any number of strategic groups depending on the level of specificity desired. One or two competitors may also seem to be functioning between groups and thus be difficult to classify. For these reasons, the concept of strategic groups can be used as a means of understanding and illustrating competition within an industry, but the limitations of the approach should always be considered.

The challenging task of formulating and implementing a generic strategy is based on both internal and external factors. Because generic strategies by nature are overly simplistic, selecting generic approach is only the first step in formulating a business strategy.[1] 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.

7-1 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, most 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 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] This is not necessarily the case, however, 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.

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). The low-cost and differentiation strategies with and without focus comprise those in Porter's original framework.

7-1a Low-Cost (Cost Leadership) Strategy

Businesses that compete with a **low-cost strategy** produce basic, no-frills products and services for a mass market 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

TABLE 7-1 Generic Strategies Based on Porter's Typology

Emphasis on Entire Market or Niche	Emphasis on Low Costs	Emphasis on Differentiation	Emphasis on Low Costs and Differentiation	Emphasis on Various Factors Depending on Market
Entire Market	Low-Cost Strategy	Differentiation Strategy	Low-Cost-Differentiation Strategy	Multiple Strategies
Niche	Focus-Low-Cost Strategy	Focus-Differentiation Strategy	Focus-Low-Cost/Differentiation Strategy	

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 recent years.

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 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 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 Real

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 percent of Mexican sales, and Pepsi had 21 percent. Consumers in Mexico drink more Coke per capita than those in any other nation.

In the early 2000s, however, both well-known colas have been challenged by an unlikely upstart from Peru known as Kola Real (pronounced "ray-'al"). Launched in Mexico in 2001, Kola Real captured 4 percent of the Mexican market in its first two years.

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 percent of revenues on concentrates, the Ananos family makes its own. Whereas 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 the majority of 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 of their own, although they will not be able to challenge Kola Real's low-cost position on a large-scale basis.

Source: Adapted from D. Luhnow and C. Terhune, "A Low-Budget Cola Shakes Up Markets South of the Border," Wall Street Journal, 27 October 2003, A1, A18.

A cost leader may be more likely than other businesses to outsource 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 nobody is willing to purchase.

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.[8] Manufacturers that employ a low-cost strategy, however, are vulnerable to intense price competition that drives down profit margins and limits their ability to improve outputs, to augment their products with superior services, or to spend more on advertising and promotion.[9] 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 several upstarts even before the events of 9/11, and made it even more difficult to raise fares shortly thereafter.[10]

Success with the low-cost strategy can be short lived, however. Low-cost airline AirTran, for example, boasted a 2003 profit of $101 million while Delta squabbled with its pilots throughout the year in an effort to reduce costs. Delta dominates Atlanta where AirTran also has a hub, but has had difficulty cutting costs. In 2004, however, Delta finally made headway and began cutting many of its fares, some by as much as 50 percent. By 2005, AirTran, along with other low-cost airlines, began to feel the squeeze as major airlines such as Delta became more price competitive.[11]

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 fact 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.[12]

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.

7-1b Focus–Low-Cost Strategy

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.

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 often 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. Functional operations are tightly coordinated around a single strategic objective: low costs. Efforts are targeted to consumers with low to moderate incomes.

Aldi minimizes costs 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 percent 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 forego 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. Its prices are competitive with those at Wal-Mart, but Save-A-Lot pursues locations in urban areas that Wal-Mart rejected. Save-A-Lot also 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.[13]

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. For instance, several years ago, Laker Airways successfully used the focus–low-cost strategy by providing the first no-frills, low-priced trans-Atlantic passenger service. The major airlines responded by dropping prices, eventually driving Laker out of business. The large competitors, because of their greater financial resources, were able to weather the short-term financial losses and survive the shakeout.[14] Southwest Airlines, in contrast, adopted a similar strategy and has been able to perform well despite competitive pressure from its large rivals.

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, and newspapers. 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 large rivals. In 2004, Ireland's state carrier Aer Lingus added routes and lowered prices in an attempt to model itself after Ryanair.[15]

Founded in 2003, Hungary's low-cost airline Wizz Air specializes in transporting Hungarians, Poles, and other 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.[16]

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

Business Web
A system of internetworked, fluid, specialized businesses that come together to create value for customers.

