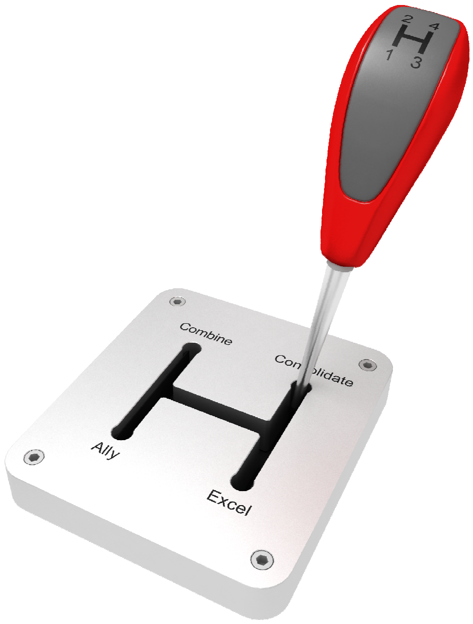
The strategy accelerator

Strategies for sustainable competitive advantage

Alfred Griffioen



Abstract:
There is only a limited number of models that give direction on how to make a profit, these models focus on differentiators or on portfolio management. However, the increasing availability of all kinds of knowledge through the internet and the globalisation of the financial markets are not taken into account in these models. This article investigates how a company can make a profit in the current market. It proposes a directive framework based on market relevancy and whether the company has a unique product. Based on these parameters, a company should either consolidate its position, aim to excel more and more in its products, effectively combine products or ally with another company to differentiate or profile itself more.

Introduction

The question of ‘how to make a profit’ is one of the most relevant for business economics, but only few researchers and authors have formulated directive rather than descriptive answers. A better direction can be found in basic economy teachings: If you can differentiate yourself from your competitors, you have a sort of monopoly. In a monopoly you can choose your own optimum of price and quantity on the demand curve. As soon as you get competitors, the power shifts to the customer: the price is set by the market and you can only follow. Only by differentiation can you outperform your competitors.

Especially in the early life cycle phases of a new product or business model the profitability will be higher due to the fact that there are few competitors. In the development phase the turnover will be limited and clients have to be convinced of the usefulness of the model. In the acceptance phase the turnover increases, but it is still possible to sell the product at a premium price. Later on this price premium will erode.

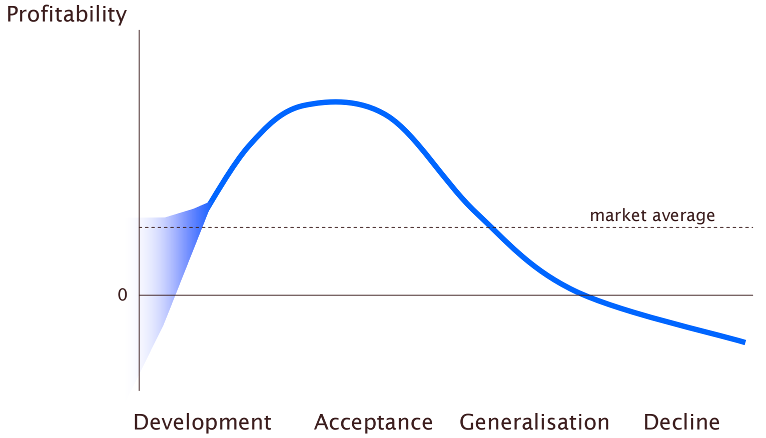


figure 1, Profitability in the different life cycle phases of a product or business model

Companies need to develop and adapt new products and business models in order to differentiate themselves from their competitors and to outperform them. These new opportunities can be found by evaluating the needs and competences of the companies in your value chain, or rather, the value network around you. Hardly any company has one single supplier and one single customer group (see figure 2). On basis of a needs analysis you can find completely other ways in servicing your direct customers or their customers. Or by integrating activities from one of your suppliers, customers or the other suppliers of your customers you can change your business model.

