching an organization, intrapreneurship involves the creation of new business ventures within an existing firm. Established firms seeking to foster a culture that encourages the type of innovative activity often seen in upstarts must provide time, resources, and rewards to employees who develop new venture opportunities for the organization.

Defenders are almost the opposite of prospectors. They perceive the environment to be stable and certain, seeking stability and control in their operations to achieve maximum efficiency. Defenders incorporate an extensive division of labor, high formalization, and high centralization. The defender concentrates on only one segment of the market. Whereas prospectors pursue first-mover advantages, defenders avoid early market entry. Being the first mover can be costly and risky, and savvy rivals can often leapfrog first movers with better designs and more efficient production processes. Defenders choose to wait until markets are more predictable. Analyzers stress stability and flexibility and attempt to capitalize on the best of the prospector and defender strategy types. Tight control is exerted over existing operations with loose control for new undertakings. The strength of the analyzer is the ability to respond to prospectors (or imitate them) while maintaining efficiency in operations. An analyzer may follow a prospector's successful lead, modify the product or service offered by the prospector, and market it more effectively. In effect, an analyzer is seeking a second-mover advantage.⁶²

Reactors lack consistency in strategic choice and perform poorly. The reactor organization lacks an appropriate set of response mechanisms with which to confront environmental change. There is no strength in the reactor strategic type.

There is a connection between strategies in the Miles and Snow typology and the industry life cycle discussed in Chapter 2. The prospector strategy is often appropriate when an industry is in the introduction or growth stages and there is a premium for new product development. Successful businesses may shift to an analyzer approach during the shakeout stage and ultimately a defender approach during the maturity stage when markets tend to be well defined. These are generalizations, however; it is incorrect to suggest that a business *must* modify its strategy as its industry evolves. Nonetheless, strategic success at the business level depends on

product, customer, and competitive challenges that must be addressed at the industry level. Savvy executives understand this link and consider it when formulating competitive strategies.

In some respects, Porter's typology and Miles and Snow's typology are similar. For example, Miles and Snow's prospector business is likely to emphasize differentiation whereas the defender business typically emphasizes low costs. These tendencies notwithstanding, fundamental differences exist between the typologies. Porter's approach is based on economic principles associated with the cost-differentiation dichotomy whereas the Miles and Snow approach describes the philosophical approach of the business to its environment (see Case Analysis 7.1).

Case Analysis 7.1

Step 10: What Is the Current Business-Level Strategy?

One needs to examine each major business unit (if there is more than one) and identify which generic strategy best describes the strategy of each business unit. *Both* strategy typologies (e.g., Porter, and Miles and Snow) should be applied, but additional support should also be provided. Each business has its own unique strategy based on its own combination of resources. Hence, it is also important to discuss how the organization's business-level strategy differs from others in the industry that might share the same generic strategy. What makes the organization unique? This phase of the strategy management process is critical and often neglected.

The notion of business-level strategy cannot be understood independent of industry definition because an organization's business-level strategy is expressed in terms *relative* to others in the industry. For example, the competitive strategy for retailing giant Wal-Mart might be considered that of differentiation or low-cost-differentiation if the industry is defined "discount retail," whereas it might be considered as low-cost if the industry is defined more broadly as "department stores."

Moreover, a given generic strategy may be more heavily represented in one industry because of structural characteristics or demand patterns. For example, because the computer software industry tends to reward innovation, a high percentage of competitors in the industry might be categorized as prospectors. It would be incorrect to simply classify *all* rivals as prospectors, however. As mentioned previously, an effort should be made to examine each business in *relative* terms.

Business Size, Strategy, and Performance

A number of studies have been conducted to examine the relationship between a business unit's size and its performance, relative to those of its competitors. Interestingly, midsize business units often perform poorly in comparison with small or large competitors because they typically do not possess the advantages associated with being flexible like their small rivals or possessing substantial resources like their large rivals.⁶³ Specifically, small businesses enjoy flexibility in meeting specific market demands and a potentially quicker reaction to environmental changes. Because of their lower investments, they may be able to make strategic moves and pursue more limited revenue opportunities that would be unprofitable for midsize or large businesses. Likewise, large businesses can translate their economies of scale into lower costs per unit and may be better able to bargain with their suppliers or customers or to win industry price wars.

Because midsize business units tend to lack the advantages of either small or large rivals, many choose to become larger or smaller to capitalize on some of the advantages of their competitors. Specifically, they may seek to expand their operations (i.e., increase their size) to take advantage of scale economies, or they may retrench (i.e., decrease their size) to avail themselves of the advantages possessed by small companies. Either option can be difficult and may not even be feasible, depending on various competitive and industry forces.⁶⁴ Of course, not all midsize businesses perform poorly, so top managers in such companies should not aggressively attempt to increase or decrease size. Nonetheless, strategic managers should understand the relationships between size and performance and consider them when evaluating the specific needs of their business units.

Assessing Strategies

Although the distinctions between such strategies as cost leadership and differentiation or prospectors and differentiators are readily made in theory, they are not always easy to assign in practice. Considering Porter's typology, cost leadership and differentiation may be viewed as opposite extremes on a continuum. Likewise, focus and no-focus can also be seen as opposite extremes. Figure 7.1 illustrates this approach with a hypothetical industry containing six rivals. Company A is the only focus–low-cost competitor. Companies B and C—generally seen as part of the same strategic group—are slightly “less focused” than A; both B and C are more differentiated than A, but C is more differentiated than B. Companies D and E—clearly members of the same strategic group—employ low-cost (no focus) strategies whereas company F follows a differentiation (no focus) approach. Viewing generic strategies as a matter of degree enables analysts to illustrate relatively minor distinctions between businesses employing the same generic strategy. This approach can also be applied to the Miles and Snow typology with prospectors and defenders anchoring ends of a continuum and analyzers in the middle.⁶⁵

