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Generic Strategy Matrix
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Generic Strategy

Adapted from the work of Michael Porter

Competitive advantage grows fundamentally out of the value a firm is able to create for its buyers.

—Michael Porter²⁶

In his epic 1980 book, *Competitive Strategy*, Michael Porter lays out one of the most complete and coherent foundations in the field of strategy. Each industry is shaped by a set of competitive forces that determine its nature and profitability in structured and predictable ways. Competition within industries is natural and inevitable. Firms gain a competitive advantage by creating value for buyers. Strategy should be intentional, not accidental or optional. Two central issues shape the work of the business strategist: the attractiveness of the industry and the relative positioning of a firm within an industry.

An industry's attractiveness is largely determined by the interplay between a set of core competitive factors. Applying what is now known as Porter's Five Forces model, strategists are directed to a careful consideration of Entry Barriers, Buyer Power, Supplier Power, Threat of Substitutes, and Rivals to understand the structural makeup of an industry. For example, concentrated Buyer or Supplier Power limits the range of freedom and negotiating room, while low Barriers to Entry will keep incumbent competitors more vigilant and price sensitive than ever before. Not all industries are equally attractive, and Porter offers a rich analytic approach to determining what is going on and where to concentrate investment efforts.

Profitability and long-term sustainability depend on a firm's positioning within an industry. Even some relatively unprofitable industries, like computers and cable television, reap sizable rewards for certain of the value chain participants. In Porter's modeling of Generic Strategy options (Figure 6.23), he maintains that firms may possess a myriad of interesting and unique strengths and weaknesses. However, their competitive advantage is determined by one of two things: low cost or differentiation. Strengths are relevant to the extent that they enable or block these two strategies. The context in which this advantage is pursued can be either broad or focused, creating an additional set of strategic approaches. Companies are advised to avoid straddling more than one option, since dilution limits their ability to execute their strategy and makes them vulnerable to others with greater focus and discipline.

Porter has continued to develop his ideas on competition and strategy, first looking at their application to governments in the *Competitive Advantage of*

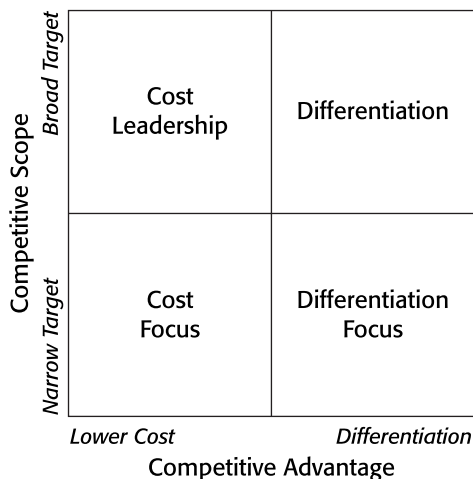


Figure 6.23. Generic Strategy Matrix

Nations, and more recently the competitive importance of geographically based clusters like Silicon Valley for computing, Grand Rapids, Michigan, for furniture, and northern Italy for weaving.

The Two Dimensions and Their Extremes. The Generic Strategy matrix explores two key dimensions: Competitive Advantage and Competitive Scope:

Competitive Advantage. Firms must choose between Lower Cost and Differentiation. These are inherently in contradiction to one another, since Differentiation generally requires a higher level of investment.

Competitive Scope. Firms can compete Broadly across an industry, or they can Focus Narrowly on one or several segments.

The Four Quadrants. Porter writes, “‘Being all things to all people’ is a recipe for strategic mediocrity and below average performance, because it often means that a firm has no competitive advantage at all.”²⁷

Firms often gain advantage by adopting one of the generic strategic approaches, and then relinquish it when they attempt to pursue one of the other strategies in tandem. While it may be tempting at times to do this (Porter refers to this as “getting stuck in the middle”), it is rarely advisable or sustainable. Each of the four options in the matrix is a unique response to industry structure and the strengths a company can call on:

- Upper left: Cost Leadership. This is the clearest of the generic strategies. Cost Leadership involves achieving the lowest costs in an industry while main-

taining an acceptable level of quality. Typically, only one competitor can win with this strategy. Low costs are attainable in a variety of ways, drawing on the industry structure and the company's strengths. Some of the cost-limiting sources are preferential access to raw materials, better production methods, economies of scale, and more efficient distribution channels. A common low-cost strategy is to offer the no-frills version while ensuring that the most highly weighted aspects of customer value are preserved. It is important to maintain what Porter calls parity in the offer to prevent erosion of customer goodwill due to an unacceptable drop in quality as compared with available alternatives.

- Lower left: Cost Focus. In the Cost Focus strategy, a firm takes advantage of the unique needs of a segment of an industry that is difficult or uneconomical for the Broad Cost supplier to service adequately. Sometimes Broad Cost competitors must overperform to meet the special needs of some segments, where a less costly solution or product would suffice. This occurs in the world of high-tech equipment when manufacturers sell higher-grade devices and components set to a lower performance level. Or there may be custom requirements that lend themselves better to smaller, more tailored low-cost offerings. A group with special dietary needs may be better served by a company that can focus exclusively on them than by generic suppliers. Porter uses the example of a small paper mill's superior ability to execute cost-effective, low-volume runs of high-quality specialty paper.

