THE APPLICATION OF COST, DIFFERENTIATION AND HYBRID STRATEGY IN BUSINESS OPERATIONS: WILL HYBRID STRATEGY BECOME THE NEW COMPETITIVE STRATEGY?

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ABSTRACT

Both strategic management researchers and practitioners have realized the importance of the cost, differentiation and combination strategies for effective organizational performance and excellence. Recently, many large business companies in different parts of the world have been applying both strategies (hybrid strategy) at the same time, rather than applying a single strategy at one period of time. The implementations of those three strategies are commonly used by the big giant companies where their business operations level is ranging from domestic, regional, international and global. Thus, the principal aim of this paper is to explore the application of these three strategies (cost strategy, differentiation strategy, and hybrid strategy) in various business companies.

Keywords: Cost leadership strategy, differentiation strategy, single strategy, hybrid strategy

INTRODUCTION

In the competitive market, certain industries are having very heavy competitive rivalry among the company players. The coverage of the industries could be domestic, international, or global of which are depending upon products or services to be provided.

In this paper, we use cost leadership and differentiation strategies, because they are the commonly used strategic management dimensions in the literature (Dess & Davis, 1984; Nayyar, 1993).

However, for a firm to earn superior profits and outperform its competitors, it must make clear choice between a cost leadership and differentiation strategy in order to avoid “the inherent contradictions of different strategies” (Porter, 1996, p. 67).

Many believe, in competitive industries, that the companies would not be able to survive, unless they give effort to create two corporate strategies, of which are: i) cost strategy which is to process the value chain in most efficient way, in order to produce products or services with the lowest price without jeopardizing the quality, and ii) differentiation strategy which is to produce a unique products or services, compare to its competitors, such as better quality, simpler way to operate, better look, in other words the company should have the ability to be creative and innovative.
According to Porter (1985), each of these three generic competitive strategies is completely different way of creating a sustainable competitive advantage. A firm must, therefore, make a choice between cost-leadership and differentiation strategies or it will become stuck-in-the-middle without coherent strategy (Acquaah & Yasai-Ardekani, 2006).

Many evidence that companies which have been doing very well in a single strategy, cost leadership or differentiation strategy. The companies of which have been implementing a single strategy – a cost leadership strategy are among others: Wal-Mart, and Air Asia.

Meanwhile, according to Tutor Vista.com (2010), the companies of which have been implementing a single strategy – differentiation strategy can be described by some basis of differentiation strategy such as:
- Differentiation by Brand : Harley Davidson, and Mercedes Benz
- Differentiation by design: Titan watches with gold studded gems, diamonds and precious metals.
- Differentiation by positioning: Domino Pizza “30 minutes delivery “.
- Differentiation by technology: Apple Computers.
- Differentiation by innovation : 3M

Furthermore, there are companies which have been successful with the combination or Hybrid-strategy, that are the companies which are implementing both cost leadership and differentiation strategy at the same time. Few examples of companies of which have been implementing the Hybrid Strategy are: IKEA, German’s automotive industry, and Tesco supermarket.

The description of the Porter’s Generic Strategies is, of which is consisting of three strategies: Cost leadership Strategy, Differentiation, and Focus, described in Figure 1.

**FIGURE 1: PORTER’S THREE GENERIC STRATEGIES**

Source: Proven Models b.v. 2005
COST AND DIFFERENTIATION STRATEGY

Cost Leadership Strategy

The cost leadership strategy represents attempts by firms to generate competitive advantage by achieving the lowest cost in the industry. The focus of firms implementing a cost leadership strategy is on stringent cost control and efficiency in all areas of operation (Porter, 1980).

A company that decides to follow a cost leadership strategy has the objective of being able to realise its offer at lowest possible cost. The competitive advantage of cost leadership is achieved by performing important value chain activities at lower cost than competitors (Porter, 1985).

Cost-leadership strategy also strives to supply a standard, no-frills, high-volume product at the most competitive price to customers (Bingxin Li & Juan Li, 2008). These types of strategies are more preferred in developing countries such as Indonesia, Malaysia, India and China where these countries could provide with a lower labour cost hence to having a lower production cost (Aulakh et al. 2000). In contrast, a differentiation strategy is to create value to customers by providing superior quality, innovative products, brand image, and good services. This will make the product differentiation which means the product will be more competitive from others (Hutchinson et al. 2007; Frambach et al. 2003; Porter, 1980).