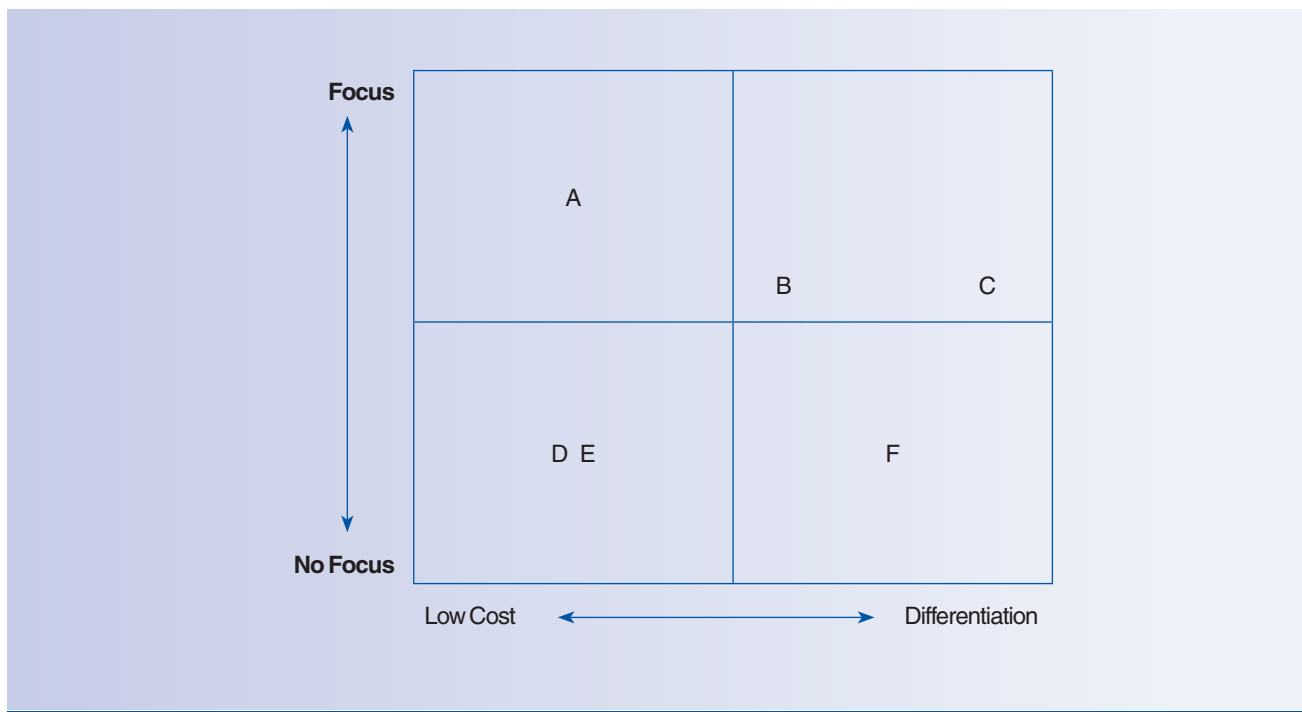


Figure 7.1 Porter's Generic Strategy Matrix

Categorizing businesses in such a matrix is not easy and can be somewhat subjective. Consider Wal-Mart as an example. Traditionally, the retailer has eschewed a focus approach in favor of a one-size-fits-all approach geared at selling to most consumers. Although this approach was successful for a while, sales growth in the United States began to decline in the early 2000s. In 2006, the retailer began modifying its product mixes in many of its U.S. stores to target six groups: (1) African Americans, (2) the affluent, (3) empty nesters, (4) Hispanics, (5) suburbanites, and (6) rural residents.⁶⁶ On the one hand, this move reflects an attempt by Wal-Mart to concentrate its efforts on specific markets, an approach consistent with Porter's

focus strategy. On the other hand, however, the six groups identified together comprise the majority of the U.S. population, suggesting that Wal-Mart's competitive strategy does not qualify as a focus strategy but rather as a no-focus strategy with some degree of tailoring each store to the needs of its clientele. While it might not be appropriate to reclassify Wal-Mart's strategy as a focus approach because of this strategic shift, a modest move toward the focus end of the continuum may be warranted.

In addition, formulating an effective competitive strategy is almost impossible without a clear understanding of the primary competitors and their strategies. Specifically, it is important to comprehend how rivals compete, what they are attempting to accomplish (i.e., their goals), what assumptions they hold concerning the industry, and what their unique strengths and weaknesses are relative to others in the industry. Developing this understanding not only helps top managers formulate strategies to position a business in the industry but can also help them forecast any competitive responses that rivals might make if a major strategic change is implemented (see Case Analysis 7.2).

Case Analysis 7.2

Step 11: What Business-Level Strategies Are Presently Being Employed by Competitors?

To analyze all the competitive options available to a business, one needs to understand the strategic approach of competitors. Because obtaining detailed information about all competitors is often difficult, a focus on the primary competitors utilizing *at least one of the business strategy typologies* is appropriate. The key here is to understand how different competitors in the industry utilize various strategic means to serve customers and pursue profitability. It is helpful to identify how the companies are similar and different in their strategic approaches. This insight can help strategic managers predict how competitors might respond to a change in strategy.

It is often necessary to refine Step 10 after Step 11 is completed. Because competitive strategy is a relative term, it cannot be fully understood without first identifying the range of strategic action present in an industry. For example, the extent to which McDonald's pursues cost leadership *relative* to its rivals (e.g., Burger King, KFC, Taco Bell) becomes clearer *after* the strategic groups in the industry are identified.

Many strategic moves are not instituted by businesses when they anticipate a competitor's activities but rather in response to moves that have already been implemented. For example, online hospitality sites Hotels.com and Expedia.com have joined a number of franchise hotels with unused capacity to fill extra rooms at discounted rates. As a result, consumers were able to secure high-quality accommodations at substantial savings. The hotel chains associated with these franchised units earn substantial profits from their reservation services and therefore began to restrict franchisees from offering rates at websites lower than those offered by the hotel chain's site. As one executive put it, "If we are not careful, these wholesalers will become . . . so big and powerful that we will have to work with them. . . . And you will have to pay a premium to be on their shelves."⁶⁷

Taking advantage of a competitor's misfortune is not always easy, however. In a famous 2000 case, Bridgestone's Firestone unit was forced to recall 6.5 million tires linked to fatal accidents on Ford Explorers in a widely publicized challenge to its credibility. Goodyear, however, was unable to meet the sudden increase in demand for its tires and responded by raising prices. Although sales stabilized at Bridgestone in the early 2000s at a market share about 2% lower than before the recall, Goodyear's market share had declined back to its pre-recall levels by 2003. In this instance, Goodyear was unable to respond effectively to Bridgestone's woes.⁶⁸

Global Concerns

Identifying the competitive strategy of a business operating in global markets can be a complex task because businesses often modify their approaches across borders. Moreover, there is no



simple formula for developing and implementing successful business strategies across national borders. In 2006, Saks Fifth Avenue announced plans to open the first American department store in China—prior to the opening of the 2008 Olympics—but difficulty persuading independent fashion designers to work with them and obtaining required government permits delayed the project.⁶⁹

A popular approach to this global strategy challenge is to “think globally, but act locally.” Following this logic, a business organization would emphasize the synergy created by serving multiple markets globally but formulate a distinct competitive strategy for each specific market that is tailored to its unique situation. Others argue that consistency across global markets is critical, citing examples such as Coca-Cola, whose emphasis on quality, brand recognition, and a small world theme has been successful in a number of global markets. These two approaches represent distinct perspectives on what it takes to be successful in foreign markets. Consider several examples.

