Developing competitive position in fragmented markets through generic strategies.

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ABSTRACT

A competitive position is about determining how an organization will “differentiate” itsproducts / services and create value for its served market. It's about creating a position in the competitiveenvironment, putting organizations stake in the landscape, and acquiring mindshare in the marketplace.As defined by Michael Porter a fragmented industry is an industry in which no firm has a significant market share that can strongly influence the industry outcome. An industry is fragmented for variety of reasons. Company can overcome fragmentation by employing various strategies. The three strategies proposed by Porter are: ‘overall cost leadership’, ‘differentiation’ and ‘focus’.

A low-price strategy pursues to achieve a lesser price than competitors at the same time trying to uphold comparable perceived product or service benefits to those presented by competitors. A differentiation strategy pursues to deliver products or services benefits that are different from those of competitors and that are broadly valued by buyers. While in case of the focus strategy the strategic target is narrow market. The two focus strategies an organization can employ are focussed cost leadership and focussed differentiation. A focused differentiation strategy strives to provide high perceived product / service benefits giving good reason for a sizeable price premium, generally to a selected narrow market segment.

This study looks at generic strategies and their application in achieving a competitive position in a fragmented industry.

KEYWORDS: Competitive position, Generic strategies, Fragmented markets

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INTRODUCTION

A fragmented industry is an industry in which no firm has a significant market share that can strongly influence the industry outcome[i]. Porter also recommended a number of steps for articulating competitive strategy in fragmented industries. These steps include evaluation of the structure of the industry and the positions of competitors? Identifying reasons for industry fragmented? Evaluating if the fragmentation can be overcome and how? If it would be profitable to overcome fragmentation? If yes where? What is the paramount substitute strategy to overcome fragmentation, if it is evitable?

An industry is fragmented for variety of reasons. The reasons may be, low overall entry barriers, considerable number of small and medium-size firms, deficiency of economies of scale or experience curve, prohibitive inventory costs or unpredictable sales fluctuations, no advantage in size in trade with collaborators, distinct market needs, high product differentiation etc.

A company can overcome fragmentation by employing various strategies. These include building economies of scale or experience curve, evening out dissimilar market needs – amalgamating tastes, counterbalancing or splitting off features supremely accountable for fragmentation (i.e., production or service delivery process), employing M & A strategies to achieve critical mass, anddiagnosingindustry trends timely.

The other strategies that a firm can employ in order to cope with fragmentation may include; securely managed decentralization i.e. keeping exclusive operations small and as self-governing as possible, bolstered with central control and a strong promotion-from-within policy, creating efficient low-cost facilities at various locations, augmented added value i.e.delivering more service with sale, enrich product differentiation, or forward integration, specializing by product type or product segment, specializing by customer type; typically the customer with the least bargaining power, specializing by type of order; fast delivery, a focused geographic area, bare bones/no frills, and backward integration; selective backward integration may lower costs and put pressure on competitors who cannot afford such integration.

Competitive strategy is concerned with the basis on which a business unit might achieve competitive advantage in its market[ii]. Michael Porter pioneered thinking in the field of competitive strategy by proposing the three discrete generic strategies by which an organisation could achieve competitive advantage. The three strategies proposed by Porter are: ‘overall cost leadership’, ‘differentiation’ and ‘focus’.

As many misperceived Porter’s ‘cost leadership’ with low prices, Bowman and D’Aveni proposed ‘market-facing’ generic strategies[iii]. These are founded on the principle that organisations attain competitive advantage by offering their customers with what they want, or need, better or more effectively than competitors.

A low-price strategy pursues to achieve a lesser price than competitors at the same time trying to uphold comparable perceived product or service benefits to those presented by competitors. The strategy can lead to reduced margins, inability to invest to develop to develop product or service.

A differentiation strategy pursues to deliver products or services benefits that are different from those of competitors and that are broadly valued by buyers. The objective is to realize competitive advantage by offering superior products or services at the same price or enhancing margins by pricing slightly higher. The strategy warrants careful monitoring of who is the strategic customer and who are the competitors?

In case of the cost leader ship and differentiation strategies the strategic targets are broad markets. While in case of the focus strategy the strategic target is narrow market. The two focus strategies an organization can employ are focussed cost leadership and focussed differentiation.

A focused differentiation strategy strives to provide high perceived product / service benefits giving good reason for a sizeable price premium, generally to a selected narrow market segment.

In order to sustain a competitive advantage in case of price based strategies a firm has to accept reduced margin, win a price war, and reduce cost. Whereas for a sustainable competitive advantage in differentiation the organization has to create difficulties for imitation, achieve imperfect mobility with respect to resources and competencies and reinvest margin.

Review of literature

Dollinger Marc J. (1990)[iv] in his article “The Evolution of Collective Strategies in Fragmented Industries” expands the theory of collective strategy to include firms in fragmented industries. The article offers a process model and a mechanism for aggregating pairwise activity into collective activity based on an extension of the prisoner’s dilemma game. A curvilinear relationship between environmental factors and cooperative behavior is proposed. Propositions suggest that the effects of cooperation on performance shift from the firm level to the population level as colonization is completed.

Wright, Peter et al (1991)[v] concluded the presence of three strategic profiles. They are unsuccessful low cost businesses with the lowest performance, unsuccessful differentiated businesses with the second lowest performance, and successful businesses with combination strategies with the highest performance.