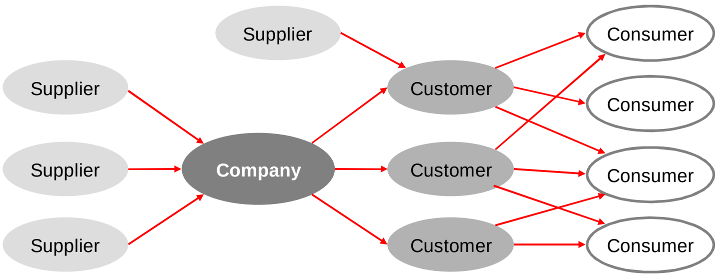


figure 2, The value network around a company

Models for competitive advantage

On a more abstract level, there are two models often referred to that give direction on how to stand out with your customer value proposition: Porter [1] with product differentiation, cost leadership and focus strategy and Treacy & Wiersema [2] with product leadership, operational excellence and customer intimacy.

If you have more products, the Boston Consulting Group portfolio matrix gives guidance how to direct the cash flows in your company: depending on market growth and market share, one should invest or divest in certain activities. Although corporate finance has changed significantly over the last decade (see below), the model is widely used because of its conceptual simplicity and the clear answers it gives.

However, Porter's strategies were first published in 1980, Treacy & Wiersema introduced their model in 1995. The BCG portfolio matrix was first used in 1959. Since then the world has changed, and some changes have affected the validity of these models.

If one development has been dominant in the last decade in the way consumers and companies do business, it is the ever growing availability of information, facilitated by the internet. Consumers, purchasing companies and governmental institutions have increasingly better knowledge of the market and can compare products from several companies. With a few mouse clicks and phone calls they can fulfill their needs with suppliers from all over the world. Internet search and even online auctions replace more and more the relationship based purchasing process[3].

Through this availability of information it is also easier for small innovative companies to offer their services and to compete with large players. This leads to faster product rationalisation. With easier distribution of technology the number of competitors for a certain product increase and prices decline. A good example can be found in two comparable products: the video recorder and the dvd-player, as can be seen in figure 3. The video recorder was developed in a time when information exchange was slow. It took competitors a long time to develop a comparable product. With the dvd-player this was already different.

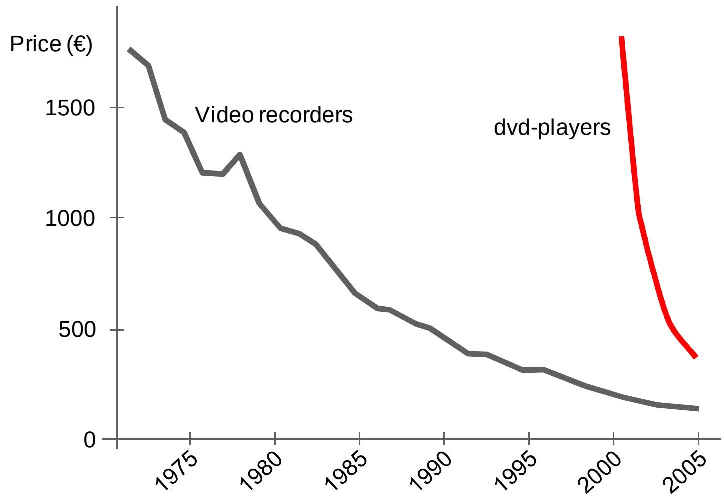


figure 3, Price development of video recorders and dvd players[4]

These developments force companies offering products and services to concentrate on those activities where they have real 'value for money'. Distribution channels can only add value by presenting relevant combinations of products or services within the right sales concept.

A second important development in the last decade is the increased transparency of financial markets. In the twentieth century the main objective of practically every company was growth. Growth provided economies of scale, made a lucrative position as market leader possible and above all: growth and the connected investments were a logical way to reinvest profits. The BCG portfolio matrix is based on these assumptions.