Coca-Cola’s global approach to marketing the popular soft drink has been relatively consistent across borders. Some product differences exist, however, due to availability and cost factors. In Mexico, for example, Coke contains readily available cane sugar. In the United States, where customers are not believed to perceive a major difference in sweeteners, Coke changed to high-fructose corn syrup, a less expensive alternative.⁷⁰

Starbucks also rejects the notion that localizing the product line is essential for success. Almost all of its products are consistent across global markets. According to former chief operating officer (COO) Martin Coles, many retailers fail with a globalized product line because execution is inconsistent. Training and development efforts are important, especially when employees in countries where coffee is not a strong tradition must follow specific procedures to produce a cappuccino indistinguishable from one served in the United States. For Starbucks, this is an ongoing challenge in a number of its global markets, including China.⁷¹

Dunkin’ Donuts has also followed a largely global approach, opening 20 stores in Moscow in 2010 after retreating in 1999. Coffee has become more popular in the country, but few Russians were familiar with donuts prior to Dunkin’ Donuts’ reentry. Several unique fillings were developed for the Russian market, but the traditional coffee-and-donuts product mix common in the United States was employed in Moscow with limited changes.⁷² Dunkin’ Donuts opened its first store in India in 2012 and plans to open about 100 throughout the country by 2017. Dunkin’ faces the same challenges in India; although coffee consumption has increased during the past decade, most Indians are unfamiliar with donuts. To address local tastes, Dunkin’ Donuts’ Indian menu includes spicy ciabatta sandwiches, mango donuts, and Alphonso mango smoothies.⁷³

Compared to Coca-Cola, Yum Brands takes a more localized approach with its KFC business unit. KFC emphasizes chicken in its host country—the United States—but added fish sandwiches to menus at its Malaysian outlets in 2006 and other local favorites to Asian stores throughout the late 2000s. According to KFC Holdings (Malaysia) executive director and COO To Chun Wah, “As much as our customers love our chicken products, they also want a greater variety of meat products at KFC. Our market surveys show that our customers want more than just tasty, high quality and affordable chicken but are also constantly on the lookout for new and interesting things to eat.” This reflects a clear move to *localize* business strategies along the lines of taste. Outlets in Malaysia are not required to carry the fish sandwich if they prefer not to, however. Fish sandwiches had already proven to be successful in other Asian markets, such as Beijing, Shanghai, and Taipei.⁷⁴

Yum Brands took localization another step further in 2004 when it launched East Dawning, a bright, clean fast-food restaurant in Shanghai. East Dawning operates like Yum’s KFC restaurants except that its menu and décor are Chinese. Menu offerings include Chinese favorites such as noodles, rice, soy milk, fried dough, and plum juice. Yum executives hope to turn East Dawning into China’s largest fast-food restaurant in the future, although it had amassed only 20 units by 2011.⁷⁵

Kraft took a similar approach with Oreo cookies. Instead of producing the American version of the icon—white icing surrounded by two chocolate cookies—Kraft tested multiple versions and now produces for the Chinese market a long, thin, four-layered cookie coated in chocolate. With global revenue accounting for about 40% of its total, Kraft secured the market leadership position in China by modifying its product to meet different consumer tastes.⁷⁶

Consider Swedish home furnishings designer Ikea. Responding to frugality in the local market, Ikea sells many of its products in China at prices well below those in other parts of the world. The Beijing store, opened in 2006, is its second largest store in the world, behind Ikea's Stockholm store, and draws an estimated three times as many visitors as its other outlets. Ikea has experienced success selling to the growing middle class in China, but at prices that would be considered bargains elsewhere in the world.⁷⁷

The localization perspective can be extended further to **micro-localization**, customizing products and services to suit the taste and needs of diverse consumers across a nation or region. Micro-localization is common in India because Indian tastes not only differ substantially from those in other markets but are also quite diverse throughout the nation. India's Barista Coffee chain sells south Indian filter coffee on the Bangalore-Mysore highway but offers yogurt-based drinks in the north. Indian consumer products company Godrej alters the scents in its Godrej No. 1 soap from sandalwood to rose across regions of the country. LG microwaves in the south of India come with auto cook options for regional rice-based breakfast foods like idli and upma, while those produced in the east are programmed for cooking Bengali fish curry or the mixed vegetable dish known as shukto.⁷⁸

There is wisdom in both global strategy perspectives—localizing and maintaining consistency across borders—although the most effective approach will depend on the mission, goals, and characteristics of the organization. Tailoring a business strategy to meet the unique demands of a different market can be especially challenging because it requires that top managers understand the similarities and differences between the markets from both industry and cultural perspectives. Because businesses rarely operate at one extreme or the other, in practice these alternative approaches can be viewed as opposite ends of a continuum. Regardless of choice, there are costs and trade-offs associated with every position along the continuum.

Given the intense competition in most markets in the developed world, strategic managers must remain abreast of opportunities that may exist in emerging economies. This is further complicated in a global economy when a firm seeks to offer different products and services—at substantially different prices—in different markets. Pharmaceutical companies typically sell the same drugs for less in Mexico than in the United States. As a result, many Americans do not see these companies in a positive light and some even cross the border to make their purchases at a discount.

In 2005, Renault set out to develop an affordable, no-frills, low-priced car for sale in developing markets like India. Sales of the vehicle line were lackluster in these markets, but they exceeded expectations in developed markets. Renault sold about 685,000 low-cost models in 2010—about half in Europe with its Dacia brand and the other half in emerging markets with low-end Renault models. While the carmaker welcomes the unanticipated surge of low-priced cars in developed markets, the extent to which this has cannibalized sales for pricier models with higher margins is unclear.⁷⁹

In 2010, Google targeted Africa for growth despite the fact that its roughly 1 billion inhabitants account for only 4% of the world's Internet users, and mobile phone and Internet service charges are much higher than in developed nations. With an initial focus on Nigeria, Kenya, and South Africa, Google aims to convince more African entrepreneurs, students, and aid workers to make use of its search, mapping, and mobile phone technologies. While some see developmental challenges in Africa, Google sees pent-up demand for connectivity and access.⁸⁰

Brazil has also enjoyed considerable economic success in recent years. The country boasts the largest automobile market in Latin America and passed Germany as the world's fourth-largest market.⁸¹ India has enjoyed considerable growth as well. Some firms have “outsourced” jobs in technical areas to India where trained workers are available at considerably lower wages. Economic liberalization in the country has invited additional foreign investment into the country. India's Tata Motors helped overcome the country's reputation for poor production quality by exporting an estimated 20,000 CityRovers to the United Kingdom in 2004.⁸²

India, however, has received only a small fraction of the level of foreign investment made in China, which boasts the world's largest population and has been tabbed as a rising world economic leader. China entering into the World Trade Organization (WTO), declining import tariffs, and increasing consumer incomes suggest a bright future for the nation. China remains a mix of the traditional lifestyle based in socialism and its own form of a neo-Western economic development. Nowhere is this friction seen best than on the roads of the capital, Beijing, where crowds of bicycles attempt to negotiate traffic with buses and a rapidly increasing number of personal automobiles. U.S.-style traffic reports have even become pervasive in a country where the world's largest automakers are fighting for a stake in what many experts believe will be a consumer automobile growth phase of mammoth proportions.⁸³

When a Western firm seeks to conduct business with one of its Chinese counterparts, managers from both firms must recognize the cultural differences between the two nations. Recently, a number of consulting and management development organizations in both China and the West have been busy training managers to become aware of such differences and take action to minimize misunderstandings that can arise from them. For example, Chinese managers are more likely than Americans to smoke during meetings and less likely to answer e-mail from international partners. In the United States, it is more common to emphasize subordinate contributions to solving problems whereas Chinese managers are more likely to respect the judgment of their superiors without subordinate involvement.⁸⁴

