

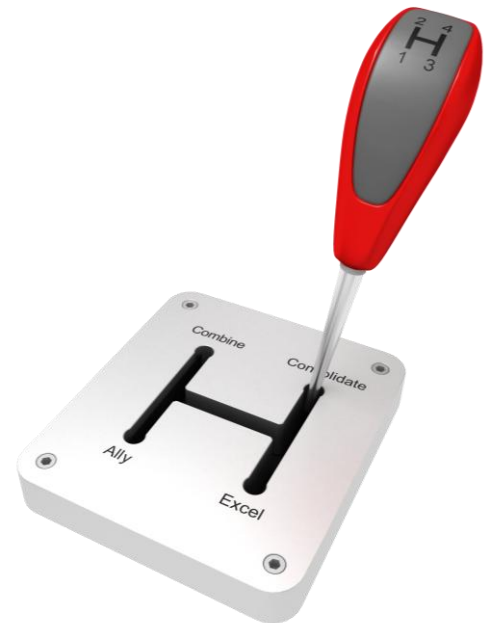
The strategy accelerator

Strategies for sustainable competitive advantage

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Abstract:

There are a limited number of models that give direction on how to achieve competitive advantage, and all focus on differentiators or on portfolio management. However, these models do not take into account the increasing availability of all kinds of knowledge through the Internet and the globalisation of the financial markets. This article investigates how a company can make an above-average profit in the current market. It proposes a directive framework based on customer relevance and on whether the company has a unique product. Based on these parameters, a company should either consolidate its position, aim to excel further in its products, effectively combine products, or ally with another company to differentiate or profile itself more.



Introduction

The question ‘how to be successful in the market’ is among the most relevant for business economics, but only a 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 price and quantity optimum on the demand curve. As soon as you encounter competitors, the power shifts to the customer: the price is set by the market and you can only follow. The only way to outperform your competitors is through differentiation.

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

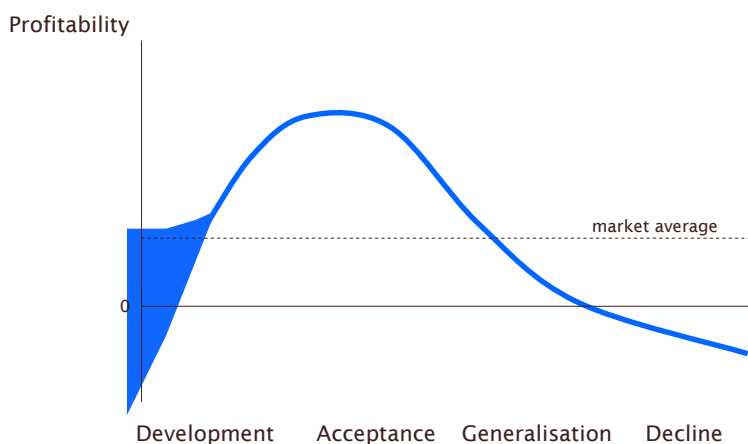


Figure 1. Profitability in the different life cycle phases of a product or business model

Companies need to develop and adopt 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 a single supplier and a single customer group (see Figure 2). On the basis of a needs analysis, you can identify entirely different ways of servicing your direct customers or their customers. Alternatively, by integrating activities from one of your suppliers, customers or the other suppliers of your customers, you can adapt your business model.

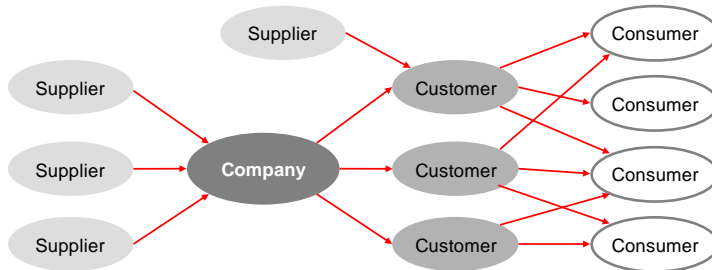


Figure 2. The value network around a company

Models for competitive advantage

On a more abstract level, there are two models often referred to that give direction on how to get your customer value proposition to stand out: Porter's model¹ on product differentiation, cost leadership and focus strategy, and Treacy & Wiersema's model² on product leadership, operational excellence and customer intimacy.

