

Generic Strategy: Differentiation

Key Points:

- A differentiation strategy focuses a firm on the objective of creating a perceived difference in the product or service offered. Each industry can have several different differentiators.
- To achieve a differentiated position, a firm's overall policies, goals, activities, investments and focus need to be geared toward delivering something different, either in the form of brand, technologies, features or service as examples.
- Differentiators risk losing their differentiated positions when the gap between their unique value and low-cost competitors becomes too small, when the differentiation no longer creates the perception of value, as well as when imitation eliminates perceived differentiation.

Main Thoughts:

Firms can achieve better than average returns in their industries by achieving differentiated positions. To do this, a firm's overall policies, goals, activities, investments and focus need to be geared toward delivering something different, either in the form of brand, technologies, features or service. Unlike a cost-leader, the firms that differentiate are willing to bear additional costs in selected value chain activities in order to improve margins. It is important to note that firms do not bear additional cost in all areas of the value chain; differentiators still need to be mindful of overall costs. However, firms that differentiate are willing to incur greater costs in those areas of the value chain that directly support their strategies.

Differentiation is effective because—like the cost-leader—it mitigates many of the challenges faced in industry competition, but in ways different from a cost-leader. The uniqueness of the offering attracts customers who are willing to pay for additional features or services and thus act in a less price sensitive manner. Customers' loyalty to the brand reduces their propensity to switch or substitute, while creating barriers for competing firms in or entering the industry. Additional margin derived from improved pricing also helps combat buyer power. In short, differentiation is an effective generic strategy.

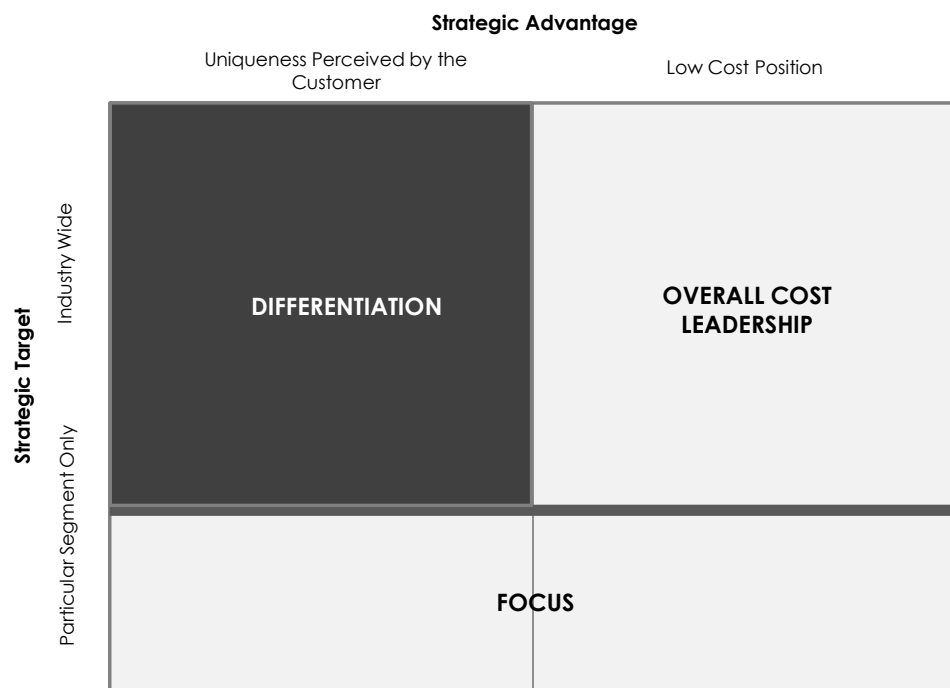
Finding and defending a differentiated position does not typically require high market share or scale in operations. In fact, effective differentiators can thrive with low market share. Further, they are not precluded from having high share. Some firms have achieved a defensible differentiated position by combining several forms of differentiation in one value proposition. For example, Coke and Pepsi command very high market shares in the soft drink industry through effective marketing to consumers and skilled management of the bottling network. The following table highlights common requirements of a differentiation strategy:

<u>Skills & Resources</u>	<u>Organizational Requirements</u>
Marketing	Coordination among functions
Product Development	Subjective Incentives
Channel Management	Skilled Labor
Quality	

Figure 1: Differentiation Strategy Requirement (Adapted From Porter, Michael, Competitive Strategy, 1980, Free Press)

Maintaining the differentiated position requires a vigilant focus on cost management. As well as a focus on selective spending on differentiating activities in order to prevent cost competitors from creating too great of a value gap (between their basic offering and the differentiated ones). Further, firms pursuing this strategy must ensure the value of the differentiation remains high relative to cost relative to competitors or other differentiators. Lastly, differentiation strategy firms must be mindful of imitation from other competitors.

Figure 2: Generic Strategy Matrix (From Porter, Michael, Competitive Strategy, 1980, Free Press)



As an Example:

An example of an effective differentiator is Target. Unlike Wal-Mart, the industry cost leader, Target differentiates on the quality of its merchandise, the shopping experience, as well as the marketing message (i.e. cool, hip, and upscale). Overall, for their identified customers, Target's prices are higher than Wal-Mart's. Target provides an enhanced shopping experience for which they are willing to pay. Target's image and store layout help deliver this overall experience in a way that is markedly different from Wal-Mart's.

Editorial

Differentiation is an effective way for firms, other than the cost leaders, to compete because typically there are a number of different value propositions that appeal to a variety of different customer segments. A differentiated offering and unique configuration in value chain activities follow a deliberate decision regarding which customer segments to serve. Customer selection must come first, because without a

clearly defined set of customers, it is virtually impossible to develop a value proposition unique to their needs. Therefore, a true differentiation strategy rests upon meeting the needs of a broad set of customers better than rival firms do.

Another key concept for the differentiating firm is to make investments in the value chain in areas that directly support the differentiation value proposition, while managing other investments and costs to a minimum. A differentiation strategy is not a license to increase costs across the board. To be effective, differentiation has to be meaningful; the differentiator has to deliver enhanced value in the products or services selected for the target customer groups. To deliver this enhanced value, the differentiator will incur additional costs. These costs have to be in areas that enhance the customer's willingness to pay. If these additional costs fall in areas where the customer is not willing to pay, margin erosion will occur.

For More Information See:

Articles:

n/a

Text

Porter, Michael, E., Competitive Strategy: Techniques for Analyzing Industries and Competitors, Free Press, 1980.