

Differentiation as a generic strategy



Previous to the merger Daimler-Benz had a clear generic strategy of ‘ Differentiation’. This differentiation represented uniqueness, something which customers were prepared to pay high prices for (Porter, 1985). The most well-known division of Daimler-Benz was perhaps Mercedes that showed differentiation through ‘ design or brand image’. Contrastingly, Chrysler had a main generic strategy of ‘ cost leadership’ before the merger. This targeted mostly the middle class in the US and involved a high quantity (as opposed to quality) selling to generate profit.

After the merger the range of models produced were considerably extended to fit in with the new name. The new models in the range combined luxury cars, sports cars and cheaper practical cars.

The main issue raised by the case study is whether a combination of cost leadership and differentiation strategies (with the merger) can ever be successful. To explore this in the larger sense, DaimlerChrysler will be compared to the case of Singapore Airlines. Much like DaimlerChrysler, this airline combines a differentiation strategy (through service excellence and continuous innovation) with cost leadership. (Heracleous and Wirtz, 2010)

The main risk is that DaimlerChrysler lose their market share in the luxury car business. The extension of the model range sets their differentiation strategy aside and the brand may be devalued as new affordable and less luxurious cars are added to it. This also opens the market to new competitors, such as BMW in this case. As Porter puts it: ‘ being “ all things to all people” is a recipe for strategic mediocracy and below average performance’ (Porter, 1980: 12).

There is little evidence in the case that the new model range specifically has damaged Mercedes Benz's financial performance. This is owing to the fact that Mercedes Benz doesn't provide profitability figures per model. However it has been argued that the Smart model never made profit (Jenkins, 2006) and that their loss amounted to 600 million euros in 2005 (Mackintosh and Milne, 2006). In addition, the discontinuation of the smart roadster and the cancellation of the intended Smart sports utility vehicle with the restructuring charges and compensation payments related to that (1.1 billion Euros loss), indicates that the model wasn't doing well. Furthermore, graph 1 shows a decrease in profit from the year 2004 and a loss in 2005, however it is unclear if these figures are solely related to the extension in product range.

Graph 1: Mercedes Benz/Smart Cars Division: Operating Profit (loss) 2000-2000 (Cutler, 2006: 1, Table 1)

Much like Porter, Heracleous argues that it is impossible to combine the two since 'dual strategies entail contradictory investments and organizational processes.' (Heracleous, 2010). However he recognises that some companies view the dualities as opposites that form part of a whole (Heracleous, 2010). If DaimlerChrysler managed to do this, a dual strategy might not be a problem. This can be seen for example in the sharing of products between models for example, where the Chrysler Jeep Grand Cherokee uses a Mercedes diesel engine and automatic transmission. This reduces costs such as R&D and cost of suppliers. Moreover, the creation of the Chrysler group as a separate division might distance them from Mercedes Benz and thus protect Mercedes' brand value.

This question can also be linked to Singapore Airlines in the purpose of comparison, as they have managed to combine cost leadership and differentiation successfully. The general explanation to their success is best explained as:

“ SIA manages its two main assets-planes and people-so that its service is better than rivals’ and its costs are lower. The airline invests heavily in areas of the business that touch the customer in order to enhance SIA’s premium positioning. Everything behind the scenes is subject to rigorous cost control.” (Heracleous and Wirtz, 2010: 146)

A more detailed explanation lies in their carefully thought-of spending plans (Figure 1):

Figure 1: SIA spending plan (Heracleous and Wirtz, 2010)

Porter clearly distinguishes between differentiation and product quality. He describes differentiation as being rewarded for its ‘ Uniqueness’ (Porter 1985: 14) which should not be confused with quality.

In fact, he explains Mercedes-Benz as having a strategy of differentiation, but it is not necessarily a quality car. This is shown as many cheaper Japanese models had less warranty claims (Cutler, 2006: 3: Table 3), compared to Mercedes Benz. Moreover, the Smart Car, which is known as the least luxurious one, was the only Mercedes-Benz model to attain 100% reliability rating (no breakdowns) (Griffiths, 2003).

The United States labour market is seen as flexible because of the ‘ North American Agreement on Labor Cooperation’ within the North American Free Trade Agreement (NAFTA).
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Trade Area. This states that: ' Each Party to establish its own domestic labour standard' (Article 2 of the Agreement). This creates flexibility and reduces costs in a number a ways such as, The ease and cost of hiring and firing workers, possibility to switch to shorter-term employment contracts and greater flexibility in pay arrangements. Furthermore, the minimum wage levels in constant dollars going down has facilitated flexibility and also enabled cost reductions. It has adapted to the fluctuating market by going up in current dollars, however, in terms of value (constant dollars) the minimum wage has gone down (graph 2).