Western manufacturers such as Eastman Kodak, P&G, Group Danone of France, and Siemens AG of Germany have already established a strong presence in China. A number of Western restaurants and retailers have also begun to expand aggressively into China, including U.S.-based McDonald's, Popeye's Chicken, and Wal-Mart. As the CEO of Yum, owner of KFC, Pizza Hut, and Taco Bell, put it, “China is an absolute gold mine for us.”⁸⁵ French-based Carrefour has about 170 stores in China, although rising inflation and supplier problems resulted in a number of closures in 2011.⁸⁶ Product mixes in the Chinese stores tend to be similar to those in the domestic market with adjustments made for local preferences. For a number of firms, the only attractive prospects for growth lie in emerging economies such as China, Brazil, and Mexico.⁸⁷

Summary

At the business level, top managers determine how the organization is to compete effectively with its rivals. According to Porter's framework, managers must decide whether to focus on a segment of the market—a strategy often appropriate for small businesses—and whether to emphasize low costs or differentiation. Each approach has its own set of advantages and challenges. Business units may also seek to combine the low-cost and differentiation strategies, although this approach can be difficult to implement effectively.

According to Miles and Snow's framework, managers may select a prospector, an analyzer, a defender, or a reactor strategy. Each of the first three approaches can serve as an effective approach whereas the reactor strategy is a suboptimal choice. Top managers should also consider the roles of business size, the strategies of rivals, and opportunities in emerging markets when seeking to develop business strategies.

Key Terms

Business Strategy: A strategy delineating how a business unit competes with its rivals; also called competitive strategy.

Business Unit: An organizational entity with its own unique mission, set of competitors, and industry.

Competitive Advantage: A state whereby a business unit's successful strategies cannot be easily duplicated by its competitors.

Differentiation Strategy: A generic business unit strategy in which a larger business produces and markets to the entire industry products or services that can be readily distinguished from those of its competitors.

First-Mover Advantages: Benefits derived from being the first firm to offer a new or modified product or service.

Focus-Differentiation Strategy: A generic business unit strategy in which a smaller business produces highly differentiated products or services for the specialized needs of a market niche.

Focus-Low-Cost-Differentiation Strategy: A generic business unit strategy in which a smaller business produces highly differentiated products or services for the specialized needs of a select group of customers while keeping its costs low.

Focus-Low-Cost Strategy: A generic business unit strategy in which a smaller business keeps overall costs low while producing no-frills products or services for a market niche with elastic demand.

Generic Strategies: Strategies that can be adopted by business units to guide their organizations.

Intrapreneurship: The creation of new business ventures within an existing firm.

Low-Cost-Differentiation Strategy: A generic business unit strategy in which a larger business unit maintains low costs while producing distinct products or services industry-wide for a large market with a relatively inelastic demand.

Low-Cost Strategy: A generic business unit strategy in which a larger business produces, at the lowest cost possible, no-frills products and services industry-wide for a large market with a relatively elastic demand.

Micro-localization: Customizing products and services to suit the taste and needs of diverse consumers across a nation or region.

Multiple Strategies: A strategic alternative for a larger business unit in which the organization simultaneously employs more than one of the generic business strategies.

Process Innovations: A business unit's activities that increase the efficiency of operations and distribution.

Product Innovations: A business unit's activities that enhance the differentiation of its products or services.

Quality: The features and characteristics of a product or service that allow it to satisfy stated or implied needs.

Strategic Group: A select group of direct competitors who have similar strategic profiles.

Structural Innovations: Modifying the structure of the organization and/or the business model to improve competitiveness.

Value Innovations: Modifying products, services, and activities in order to maximize the value delivered to customers.

Review Questions and Exercises

1. What is the difference between a corporate strategy and a business strategy?
2. Identify the generic business strategy configurations available to strategic managers according to Porter's typology.
3. Is it possible for a business to differentiate its outputs and lower its costs simultaneously? Explain.
4. Identify the generic business strategy configurations available to strategic managers according to Miles and Snow's typology.
5. How are the business strategy typologies by Porter and those by Miles and Snow similar? How are they different?
6. Why might one expect the performance level of midsize business units to be lower than the performance level of either small or large business units?

Practice Quiz

True or False?

1. The focus-differentiation strategy emphasizes low overall costs while serving a narrow segment of the market.
2. Businesses that employ the focus strategy produce and market to the entire industry products or services that can be readily distinguished from those of their competitors.
3. The combination strategy can also be referred to as multiple strategies.
4. There is no advantage to the reactor strategic type.
5. The generic strategy typologies developed by Porter and Miles and Snow possess both similarities and differences.
6. Midsize businesses tend to be outperformed by their smaller and larger counterparts.

Multiple Choice

7. Businesses adopting the same generic strategy are referred to as _____.
 - A. low-cost businesses
 - B. differentiated businesses
 - C. a strategic group
 - D. none of the above
8. A no-frills product targeted at the market at large is consistent with the _____.
 - A. low-cost strategy
 - B. differentiation strategy
 - C. focus strategy
 - D. none of the above
9. Which of the following is not a key advantage of the low-cost–differentiation strategy?
 - A. It enables the business to compete from a cost leadership position.
 - B. It is easier to implement than either the low-cost or differentiation strategy.

- C. It allows the business to distinguish its products from the competition.
 D. It offers the prospects of high profitability.
10. Modifying the structure of the organization and/or the business model to improve competitiveness is consistent with _____.
- A. the low-cost strategy
 B. the focus strategy
 C. the differentiation strategy
 D. the low-cost–differentiation strategy
11. Analyzers _____.
- A. seek first-mover advantages
 B. control a distinct segment of the market
 C. display some of the characteristics of both prospectors and defenders
 D. none of the above
12. Emerging markets are often more attractive than developed ones because _____.
- A. competition is not as intense
 B. consumer incomes in emerging markets are not a concern
 C. the infrastructure in emerging markets is already developed
 D. none of the above

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Strategy + Business Reading

Growth Through Focus: A Blueprint for Driving Profitable Expansion

Rather than seek increased revenues and profits by expanding products and markets, companies should follow a seven-step strategy for achieving more with less.

by Sanjay Khosla and Mohanbir Sawhney

Faced with economic headwinds, many global corporations are struggling to grow their businesses profitably. In the consumer packaged goods business, for example, the worldwide recession has hurt premium brands as consumers have traded down to cheaper brands, private labels, or generics. In the retailing business, same-store sales are flat or declining for numerous companies. Meanwhile, many business leaders continue to seek growth by extending their existing product lines and brands, as well as by entering new geographic regions. After all, growth is supposed to be about “more”—more products on the shelf, more categories, more brands, and more markets.

However, this approach is exactly the opposite of what business leaders should do to drive increased revenues and profits. A typical “growth through more” strategy diffuses the organization’s efforts. It increases the complexity of the organization and its operations. We have found that “growth through less,” or more precisely “growth through focus,” is the best prescription for growth, regardless of the economic environment. This conclusion is based on our own experience in three well-known companies—Kraft Foods, Unilever, and Fonterra Brands (a dairy products business based in New Zealand)—on three continents over 10 years. In all three cases, a deliberate strategy of focusing on a few markets, brands, and categories produced impressive revenue and profit expansion. We have learned that seemingly mature businesses can be energized by making fewer but larger bets and by focusing relentlessly on executing a simple but powerful vision.

