WHY DO SOME FIRMS OUTPERFORM OTHERS?

David Eccles School of Business
THE UNIVERSITY OF UTAH
EXECUTIVE EDUCATION

WHY DO SOME FIRMS **OUTPERFORM** OTHERS?

In her Competitive Strategy course, Professor Bonita Austin examines the strategies of 'cost leaders' and 'product differentiators'.

BY BONITA AUSTIN
(AS TOLD TO RACHEL FARRELL)

In this course, we are trying to answer the question "why do some firms outperform others." In essence, the answer is that some firms are able to establish a profitable position in a market and defend it because they have some combination of resources and capabilities that allow them to gain an edge or an advantage over their competitors. So, the central organizing theme for this course is competitive advantage.

Competitive strategy gives managers the building blocks to establish an overarching plan for how to succeed in their marketplaces – meaning that the plan a firm comes up with to establish a market position has to be shaped to respond and adapt to the competitive environment. Your firm's competitors and their market positions to some extent define what you can do as a firm. Typically, the firms that have the best fit between their resources, strategy, and marketplaces tend to perform the best financially.

One large piece of competitive strategy is industry analysis. In this course, we look at the industry forces that are likely to impact your firm's financial performance. The number of firms in an industry and their market shares along with the relative negotiating power firms have with suppliers and buyers have big impacts on profits. For example, to make a computer, a firm needs an operating system among other things. The largest computer maker in the world – Lenovo – only holds about 22% of the market. While Lenovo is an important purchaser of operating systems, its systems supplier is more powerful. Microsoft's market share of operating systems has been above 90% for many years. In 2016, the company's share dropped to just under 90% but the company's

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negotiating position remains very strong – helping to keep Microsoft's profits high. Experienced managers understand that they also have to pay attention to the providers of substitute products because the existence of good substitutes increases customer options and puts a cap on pricing. A simple example of how this works is Coca-Cola versus Gatorade. Coca-Cola is a carbonated soft drink. Gatorade is not a carbonated soft drink, but customers routinely compare the benefits of Coke to the benefits of Gatorade – meaning that if Coke becomes too expensive, it increases the attractiveness of Gatorade to thirsty people and vice versa.

In addition to thinking about industry forces, we also examine the dominant business model in different industries in competitive strategy. How do different firms create value for their customers and for their organizations? This helps us understand whether we have to put together a firm that looks similar to the others in the industry in terms of what we do ourselves – manufacturing, marketing, distribution etc…. versus purchasing these parts of the creation of our product or service from outsiders -- or can we gain an edge over the competition by doing something differently a la Ikea or Starbucks. Somewhere along the way, we have to do something different and better than our competitors or we will not get that edge or competitive advantage that I keep referring to. We have to create new or better value for our customers than the competition or find new ways to fulfill customer needs less expensively.

For example, it is common for the companies that make high-end jeans to design and market premium jeans but not to manufacture or finish them. If you look at the value chain – or as I like to think of it, the progression from dirt to raw materials to product to the final customer and the activities that transform the pieces into that finished good – for premium jeans, you'll notice that some jeans makers recently have changed the types of things they do. J Brand, started and owned by Jeff Rudes, now makes their own jeans here in the US. This is due to the company's recognition that the fashion cycle has become much shorter and lead times for new products are much shorter than in the past. That's because of the growth of "fast fashion" and shifting consumer preferences. Making their own jeans close to the end market, the US, means J Brand can control the lead time and shorten the lead time on getting their products out to retailers.

Another piece of competitive strategy is understanding the resources and capabilities your firm has and putting those in context of the competition to figure out whether or not they will give your firm a competitive advantage. In this course, we use a systematic approach to comparing what a firm has to what its competitors have, which helps us figure out what a firm needs to do to get that edge versus its competition. These two pieces – industry analysis and internal analysis – allow managers to understand what firms can do strategically.

Once managers understand industry and internal analysis, they can select the strategy that best fits the resources and capabilities of the firm and the industry. As I like to tell my students, you have two choices as a firm: "You can make it good or you can make it cheap." Translating that into strategy terms, firms can choose to be product differentiators or cost leaders.

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Cost leadership firms create value for their customers by focusing on selling an acceptable product at a lower price than competing products. Note that the acceptable level of quality of a product or service is going to vary by industry, and by what the customers demand in that industry. The way the firm makes money and creates value for shareholders is by pushing its cost structure down as low as possible. Walmart and Bic both pursue cost leadership strategies. In this course, we examine the ways firms can get cost advantages and the possible sources of cost advantage.