When the financial sector globalised as well, it became easier to reinvest profits from one company into another if that company had a better performance or lower risk profile. In recent years under the influence of large private investors transparency has increased, moving the investment decision from a company level to an activity level. The added value of a holding company or corporate head office is under discussion more frequently.

Both developments make the resources available in a company less relevant. Knowledge can be more easily obtained, relevant components and partners can be found all over the world, and with a good idea financial resources can be more easily obtained. Active investors can choose in which company to invest and which capabilities to combine. This makes but specialised organisations with high added value activities leading in the new economy, instead of large corporations.

Facilitated by the increasing transparency of information and markets and increasing competition, more specialised players will arise, creating a bigger supply of highly differentiated products and therefore further increasing competition. This vicious circle can be found in figure 4.

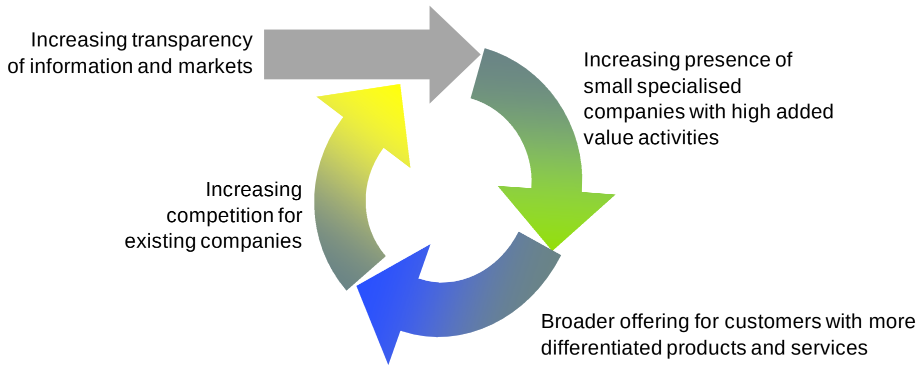


figure 4, vicious circle of increasing specialisation and competition

How to make profit in a transparent world?

Given the fact that the availability of information since then has increased, pay-back times of new products shorten and globalisation of financial markets has rerouted cash flows, the question arises: how to make profit in such a transparent world?

We can look at the strategies suggested by Porter and Treacy & Wiersema and evaluate them on their current validity (see figure 5).

The three strategies of Michael Porter (1980)	The three directions of Treacy & Wiersema (1995)	What happened in the internet age?	Current validity
Cost leadership: having the lowest costs	Operational excellence: having the lowest total costs, including costs of your client	Cost advantage is easily copied or leveled down. Scale can be bought	No sustainable strategy
Product differentiation: having a better product	Product leadership: continuously introducing new products	The enormous diversity of products makes it hard to stand out	(Continuously) having unique products
Focus strategy: targeting on a niche	Customer intimacy: having a complete offering for specific customer groups	There are many suppliers with a broad offering. Customers can choose	Market relevancy: being seen as relevant by your customer group

figure 5, Evaluation of generic strategies of Porter and Treacy & Wiersema

Strategies for cost leadership or operational excellence can easily be copied as much more information about companies and their suppliers is available than before. Globalisation of financial markets makes that, when scale is necessary, funds can be arranged to buy this scale. Therefore the validity of these strategies has decreased.

Product differentiation alone is not good enough anymore, as product choice has increased enormously and the differences between product variants are becoming smaller. Product leadership, in the sense of continuously being at the edge of technology and creating a really unique product, is a valid strategy.

Focussing on your customer, later called customer intimacy, is a strategy seen from the company. It is actually the most market-oriented strategy type of the three. However: with a growing diversity of companies and brands, the perspective from the customer becomes more important: how relevant is the company for its market?

If a company has multiple products or markets, the analysis should be done per business activity.

This evaluation results in two strategies for having a sustainable business model:

- Having a unique product
- Having market relevancy

Empirical evidence

The relationship between strategy and actual profitability has been researched in a number of papers. The most important studies before 2000 are combined in a meta-analysis of Campbell-Hunt[5]. From these 17 studies six general strategies can be defined, each with components (such as high prices, intensive promotion or operating efficiency) that are often used together. For each of these strategies the correlation with financial performance can be measured.

