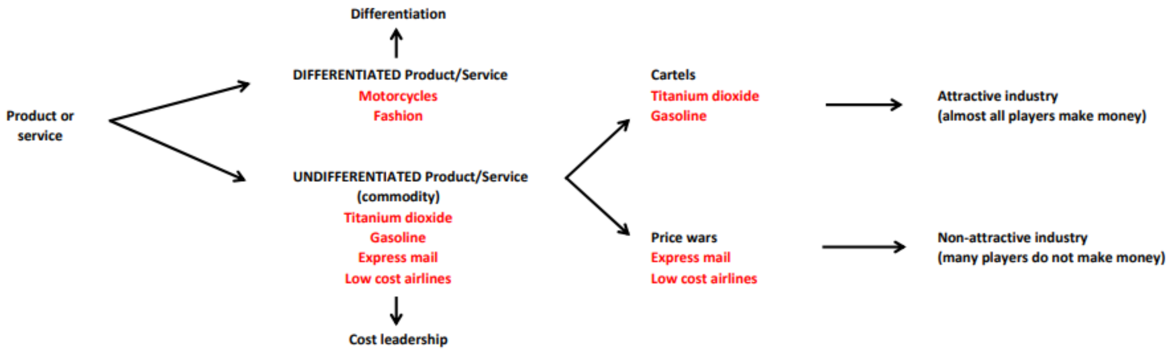
CHAPTER 4: DIFFERENTIATION.

Definition.



Process for a company in an industry.

I have decided to put the resume before the hole explanation as most of it will be from research in the internet and learnings of my own during my 3 years in IQS.

1) Choosing your way of business.

As a company you will be choosing to do business with a product or a service, even both sometimes. But the main decision will come on the industry you are into and the room for a competitive advantage you can obtain from your product/service.

a) Differentiation.

Most of the companies which have succeeded have two characteristics in common, they have a differentiated product and service and they know how to communicate to the public that differentiation. With a differentiation you will be able to:

- **Increase the willingness to pay:** If you know how to show that differentiation you will have to worry less about industry prices as people will be willing to pay that differentiation. **Ex.:** Harley motorbikes.
- **Loyalty:** Usually it creates an environment of loyalty where you gain consumers who are willing to pay what you offer forever. **Ex.:** Ducati.
- **Attractive industry:** You will have room for benefits, and you will be able to compete almost being invincible to strategies that aim to eliminate competitors, like price wars. **Ex.:** Infraspeak maintenance industry.

b) Commodity.

Commodities are industries where the products or services offered have little difference and can be easily provided by numerous companies. Companies compete in this industry through effectiveness in their operations, low margins and above of all, low prices. There are two possible outcomes in these industries:

1. **Cartels:** Which is just an agreement between the members of an industry, so they all have benefits, turning the industry into an **attractive industry. Ex.:** Petroleum.
2. **Price wars:** Fight on effectiveness in the operation so the price can be lowered more and steal clients from the other players. **Ex.:** Mail industry.

Cartels.

A **cartel** is a formal agreement among firms in an oligopolistic industry. The members forming a cartel may agree on terms, called **collusion**, such as:

- **Prices:** Prices are set by one of the members of the industry and it is "accepted" by the rest of the members, stablishing the same price.
- **Quantities:** Another way of controlling indirectly the price and the share of a market is through the quantitates. **Ex.:** OPEP with the petroleum.
- **Commercial terms:** In order for no differentiation and controlling the amount of clients that each player has. **Ex.:** Everybody pays on cash.
- **Market-sharing of customers:** Everybody maintains their clients, there is no steal between players.
- **Market-sharing of geographical areas:** Distribution of areas between players. **Ex.:** The beers in Spain did this.

Note: Cartels are not legal, and they are an attempt against the integrity of the rules of Capitalism. Basically, it turns the law of offer and demand into rubbish.

Price Wars.

Price wars a phenomenon that occurs in an industry when some of the players compete between each other through **lowering prices** with the only objective of **eliminating** the rest of the competitors.

Example:

This is what happened with the mail industry, and this is how **Airborne Express** got in almost bankruptcy and it had to be bought by another company.

Prisoners dilemma (Xbox vs PS3)

- **Way prices are set:** Both players set prices at the same time without information of the other prices and they cannot change their decisions at the beginning.
- **Incentive to reduce the price:** So, this incentive will make both to reduce prices and earn more.

		MICROSOFT $399		MICROSOFT $299	
SONY	$399	1.032,5	960,0	767,3	1.012,5
SONY	$299	1.186,8	637,0	978,8	920,0

Here is clearly seen the different motivation between Microsoft and Sony to lower the price.

Competitive Advantage.

This part is pretty correlated to the differentiation as you will be able to see.