If you have more products, the Boston Consulting Group portfolio matrix offers guidance on 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 provides.

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

If there is one development that has dominated how consumers and companies do business in the last decade, 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. A few mouse clicks and phone calls is all it takes to fulfil their needs with suppliers from all over the world. Internet search and even online auctions are steadily replacing the relationship-based purchasing process³.

Thanks to this availability of information, it is also easier for small innovative companies to offer their services and to compete with larger players. This leads to faster product rationalisation. Through the faster distribution of technology, the number of competitors for a certain product increases while prices decline. A good example is offered by two comparable products: the video recorder and the DVD player, as shown 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.

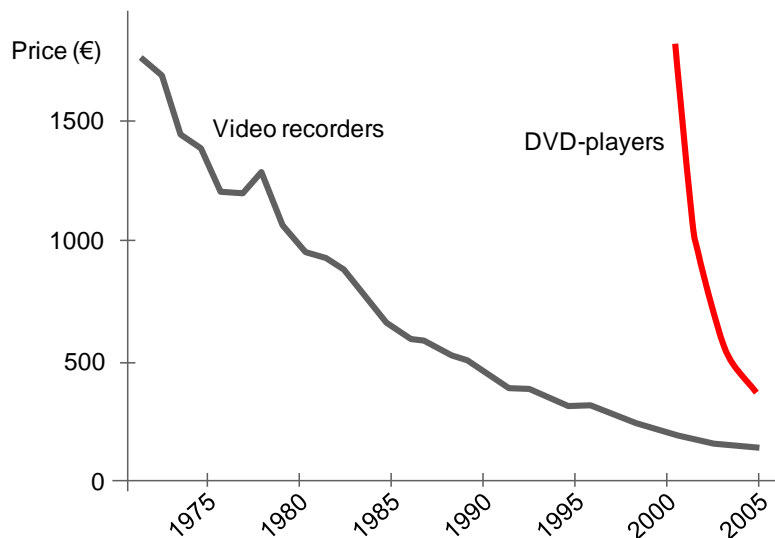


Figure 3. Price development of video recorders and DVD players⁴

These developments force companies offering products and services to concentrate on those activities where they can offer 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 associated investments were a logical way to reinvest profits. The BCG portfolio matrix is based on these assumptions.

As 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 and 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 now debated more frequently.

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

Facilitated by the increasing transparency of information and markets and increasing competition, more specialised players arise, creating a larger supply of highly differentiated products, and thereby further increasing competition. This self-propelling dynamic is displayed in Figure 4.

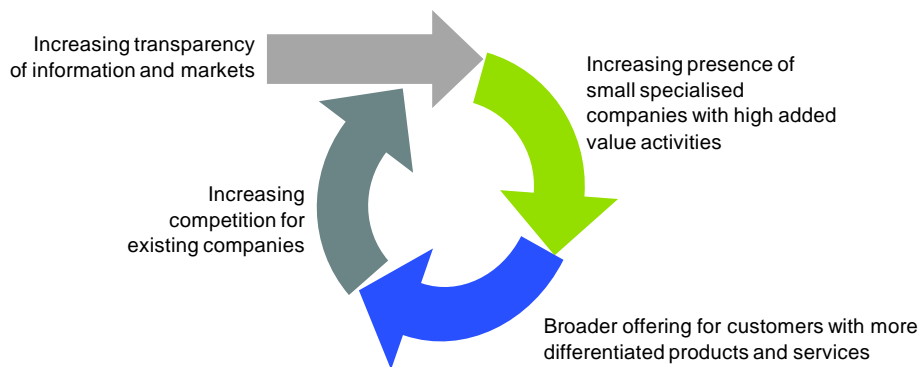


Figure 4. The self-propelling dynamic of increasing specialisation and competition

How to make a profit in a transparent world?

Given that the availability of information has continued to increase, pay-back times of new products have shortened and the globalisation of financial markets has rerouted cash flows, the question arises: how to make a profit in such a transparent world?