Campbell-Hunt finds that two generic strategies have a positive influence on profitability: he defines them as 'Innovation and operations leadership' and 'Broad quality and sales leadership'. 'Cost economy' has a significant negative influence on profitability. The most important components of each of these strategies are shown in table 1.

Innovation and operations leadership	**Broad quality and sales leadership**	**Cost economy**
High prices New products Specialty products Operating efficiency	Promotion Sales force Service quality Product breadth Customer breadth	Economies from/in - new products - low prices - advertising

table 1, Components of generic strategies as researched by Campbell-Hunt

Another finding is that the strategies do not exclude each other, where Porter for example claims that combining Cost Leadership and Differentiation leads to getting 'stuck in the middle'. The innovation and the quality and sales leadership strategies have their own effect on profitability. This would suggest that a company can successfully strive for both unique products and market relevance.

One of the most used models to measure 'relevance' is the Brand Asset Valuator of Young & Rubicam[6]. In this model brand differentiation, relevance, esteem and brand knowledge are measured and combined to one score. Brand strength (the combination of differentiation and relevance) is seen as a predictive measure, brand stature (the combination of esteem and knowledge) as a following measure. The relationship between the various components and the financial performance of a firm has been researched by various scholars. All research highlights the predictive relationship between brand strength and financial outcomes.

In a study with 115 companies Jonathan Knowles[7] shows the relationship between brand strength and market value of a company, attributing the effect mainly to brand differentiation. Frank H.M. Verbeeten en Pieter Vijn[8] predict in an empirical investigation of 70 Dutch brands a ROI growth between 0,1 and 0,3 % for every 10 % of competing brands that a company will leave behind in brand strength. They also show that brand strength has long-term effects on profitability. Natalie Mizik and Robert Jacobsen[9] also conclude that financial markets mainly value brand relevance, followed by the expectation that a brand will meet customers' needs in the future.

Mehmet Bert Ataman[10] examines concrete measures to improve profitability in his study of 295 brands over the course of five years. He finds that discounts have a positive impact on short term sales, but a negative impact on long term profitability. Advertising only helps up to the moment that a brand is sufficiently known. The length of the product line and the extent to which its composition helps to differentiate the brand is a very important driver for profitability. The effect of the number of distribution points and the share of a brand at these distribution points however exceeds all other effects and is crucial for all brands.

Wooseong Kang and Mitzi Montaya[11] researched the impact of product portfolio and innovation strategy on financial performance in the medical device industry. They found a positive correlation between the number of products with which the company was the first on the market and the profitability. Scott Newbert[12] confirms this profitability from innovation. In analysing the relationship between value, rareness, competitive advantage and performance he finds that especially rare resources have a significant impact on both competitive advantage and performance.

Combination in the Strategy accelerator

The literature review shows that both having unique products and having market relevancy can lead to higher profitability, and that these effects are independent of each other. Therefore the two criteria can be set out in a matrix (see figure 6). Which gives four possibilities. This matrix is further referred to as the strategy accelerator.

Why an accelerator? Just as with a car one doesn't start a company in the fourth gear, you have to build up your sources of profitability. The path goes either thought a unique product or high market relevancy, in which an alliance with partners can help. And finally: switching gear in a car is a deliberate action that takes time and effort. This is no different from a company.