Growth through focus is not as easy as choosing what strategic bets to make. Rather, it requires the leadership team to follow a systematic approach that spans everything from strategy and vision to execution and measurement. We propose a framework that consists of seven steps that an organization must go through in its quest for growth through focus. Our framework is grounded in three key ideas: focus in strategy, simplicity in communication, and empowerment in execution.

Growth and the Winemaker’s Logic

To understand the logic behind growth through focus, consider what winemakers know about getting the best out of grapevines. Grapevines are very vigorous. With abundant water and nutrients in the soil, they tend to grow into large, leafy plants. However, overly vigorous vines produce lower-quality wine and smaller crops. When growing conditions are too rich, grapevines grow more leaves and become tangled. Leaves take nutrients away from grapes, which contain the seeds for future growth, and create shade, which inhibits ripening. To improve the quality of grapes, winemakers carefully prune grapevines and remove excess bunches of grapes to reduce yields. The remaining bunches ripen more fully and ultimately produce more concentrated wine.

Many companies, in effect, behave like inattentive vintners. Growth initiatives are often overstimulated with money and leadership attention. The result is lots of activity and a large number of growth projects, and this activity often does not correlate with outcomes. Quantity does not mean quality. To improve the quality of

Contrasting the Conventional Approach with the Growth through Focus Approach		
	Conventional Approach	Growth Through Focus Approach
Core Belief	Growth is about doing more—more arrows and more targets	Growth is about doing less—fewer but stronger arrows
Growth Drivers	Extensions [products, brands] and expansion [markets, segments]	Focus [brands, categories, markets] and simplification [vision, process, people]
View on Complexity	Complexity is inevitable	Complexity is the enemy
View on Planning	Plan longer, act shorter	Plan shorter, act longer
View on Time Frame	Several years, emphasis on blockbuster successes	Immediate, emphasis on quick wins
View on Leadership	Leaders as visionaries who know the answers	Leaders as facilitators who inspire their people to discover the answers
View on Resources	Conserve resources: the budget as constraint	Unconstrained resources; imagination as constraint
View on Organizing	Organize growth teams within the boundaries of business units and hierarchy	Form networked teams and communities that cut across organizational boundaries and hierarchy
View on Process	Focus on analysis [the “what”], emphasize words and numbers, have structured meeting agendas	Focus on action [the “now what?”], emphasize pictures and slogans, have unstructured meetings

Source: Sanjay Khosla and Mahanbir Sawhney

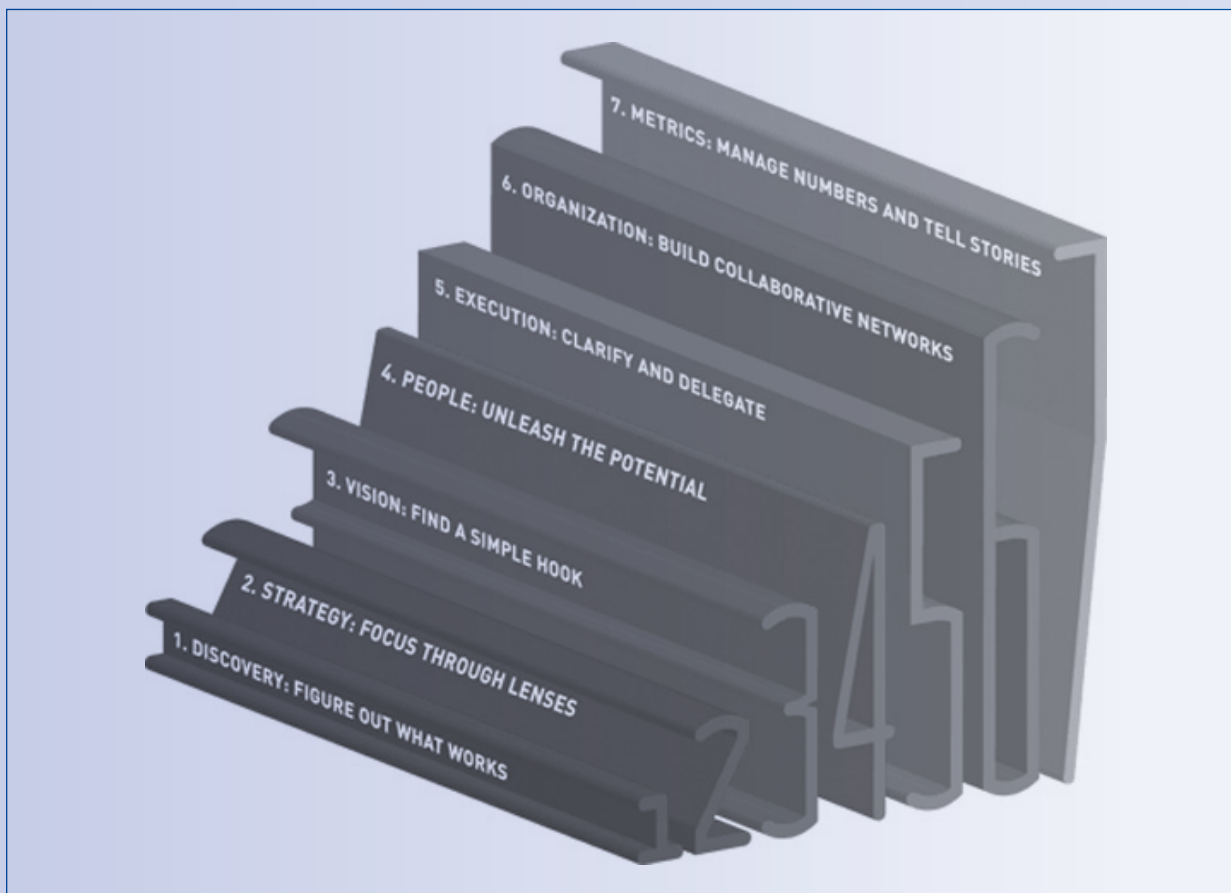
growth, business leaders need to cut back on marginal products, brands, and markets so that they have a better chance of winning in their chosen areas of focus.

Following the winemaker’s logic, company leaders must overturn conventional thinking about how to manage the organization, processes, and people for growth. (See the exhibit.) For example, a conventional core belief about growth is that companies need to extend their product lines and brands and to expand their categories and markets. Leaders hope that the more arrows they have in their quiver and the more targets they have to shoot at, the more bull’s-eyes they will score. But in reality, growth often comes from fewer but stronger arrows aimed at fewer targets. The engines of growth are focus (fewer brands, fewer categories, and fewer markets) and simplicity (simple vision, simplified execution, and simpler organizational designs). Conventional thinking also assumes that although complexity adds cost and makes the organization less agile, it is inevitable in a large global company. But complexity is an avoidable enemy of growth if you know what you are doing.