Cost Leadership aim to be competitor rather than customer oriented (Frambach, et. al, 2003). The explanation of why the cost leadership is to be competitor can be described as cost leadership requires a strong focus on the supply side as opposed to the demand side of the market. And this requires a high level of competitor orientation (Day & Wendley, 1988). Therefore, firms that pursuing a cost leadership strategy must continuously benchmark themselves against other competing firms in order to assess their relative cost (and therefore profitability) position in market place.

According to Porter (1980), a firm that pursues the cost leadership strategy also achieves a low-cost position by emphasizing aggressive construction of efficient-scale facilities, vigorous pursuit of cost reductions from experience, tight cost and overhead control, avoidance of marginal customer accounts, and cost minimization in areas like research and development (R&D), services, sales force, advertising, and etc.

The cost leadership strategy has been successfully implemented in Japan. For example, the Toyota company system has achieved superior competitiveness in cost reduction, quality and delivery time, and provided the impetus for a worldwide shift toward increasing efficiency through cost-cutting as a strategic imperative (Schonberger, 1994). In the context of Japan, customer service is defined somewhat differently than in the West, which may explain its presence in this cost leadership factor makeup (Allen & Helms, 2001).

Differentiation Strategy

The generic of differentiation strategy involves creating a market position that is perceived as being unique industry-wide and that is sustainable over the long run (Porter, 1980). Such differentiation can be based upon design or brand image, distribution, and so forth (Frambach, et al. 2003). In particular, differentiator firms create customer value by offering high-quality products supported by good service at premium prices (Walker & Ruekerts, 1987).
The effectiveness of differentiation strategy depends on how well the firm can balance product benefits and product costs for the customer, relative to competitive offerings (Slater & Olson, 2001). Companies following a differentiation strategy strive to create and market unique products for varied customer groups. They aim to create a superior fulfilment of customer needs in one or several product attributes in order to develop customer satisfaction and loyalty, which can often in turn be used to charge a minimum price for products (Morschett, et al. 2006).

A firm that pursues a differentiation strategy seeks to create a perception in the minds of customers that their products or services possess superior characteristics that are unique from those of its competitors in term of image and reputation, reliability, design features and quality (Dean & Evans, 1994; Sashi & Stern, 1995). A firm create this perception by incorporating real qualitative difference in its products and services, engaging in advertising programs, marketing techniques, and charging premium prices (Miller, 1986).

According to Acquaah & Yasai-Ardekani (2006), differentiation firms are able to achieve competitive advantage over their rivals because the perceived uniqueness of their products and services. Porter (1980) stated that, competitive strategies deal with the development of attributes that characterise a company and differentiate the value it creates and offers in comparison to its competitors. In addition, “the core idea is about how the firm can best compete in the market place” (Pearce & Robinson, 1994, p. 220).

The differentiation strategy has been successfully implemented in companies of advanced countries such as France, Sweden, Canada and these companies are likely to go to the less developed countries as foreign companies (Aulakh et al, 2000). As foreign companies, they enjoy inherent advantage over domestic firms with regard to adopting a differentiation strategy. The foreign companies having advantage in terms of financial and technological resources, trained human capital, new and modern management systems, innovative production methods better fulfil the conditions required to implement a differentiation strategy successfully (Aulakh et al, 2000).

The combination (Hybrid) strategy

The Porter Generic Competitive Strategies (1980, 1985) of overall cost-leadership, differentiation and focus on strategic management research cannot be overemphasized. Low cost and differentiation strategy may be compatible approaches to dealing with competitive forces (Allen and Helms, 2006; Miller, 1992; Spanos, et al., 2004), and postulated the pursuit of what has been termed ‘hybrid’, ‘mixed’, ‘integrated’, or ‘combination’ strategies (Kim, et al., 2004; Spanos, et al., 2004). These ‘hybrid’ strategies are the ones which combine low cost and differentiation elements (Gopalakrishna & Subramanian, 2001; Proff, 2000).

A combination competitive strategy involving high level of emphasis on both cost-leadership and differentiation strategies simultaneously should be distinguished from “stuck-in-the-middle” strategy where a firm fails to successfully pursue both cost-leadership and differentiation strategies (Acquaah & Yasai-Ardekani, 2006).