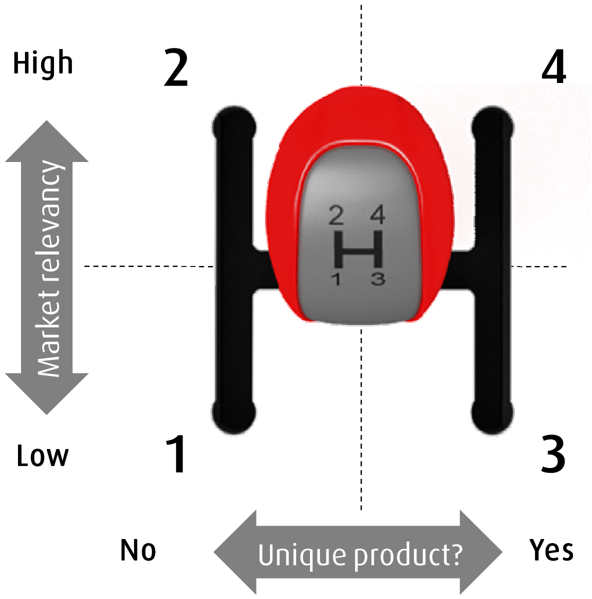


figure 6, structure of the strategy accelerator

The various options are discussed below.

First gear: No unique product and low market relevancy

The majority of companies is going forward in the first gear: they do not have any unique product and have low relevancy for their market. Their profitability is limited and mainly determined by the force field of supply and demand in their market. With increased knowledge transfer and transparency in financial markets profitable niches are discovered and filled even quicker than in the past. Examples are manufacturers of steel or bulk chemicals, non-branded clothing, accounting services or non-differentiated supermarkets.

So what should this multitude of companies do? They can either resign to their fate, or start moving out of this quadrant. With mostly limited resources, they should either choose to broaden their customer reach and relevancy (moving to the second gear), or invest in creating more unique products (moving to the third gear). This does not mean directly transforming into a ‘Ebay’ or ‘3M’. Even minor steps can help, like guaranteeing compatibility with another product to increase your customer relevancy, or offering a free annual service inspection to make your product for some time unique in your market.

Second gear: High market relevancy but no unique product

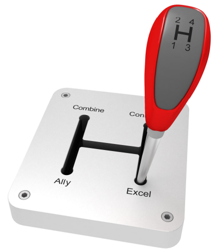
There is a larger group of companies that is a relevant supplier for their customer group, without having their own unique products. These are for example a number of grocery stores, well known hotel chains like Hilton or internet portals like Ebay and Amazon.com. Also internet search engines can be companies with a high relevancy, although they don’t sell products directly. Not every company has to be widely known: especially in business-to-business companies can have a highly relevant offering, but only for a limited customer group.

Market relevancy is connected to the company name or its separate brands. The product width, distribution model, service and marketing communication contribute to the relevancy of brand or company. Even packaging, complaint handling or added services can have their influence. Market relevancy makes that you buy a certain product from this company, and not from its competitor. It can be defined as the congruity of the brand promise with the customer needs.

One could argue that the brand logo on the clothing or the packaging makes the products that these companies provide unique. But once you see that even brand-less products are sold better through these channels, for example because of the guarantees, ease to purchase or certainty that also other products fit into your lifestyle, then the difference between the product and the customer relevancy becomes clear. Starbucks for example made a good profit selling the music they play in the stores: the fact that it is selected by Starbucks gives the value, not the music itself.

The best strategy for companies in this gear is to further enhance their market relevancy by combining the right products in their offerings. This requires market research, portfolio management, investments in store development and marketing communications. The value created lies often in the combination of attractive products in the offering. In the clothing industry brands like Burberry, Polo Ralph Lauren or Boss have to provide a complete collection for men, women and children to increase their reach. Shops become relevant by combining these brands under one roof. For a well visited shop it is tempting to introduce more and more items of its own brand, where margins can be higher. However, if this is done too much, its relevancy and customer reach will decline.

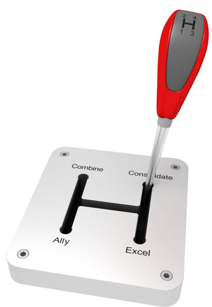
Third gear: A unique product but low market relevancy



Product differentiation has increased significantly in the last decade and so is the number of companies with unique products. What is unique in this sense? Unique is that it has a significant advantage that cannot easily be copied or substituted. Bang & Olufsen, the provider of electronic music and video equipment, has a unique product in quality and design. These design characteristics are protected by enforceable intellectual property rights. However, Bang & Olufsen has only limited outlets and distribution partners. The brand awareness is on average low and the turnover does not justify large advertising campaigns. It is important for them to get into the collection (= product combination) of companies with a large customer reach. This also includes being easily found on internet search engines.

