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[-] Directions

In Strategy Capsule 2.3 (Chapter 2), we observed that Ford's profitability was low primarily because its costs were high. Using the value chain shown in Figure 8.4 and what you know about Ford (including the information in Strategy Capsule 2.3), what suggestions would you offer as to how Ford might lower its costs of producing cars?

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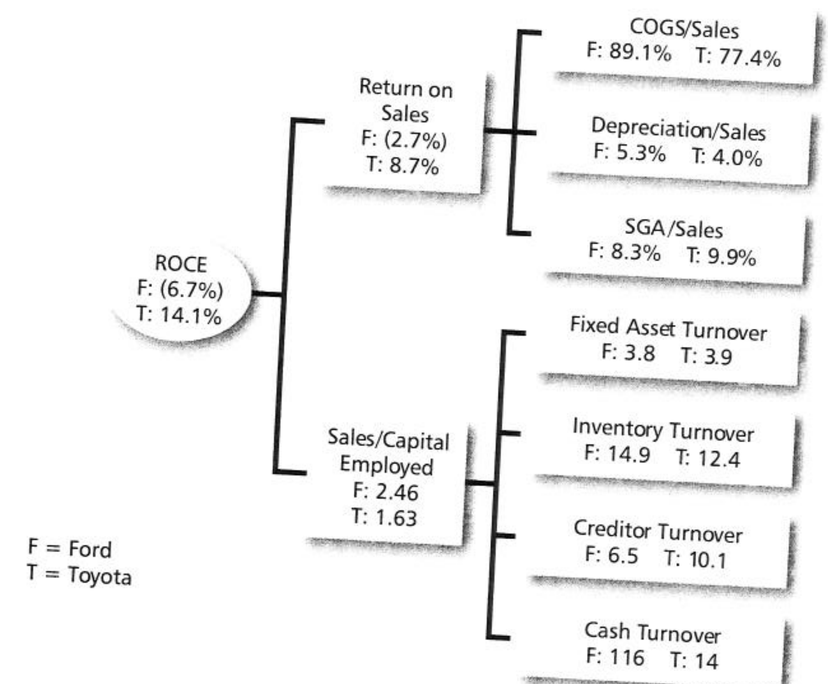
Simms- 075268 BA490 Business Policy and Strategy (26-JAN-11 / 23-MAR-11 [4037]) Discussion Fc			**Simms, Mark**	**2/12/2011**	**0**	
Main Post (Ford's Profitability)			**Heiner, Jason**	**2/12/2011**	**1**	

STRATEGY CAPSULE 2.3

Diagnosing Performance: What Ails Ford?

During the early years of the twenty-first century, Ford Motor Company continued the declining trend that had begun during the 1980s. During the five-year period 2003–7, return on equity averaged a negative 3.9% while operating losses in its automotive business totaled over $24 billion. Ford's share of the U.S. car and truck market declined from 21.8% to 16.8%. A new CEO, Alan Mulally, initiated vigorous cost cutting and asset sales, but without any significant upturn in profitability.

To understand the sources of Ford's poor financial performance, it is useful to compare Ford's automotive operations with those of the company that had displaced it as the world's second largest auto manufacturer (by volume)—Toyota. Combining data for 2006 and 2007, we can disaggregate Ford and Toyota's return on capital employed into sales margin and capital turnover, then disaggregate further into individual cost and asset productivity ratios:



Note: These ratios relate to the automotive businesses only; financial services are excluded.

FIGURE 8.4 Sources of competitive advantage

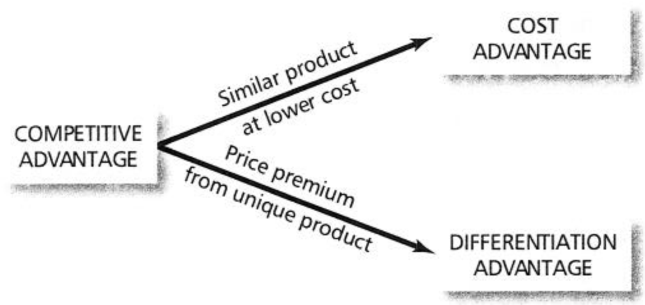


TABLE 8.1 Features of cost leadership and differentiation strategies

Generic strategy	Key strategy elements	Resource and organizational requirement:
Cost leadership	Scale-efficient plants Design for manufacture Control of overheads and R&D Process innovation Outsourcing (especially overseas) Avoidance of marginal customer accounts	Access to capital Process engineering skills Frequent reports Tight cost control Specialization of jobs and functions Incentives linked to quantitative targets
Differentiation	Emphasis on branding advertising, design, service, quality, and new product development	Marketing abilities Product engineering skills Cross-functional coordination Creativity Research capability Incentives linked to qualitative performance targe

By combining the two types of competitive advantage with the firm's choice of scope—broad market versus narrow segment—Michael Porter has defined three generic strategies: cost leadership, differentiation, and focus (see Figure 8.5). Porter views cost leadership and differentiation as mutually exclusive strategies. A firm that attempts to pursue both is "stuck in the middle":

> The firm stuck in the middle is almost guaranteed low profitability. It either loses the high-volume customers who demand low prices or must bid away its profits to get this business from the low-cost firms. Yet it also loses high-margin business—the cream—to the firms who are focused on high-margin targets or have achieved differentiation overall. The firm that is stuck in the middle also probably suffers from a blurred corporate culture and a conflicting set of organizational arrangements and motivation system.[38]