The logic of growth through focus also suggests a very different view on planning and leadership. Many companies tend to make long-term strategic plans, but they often have a short attention span in execution. CEOs and business leaders get seduced by doing something new and different well before the strategy has had time to play out. We recommend the reverse: Plan quickly and then stay the course for a long time, as long as five years. Leaders should resist the temptation to change strategies too often.

Seven Steps in Growth through Focus

Our experience suggests that growth through focus requires the organization to progress systematically through a set of seven steps: discovery, strategy, vision, people, execution, organization, and metrics. Taken together, they represent a powerful formula for driving profitable growth.



1. Discovery: Figure Out What Works

Science fiction author William Gibson observed, “The future is already here. It’s just not very evenly distributed.” And so it is with excellence. All large companies have pockets of excellent growth performance. The first step in the growth journey is to discover what is working well and where the company is already winning. These pockets of excellence help identify focus areas for growth. An effective way to uncover what works is to conduct a series of workshops with the top leaders from the company.

At Unilever’s Lipton beverages business, the process began at Colworth House, the company’s R&D center in the United Kingdom. The top 100 leaders of Unilever beverages from around the world were invited to a workshop in 2000, whose agenda was to build upon what was working well in specific markets and to scale the success across other geographies. One year later, this was followed by a “10 in 10” workshop in Brussels to discuss how to achieve sales of US\$10 billion within 10 years in these markets and to imagine the future of Lipton as seen through the eyes of Unilever’s major competitors.

In Kraft Foods’ international business, the growth process kicked off in 2007 with seven workshops in six locations around the world, each including about 20 of the company’s regional business leaders. The agenda was open-ended, with the top leaders taking a backseat to prevent their rank from impeding the flow of ideas

and insights. An external facilitator ensured that collective experience was gathered objectively. The workshops focused on what worked rather than on what did not work, because it is easier to build on what is working than to fix what isn't working. To ensure a customer focus, workshops included extensive immersion with consumers and customers to provide insights into behavior, needs, and problems. This kind of immersion generates insights in ways that quantitative market research never can.

A few themes began to emerge from the workshops. Kraft Foods had excellent people, but their insights and ideas had been getting lost because of geographic dispersion, and their potential was not being fully realized. The company's iconic brands had been built over many years, but several were underperforming. The planning process had tended to focus internally instead of externally, and had looked backward rather than forward. There was a lot of emphasis on analyzing what happened instead of figuring out what needed to be done. The conclusion was clear. The company urgently needed to establish clear priorities and accountability at a global, regional, and local level.

At the outset, the discovery process should be inclusive and democratic. It is important to involve key stakeholders within the company, particularly those who can make a valuable contribution and those who have the influence to get the masses of employees behind them. In addition, great insights often come from engaging with suppliers, creative and media agencies, and consultants who have worked with the company for a long time. On the other end of the spectrum, it is also important to listen to people who push back—and to manage dissent. As the process goes on and the framework and vision are agreed upon, debate on the strategic framework should cease and the emphasis should switch to execution.

2. Strategy: Focus through Lenses

The discovery process produces a set of success themes. In the second step, these themes need to be clustered and prioritized to define the focused bets that the company should make. Narrowing the focus is essential in order to concentrate resources on areas where the company has the best chances of winning. To take an analogy from photography, sharpening the focus on an object requires a telephoto lens that homes in on the subject while de-emphasizing background objects. Similarly, we have found that strategic focus requires lenses through which a company can look at its businesses. Lenses can be categories that the company is doing well in, brands that are performing well, geographies that are doing a stellar job, and platforms (like wellness or bone health in health-care) that can serve to unify the company's products and brands.

Consider the experience at Fonterra Brands. Through the discovery process, the company used two lenses—a product platform and a distribution channel. Using the platform lens, Fonterra identified osteoporosis as a key platform to bet on, based on its expertise in bone-health products. To pursue leadership on this platform, Fonterra entered into a partnership with GE Healthcare's Lunar business to tackle the growing global health problem of osteoporosis using Fonterra's Anlene bone-health products and GE Healthcare's bone density technology. The partnership's first initiative was the Anlene Bone Health Check, which provided free bone density screenings to millions of people in nine countries in Asia.

Using the second lens, Fonterra bet on the food-service channel as a key to its future growth. The outcome was a focused business called Fonterra Foodservices, which offers a complete suite of dairy products and tailored solutions for food-service professionals. Focusing through the distribution channel lens led to the strategy of creating a single “cow to customer” integrated business.

During the focusing process, each lens may produce several possible opportunities. These opportunities should be prioritized according to two criteria: the expected impact of the initiatives and the effort required. This exercise should result in a one-page preliminary plan that lists priorities for each lens. This preliminary plan should then go through several rounds of iteration with the input of key stakeholders. To improve the framework's odds of adoption, it is important to involve as many of these stakeholders as possible in “owning” the outcome.

Once you find out what works, you can focus on it and scale the success to other markets, products, and brands. In the Unilever workshops, the company discovered that Lipton Portugal and Lipton Arabia were

performing consistently well over time. Diving deeper into the reasons for this standout performance, the company found an interesting theme. In both markets, Lipton had been successful because it competed in the broad beverages market rather than limiting itself to the tea category. Further, in these markets, Lipton had done an excellent job of adapting its products to local tastes. For instance, Portugal had a successful iced tea business, whereas Arabia represented a successful hot tea market, despite the fact that Arabian countries have hot climates. The idea of taking a broader view of the business while remaining relevant to local tastes could be applied to Lipton's other markets and categories.

3. Vision: Find a Simple Hook

Once the focus areas have been defined, the findings need to be summarized in a compelling yet simple vision. The vision serves as a rallying cry for the organization to align its efforts behind a clearly understood goal. Too frequently, the business strategies of large corporations are poorly understood outside the corporate headquarters and beyond the senior leadership of the company. To get everyone in the organization behind the strategy, it is vital to communicate the strategy across all levels and functions in the organization. This is the role that the vision plays.

To make the vision compelling yet easy to understand, we recommend creating a “hook.” The hook should be kept consistent over time and across customer touch points. It can be a color, a number, an acronym, a phrase, or a symbol. At Fonterra, the rallying cries were “Winning through Brands” and “Dairy for Life.” The vision embodied two themes: farmers' pride (Fonterra is a cooperative owned by farmers) and the company's emphasis on natural products, captured through the blue and green color of the company's logo and merchandising. At Kraft International, the vision was expressed in numbers—“the 5-10-10 strategy,” which meant winning by focusing on five categories, 10 brands, and 10 markets. At Lipton, the vision was “Paint the World Yellow with Lipton.” The brand's characteristic color signified brightness and sunshine, and stood for a broader Lipton beverage experience than just a cup of tea.