A combination or hybrid strategy has been shown to be viable and profitable (Kim et al., 2004; Miller & Dess, 1993; Wright et al., 1991). Since cost based and differentiation-based advantages difficult to sustain, firms that pursue a combination strategy may achieve higher performance than those firms that pursue a singular strategy. Pursuit of a differentiation strategy for low-cost firms will help minimise their vulnerability due to reliance on cost-based advantages only (Yasai-Ardekani & Nystrom, 1996).
A hybrid strategy seeks simultaneously to achieve differentiation and low price relative to competitors. This success strategy depends on the ability to deliver enhanced benefits to the customers with low price while achieving sufficient margins to reinvestment to maintain and develop bases of differentiation. This is, in fact, the strategy that Tesco supermarket is trying to follow (Strategy Explorer, 2010).

THE APPLICATION OF SINGLE STRATEGY

Cost Leadership Strategy

The cost leadership strategy is the basis for the long-run, sustainable competitive strategy compare to the price competition. The price competition is easily duplicated (Porter, 1980; Ellis & Kelly, 1992). In the retail business industry for example (e.g. Giant supermarket, Carrefour), company strives for cost leadership strategy; all sources related to cost reduction must be exploited. A retail business company must minimise cost throughout its value chain (and possible intercompany chain) activities. Therefore, the most important issue for the retail business company is to pinpoint the sources of which are related with the Cost of Goods Sold (COGS).

Large retail business companies usually achieve cost leadership more easily than smaller retail companies. Because the large retail business companies usually have more power over suppliers which enable them to secure low procurement prices for purchased goods (Ellis & Kelley, 1992; Anderer, 1997).

Datuk Tony Fernandez as CEO of AirAsia Berhad said his philosophy is very clear: “before a business can grow, it needs to have its costs under control, it must be cost-efficient and profitable, and it must create value”. Based on the Datuk Tony Fernandez statement, AirAsia can be growing in the airline business if they can control their cost. The cost that they have to running there must be efficient and reliable.

AirAsia current is a market leader of LCC in Malaysia, Thailand, and Indonesia, will face competition from both existing and new players. In order to sustain its competitive advantage, AirAsia needs to leverage its competency in creating cost advantages across multiple value chains (Kho, et al., 2005). Based on that statement, AirAsia need to make a consideration and more stressed to be lowest cost carrier in the airline industry. The demand for lowest cost carrier is will be growing rapidly; it can be the great opportunity for AirAsia Company to run their business. (The AirAsia Company Strategic Management, 2009).

Differentiation Strategy

Firms in most developing economies implementing the differentiation strategy do not focus on a single dimension but emphasize several dimensions such as image, gain customer loyalty, quality, innovation and level of service, at the same time (Kim et al., 2004). Thus, a differentiation strategy in a developing economy environment may be based on simultaneously creating customer loyalty by generating differences in product image through intensive marketing and image management (Miller, 1988), creating products that are innovative, dependable, durable, and serviceable (Beal & Yasai-Ardekani, 2000).

As an alternative to price competition a retail business company can differentiate its products and services from its competitors. Davis (1992) demonstrate that the rise of efficient and professional chain store operation leads to lower cost differentials between them which simultaneously intensifies the need to use non-price attributes to distinguish and characterise retail business company. Especially in retail business, the uniformity of competition which resulted in a lack of profiled retail business companies with a clear image is often criticised and blamed on

Differentiation in retail business company can be seen as a strategy with the objective of adapting certain store attributes more closely to the specific needs of chosen customers segments (Morshett, et al, 2006). In retail business Company, as for manufacturing companies, two main arguments against Porter’s framework have emerged (see for example Mintzberg, 1996; Wortzel, 1987; Zentes and Anderer, 1994):

- Strategies that combine several competitive advantages are not considered by Porter.
- The reduction of possible competitive advantages to two basic types is simplistic, and especially differentiation advantages can be reached in many different ways.

The differentiation strategy may also be viable in transition economies like Ghana, due to economic liberalization policies, customer have been exposed to imported products with greater variety and higher quality (Acquaah & Yasai-Ardekani, 2006).

Other data show that the differentiation strategy has also been successfully implemented in across the globe (i.e. in the developing, transition and developed economies) (Tutor Vista.com, 2010).