We can look at the strategies suggested by Porter and Treacy & Wiersema and evaluate them for 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
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	Customer relevance: being seen as relevant by your customer group
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
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

Figure 5. Evaluation of generic strategies of Porter and Treacy & Wiersema

Focusing on your customer, described by Treacy and Wiersema as customer intimacy, is a strategy seen from the company. Of the three, it is actually the most market-oriented type of strategy. However, with the 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 performed per business activity.

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 cutting edge of technology and creating a really unique product, remains a valid strategy.

Strategies for cost leadership or operational excellence can easily be copied as much more information about companies and their suppliers is available than before. The globalisation of financial markets has caused that, if scale is called for,

funds can be arranged to buy this scale. Therefore the validity of these strategies has decreased.

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

- Having a unique product
- Having customer relevance

Empirical evidence

The relationship between strategy and actual profitability has been researched in a number of papers. The most important studies from before 2000 have been combined in a meta-analysis by Campbell-Hunt⁵. From these 17 studies, six general strategies can be derived, 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.

Broad quality and sales leadership	Innovation and operations leadership	Cost economy
Promotion Sales force Service quality Product breadth Customer breadth	High prices New products Specialty products Operating efficiency	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, whereas 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 customer relevance.

One of the most frequently used models to measure ‘relevance’ is the Brand Asset Valuator of Young & Rubicam⁶. In this model, brand differentiation, relevance, esteem and brand knowledge are measured and combined to form 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 resulting 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 Knowles⁷ demonstrates the relationship between a company's brand strength and market value, attributing the effect mainly to brand differentiation. Frank H.M. Verbeeten and Pieter Vijn⁸, in an empirical investigation of 70 Dutch brands, predict a ROI growth between 0.1 and 0.3% for every 10% of competing brands that a company leaves behind in terms of brand strength. They also show that brand strength has long-term effects on profitability. Natalie Mizik and Robert Jacobsen⁹ 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 Ataman¹⁰ examined concrete measures to improve profitability in his study of 295 brands over the course of five years. He found 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 recognised. The length of the product line and the extent to which its composition helps differentiate the brand is a very important driver for profitability. However, the effect of the number of distribution points and the share of a brand at these distribution points exceeds all other effects and is crucial for all brands.

Wooseong Kang and Mitzi Montaya¹¹ 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 its profitability. Scott Newbert¹² 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 having unique products as well as having customer relevance 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), yielding four possibilities. This matrix is hereafter referred to as the strategy accelerator.

Why an accelerator? Just as with a car one doesn't start a company in fourth gear; instead, you need to build up your sources of profitability. The route either runs through a unique product or high customer relevance, and in either case an alliance with partners can help. And also: switching gears when driving a car is a deliberate action that takes time and effort. It is no different when running a company.

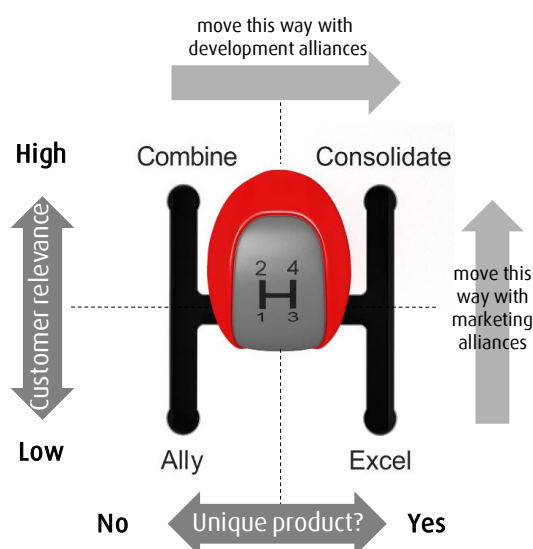


Figure 6. Structure of the strategy accelerator

The various options are discussed below.