Think about how Walmart does things. Walmart's customer value proposition is that the customer is always going to be able to get national brands cheaper at Walmart than in any other retailer. "Save money, Live Better." That's their brand promise to you. So how has Walmart had the highest return on assets out of its competitors historically? The company has about 75% of the discount department store and superstore industry. That means Walmart is able to negotiate hard with suppliers, and spread its operating costs out over a lot of customers among other things.

Product differentiators create value completely differently than cost leaders. Product differentiators focus on raising a customer's willingness to pay for a product by creating additional customer value by adding features, improving quality, innovating and coming up with new products that haven't been seen before. Product differentiators may create customer value by picking great locations and using different distribution channels than their competitors. The combination of things product differentiators do must create the perception with customers that their products satisfies their needs better than competing products. Therefore, the customer is willing to pay more. We think of product differentiators as being like Chanel, or Louis Vuitton, but Starbucks, Apple, Disney, and Procter & Gamble also are product differentiators.

There tends to be room in product categories for many different product differentiators, but there's not a lot of room for cost leaders. There is typically going to be one cost leader, because many cost advantages are associated with size – meaning that cost leaders need to have large market shares. A market can have many product differentiators, because they satisfy different customer needs or satisfy the same customer needs in different ways. It is possible for a product differentiator to also be the cost leader, if the firm has large enough market share, it is just not typical. I'd bet that Frito-Lay has a lower potato chip cost structure than its competitors because it so dominates the category, for example.


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It is possible for companies to straddle both strategies, but it‘s very difficult. It‘s kind of like Goldilocks and the Three Bears. Goldilocks was super picky; everything had to be just right. That‘s where you are if you‘re trying to do elements of cost leadership combined with elements of product differentiation. There are a lot of tradeoffs between the two. If I offer higher quality product than the minimum required by customers, I increase costs as more quality tends to come with more expensive ingredients or additional customer service or both. That means I have to charge higher prices to compensate for the addition of quality and service. If the firm operates in the middle of the market, I also have to watch my relative pricing because I'll lose customers if my prices are too high compared to competitors. If my firm uses cost leadership, I want my employees to be focused on efficiency and reducing costs. If my firm is a product differentiator, I want my employees thinking about creating new ways to increase or maintain customer willingness to pay.

In the Competitive Strategy course, we cover all of these aspects of assessing markets and formulating strategies. This course is for anybody who is in management now or wants to be. My goal is to help participants be more effective at finding ways to create competitive advantages for their firms so that their firms financially outperform the competition. I believe it also is a necessary component of management career progression. The greater your understanding of what your firm is trying to achieve and how the firm's management team is going to achieve those objectives, the more effective you can be at implementing and coming up with new ideas for growing your firm in the future. If you can do those things, you sound like a person who deserves to be promoted.

MEET

BONITA AUSTIN

Bonita Austin is a Professor (Lecturer) and Assistant Department Chair for the Entrepreneurship & Strategy Department in the David Eccles School of Business. Since joining the DESB in August 2008, Ms. Austin has received 4 teaching awards. The awards included the Brady Award for Superior Teaching and the Marvin J. Ashton Award for Teaching Excellence.

Ms. Austin has a particular interest in turnarounds and teaches a graduate strategy elective in business turnarounds as well as several seminars on the topic for Executive Education. In addition to teaching, she has published 5 strategy cases and accompanying teaching notes. Her cases include 3 cases on True Religion Jeans and the premium jeans industry, Starbucks, and SodaStream International. Her most recent cases appear in Strategic Management and Competitive Advantage 5ed Barney & Hesterly (Pearson).

Prior to 2008, Ms. Austin was an equity analyst consultant for several hedge funds. She also was a Sr. Vice President for Lehman Brothers, served on the Investment Committee for Prudential Securities, and was an Institutional Investor All-Star All-American Analyst. Ms. Austin was recognized by the Wall Street Journal for earnings estimate accuracy and frequently appeared in the Wall Street Journal, New York Times, Business Week, and other prominent business publications as well as CNBC and NPR. She was a special guest on Wall $treet Week with Louis Rukeyser and appeared in the annual Wall Street Transcript Round Table for many years.

Bonita Austin

Associate Professor (Lecturer) and Assistant Department Chair for the Entrepreneurship & Strategy Deparment

David Eccles School of Business
University of Utah

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