**THE IMPLEMENTATION OF COMBINATION OF COST LEADERSHIP AND DIFFERENTIATION STRATEGY (HYBRID STRATEGY)**

This new hybrid strategy may become even more important--and more popular--as global competition increases. Compared to companies relying on a single generic strategy, companies that integrate the generic strategies may position themselves to improve their ability to adapt quickly to environmental changes and learn new skills and technologies. This would more effectively leverage core competencies across business units and product lines and would also help produce products with differentiated features or characteristics that customers’ value and provide these differentiated products at a low cost, compared to competitors’ products.

This is because of the multiple, additive benefits of successfully pursuing the cost leadership and differentiation strategies simultaneously. **Differentiation enables the company to charge premium prices and Cost leadership enables the company to charge the lowest competitive price.** Thus, the company is able to achieve a competitive advantage by delivering value to customers based on both product features and low price (Open Learning World.com, 2010).

Acquaah & Yasai-Ardekani (2006) justified that the implementation of a combination competitive strategy is not only feasible, but will also generate superior incremental performance over the implementation of single competitive strategies. The implementation of a combination competitive strategy results in multiple sources of competitive advantage (e.g., economies of scale and brand/customer loyalty) as compared to advantages gained through pursuit of single competitive strategies. Moreover, the pursuit of a combination competitive strategy, and each of the single competitive strategies will generate superior incremental performance over the inability to successfully pursue any of the singular competitive strategies (i.e., stuck in the middle).

Furthermore, firms that pursue a differentiation strategy may also be able to achieve a low-cost position by emphasizing efficiency in their value creating activities, thereby further strengthening their competitive position vis-a-vis their rivals. The success of Japanese companies such as Toyota, Canon, and Honda has been attributed to the simultaneous pursuit of cost leadership and differentiation strategies (Ishikura, 1983).
Successful organizations adopt a combination of competitive aspects to build a Hybrid Strategy. Examples are: IKEA (differentiate in design + low cost), Toyota (quality - although under pressure + price) and Ahold (quality + price). Just competing on price alone isn’t good enough anymore (Daan Assen’s Learning, 2010).

**CONCLUSION**

The above discussions show that many researches, observations, analyses and assessments have been done by researchers, and academicians. There are no questions that the Cost leadership and Differentiation strategies have been applied very well and successful in much different kind of industries. The most interesting findings is that the Hybrid strategy (i.e. the combination of Cost Leadership and Differentiation strategies) has also shown to be successful in developing, transition and developed economies.

Thus the conclusion is that the Cost Leadership, Differentiation and Hybrid strategies have been successfully applied in developing, transition, and developed economies (across the globe). Those strategies have been applied for a very broad range of products and services, e.g. from retail products to the luxury products, and services like airline. This explanation is summarized in Table 1.

**TABLE 1: THE APPLICATION OF COST LEADERSHIP, DIFFERENTIATION AND HYBRID STRATEGY**

<table>
<thead>
<tr>
<th>No</th>
<th>Strategy</th>
<th>Where has the strategy been applied</th>
<th>Products/Services that the strategy has been applied (Example)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Cost Leadership</td>
<td>Developing, transition and developed economies (Worldwide)</td>
<td>Cars industry (Toyota), Airline business (Air Asia), Retail business (Giant and Carrefour Supermarket)</td>
</tr>
<tr>
<td>2</td>
<td>Differentiation</td>
<td>Developing, transition and developed economies (Worldwide)</td>
<td>Cars and Motorcycle (Mercedes Benz and Harley Davidson - by Brand), Watches (Titan Watches - by design), Domino Pizza (by positioning), Apple Computers (by technology), 3M (by Innovation)</td>
</tr>
<tr>
<td>3</td>
<td>Hybrid (Combination of Cost Leadership and Differentiation strategy)</td>
<td>Developing, transition and developed economies (Worldwide)</td>
<td>Car Industry (Toyota, Honda), Furniture Industry (IKEA)</td>
</tr>
</tbody>
</table>

Based on the above evidence, the one question that remains to be answered is, will the hybrid strategy become a new trend of competitive strategy in the business world? This question need further research and investigation into the theory of hybrid strategy and it implementation strategies for process and system development in the business companies.

**REFERENCES**