- Lower right: Differentiation Focus. The Differentiation Focus strategy applies the principle of added value within a small segment of a market rather than across the entire market. Customer needs are sometimes met in an uneven way, with some groups left to adapt a good deal of the offering to meet their requirements. Rural markets may require extra service; an in-depth understanding of a special technology may be worth extra money to customers seeking reliability and risk reduction.

- Upper right: Differentiation. In differentiating, a firm sets out to deliver some unique form of value that customers recognize and appreciate. A differentiation strategy depends on developing or exploiting talents and resources that set the company's offer apart in a way that is both meaningful and difficult to replicate. The reward for successfully differentiating is customer loyalty and the right to charge a premium price. Examples of differentiated offerings are plentiful, from fine wines to high-tech products from Apple and RIM. When you think quality and hard to replace, you have the basis for differentiation.

There are numerous ways firms go about differentiating themselves. They can add features and functionality to a product, improve process effectiveness to the point that it is truly significant, or dramatically enhance service quality, creating a noticeably better experience than their competitors. Unlike Low Cost, a number of competitors can pursue Differentiation strategies simultaneously, each exploiting a different valued attribute of the offering.

Example: Automotive Industry. By the turn of the twentieth century, an assortment of electric-, steam-, and gasoline-powered vehicles were being produced by a large number of mostly small craft operations.²⁸ Each automobile took several days to build, and product performance was spotty. Use of cars was reserved for the wealthy, who drove primarily for luxury and sport. The industrial revolution had provided the means for manufacturing key automotive ingredients like metal and rubber. It was the application of assembly line thinking to building the car itself that enabled wider access by lowering prices and increasing volume and quality control capabilities.

The Generic Strategy view is that over time, the strongest strategy will win. Companies need to draw on their strengths to respond competitively to the industry context, which is defined by Porter's five forces. The history of the automotive industry is instructive, as illustrated by the strategic approaches of a number of well-known companies (Figure 6.24).

In 1913, the Ford Motor Company introduced the first moving assembly line in the automobile industry and quickly became the largest car company in the world. Buyers wanted a reliable low-cost option and gladly traded uniqueness for the new standard. For almost a decade, Ford dominated the market, setting the pace for suppliers and customers, without any real direct competitors in sight.

In the 1920s, General Motors (GM) read the market forces right, offering attractive features at premium prices to an increasingly affluent public that was becoming more familiar and trusting of automotive technology. Rallying to GM chairman Alfred Sloan's famous *differentiation* dictum, "A car for every purse and purpose," GM went on to become the number one car company.

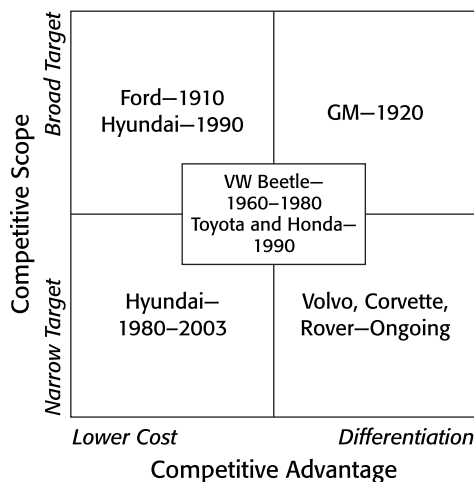


Figure 6.24. Automotive Industry Generic Strategy Matrix

Focused Cost strategies appeal to buyers willing to do some of their own maintenance and put up with a bit of inconvenience. The Russian-made Lada was sold for several years in the West at a remarkably low price; however, the consistently poor quality and after-sales service record finally deterred even most bargain hunters. The Korean Hyundai has aggressively won market share in recent years with a higher-quality low-cost offering.

A number of Focused Differentiation brands have succeeded at the higher end of the price spectrum. Volvo, Rover, Corvette, and others have been able to attract and retain loyal customers for decades by providing a unique driving experience.

Due to the size and complexity of the automobile market, it has regularly been possible for some companies to succeed with the more dangerous stuck-in-the-middle strategy. The VW Beetle did this through the 1960s and 1970s, as have the top-selling Honda Civic and Toyota Tercel more recently.

But even in this large and diversified industry, we see that companies must eventually choose a clear strategy to remain competitive as tastes change and imitators find ways to duplicate successes and remove the uniqueness of an offer.

Context. Porter's Generic Strategy is often used in conjunction with the five-forces diagnosis in devising corporate strategy. The most natural fit for the approach is in very large firms that can realistically pursue the scale of options contained in the model. It is useful for firms of all sizes for taking stock of competitive conditions and plotting the strategies of competitor firms.

Method. Generic Strategy is determined through a careful analysis of competitive forces. The steps describe the process at a high level:

- Step 1: Define. Define the domain of business interest and industry boundaries.
- Step 2: Scan. Complete an analysis of the five forces at play in the industry.
- Step 3: Diagnose. Determine which of the generic strategies is most suitable, given the industry analysis and the unique strengths and weaknesses of the firm.
- Step 4: Plan. Develop a plan to implement the chosen strategy.

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