Focus–Low-Cost/Differentiation Strategy
A generic 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.

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

value *and* by pursing 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.

Finally, the importance of **structural innovations**, modifying the structure of the organization or the business model to improve competitiveness, has been highlighted in recent years. Recent approaches to structural innovation include the virtual corporation, outsourcing, and the Japanese kieretsu. The notion of **business webs**, or systems of internetworked, fluid, specialized businesses that come together to create value for customers, has gained prominence among strategic thinkers. Within the business web model, organizations do not focus solely on their own activities, but consciously develop partnerships with other businesses, each focusing on its own core competence to better achieve its mission.[36]

7-1f 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 utilizing 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 and 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 barbeque pizza in Memphis, Tennessee—while also minimizing costs to remain affordable to the price-conscious college student.

7-1g Multiple Strategies

In some cases, business units utilize **multiple strategies**, or more than one of the six strategies identified in sections 7-1a through 7-1f simultaneously. Whereas 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.

7-2 Miles and Snow's Strategy Framework

A second commonly used framework introduced by Miles and Snow considers four strategic types: prospectors, defenders, analyzers, and reactors.[37] Miles and Snow's typology is an alternative to Porter's approach to generic strategy.

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

Intrapreneurship
The creation of new business within [illegible]

Prospectors perceive a dynamic, uncertain environment and maintain flexibility to combat environmental change. Prospectors introduce new products and 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.com's initial launch of its Web 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 Chap Stick. Being first, however, can be a risky proposition, and research has shown that competitors may be able to catch up quickly and effectively.[38] 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.

It can be argued that all businesses should be prospectors, at least to some extent. For example, Kraft revenues from traditional and "new and improved" versions of its Ritz, Kool-Aid, Maxwell House, Jell-O, and other brand products began to slip in the early 2000s. Kraft fired its CEO, Betsy Holden, in late 2003 in an effort to place a greater emphasis on new products instead of more conservative brand extensions.[39]

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.

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.[40]

Copying successful competitors can be a successful strategy when both organizations share the resources needed to effectively implement similar programs. After sales slumped in 2000 at Taco Bell, president Emil Brolick acknowledged plans to model the restaurant after Wendy's, noting Wendy's ability to gain market share without slashing prices. In 2001, Taco Bell began appealing to a more mature market with additional pricey items and fewer promotions. Although the product lines are substantially different, Brolick hopes that a similar approach for Taco Bell can produce similar results.[41]

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. The reactor strategic type also lacks strength.

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

Firms can focus their efforts in several ways. Popular retailer Cabela's has even successfully targeted its efforts to men who hate to shop! 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, indoor waterfall stocked with trout, and realistic nature scenes. As a result, Cabela's has secured a customer base largely ignored by other retailers.[23]

In general, high prices 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.[24]

7-1e 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 generally costs a considerable amount of money, which would erode a firm's cost leadership basis. In addition, a number of cost-cutting measures may be directly related to quality and other bases of differentiation. Following this logic, a business should choose *either* a low-cost or a differentiation strategy, but not both.[25]

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.

Others contend that the two approaches are not necessarily mutually exclusive.[26] For example, some businesses begin with a differentiation strategy and integrate low costs as they grow, developing economies of scale along the way. Others 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, although it is facing increased competitive pressure from differentiated competitors emphasizing Mexican, "fresh and healthy," or other distinct product lines.[27]

A more recent example of the combination strategy is the relatively young airline JetBlue Airways, launched in 2000 to provide economical air service among a limited number of cities. JetBlue distinguished itself by providing new planes, satellite television on board, and leather seating. JetBlue also minimized costs by such measures as squeezing more seats into its planes, selling most of its tickets on the Internet to avoid commissions, shortening ground delays, and serving snacks instead of meals. Hence, JetBlue's differentiation efforts increased its load factor (i.e., the average percentage of filled seats), also reducing its per-passenger flight costs.[28]

Changes in the U.S. mobile home industry in the 2000s also illustrate a link between low cost and differentiation. Traditionally, mobile homes have been positioned as a low-cost, affordable housing option to low-income consumers. In 2004, about 22 million Americans, or 8 percent of the U.S. population, live in manufactured housing. Sales approached almost 400,000 units per year in the late 1990s.

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