Helms et al (1997)[vi]suggested that business units which compete with the low cost strategy and differentiation strategy have higher ROIs than enterprises which compete with low costs only or differentiation only. As a group, however, the high profit firms are not significantly larger in size than the groups of low profit companies studied. Thus, what is elaborated is that competing with both strategies may involve benefits that are not based on advantages of larger market shares and scale economies.

Methodology

For this paper authors have conducted focused group discussions with business owners with a structured questionnaire.

Discussions

One of the classical fragmented industry in India is spices. The Indian market is fragmented and is led by several regional brands — MTR (South), Ashok &GoldieeMasale (North), Everest (pan India, mainly in North), MDH (pan-India, mainly in North), Ashi (Tamil Nadu), Shakti (Tamil Nadu) and Badshah (West). Now, big consumer companies are trying to give it a national flavour[vii].

One of the reasons spices segment is fragmented and has been localised is because brands have been able to notch out their strongholds by introducing innovative blended spices specific to markets. What is preferred in the east, may not be preferred in the north, west or south. The regional brands will continue to have their strongholds because they adapt the adapt to the local tastes and preferences. In the spices segment the regional brands will continue to have their strongholds. The unbranded segment is such a large segment that there is room for regional and national players to grow the branded segment. However, for regional and national players to succeed, carving a strong brand through astute consumer understanding, products that offer value and brand message will be the key to achieving it.

Industry fragmentation is not restricted only to FMCG products. Consumer durable sectors are also experiencing fragmentation. An air cooler Industry for instance, is highly fragmented because of all the factors listed earlier. Industry has, low overall entry barriers, considerable number of small and medium-size firms, deficiency of economies of scale or experience curve, prohibitive inventory costs or unpredictable sales fluctuations (the instances are less frequent, yet the industry is not completely immune from sales fluctuations), no advantage in size in trade with collaborators, distinct market needs, high product differentiation.

Metal body air coolers are generally assembled by sourcing various components from different supplier like, fan, pump, regulators etc. The panels are locally fabricated with least amount of design part involved. Thus the production economies of suppliers (fan, pump, regulator manufacturers or fabricators of panel suppliers) through experience curve come from the experience of suppliers which offers price competitiveness to cooler manufacturers, who are just assembling the parts. Similarly, the economies of scale achieved by suppliers are leveraged by cooler manufacturers by sourcing from them. In the recent past some amount of design is being incorporated to reduce customer pain while storing the air cooler during the off season. However, these designs are easy to emulate, with no barriers to followership. Many cooler manufacturers, traders look at the business as seasonal and pounce on the opportunity presented by the climatic conditions.

Most final products, the air coolers are thus at parity.

To address all these problems an organization will have to develop entry barriers, which are difficult for casual players to emulate, bring in the experience curve, try and reduce the sales fluctuations arising out of seasonality of demand, differentiate the product and by ensuring scale, gain the advantage in size in trade with collaborators distinct market needs.

The generic strategies can be employed by organizations to achieve competitive advantage, overcome these factors leading to fragmentation and become a leading national brand.

Identifying right technology to differentiate the brand is most useful in these cases. It is not that new technology has to be developed every time. Existing technology in other industry can be adapted for differentiating the brand.

Ram Coolers is a classic example of employing generic strategies to achieve market leadership.

Copying a model is very easy in cooler market. To differentiate its product and simultaneously ensure price competitiveness, Ram Coolers[viii] employed Deepdraw Technology, a technology adapted from the sink makers. At Ram Coolers the Deepdraw technology is used for making tanks, tops and front panel. The cost is around 5 crore, which is very high for a casual player. Moreover, different types of dye are needed depending upon the model. Ram coolers has a dedicated dye for high volume models. These create entry barrier for the casual players. To effectively use the technology, the staff also needs to have high experience as the rejection rate can go as high as 40%, which is unsustainable, if the staff is not well trained or does not have the necessary experience.

Deepdraw technology came with dual advantage. The technology helped overcome the welding problems as well as the process. Deepedraw technology did overcome the slow manufacturing process and expedited units manufactured. Though the output compared to plastic is very low, functionally (cooling ability) metal coolers were found to be very good. Ram cooler imported the better aesthetics of plastic coolers into metal cooler. Ram Coolers also changed its models as per the consumer demand. The cooler market shifted from Room Coolers to Desert Coolers to Currently popular Duct coolers. The room coolers have a market share of around 30-35 percent Desert coolers 5-10% and duct coolers dominate the market with 60%. The main advantage of the duct cooler is four side cooling, and pulls air from below, no stand required.

To overcome the demand fluctuations owing to seasonal demand for the air coolers, Ram Coolers employed attractive sales promotional strategies for customers as well as dealers. The relatively continuous demand generated by virtue of sales promotional schemes reduced the cost of carrying inventory also which for voluminous products like air coolers is quite high. The strategy also ensured better plant utilization and working capital management.

The deepdrawtechnology thus ensured that company had cost leadership as well as differentiation achieved in a fragmented industry and achieve competitive position in broad market as well as narrow markets.

CONCLUSION

In a fragmented industry to develop leadership, combination of generic strategies is most recommended. Only cost leadership or differentiation may not be sustainable. Adaption of technology, creating entry barriers, differentiating with barriers to followership will be key for an organization to sustain in a fragmented industry. If the industry is labour intensive then the experience curve is relevant, but advancing technologies and automation may make the experience curve irrelevant. Thus selection of technology to be adapted or employed plays a key role in differentiation in fragmented industry.

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