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EXCERPTS FROM THE BOOK COMPETITIVE STRATEGY
by Michael F. Porter

Competitive strategy is at the heart of a firm's performance. It grows fundamentally out of the value a firm is able to create for its consumers, customers and shareholders.

Competitive strategy is a search for a favorable, competitive position in an industry.

Two central questions underlie the choice of competitive strategy:

1. The attractiveness of industries for long-term profitability and the factors that determine it.
2. What determines the relative competitive position within an industry.

Competitive strategy must grow out of a sophisticated understanding of the rules of competition that determine an industry's attractiveness. There are five principal competitive forces that determine industry profitability:

1. Potential new entrants.
2. Availability of substitutes for the industry's products.
3. Degree of rivalry among existing firms.
4. Bargaining power of buyers (e.g., for us the trade and the consumer).
5. Bargaining power of suppliers.

These forces determine industry profitability because they influence the prices, costs, and required investments of a firm in an industry.

This framework does not eliminate the need for creativity in finding new ways of competing in an industry. Rather, it directs creative energies towards those aspects of industry structure that are most important to long-run profitability.

Often firms make strategic choices without considering long-term consequences for industry structure. They see a gain in their competitive position if a move is successful, but they fail to anticipate the consequences of competitive reaction.

For example, introducing a new product on a strong price basis could cause greater price sensitivity in the market and thereby strengthen the bargaining power of buyers. This is a key Samsonite lesson as it relates to Epsilon, CPX, EZ CARTS, etc. We must price-up on new, consumer-desired features/products. It is also the premium we should earn as a result of our innovations and investments.

Or, the entry of a company (e.g., Samsonite) could lead other companies (as it often has) to greatly increase their emphasis on technical innovation. Or, a new product design that undercuts entry barriers, or increases the volatility of rivalry, may undermine the long-run profitability of an industry.

In a real sense, industry structure determines who keeps what proportion of the value a product creates. Does the trade keep more of it; or does it go to the consumer; etc.? The crucial question in determining profitability is whether firms can capture the value they create for buyers or whether this value is competed away to others. Industry structure is an important determination in who captures the value.

Since we, at Samsonite, are the strong global leader, what we do and how we do it will greatly influence the structure of the industry. We must insure that what we do causes the structure of the industry to be low cost, high margined and responsive to our areas of strength--innovation, style/design, marketing/advertising and hardside product competencies.

The fundamental basis of above-average business performance in the long run is sustainable, competitive advantage.

There are two basic types of competitive advantage a firm can possess: low cost or differentiation.

In the main, Samsonite has followed differentiation strategies although, at times, it has lost its way on this point.

The strategic logic of cost leadership usually requires a firm to be the cost leader, not one of several firms vying for this position.

A firm on a differentiation strategy cannot ignore its cost position. Its cost must be at parity or close to its competitors, and it must be achieved by reducing costs in all areas that do not affect differentiation.

A firm that engages in both strategies, but fails to achieve any of them well, is stuck in the middle. It possesses no competitive advantage, and will likely fail.

Achieving cost leadership and differentiation are often inconsistent because differentiation is usually costly. However, reducing cost does not always involve a sacrifice in differentiation. Ways can be found to reduce costs, not only without hurting differentiation, but while actually raising it. However, cost reduction is not the same as achieving a cost advantage. When faced with capable competition also striving for cost leadership, a firm will usually reach the point where further cost reduction requires a sacrifice in differentiation. It is at this point that the generic strategies become inconsistent and a firm must make a choice.

However, if a firm can achieve cost leadership and differentiation simultaneously, the rewards are great because the benefits are additive. This is the ultimate formula for business success and Samsonite can achieve this. Our new strategies (Game Plan) will get us there.

This is possible where cost is strongly affected by market share or economies of scale such as Samsonite with global sourcing and standardization.

A firm should always aggressively pursue all cost and productivity opportunities that do not sacrifice differentiation.

Different generic strategies imply organizational structures and cultures. Differentiation may be facilitated by a culture encouraging innovation, individuality and risk taking.

Employing a common generic strategy across a multi-division global company involves some risks. One risk is that a diversified firm will impose a particular generic strategy on a business unit whose segment or geographic region will not support it.