As even a unique product can become out-of-date, get copied or be substituted, companies that focus on having unique products constantly have to adjust, improve and innovate their products and excel in their field of business. This can be done by updating their knowledge regularly, doing customer research, investing in good personnel and patenting their innovations. It is obvious that to some extend you have to market your products, otherwise you will be out of business soon. But this can be limited to bringing your product to a good ‘combiner’ with a big customer reach than investing in a top-of-mind brand name yourself. In the pharmaceutical industry there are various smaller companies like Galapagos who develop new medicines, but license their findings to big concerns like GlaxoSmithKline to clinically test and market the product.

Fourth gear: High market relevancy and a unique product



There are only few companies that have both a customer group that perceive them as positive and relevant and a continuous track record of delivering unique, hard to copy products. Apple is certainly one of them. With first the Mac, later the iPod and now the iPhone Apple has a keen sense of what customers want and the ability to translate the newest and patented technology into unique products. Although one can argue that there are multiple MP3-players on the market, only Apple has its patented click wheel and its intuitive customer interface. On being a relevant supplier for its customers, Apple combines its own products with a range of software products and music and video from various artists and amateurs in The Apple Store. Philips is also a company with on one hand a strong brand and distribution channels and on the other hand products with unique design or patented technology.

The best strategy for companies in this gear is to consolidate their position. Product leadership as meant by Treacy and Wiersema can only be sustained by constant investments in innovation and product design. Keeping your relevancy as a supplier asks for active portfolio management and regular marketing communications.

Companies should be keen on not taking their position for granted and actively pursuing their competitors.

Ways to increase your profitability

Especially for the companies in the first gear, without a unique product and large market relevancy, it is necessary to move from this position. Also for companies with unique products it can be interesting to increase customer reach, or for companies with market relevancy to develop unique products. In general there are four ways to create such a movement:

- Invest in it yourself, by hiring the right people and dedicating their time to either product development or marketing activities
- To outsource these activities, and in such a way get the necessary competences for product development or marketing. The question is: can your competitors easily do the same or haven't they done that already?
- To take over a company who has the right market position or product portfolio, or merge with it (if they want). But then: why haven't your investors already divested in you and invested in them?
- To ally with such a company, partly combining your resources, sharing your knowledge and approaching customers with a broader offering

The choice for one of these ways can be made on basis of the boundary conditions that exist in every company:

- Available time to market
- Investment size
- Acceptable risk

Investing in development activities yourself mostly takes a lot of time, certainly if you want to bring in new competences. Outsourcing is quicker, but has a larger investment size because of extra overhead and profits for the supplier. Both have the risk of investing in a non-responsive customer group or in a failing product. A takeover or merger guarantees on forehand access to an existing customer group or an existing unique product portfolio, but in many cases also means investing in overlapping or non-strategic resources. An alliance with a complementary company is preferred. This makes a short time to market possible, with a limited investment and low risks. However, this requires at least some own assets to be attractive to your partner.

An effective alliance requires in broad lines three components:

- A joint <u>business</u> model, which makes clear what the benefit can be of combining resources
- A contractual <u>basis</u>, describing the organisational form and the conditions of the alliance
- A good <u>balance</u> between the partners, both in contribution and in influence

The selection process of a partner should address these components.

The strategy accelerator completed

When we fill in the strategic directions that are proposed for companies in each gear, the strategy accelerator model is almost completed. This model gives direction on how to outperform in a transparent world. Companies can develop a higher profitability than their peers by continuously developing unique products and by combining relevant products. If they do both already, they should consolidate their position. If they do neither, they should choose a way to move away from this position by allying with others.

