Session 2: Positioning and Competitive Advantage

Wrap up ABF; Pepsi and Coke

The University of Chicago
Graduate School of Business

Strategy as positioning

- Two intertwined “positioning” choices form the heart of any coherent business unit (BU) strategy.
- **Scope**
  - What products and services will it provide?
  - What customers will it seek?
  - Essential to determine what a company does not do
  - Impossible to cover all products and customers efficiently
  - e.g.: Crown Cork and Seal’s hard to hold niche

Strategy as positioning

- **Competitive Advantage (CA)**
  - In what ways will the BU create value in a way that is distinctive from its competitors?
  - Two basic ways:
    - Provide a product or service with higher “perceived quality” (willingness to pay).
    - Provide the same product or service but do so at a lower cost.
Value Division

Customer

Firm

Supplier

Willingness to pay

Value captured by customer

Price

Value captured by firm

Cost

Value captured by supplier

Supplier opportunity cost (willingness to sell)

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“Generic” Options to Improve Cost Position

- Cost drivers related to firm size, scope and experience
  - “Buy” share, i.e. low prices to increase scale or experience
  - Introduce new products to better utilize shared facilities
  - Enter new locations to improve capacity utilization or increase scale

- Shifters of average cost function:
  - Relocation of facilities to low input-cost regions
  - Input substitution (e.g., capital for labor)
  - Use lower-cost components
  - Incentive changes
  - Outsource major cost centers
  - Improve material yields

- Other cost drivers within the firm’s activities
  - Reduce complexity (e.g., reduce SKUs)
  - Alter design to improve manufacturability
  - Improve asset management (i.e., lower inventories)
  - Architecture/organizational structure
  - e.g., major re-engineering initiatives

Dramatically reconfigure firm’s value chain

Easy to imitate, but may create positional or early-mover advantages

Not that difficult for competitors to imitate

More difficult to imitate

Hard to do

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“Generic” Options to Improve Benefit Position

- Bundle complementary products or services
  - Warranties/service contracts
  - Spare parts

- Enhance sale or delivery of good/reduce buyer purchase costs
  - Generosity of trade credit
  - Easy order-placing
  - Product-line extension for “one-stop” shopping

- Improve product image
  - Compelling advertising messages

- Create uniqueness in drastically different ways
  - Paradigm-breaking new product concepts

Easier for rivals to imitate

- Add features
- Improve aesthetics

Bundle complementary products or services

- Warranties/service contracts
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Enhance sale or delivery of good/reduce buyer purchase costs

- Generosity of trade credit
- Easy order-placing
- Product-line extension for “one-stop” shopping

Improve product image

- Compelling advertising messages

Create uniqueness in drastically different ways

Harder for rivals to imitate

- Enhance performance
- Enhance durability
- Reduce defect rates

- Quality pre-sale technical advice/training
- Post-sale consulting services

- Speed/timeliness of delivery

Trade-offs

- So far little strategy in this:
  - Firms with good products do well
  - So race to lower C and raise B?

- Typically, not possible to serve efficiently all segments: position entails trade-offs
  - It is typically impossible to outperform competitors on all dimensions.
  - Delivering superior customer benefits is usually costly
  - Reducing costs often entails quality compromises.

- Two broad routes to competitive advantage
  - Cost advantage.
  - Differentiation (benefit) advantage.

- Optimal B-C depends on market segment

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Sources of trade-offs

1. Consistent image necessary for reputation
   - Ex. Fed-ex guarantees
2. Different positions require different configuration of activities
   - Counterexample: Continental-Lite; Ted
3. Internal coordination and control mechanisms
   - Example: Incentives of mgrs in Crown Cork vs. Continental

Federal Express Services

- FedEx Express
  - “Time-definite” delivery
- FedEx Ground
  - Second Largest small package carrier
  - FedEx Home Delivery – Low cost business to consumer
- FedEx Freight
  - U.S. Market Leader next-day and 2nd-day regional service
  - LTL freight services
- FedEx Custom Critical
  - Surface-expedited carrier, 24x7 pickup and delivery
- FedEx Trade Network
  - Trade Services (customs brokerage, freight forwarding, IT)
- FedEx Services
  - Supply Chain Services: customized transportation management, integrated logistics, and consulting services

2. ABF – Follow Up: Fed Ex and RPS

- October 6, 97, FedEx acquired Caliber including subsidiary RPS in October 1997, for $2.4bn
- Viking (FedEx Freight West) American Freightways (FedEx Freight East) in 2000/2001
- Fred Smith
  - “This acquisition creates a powerful combination that will propel both companies to new heights. Customers will now have a broader portfolio of services unmatched by any competitor. … With the addition of Caliber Systems, FDX Copr. Will be best position to provide broad-based supply chain solutions to companies both large and small
- An analyst:
  - “Without Consolidation, the small guys will die a slow death” [Brian Clancy, Merge Global]

ABF – Update

- ABF Net Income grew for first years $27m ’96 to $137 98
- June 99- USPS deal
  - agreement to use USPS to carry e-commerce packets in last mile
  - Still pretty focused on custom solutions for large customers
- UPS
  - recovered well from strike; successful ’99 IPO,
  - 50% e-commerce deliveries
- Fed-Ex troublesome RPS integration
- 1999-2000 dramatic worsening of situation for ABF
  - Success of FedEx and UPS
    - bundled services and cherry picking ABF short haul business through distance-based pricing
    - Fuel price increase differentially damaged ABF (old planes)
  - Net income: $92m 99, $28m ’00, -$20m ’01
  - 1st 6 quarters of 2002 – gain of 0.12 per share major cost cutting and fuel prices helped
- Distance based pricing
  - Jan 2001, ABF introduced distance based pricing
**ABF Takeaways**