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Generic strategies in the strategic planning process. Plans are too often built on projections of future prices and costs and market shares that are almost invariably wrong, rather than on a fundamental understanding of industry structure and competitive advantage that will determine profitability no matter what the actual prices and costs turn out to be.

Some firms set the goal that all their business units should be leaders in their industries. This approach to strategy is as dangerous as it is deceptively clear and tempting. The pursuit of leadership for its own sake can sometimes divert attention from achieving and maintaining competitive advantage.

Competitive advantage describes the way a firm can choose and implement a generic strategy to achieve and sustain competitive advantage. A reality check is necessary--can the corporation achieve its financial goals with the strategy that it chooses? This is key for Samsonite and its key operating plans and strategies for FY 1998.

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Cost advantage. The behavior of a firm's costs and its relative cost position stems from the value activities the firm performs in competing in an industry. Cost inefficiencies stem from the non-value or non-strategic activities staffed and performed by the firm. **This is a clear opportunity area for Samsonite.**

Costs should be segregated into parts so as to reflect: 1) the size and growth of the cost represented by each activity; 2) the cost behavior of the activity, e.g., what drives its cost; 3) competitor differences in performing the activity and 4) its importance to achieving the firm's key strategies.

A firm's cost position results from the cost behavior of its value activities. Cost behavior in turn depends on a number of structural factors that influence cost. Porter calls them cost drivers. There are ten of them. Knowing what they are allows a firm to understand the sources of its relative cost position and see how they might be improved:

1. Economies or diseconomies of scale.
2. Learning and spillovers. Start-up costs are a good example of this.
3. Pattern of capacity utilization. (N.B., the Denver Plant)
4. Linkages, e.g., getting better and less costly materials from fewer suppliers. These would be vertical linkages.
5. Interrelationships with other business units within a firm affect cost, e.g., sharing a sales force between two business units, for example.
6. Integration. How much vertical integration should be provided?
7. Timing, the importance of being first; or not being first.
8. Location. The geographic location of a value activity can affect its cost.

9. Institutional factors.
10. The cost of purchased inputs - major area of expense. Yet, one where there isn't enough systematic attention given to drivers that can reduce costs, e.g., economies of scale linkages; etc.

We need to work with suppliers to exploit vertical linkages and ways of eliminating non-added value costs incurred by our suppliers. Xerox, for example, provides suppliers with its manufacturing schedule through computer terminals enabling suppliers to ship parts precisely when needed. We, at Samsonite, need to work with our suppliers to take costs out of their systems/materials to improve our costs.

Costs do not go down automatically or by accident, but rather as a result of hard work and constant attention. Firms differ in their abilities to lower costs even when they have similar scale or cumulative volumes or when guided by similar policies. The importance of symbolic factor in creating the climate for cost reduction also cannot be overstated. Successful cost leader usually pay a great deal of attention to discretionary costs in addition to seeking to achieve minimum operating costs.

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Pitfalls in cost leadership strategies

1. Exclusive focus on the cost of manufacturing activities. Not enough emphasis on marketing, sale, and technology development costs. This usually stems from too much emphasis on low pricing. (Samsonite has done this).
2. Ignoring procurement. Many firms work diligently to reduce labor costs, but pay too little attention to purchased inputs. They tend to view purchasing as a secondary staff function and devote few management resources to it.

3. False perception of cost drivers. Firms often misdiagnose their cost drivers. I feel we may not have put enough emphasis on the role being played in our above-average profitability of lower marketing cost rates, and, in some cases, I think we're losing this.
4. Failure to exploit linkages.
5. Thinking incrementally rather than looking for ways to reconfigure the chain.

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Differentiation. A firm differentiates itself from its competitors if it can be unique at something that is valuable to consumers and/or customers. It leads to superior performance if the price premium achieved exceeds any added costs of being unique.

Differentiation grows out of the firm's value chain. Virtually any value activity is a potential source of uniqueness, e.g., the procurement of raw materials can affect performance; technology development, of course, leads to unique product designs; quality control in manufacturing impacts performance; advertising builds uniqueness in the product. Value activities representing only a small percentage of total cost can have a major impact on differentiation, e.g., plant inspections and work practices.