Characteristics & Definition.

A company enjoys a **competitive advantage** against the rest of the players of the industry when:

- ✓ **Makes more money:** If it allows the company to make more money than the rest of the players. **Ex.:** The IOs of Apple when it was invented.
- ✓ **Always wins the competitive battles:** One clear example can be in F1 when Mercedes always win in the classification because of the competitive advantage of their car.
- ✓ **Consumer always prefers its products:** Everybody prefers a Spanish made by a Spaniard than from anyone else in the world.

Consequences.

The consequences of a competitive advantage are that the company should put their resources in **maintaining** and **protecting** that competitive advantage.

Process of creation.

A competitive advantage emerges from a result of an **external** or **internal change.**

- **External change:** Due to differences in resources and capabilities, the impact of the external change on the industry firms differs. **Ex.:** When they made a tariff on Spanish wine in USA, the average wine in USA increase the marked.
- **Internal change:** Innovation, that is it. **Ex.:** Product changes like Ferrari, Process, like Airborne Express with massive mailing, Business model, like Facebook being exclusive.

Protection.

A company needs to protect its way of doing things and business, it can do that by:

- **Barriers to imitation:** With intellectual property protection in countries.
- **Hide firm's profitability:** In order for other people to not see the profitability of the industry and your way of doing things.
- **Dissuasion:** Convince our competitors that imitate will not compensate. **Ex.:** DAS system with Mercedes.
- **Anticipation:** Grow fast and early so you have a good market position. **Ex.:** Facebook, which was everywhere before the rest.
- **Casual ambiguity:** Difficulty in identifying the relationship between capabilities and performance of our company.

But at last what we are gaining is time to innovate more, time which our competitors will not have as they will need to imitate to compete against us.

Joke.

- How do you get a squirrel down from a tree?
- You pull down your pants and you show him your nuts.

Types of Competitive Advantages.

A. **Cost Leadership:** It affects to those industries which are **commodities** and the objective should be to become the lowest-cost player.

Characteristics.

- **Scale economies:** Size of the plant, lower the cost through mass production.
- **Learning economies:** Cumulate knowledge and pass it from one to another in the company.
- **Process redesign:** Start from scratch in order to be more efficient.
- **Design easy to manufacture products:** So, the scale economies can be achieved.
- **Utilization of the manufacturing capacity:** Achieving the diversification of the costs.
- **Reduce the cost of inputs:** So, we can have higher margins. We can use the bargaining power here.
- **Ability to reduce prices without incurring in losses in price wars:** Knowing when to do it so you don't start a price war which could end up with you out off business.
- **Lower costs does not imply low prices:** We need to take into account that the company will **win more money** through higher margins than lowering the price and provoking a price war.
- **Advertising becomes important:** It increases the sales and with that lowers the costs of the products or services through scale economies.

B. **Differentiation:** Affects products which are complex in their existence and the needs which they provide a solution.

Characteristics.

- Higher Willingness to pay = higher price and also higher costs.
- **Direct costs:** Has less power than economies of scale as we outsource more parts.
- **Indirect costs:** No scale economies can be done and no learning economies either as there is continuous improvement in the products/services provided.
- **Companies must control their cost:** If not they might not be able to survive as lots of investment is need it to secure the future through innovation.

Characteristics of both.

Both strategies are mutually exclusive, one has to be chosen, if not we will end up in the middle and not gaining that competitive advantage.

Drivers of Uniqueness.

Something we have touched in the different cases we have been doing. Here it is where we can get these drivers:

- **Brand:** Name which guarantees the quality and reduces the purchase costs.
- **Technology:** Allowing the companies to lower the costs.
- **Product features and performance:** You know what it is.
- **Complementary services:** Exceed the expectations or main features.
- **Customer experience:** Key for loyalty.

Frequent mistakes.

- **Mistake 1:** Offer product attributes which the consumer does not want.
- **Mistake 2:** Do not offer those attributes which the consumer demands because of short capabilities or resources.
- **Premium price for the attributes the consumer wants:** Making them pay for the basis.

Cluster.

A **cluster** is the geographical concentration of different business which they operate in a similar or same activity in order to improve its productivity. They compete between each other, but that geographical place might have benefits in:

- **Availability of inputs:** Raw materials in Africa which attracts a lot of producers.
- **Strong consumer demand:** All the investment banks in London are there because of the financial power of the region.
- **Related firms and industries supporting the industry (ecosystem):** That can be seen with the startups in Barcelona.
- **Market structure (competition):** There was a time when all the textile producers where in Catalonia because it was the key of the industry and the right structure to compete.

End of Chapter 4

← CHAPTER 3 CHAPTER 5 →

https://youtu.be/Ga45GHYVlBA - I love it.