Graph 2: US Federal Minimum Wage Levels in current and constant dolars and average hourly earnings of production workers (current dollars)
(Statistical Abstract of the United States, 2001)

The differences in the German and United states labour market seems to have a significant impact on where they locate labour. It is clear to see that the Chrysler Group's employment trends are greatly affected by their cost leadership strategy. About 80% of Chrysler group employment is in the United States because of its advantages in flexibility, mentioned above. This has also enabled the Chrysler Group to cut their labour force (graph 3) in order to adapt with difficult financial times. This sudden cut down of workers could not have been possible in Germany, where most of the Mercedes Benz employees are located, because of various laws and regulations. These laws are considerably different to the ' North American Agreement On Labour Co-operation', as Germany take on a more regulative than flexible role to protect the workers. This can be seen in the 1972 Works Constitution Act

(Vitols, 2001, 343) and the 1976 co-determination Act for example. (ibid.: 343)

Graph 3: Chrysler Group Employment Trends (Daimler Chrysler, 20F Form, 2002)

Contrastingly to the Chrysler Group, Mercedes Benz can afford to locate in countries such as Germany because of their Differentiation Strategy and premium prices. They can afford to be consistent with relatively high pay and related 'social' costs such as pension, and are in fact expected to do so. This also means that they have to conform to a more constant employment trend, unlike the Chrysler Division.

Conclusion:

Finally, it is also important to note that ChryslerDaimler split in 2007 after this report was written. This suggests that their dual strategy of combining cost leadership and differentiation was ineffective. It was reported that Daimler was relieved to get rid of Chrysler as they were struggling financially and a new strategy of expanding Daimler's truck business to India and US was set in place. However, it is also important to recognise that getting rid of Chrysler would not automatically make Daimler the market leader of luxury cars again. In fault of the merger they fell behind competitors in areas such as fuel economy, hybrid technology and production costs. Furthermore, other new competitors such as BMW, Audi and even Toyota's Lexus and VW are taking over the market share in the luxury car industry. (Country Monitor, 2007)

However, Michael Porter's argument that having a dual strategy leads to mediocracy is not always true. Success in executing a dual strategy is unusual but it is possible, as best illustrated by Singapore Airlines.

4. In the automobile sector consumer surveys of product quality are often presented in 'league table' form (c/f Table 3) in what respects could such 'league tables' be misleading.

League tables are misleading because they are influenced by consumer expectations of certain products. As Mercedes Benz is a accomplished brand and charge premium pricing consumers expect high quality products or services for what they are paying for. Mercedes-Benz, in contrast, exuded disciplined German engineering coupled with uncompromising quality. The price of a car affects people opinions the higher the price of the car the greater quality of manufacturing and services provided are expected.

Therefore the premium prices charged by Mercedes Benz incur more scrutiny as a higher level of quality is expected than compared to Daimler Chrysler who are volume car business where more production is favored than output quality. This is shown from table 3: warranty claims per 100 vehicles: 2003 as Mercedes Benz has a warranty rate of only 26 compared to 51 for Daimler Chrysler (Cutler 2006: 3). From this we can see that as Mercedes Benz provide higher quality cars they have a lower warranty rate as consumers have less complaints or problems with reliability. Table 3 show Daimler Chrysler have a high warranty rate this is due to Daimler Chrysler being a volume car business where competitive prices are used in order to gain a competitive advantage and larger market share. Therefore product quality is not high priority for Daimler Chrysler so more reliability and consumer

dissatisfaction problems are expected. However in most cases faults picked up upon by consumers are not entirely relevant as some consumers expect too much from the cars they have purchased or expect more from premium priced vehicles.

5. In comparative terms the United States is characterized by both a high average income per capita but also a relatively high level of inequality of income, are there any aspects of Mercedes Benz sales which relate to these features?

From Table 8 we can see that the sale of Mercedes Benz Smart cars has increased over the five years in the graphical region of USA (Cutler 2006: 5). This shows that even with the United States having a high income per capita less high quality cars are in demand. The reason for this could be down to the affordability of Mercedes as they are a high quality brand and charge premium pricing therefore not all of the US public can afford their cars thus showing the inequality of income as sales of the smart car have increased. Consumers opt for the Mercedes smart car because of the brand name as Mercedes has established itself to be recognized as a luxury and being differentiated from all its competitors. Sales have increased as consumers want an affordable car but that is well established and has good reliability so more sales have been achieved as Mercedes is known for having good manufacturing and high levels of reliability so consumers experience little if any trouble at all with their products or services that they have purchased.