Uniqueness does not lead to differentiation unless it is valuable to the buyer. It creates value for the buyer by either lowering buyer cost or by raising buyer performance or both. That's why we must use market research to truly understand what consumers truly like and want.

Buyer purchase criteria can be divided into use criteria and signaling criteria (those product characteristics such as styling which stimulate a psychographic response). The latter includes advertising, reputation, etc.

It is important that the consumer purchase criteria for any product be identified precisely in order to be meaningful for developing differentiation strategy.

This calls for careful consumer research. In Samsonite's case it is clear-- 1) ease of mobility, 2) internal organization, 3) ease of handling/weight, and 4) styling/aesthetics.

Nearly all the use criteria will reach a point of diminishing returns and this needs to be established. Meeting some use criteria may also involve trade-offs with others.

Signaling criteria should be defined as precisely as possible, too.

Steps in differentiation

1. Determine who the real buyer is.
2. Identify the buyer's value chain and the firm's impact on it.
3. Determine buyer purchasing criteria.
4. Assess the existing and potential sources of uniqueness in a firm's value chain.
5. Identify the cost of existing and potential sources of differentiation.
- 6.. Choose the configuration of value activities that creates the most valuable differentiation for the buyer relative to cost of differentiation.
7. Test the chosen differentiation strategy for sustainability.
8. Reduce cost and activities that do not affect the chosen forms of differentiation.

Industry Segmentation and Competitive Advantage

Industries are not homogeneous. Some segments have more inherent profitability than others due to the strength of the five competitive forces. **Crucial strategic questions facing a firm become -- where in an industry to compete -- and in what segments will focused effort be sustainable because barriers can be built between segments. This is a key issue for Samsonite regarding (1) casual bags, (2) business bags and (3) Legacy products.**

Interrelationships Among Business Units

Most companies today have divided their business into units with a good deal of decentralization. The strategic planning surrounds these units. There isn't enough horizontal strategy which can cross divisional boundaries. Horizontal/Global strategies are the essences of corporate strategy. Horizontal strategy is something that few firms today can afford to ignore, including Samsonite. Reasons:

1. Technological change is proliferating interrelationships and making them more achievable.
2. Multi-point competition is increasing. Where a firm has multi-point competitors, it must view its competitors more broadly than at the single-business unit level.
Multi-point competitors must be viewed in their totality for purposes of offensive and defensive strategy.
3. First mover advantages can and should be global in scope to maximize return to the corporation.

Horizontal Strategy

There are two fundamental issues in corporate strategy for the diversified firm:

1. What industries to compete in.
2. How the strategies of the firm's business unit should be coordinated.

An explicit horizontal strategy should be at the core of corporate strategy.

A new pattern of competition is emerging in many industries featuring competition among clusters of related business units rather than among individual business units. Coordinated business unit strategies and related diversification into new industries will deepen and extend any relationships.

Horizontal strategy can't be left implicit and it won't emerge on a bottom-up basis.

This will be critical for Samsonite in hardside versus softside as well as regionally/globally.

Complementary Products and Competitive Advantage

It always makes sense to step back and systematically review possible opportunities to introduce complementary products to ones we are already making.

Where an industry's product is used with complements, an important strategic issue arises, i.e., the extent to which a firm should offer the full range of complements or leave some to be provided by independent suppliers perhaps as a Joint Venture.

Competitive advantages theoretically arising from controlling complements are: 1) improved buyer performance in differentiation; 2) true perception of value; 3) higher mobility barriers.

Potential problems of trying to control complements arise from the possibly lower margins of the complementary product as well as the possibility that the complementary industry may involve different practices/requirements/ethics.

For Samsonite, travel-related products, ladies' handbags and Travel Expo retailing are big future opportunities for us.

Industry Scenarios

An industry scenario is a useful mechanism to understand the strategic implications of uncertainty. A scenario is an internally consistent view of what the future might turn out to be. Allow a firm to move away from dangerous single-point forecast of the future in instances where the future cannot be predicted. Can help encourage managers to make their implicit assumptions about the future explicit and to think beyond the confines of existing conventional wisdom. The

firm can then make well informed choices about how to take the competitive uncertainties it faces into account.