First gear: No unique product and low customer relevance

The majority of companies move forward in first gear: they do not have a unique product and have low relevance for their customers. 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 can be discovered and appropriated even faster 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 remain resigned to their fate, or start moving out of this quadrant. Generally having limited resources, they should either choose to broaden their customer reach and relevance (switching to second gear), or invest in creating more unique products (moving to third gear). This does not mean directly transforming into an 'Ebay' or '3M'. Even minor steps can help, like guaranteeing compatibility with another product to increase your customer relevance, or offering a free annual service inspection to make your product unique in your market, at least for some time.

Second gear: High customer relevance but no unique product

There is a larger group of companies operating as a relevant supplier for their customer group, yet without having their own unique products. These include, for example, a number of grocery stores, well-known hotel chains like Hilton, or Internet portals like Ebay and Amazon. Internet search engines can also be companies enjoying high relevance, even though they don't sell products directly. Not every company has to be widely known: especially in the business-to-business market, companies can have a highly relevant offering for a limited customer group only.



Customer relevance is connected to the company name or its individual brands. The product width, distribution model, service and marketing communication contribute to the relevance of brand or company. Even packaging, complaint handling or added services can have their influence. Customer relevance prompts the customer to buy a certain product from this particular company, and not from its competitor. It can be defined as the congruity of the brand promise with the customer's needs.

One could argue that it is the brand logo on the clothing or on the packaging that makes the products offered by these companies unique. But once you see that even brand-free products are sold better through these channels, for example because of the guarantees, purchasing ease or the certainty of their compatibility with one's lifestyle, then the difference between the product and customer relevance becomes clear. Starbucks, for example, made a handsome profit selling the music they play in their stores; here, the fact that it is selected by Starbucks is what produces the value, not the music itself.

The best strategy for companies in this gear is to further enhance their customer relevance by combining the right products in their offerings. This requires market research, portfolio management, investments in store development and marketing communications. The value created often lies 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 pursued too far, the store's relevance and customer reach will decline.

Third gear: A unique product but low customer relevance

Product differentiation has increased significantly in the last decade, and so has the number of companies offering unique products. What is unique in this sense? Unique is that it has a significant advantage that cannot be copied or substituted easily. Bang & Olufsen, the manufacturer of music and video equipment, has a unique product in terms of 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 be part of the collection (= product combination) of companies with a large customer reach. This includes being found easily by Internet search engines.



As even a unique product can become out-dated, be copied or substituted, companies that focus on having unique products constantly have to modify, improve and innovate their products and to excel in their line of business. This can be achieved by regularly updating their knowledge, conducting customer research, investing in good personnel and patenting their innovations. It is obvious that, to some extent, you have to market your products, otherwise you will be out of business soon. But this can be restricted to bringing your product to a good 'combiner' with a large customer reach, rather than investing in a top-of-mind brand name yourself. In the pharmaceutical industry there are various smaller companies, like Galapagos, that develop new medicines but license their findings to big corporations like GlaxoSmithKline to clinically test and market the product.

Fourth gear: High customer relevance and a unique product

There are only a 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 may argue that there are multiple MP3 players on the market, only Apple has its patented click wheel and its intuitive customer interface. By being a relevant supplier for its customers, Apple can combine its own products with a range of software products and music and video from various artists and amateurs in The Apple Store. Philips is another company with a strong brand name and distribution channels on the one hand, and products with a unique design or patented technology on the other.



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. Maintaining your relevance as a supplier requires active portfolio management and regular marketing

communications. Companies should be sure to not take their position for granted, and to be keen on pursuing their competitors.

Ways to increase your profitability

Especially for companies in first gear, without a unique product or large customer relevance, it is necessary to move on from this position. Also for companies with unique products it can be worthwhile to increase customer reach, or for companies with customer relevance to develop unique products. Basically, 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 that way obtain the necessary competences for product development or marketing. The question is: can your competitors easily do the same, or haven't they done so already?
- To take over a company who has the right market position or product portfolio, or merge with it (if they are willing). 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 the basis of the boundary conditions that exist in every company:

- Available time to market
- Investment size
- Acceptable risk

Investing in development activities yourself generally 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 carry the risk of investing in a non-responsive customer group or in a failing product. A takeover or merger guarantees access to an existing customer group or an existing unique product portfolio, but in many cases it also means investing in overlapping or non-strategic resources. An alliance with a complementary company is preferred. This makes possible a short time to market, with a limited investment and low risks. However, it requires having at least some in-house assets to be attractive to your partner.