Comparable with changing gear in your car, moving from one strategy to another is a deliberate step and requires either large investments or cooperation with other companies. Marketing alliances can bring a company from the first to the second gear, but also from gear three to four. Development alliances can bring a company from the first to the third gear, but also from gear two to four. If we add the possible types of alliances per development direction, a concise model is created (figure 7).

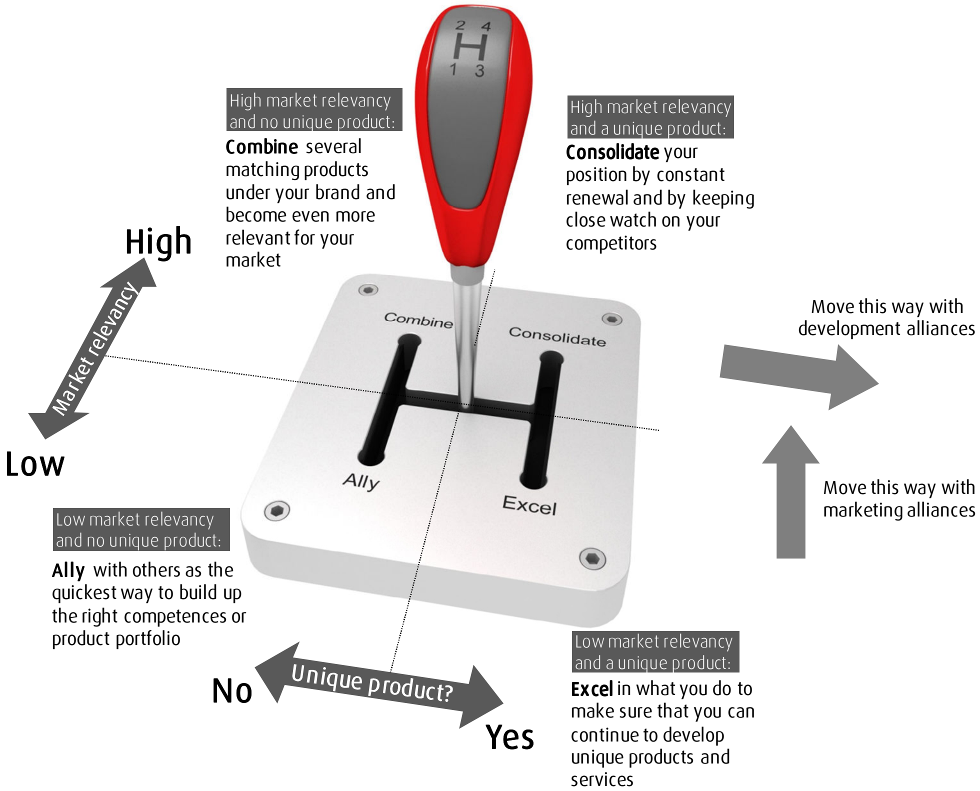


figure 7, The strategy accelerator completed with development directions

The model combines aspects from ‘outside-in’ theories that primarily focus on market opportunities and ‘inside-out’ theories like the Resource Based View that take the capabilities of the company as a starting point. With an external view an assessment is made whether a company has clearly unique products and/or high relevancy for its customer groups. This reveals whether a company has zero, one or two types of sustainable competitive advantages. With a more internal view a strategy is suggested how to enhance existing advantages or to create new ones.

Neither a model like this nor an article can give a complete answer on how to manage your company. But the value of this model is that, on the basis of a simple assessment of the firm’s position, it gives clear directions on how to further develop the company towards profitability. The concept of the accelerator stresses that this is always a step-by-step approach.

About the author:

Alfred Griffioen (1972) has a background as strategic marketeer and business development manager. After a period as manager with a strategy consultant he is now partner of Alliance experts, advising on strategic partnerships and matching companies that are looking for an alliance partner. He is the author of the book ‘Het Senseo-effect’ which is a practical guide on alliances. This article is based on his second book ‘De Strategieversnelling’. For more information and a weblog with the latest insights see www.strategy-accelerator.com.

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