Once a vision is chosen, it needs to be launched with a bang through a seminal event designed to inspire the team. For Kraft Foods' international business, the top 100 leaders were brought together on the 99th floor of the Willis (formerly Sears) Tower in Chicago in May 2007. The event kicked off with awards for teams around the world that recognized great work in various categories. Awards can set a positive tone, instill a can-do attitude, and make people feel like winners. At Lipton, the kickoff event was held at Colworth House, the 18th-century mansion at Colworth Science Park, where everything was painted yellow—including the lawn in front of the building. The theme “Paint the World Yellow with Lipton” was brought to life through winning stories from successful markets.

In communicating the vision, pictures are often worth a thousand words or PowerPoint slides. Simple visuals that depict the “from-to” journey can serve as powerful communication tools. Lipton used two visuals to bring the transformation journey to life—a picture of Audrey Hepburn, representing the Lipton brand as it was (classic, aristocratic, reserved), and a picture of Cameron Diaz, representing the new Lipton (bright, sunny, vibrant).

4. People: Unleash the Potential

Once the vision and strategy have been defined and powerfully communicated, the next step is to find the right people and to place disproportionate resources in their hands. The right people need to be placed in all functions—supply chain, R&D, marketing and sales—to ensure that you have the skills to win. Selecting those people requires a rigorous process of matching skills with the needs of the business. For instance, if the strategy involves focusing on a specific channel or set of brands, you need to find people who have expertise in the relevant channels and brands and put them in charge.

In Kraft Foods' international business, significant changes were made in the top leadership. Less than two years after launching the transformation initiative, two-thirds of the top 30 leaders were new to their roles. Many of the new leaders came from within Kraft Foods. Some were hired externally, and some came from the successful acquisition of Groupe Danone's biscuit business in November 2007. Similarly, at Lipton, a number of managers were hired from leading companies in the beverage industry (Coke, Pepsi, Schweppes) to augment the traditional grocery skills within Unilever.

Once new leaders are appointed, they need to be given the freedom to operate within the strategic framework so that their potential can be truly unleashed. Leaders should be challenged to act as entrepreneurs within large companies that have traditionally been perceived as process-driven and bureaucratic. In our experience, the biggest enemy of creativity and imagination in large companies is the budget. Resource constraints, real or perceived, limit the imagination of business leaders and prevent them from thinking creatively. To liberate people from these constraints, we recommend a counterintuitive approach: Give people huge targets and empower them with virtually unlimited resources. The targets should represent a quantum leap from historical results. Although it may seem that unlimited resources would encourage profligate spending, business leaders have a strong incentive to spend wisely, because they do need to deliver profits and margins, not just revenue increases. When leaders are asked to act like owners, they behave with an amazing sense of responsibility and often arrive at sensible trade-offs among risks, rewards, and resources. It is important that leaders not be penalized for failure unless they consistently fail to learn from experience.

Unleashing the potential of people also involves identifying and nurturing tomorrow's growth leaders. During Kraft Foods' transformation journey, a formal program called the Winners' Circle was created to recognize and reward performance and potential in the international business. This program was designed after benchmarking against some of the world's best companies. Rising stars from around the globe were nominated through a rigorous selection process, and the Winners' Circle members were inducted into a leadership program designed to build their capabilities. Today, their career progress is carefully monitored and they are selected for challenging growth assignments across the company. The program has generated tremendous buzz within Kraft Foods because of its richness and depth.

5. Execution: Clarify and Delegate

With the discovery, strategy, vision, and people in place, the next challenge is execution. This is the most important step in the journey, and it is also the most difficult. Execution has two key elements. First, everyone needs to be clear about who will do what, to avoid ambiguity about roles and responsibilities. Second, decision making needs to be moved closer to customers and consumers so that the people responsible for results have the operating freedom they need. Most organizations have a mistaken conviction that the leadership team has superior knowledge on every subject. This belief conditions managers to assume that success lies in pleasing the leadership team rather than in winning in the market.

Kraft Foods found that the organization had become such a complex matrix that accountability was fragmented across functions, markets, and business units, yet decision making had become highly centralized. Decisions such as product pricing were being made at corporate headquarters, which took longer and excluded the rich knowledge and context of local markets. Even such routine decisions as the pricing of coffee in Germany were made at the corporate headquarters in Northfield, Ill.! This was changed to give business leaders the freedom to make decisions that would allow them to compete effectively in their markets. The role of corporate headquarters was made more strategic and less operational. Certain decisions involving food safety and purchasing were still kept centralized because they had to be made on a large scale, as opposed to those that demanded intimacy with local consumers and customers. These changes have had a profound effect in making the organization more nimble.

To accelerate execution, we recommend a strong bias for action. Business leaders should demand a dramatic reduction in internal documents and meetings. In our experience, too many meetings and documents foster

analysis paralysis, promote internal focus versus external focus, and emphasize the past over the future. Much of the documentation is generated to please senior management, with endless hours spent on “wordsmithing” and editing. For the most part, we suggest a “no PowerPoint” policy in presentations; meetings are often far more productive if they focus on discussion based on pre-reading. Numbers may help tell the story, but too often, we find that numbers become the story and the big picture gets lost.

6. Organization: Build Collaborative Networks

Growth initiatives rarely fit within organizational silos of function, geography, and business unit. Rather, they need to be managed by creating communities and networks across the company, formal as well as informal. At Kraft Foods, certain networks, such as R&D, have always been strong. However, as business units were pushed to take P&L responsibility, it was important to set up collaborative networks to ensure that the best people with the best ideas were connected to leverage expertise and scale. Kraft Foods set up global category teams consisting of executives drawn from different functions and geographies to manage global brands, innovation, and supply chains across markets. Each team follows the approach that works best for its brand or category in terms of what needs to be done by whom, globally or locally.

Consider the example of Oreo cookies, one of Kraft Foods’ billion-dollar brands. Oreo was a strong brand in the United States but had historically been weak in the rest of the world. One reason was the assumption that what was good for Oreo in the U.S. was also good in China, the U.K., and elsewhere. The company learned from experience that this was not the case. To grow the brand in China, Oreo cookies were made less sweet to suit local consumer tastes. Oreo packages were made smaller, and new forms, like wafers, were introduced. Heavy emphasis was placed on local promotions and on-the-ground marketing activities unique to China. This localization, however, was carried out within the global brand positioning for Oreo. After implementation of the new strategy, Oreo became the market leader in China, and the Oreo business outside the U.S. began growing about 30 percent per year. Through the global category teams, Kraft Foods now has an energized, highly motivated community of employees around the world who sleep and dream Oreo.

This approach of matching skills with priorities and connecting communities to get the best mix of global and local ideas, within a clearly defined strategy, has a powerful effect in leveraging scale and expertise.

7. Metrics: Manage Numbers and Tell Stories

As the execution and organization processes get under way, it is important to keep score. Scorecards should be objective, and they should be kept simple. Overly complex metrics take attention away from the measures that really matter and can obfuscate execution priorities. At Kraft Foods, Chairman and CEO Irene Rosenfeld asked that the businesses create a one-page scorecard system that included three key measures—sales, profits, and cash flow. These three measures were made the basis for bonuses to all employees. This simple scorecard dramatically reduced reporting complexity and created clear accountability for results. Kraft Foods’ international business also uses a single-page scorecard to monitor the progress of the 5-10-10 strategy. Simplicity begets focus, because everyone knows what numbers the executives are looking at.