An effective alliance broadly requires three components:

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

The selection process of a partner should address these components.

The strategy accelerator completed

To complete the strategy accelerator model, we need to elaborate the strategic directions proposed for companies in each gear. This model offers 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 already engage in both activities, they should seek to consolidate their position. If they do neither, they should choose a way to move away from this position by allying with others.

Similar to changing gears in your car, to move from one strategy to another is a deliberate step that requires either large investments or some form of 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 emerges (Figure 7).

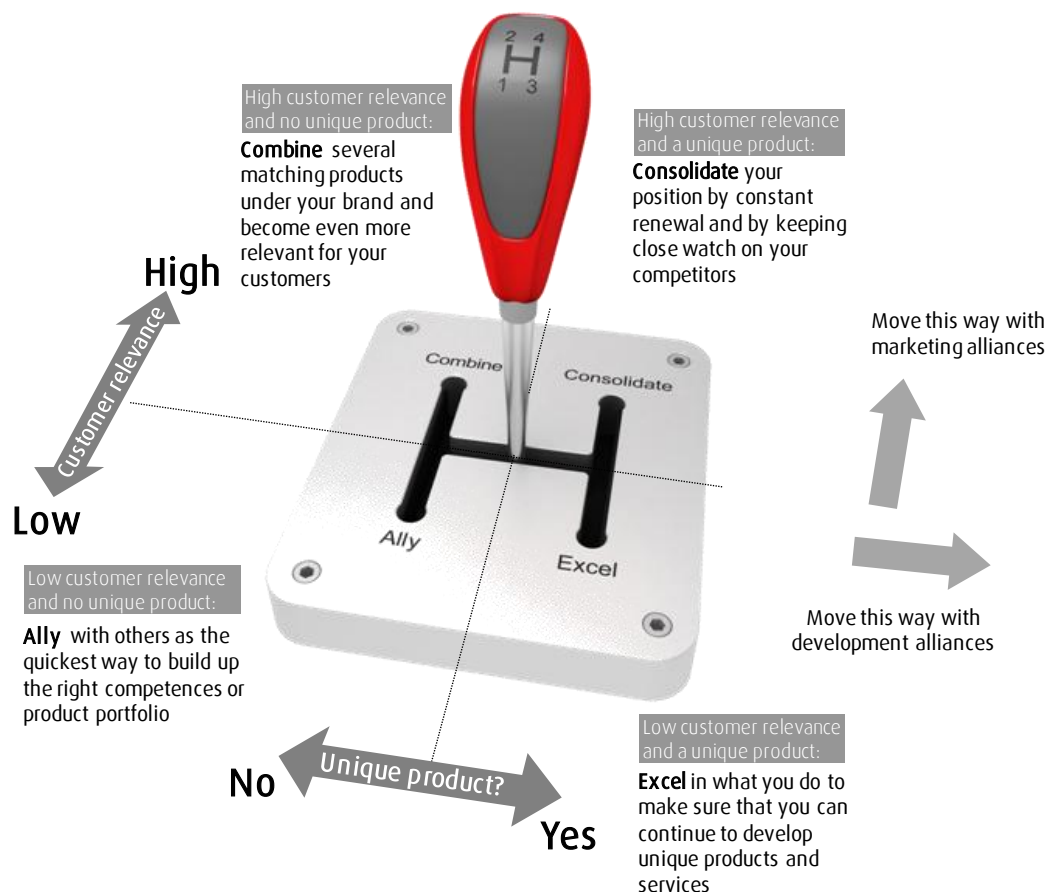


Figure 7. The strategy accelerator completed with development directions

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

Neither a model like this nor an article can provide a comprehensive 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 emphasises that this is always a step-by-step approach.

About the author:

Alfred Griffioen (1972) has a background as strategic marketer and business development manager. After a period as manager with a strategy consultancy 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 see www.allianceexperts.com.

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