The process involves determining the major uncertainties and the key causal factors that will drive them. Uncertainties are placed in one of three categories: constant, predetermined, and uncertain. The uncertain ones are the critical ones. They can be listed under the same five key competitive factors talked before: entry barriers, buyers, rivalry, substitutes and suppliers.

Entry barriers will be affected by new product designs, scale economies in manufacturing, and difficulty in gaining access to distribution. Buyers will be affected by the degree of price sensitivity and degree of demand. For Samsonite, we must focus on product innovation, styling and economies of scale.

The future industry structure under each scenario will usually have different consequences for different competitors.

A major purpose of industry scenarios is to ensure an internal consistency in the firm's view of the future. Having developed and analyzed the set of scenarios, the net task is to formulate competitive strategy. Options include betting on the most probable scenario or betting on the "best" scenario to make it happen. At other times, flexibility will need to be maintained between a number of scenarios, when one is not an odds on favorite.

Defensive Strategy

Aim is to lower the probability of competitive attack or lessen their intensity. The object is to make a firm's competitive advantage more sustainable. It rests on influencing competitors decision-making processes in order to make an attack on a firm's position less desirable from the challenger's perspective and/or more desirable from our standpoint.

Generally a challenger's commitment increases as it progresses in the process, especially if some success is achieved. This makes it vital that rapid action be taken to deflect initial success. Also important to take defensive action where possible before exit barriers (e.g., capacity) have risen.

Five types of defensive tactics underlie any defensive strategy:

1. Raising structural barriers -- This can be done by filling product or positioning gaps (hardside @ higher price points, business and computer cases, and casual bags); foreclosing alternative marketing themes; defensive low pricing of product varieties adjacent to competitors' lines in order to discourage competitor line extensions (Legacy); and encouraging good competitors that fill gaps and are profit driven without threatening the firm.

Also look at increasing scale economy; foreclosing alternative technologies; investing and protecting proprietary know-how; look for barriers to a challenger's access to the best source of raw materials.

2. Increase expected retaliation -- Signal commitment to this end. A firm's reputation for retaliation is strongly influenced by its history, particularly its response to past challengers. Establish blocking positions in categories which are important to the competitor.
3. Retaliation during attack. -- Challengers have a tendency to read a lot into early results, often using them as a basis for longer-term projections. Hence, even if a defender's retaliation is unsustainable for long, it can achieve its objectives. As a general rule, quick and vigorous retaliation is necessary to limit an attack.
4. Look at leapfrogging in a new product or process during a challenger's attack. Said more specifically, how can we change the rules of the game in Samsonite's favor -- e.g., warranties issue -- change the rules of warranties in our favor.

5. Lowering the Inducement for Attack -- The following are key methods:

Reducing Profit Targets -- Many firms have invited attack by being too greedy.

Deterrence -- the cost of deterrence is often less than the cost of fighting battles once a challenge has begun and the challenge has a beach-head (initial success).

Important steps in deterring attack:

1. Thoroughly understand existing barriers. Build them.
2. Anticipate the likely challengers.
3. Forecast likely avenues of attack -- and seek to preempt them.
4. Manage the firm's image as a tough defender.
5. Set realistic profit expectations. No defensive strategy can be effective unless a firm has realistic profit expectations. It must reflect barriers it possesses and those that can be created.

Response to Price Cutting -- Price cutting by competitor often rests on the assumption that a firm will not react aggressively but will maintain a price umbrella in the hope of preserving profits. Early and vigorous response is thus often necessary if price cutting is to be contained. A firm must convince a price cutter that mixed motives will not paralyze it. **A competitor must lose hope that this strategy will be effective.**

The single biggest pitfall on defense is a narrow concern with short-term profitability which conflicts with the reality that defense requires investment. The second largest pitfall is complacency. Firms often do not examine their environment for potential challengers moreover firms often invite competitors into their industry by earning unsustainable margins thereby ignoring buyer needs. Complacency hurt us on uprights. Management must imbue in organization a healthy discomfort with status quo. Even if a company is currently "winning", it is then that it must strive even harder to succeed.