Managing growth requires a focus on numbers, but numbers alone are not enough. Storytelling is a powerful tool for propagating the culture of winning in the organization. A conscious effort should be made to write up and disseminate success stories from around the world. Leadership should make it a point at every large internal meeting to put successful people on the stage to share their stories with their colleagues. Success stories become part of the culture, and successful people become heroes in the eyes of their peers and managers. Moreover, highlighting the achievements of successful teams creates “positive shame”; the teams that are not on the stage feel strong peer pressure. This positive pressure is far more effective than the “negative shame” that would be created if the less-successful teams were berated in reviews.

Avoiding the Traps

With any transformation initiative, there are pitfalls to avoid and hurdles to overcome on the way to success. Here are a few to keep in mind in implementing growth through focus.

One common pitfall is to seek to build scale before fixing underlying problems. In choosing the markets and categories to focus on, for example, it is easy to get seduced by the size of the opportunity. Most large companies covet the hundreds of millions of consumers in emerging markets such as China, India, and Brazil. And they quote the minuscule per capita consumption of their products as an indicator of vast untapped potential. To convert potential into actual revenues and profits, however, you first need a business model that works. You must have the distribution reach, the supply chain, the manufacturing capabilities, and the right products before you can scale the business. Kraft Foods was in China for many years and had set ambitious targets that it did not achieve. In reality, the model was not working and the business was losing money. Scaling up the model simply made things worse. To fix this problem, Kraft Foods redesigned its business model, integrated its business with the acquired Danone biscuits unit, and got the appropriate talent on the ground. Only then did Kraft Foods' business in China begin to grow and make money.

Another potential trap in implementing growth through focus is neglecting or mismanaging the parts of the business that do not fall within the core focus areas. This is the “tail” of your business—products, brands, categories, and markets that do not make it to the priority list. Consider, for example, the brand portfolio. Most large companies have hundreds of brands, but only a few will make it to the priority list. So what should you do with the rest? Simply cutting off the tail can be disastrous, because the decline of the tail is often faster than the growth of the core. Further, the non-core businesses often have fixed costs that are linked to the core businesses. Finally, cutting and divesting can have a huge demoralizing effect, because people often have strong emotional ties to some of these businesses.

What you need is a clear plan to manage the tail. We find it helpful to cluster the non-core businesses into two buckets—“milk or divest” and “local jewels.” The two buckets need very different management approaches. The first category includes businesses that do not make money and have no hope of making money, despite repeated promises of future turnarounds. These need to be divested over a defined time frame. Fonterra Brands exited markets such as Mexico and Egypt where the business had not performed well for some time, which freed valuable resources that could be redeployed to grow the core businesses. Local jewels are successful local businesses that can be retained in the portfolio but managed at arm's length by local teams, leaving the global teams to focus on the core businesses. At Kraft Foods, the company found a number of such jewels that are now managed locally, but still help to provide scale in manufacturing and distribution. These businesses should be left to determine their own destiny but should be held accountable for revenues, margins, and cash flow.

Too often, when companies rationalize and focus, they slash expenses across the board. Two areas that take the brunt of cost cutting are people-related expenses (recruitment, training, travel) and brand advertising. However, talent and brands are the two most valuable assets for driving growth. We recommend increasing investments in hiring and developing talent, even ahead of the company's needs. We also recommend increasing investments in building brands. The good news is that the growth-through-focus approach yields significant cost savings through elimination of management layers, reduction of overhead, and elimination of marginal businesses. Focus frees up resources that can be used to invest in the future.

Once a strategic direction has been established, it is important to stay the course until the strategy has been fully implemented. We find that large companies suffer from “corporate attention deficit disorder”—they tend to search for new strategies every few years, particularly after a change in leadership. But growth through focus requires patience and perseverance. In our experience, the transformation process takes as long as five years to play out. Leaders should resist the temptation to go for the “next big thing” in strategy peddled by management consulting firms and management gurus. Change for the sake of change merely produces a loss of momentum.

Finally, keeping a positive tone is vital to the success of growth through focus. It is very easy to slip into a negative spiral that can destroy morale and derail the transformation initiative. Although you do need to face the facts and make the difficult decisions, it is important to keep a positive tone and to promote a can-do attitude among employees. The energy that comes from winning is infectious. It inspires people to achieve goals that they have never before considered possible. Leaders should act as evangelists and cheerleaders, spreading the positive energy and making sure the teams are having fun at winning.

The sun generates a tremendous amount of energy, but it gives us only a warm glow. By contrast, a laser beam that uses a few kilowatts of energy can cut through metal. Such is the power of focus. If you are running a large global business with a big portfolio of brands, products, and markets, adding to your portfolio is likely to create more complexity than growth. To win in your businesses, you must harness the power of focus. By following the seven steps in our blueprint, business leaders can drive profitable growth even in difficult economic times.

Building Scale For Focus: A Tale Of Two Acquisitions

Growth through focus involves a reduction in the number of products, categories, brands, and markets that the company should focus on. But it also demands an increase in the scale of the businesses that the company chooses to focus on. Scale can be generated by building on the brand and product assets that the company has in its portfolio through organic growth. However, organic growth may not be enough to get to the required scale, particularly when the company is betting on markets or categories in which it is not a market leader. Further, in some emerging markets, building distribution networks from scratch is a Herculean task. This is where acquisitions play an important role in the growth-through-focus approach. They can help the company acquire scale in its chosen domains. The acquisition strategy should be driven by the focus strategy, and a clear logic should link the acquisition to the strategic framework for growth.

Consider Kraft Foods. The company had chosen biscuits and chocolates as two of the categories it wanted to focus on. It had also determined that markets like India, China, Brazil, Russia, and Mexico would be important for the company in the future. However, it lacked the scale, the brands, and the distribution networks it needed to compete globally in these categories and these markets.

Using this focus strategy, Kraft Foods identified two key acquisitions—the global biscuit business of Groupe Danone and Cadbury PLC, the U.K.-based confectionery company. In November 2007, Kraft Foods acquired the global biscuit business of Groupe Danone for US\$7.8 billion. After this acquisition, Kraft Foods' biscuits business accounted for 20 percent of the company's revenue and catapulted Kraft Foods into the leading position in this category across the world. More importantly, it gave Kraft Foods an engine for faster growth in emerging markets. And in February 2010, Kraft Foods completed the acquisition of Cadbury for \$19.5 billion, which has made the company a global powerhouse in snacks, confectionery, and quick meals. Kraft Foods now has access to Cadbury's strong international distribution networks, which will allow it to penetrate deeper into emerging markets.

The focus lenses chosen in the second step of our approach can be used to identify and prioritize acquisition targets. In the case of Kraft Foods, the Danone biscuits and Cadbury business were attractive targets because they represented a triple win on the 5-10-10 scorecard—priority categories, strong brands, and strong presence in the key markets that Kraft Foods had decided to focus on. Further, these acquisitions brought in talent and a diversity of culture that will be a powerful asset for Kraft Foods as it grows its international business.

—S.K. and M.S.

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