- Analyze internal consistency of positions
  - Study cost drivers
  - Study activities behind cost drivers
  - Study consistency of activities with each other
  - Were are the trade-offs? are activities of others inconsistent with our position?
- **Industry dynamics**
  - Competition and endogenous sunk costs
    - Competition leads to escalation of sunk costs
    - This leads to increasing concentration and BTE

**Cost-Quality Frontier**

Difference between move toward frontier (operational Effectiveness) and along frontier (positioning choice)

- Leads to possibility of multiple, viable positions (though value of any position depends on demand)

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**Strategy it not just about choosing a position**

- Often what is required is not “choice” of a position within an existing segment
- Key: discovering that the segment exists (and can be profitably and sustainably served)
  - E.g. ABF’s Smith’s insight “packages don’t care how far they travel.”

**Dynamics: Commitment to Position**

- Positioning choices are commitment intensive
  - Activities tailored towards a particular position
    - E.g. : Airborne’s ground/truck intensive operation
  - Without continuity, difficult to develop unique skills and assets and build reputations
    - FedEx on time guarantees
- Thus strategic choices have long horizon
  - If no commitment necessary try out and reverse
  - Irreversibility requires looking into future
3. Coke vs. Pepsi Takeaways

a. Softening Rivalry
b. Industry analysis and value chain
c. Value Creation vs. Value Capture
d. Exogenous and endogenous sunk cost –first cut

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a. Softening rivalry: theory

- In simple spatial models (beer on the beach), effective product differentiation pushes products apart in the preference space
  - Allows firms to raise price above marginal cost
- Brand proliferation is an effective strategy to deter entry in differentiated product markets
  - Schmalensee (1978) demonstrated this in the breakfast cereal market
  - Numerous follow-on studies have occurred

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Softening Rivalry: implications

- Managers have to choose how they want to compete in an industry – “sacrifice some forces to enhance others”
  - In the CSD industry, the competitors engaged in fierce product differentiation and advertising competition, and avoided an all-out price war
    - Less destructive competition -- allows for differentiation, which supports higher prices
    - Most importantly => raises barriers to entry
      - Brand proliferation
      - Advertising
      - Product Packaging
      - “Fighting brands”
    - This works because only two main firms engaged in repeat play with discretionary fixed costs

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2. From Industry to the Value Chain

- Must understand entire value chain to assess industry attractiveness and opportunities/threats
  - While Coke & Pepsi are technically confined to the CP segment, C & P’s strategies (and, as a result, industry conditions) are such that the entire chain is involved.
Managing the Value Chain at Coke

- Raw Materials
- CP
- Bottlers
- Retailers
- End-Users

- Economies of Scale
- Non-Price Rivalry
- Equity Stakes
- Partial Exclusive Contracts
- Shelf Space
- Store Delivery
- Rebates
- Unique Packaging
- Marketing Assistance
- Negotiate with Cans
- Advertising
- Brand Proliferation

From Industry to the Value Chain

- C & P exemplify “vertical architect” strategy (other examples: Nike, Benneton, De Beers):
  - Minimize transaction costs by relying on market
  - Controls distribution of rents through chain to reward and motivate.
  - Manages the identity/brand of the product in the chain.
  - Key investments would probably not have been made if the chain were more dis-integrated— even though they benefit all.

3. To Capture or to Create?

- Traditional industry analysis (5 Forces) focuses on value capture.
  - The better able are incumbents to exert power over their exchange partners, the better.
- But this assumes:
  - A fixed PIE.
  - Acting to capture value does not impact value created.

To Capture or to Create?

- In reality:
  - PIE growth is obviously desirable.
  - Acting to capture value may lower value created.
- In particular:
  - The vertical architect often must give up power in order to give weaker members of the chain sufficient incentives to make relationship or chain-specific investments.
To Capture or to Create?

- Whether a firm is in value-capture or value-creation mode often depends on the time in its development.
  - For instance, it often makes sense to develop relationships as one is building a market but then shift to a more extractive mode (e.g., Coke).

4. Challenges Facing Coke and Pepsi

- Non-Carbonated Drink Segment
- Flat Demand
- International Segment

=> Where will profitable growth come from?

Endogenous and Exogenous Sunk cost (first cut—will see it again)

Two types of sunk fixed costs:
  - Technologically determined (exogenous)
    - e.g. plant must produce 500,000 platforms (cars)
    - as market size increases, concentration decreases.
  - Discretionary (endogenous)
    - firms can choose to incur sunk expenditures whose ultimate effect is to increase consumers’ preferences for their products relative to their competitors’.
    - Advertising (coke), product-related R&D, IT (ABF) have this feature.
    - in this case, the advantage of the large EOS persist
    - Example (1): IT. Intel Invests 1bn in chips; Apple/Motorola matches
      - Intel sells 100 m chips- $10 per chip R&D cost; Apple sells 10m - $100 R&D per chip
    - Example (2): advertising per barrel can: with equal intensities, much lower per can spend of Coke than Cadbury-Schweppes
    - Here advantages due to ‘big enough for one’ do not go away as industry grows.