WealthCE

Firm Strategy

The strategy created by a management team determines whether or not the firm will succeed. In order to determine whether or not a firm can or will be successful in the long term you must determine the firm's long term strategy. Does this firm have an advantage over competition? What is this firm's edge? What attracts consumers to this firm over the other firms? Why do consumers actually purchase this firm's products?

The firm's strategy over the long term is a key determining factor to how well the firm will produce returns. It should always be reviewed in depth before investment.

In general, all strategies pivot around a central idea, which can be narrowed down to a few specific points. You will need to determine which of these reasons the firm is growing. Many of these may apply at the same time. In some firms all of these apply, but the firm's biggest bonus will usually only come from one or two core strategies.

The five most basic strategies are as follows:
The firm can build a better offering than competitors.
The firm can find ways to force reliance by its customers.
The firm can make the industry difficult for entry or competition.
The firm can undercut its competition.
The firm can use superior branding or reputation to influence consumer preference.

Have Better Offerings
Firms often pivot their strategy around building a stronger offering. They build their success on the interrelation of quality, price, and features. This separates them from other companies that offer products with less durability, adaptability, usages, or duration. People are willing to purchase their product or service offering simply because of the quality. It is not enough to create higher quality, it must be done at equal profit margins or greater margins than others at the same price range. This strategy only works if creating the high quality does not erode the profit margins of the firm. This is actually highly difficult: Ensuring a better offering devours cash flow due to Research and Development costs. There are some other issues as well. If a firm's only edge is its product quality, what happens when that quality is surpassed? If the only edge is price, what happens when the price is suddenly not the lowest? At some point, if the single aspect keeping the product or service afloat is surpassed they will need another strategic draw to their firm. There must be multiple lures to the firm. It can be customer service, contracted obligation, brand perception, or lowered cost, but it must still exist.

Inconvenience Parting Customers
A great way to ensure that business is created for a firm in the future is by creating a real or artificial obligation for them to continue dealings with the company. They ensure that profits are made in the future. How does this occur? They simply obstruct the ability to stop comfortably doing business with the firm. This is quite common and easier than it seems.

Long term contracts force customers to use the firm's product or service for an extended period of time so the firm is guaranteed money. This is most effective when there's a cost for cancelling the contract or a large inconvenience. An example is switching network providers for a service: customers may experience downtime and be forced to pay for breaking a two year contract for a variety of services. Customers may have to learn to use the new service or product, which wastes time. They may have purchased other services or products which supplement this one. Lastly, they may have to incur all of these downsides together. The result is customer reliance on the provider.

A firm can also make its system unique to itself, and incompatible with others. This forces the customer to stay if it's part of a network by forcing reliance. This example is readily identified in cellular technology. They cannot use the vast majority of phones provided by Sprint or Verizon on T-Mobile due to technological differences. They are incompatible, and they will be forced to purchase a new phone to switch. This orients them towards making choices between alternatives, or forces them to get both for complete compatibility.

Any inconveniences created by leaving the firm help customers remain with the firm. This guarantees the firm will retain profits, and is a strategy often employed to ensure customer retention.

Make Competition Difficult
This strategy creates an inability for competitors to compete against a firm. By dissuading others from competition, firms have time to build, market, advertise, and earn without worry. If a firm enters the market at a later time, they will be at a distinct disadvantage compared to the established firm.

If a firm can acquire the right to be the only provider in the local market, they force dependency for that area's customer base. This right for exclusivity is gained via permit, regulation, patent, government lobbying, or law. In private sectors, this advantage is gained via a contract that bars a product's retailers from selling products which compete with them, or stops suppliers from providing similar materials to competitors. It appears in non-compete agreements for employees leaving the firm. The result is the same. Customers can only purchase a service from firms accessible it to them. When there is only one provider, they must deal with that firm to enjoy the services or market.

This strategy does have issues. If the legal support is temporary, they may have a flood of competition when it expires. If this is the firm's only advantage, they will suffer when the restriction preventing competition appears. They will have major issues if they have not made the industry difficult to enter in other ways or built a strong advantage.

The barrier can also be financial. If a competitor has to raise substantial funds in order to compete the chances that the firm will face competition decreases drastically. If the product or service requires an initial investment beyond that which can feasibly be raised, the chances of new firms competing in the marketplace are slim.

Relying on Branding or Reputation
Certain firms work hard to create a strong brand name. This usually occurs by consistently releasing high quality products or services. These products add to the reputation of the firm. After a long enough time of releasing high quality products, the firm's reputation begins to gain trust with consumers. Once established, the trust in the brand overrides consumer's realization of a limited amount of defects or downsides. Simply the perception that the brand equates to quality will allow them to be purchased over other products. Brand advantages will eventually erode if other brands pass them in quality at the same price range for long periods of time. They will erode if their quality takes substantial decreases.
This is why firms spend so much money protecting and building their brand. They invest deeply in advertising, marketing, copyrighting, and trademarking to insure that their brand is not damaged. Successful branding results in biased customers, which will chose their product over competitors at equal costs and sometimes at higher costs. A successful brand can be equivalent to substantially higher profitability. In the long run, this often is only as good as the product's quality.

Undercutting Competition
A firm can force its competitors into non-existence or keep its market share high simply by being cheaper than them to purchase products/services. Undercutting, frequent sales, or fire selling results in customers being more willing to shop at another competitor. If the firm frequently offers better prices, a customer may begin to believe they have the best pricing and shop there normally.

There are problems with this strategy. Industries which compete on price slashing strategies will often "race to the bottom". This results in a game to see who is the most willing to lower their profit margins. The firm with the lowest expenses will have an advantage since they can maintain a profit margin longer. You should remain aware that they are reducing return even if they can maintain a profit margin. That is why you should avoid industries where this strategy is the only way to gain an advantage. If anyone can slice prices, when one firm reduces price the competitors will be forced to slice prices as well. This means one firm will reduce returns for all shareholders of firms engaged in competition. The competing firms will be less affected if they can reduce expenses while retaining product quality, or increase efficiency in other business sectors outside of the price competition.

How do you determine if a firm you are investing in can even survive in this environment? You determine if the firm can afford to slice prices cheaper than competitors. To start, if they are forced to sell products below production costs, they can't afford price cutting competitions. If the firm is forced to reduce product quality, they are damaging their reputation. If they reduce return below your desired rate of return they should not receive your investment.

There are three basic ways a firm can deal with this strategy. They split into cheaper supply costs, cheaper manufacturing process costs, or better distribution patterns. All of these can result in an ability to sell a product cheaper than another competitor, but cheaper supply costs and cheaper manufacturing processes can result in long term business problems. A cheaper supply cost should be achieved by negotiating a purchase of quality supplies at lower prices. They produce the same product quality at lower costs. The company reduces prices without hurting margin and keeps product quality reputation.

The problems begin if the firm is saving money by purchasing low quality supplies for cheap and reducing prices. Low quality product may undermine the brand's reputation or prevent them from building one. If the quality of the product saves the firm money but undermines future business they may lose customers anyway. This defeats the point of saving money selling products over the long term since the growth is hindered unless the firm uses additional strategies.

The same principle applies to the manufacturing process. If the firm attempts to save cash on manufacturing but ruins the brand's reputation with defective products, they harm themselves in the long run. Shaving costs in ways that hinder the company's reputation results in more harm than good. You should ensure that the strategy the firm uses doesn't harm it in the long term.