8. A significant part of Chrysler's group's losses in 2001 related to restructuring costs such as 725 million Euros for incentives for early

retirement and 649 million Euros for involuntary severance benefits. How would you account for such costs to Daimler Chrysler in the 'flexible' US labour market? (Relate your answer to table 14)

The USA is seen as one of the most flexible labour markets this is due to the cost leadership strategies that most company's use. By using cost leadership strategies it allows for zero contract hours so that employees are only called upon when needed thus allowing for the company to have financial flexibility as they do not have any fixed costs such as wages or salaries. Therefore there is a reduced gap between output and the number of employees needed for production. Table 14 shows that there is a high union density of 16.0% in the construction industrial sector and also a union density of 13.5% in manufacturing (Cutler 2006: 8). The level of union density shows the reason behind the restructuring costs as the unions have a four-year collective bargaining agreement that covered 58,000 workers for Daimler Chrysler. The agreement limits Chrysler ability to close plants, reduce employment levels or dispose of operations. Therefore high costs had to be incurred in order to shut down production of the smart roadster and the cancellation of sports vehicle as Daimler Chrysler has to honor the agreement they had. The changes triggered compensation payments to dealers and suppliers and the writing down of production facilities and inventories.

9. A potential obstacle to the completion of the merger was US anti-trust regulation which seeks amongst other things to prevent enterprises achieving a dominant position in the US market, using material in the case explain why did not pose an obstacle to the merger.

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The US anti regulation did not pose an obstacle to the merger as the two company's are distinctly different as Mercedes Benz is a luxury brand where as Chrysler concentrates towards a more volume production basis. The two companies operations are within different target markets as Mercedes is based in Europe ' where 68% of its unit sales are in Western Europe, of which 38% in Germany alone' and Daimler Chrysler in North America with 83% of unit sales coming within the U. S. As they differ in consumers the merger of the two organizations should lead to higher unit sales therefore generating a higher operating profit. From this Porter (1985: 14) states that ' In a differentiation strategy, a firm seeks to be unique in its industry along some dimensions that are widely valued by buyers. It selects one or more attributes that many buyers in the industry perceive as important and uniquely positions itself to meet those needs'. So according to Porters definition the merger between Chrysler and Mercedes should have formed a successful combination of the two manufacturers as they should be able to meet any consumer demands within the car industry by providing a range of vehicles. This can be shown from the more luxurious cars of Mercedes to the everyday use car from Chrysler. In spite of this the merger failed due to clashes of organisation cultures. One reason was because of the release of the Mercedes A Class and M Class SUV, which sidelined the promising launch of the Dodge Neon and Grand Cherokee Jeep within Europe. In addition the A-Class appeared both overpriced and under-engineered for the highly competitive European compact market this is shown as consumer opinions as Consumers who ordinarily would have paid a premium for Mercedes' engineering and safety record had been disappointed by the A-Class — which failed an emergency maneuver test conducted by a Swedish television

station in 1999 (Vlasic and Bradley 2001). The Dodge Neon, in contrast, could have competed more effectively in this segment as it had similar mechanical specifications and greater reliability. The outcome of this was that Mercedes reputation of being a highly esteemed brand had been tarnished from merger due to brand bias.

10. In what does the data on BMW support the view that differentiation strategies can underpin high pay and related social contributions for the workforce?

From table 16 we can see that employment numbers have decreased between 2004-2005 but wages and social contributions have increased (Cutler 2006: 9). By using a differentiated strategy it allows BMW to increase salaries and social benefits for employees as greater efficiency is achieved within the company in output of cars produced. In 2004 wages were 5954 million Euros where as in 2005, the wages increased to 6104 million Euros (Cutler 2006: 9), this may suggest that BMW have had a increase in overall operating profit which has been gained from the premium pricing strategy that is used for it's products. The increase in profit allows BMW to reward employees with greater benefits other than their salaries such as better pension funds or providing improved training courses. By providing these social incentives and greater perks employees will feel more motivated as their contributions are being acknowledged therefore they will be more satisfied and less likely to leave to competitors. As a result employees feel more satisfied leading to higher levels of production as they work with a greater work ethic overall leading to higher profit margins as the greater output means more sales can be achieved thus higher operating profit