International Journal of Advance Research in Science and Engineering
Volume No.08, Issue No.01, January 2019
www.ijarse.com
IJARSE
ISSN: 2319-8354

Differentiation strategy and Organizational Performance

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ABSTRACT

The aim of this paper is to study the impact of Michael E Porter's one of the business level strategic type i.e Differentiation strategy on organizational performance within Indian telecom secor. In order to operationalize performance three non-financial variables have been used(company image, customer loyalty and customer satisfaction).

Keywords: Differentiation strategy, organizational performance, telecommunications

1. INTRODUCTION

Firms that adopt a differentiation strategy seek competitive advantage by creating products or services that are perceived by customers as being distinctive and for which the customers are ready to pay a price premium (Porter 1985). Key to the success of differentiation strategy is that the "price premium exceeds the extra costs incurred in being unique" (Porter 1985, p. 14). A successful differentiation strategy is often backed up with many costly activities such as product design, research and marketing expenditures (Miller & Friesen 1986). To be effective, differentiators must choose attributes to differentiate that are clearly different from the competitors. While the cost leadership strategy is limited to one singular approach, firms using a differentiation can choose to select from a number of attributes that are of value to buyers (Porter 1985). As low cost leaders, differentiators also pursue to cover larger parts of the market but tend to have lesser relative market shares than the cost leaders. Research posits that differentiation can be created on the basis of marketing, aimed at creating a superior company image; and other on the basis of innovation and technology (Miller 1986; Miller 1988). The underlying basis for a successful differentiation strategy is that customers find value in the firms product attributes than the price. Thus, demand for the product is likely to be price inelastic due to the customer loyalty for the brand (Aulakh, Kotabe&Teegen 2000). Customer's loyalty to the attributes of a product, other than price, is an essential condition for the accomplishment of product differentiation strategy; however, it is not a sufficient condition. To be feasible, the differentiation strategy must be sustainable, and thus a firm must be able to advance the brand image, packaging, pre and post-sales service and financing arrangements continually (Murray 1988). As the industry matures, the possibility that significant product innovations occur tends to reduce (Abernathy &Utterback 1978; Porter 1985). As a product reaches the end of its life cycle, firms reduce research and development expenditure because product offerings from all players in the industry tend to converge to those products and their attributes, most favored by customers. The outcome is that sustained product innovation is difficult to sustain, as a single act of imitation can eliminate the competitive advantage that the innovative product provides for a firm (Murray 1988). Further, Murray goes on to recommend that it would be better to establish a differentiation strategy upon product quality and service attributes. As the industry matures, customers are able to gather data from various industry players about the actual product performance versus claimed product performance. Therefore, within a mature industry, quality variation may have a positive impact upon sales (Murray 1988). The higher the cost to the customer of this quality variation then the greater ability there exists for an organization to implement and sustain a differentiation strategy (Porter 1985). Also a differentiator cannot ignore its cost position. Excessive costs, can easily nullify the premium prices gained (Porter 1985). Hill (1988) suggested that the immediate effect of differentiation would be to increase in unit cost. He also anticipated that differentiation diminishes elasticity of demand and is capable of shifting the demand curve to the right by increasing the appeal of the product or service. If consumer demand increases the production volumes subsequently increase in order to match the increased demand, then the long-run result may be a decrease in unit production costs. This decrease in cost of production may be derived from three potential sources including: economies of scale, learning effects, and economies of scope (Hill 1988). Porter suggested that, as all firms do not

perform equally well even in the same industry, it is the distinct generic strategy employed by the firm that provides the ability to achieve higher returns. Porter (1980) in his Five Forces Model argues that differentiation strategy enables the firm to attain five key benefits. First is that of loyalty towards the brand and the resulting lower sensitivity of the customer to price. The second advantage is that differentiation through a mechanism of higher margins allows the firm to better deal with the power of suppliers. Supplying firms are less able to capture a greater share of available industry profit margins if the firm has higher initial margins to trade-off. The third advantage is that buyer power can also be mitigated by the inability of buyers readily seek product alternatives. The implication is that tailored specialty products suitable for specific customer use can result in a diminished ability for customers to negotiate lower input prices. The fourthly the increase in customer loyalty is able to provide product uniqueness and a consequently a barrier to entry. Higher product complexity, which is correlated with a higher level of specialty production process and engineering skill results in less ability of competitors to enter the field of a rival competitor. The final benefit alludes to the fact that the firms, on account of increased customer loyalty, will be in an advantaged position with regard to substitutes compared to its rival firms. A summary of the benefits of the differentiation strategy and how they affect the creation of value within the firms value-chain, is presented in Table below.

HOW DIFFERENTIATION CAN HELP COUNTER INDUSTRY FORCES

	Five Forces				
Strategy	**Competitive Rivalry**	**Barriers to Entry**	**Threat of Substitutes**	**Bargaining power of buyer**	**Bargaining power of Supplier**
Differentiation Strategy	Better and distinctive value to customers protects customer base from rivals	Customer loyalty because of the value of products to customers discourages new entrants	Distinct differentiating product attributes satisfy customer requirements, makes it difficult to create equivalent substitutes	Powerful buyers have fewer alternatives, so have lesser negotiating power	Firms have better capabilities to pass on the price increases by suppliers to its customers

Source: Porter (1980).

Paradoxically, differentiation strategy can be used to help achieve a low cost position within an industry (White 1986). Furthermore, researchers have suggested that there are five conditions necessary in order that differentiated strategy is able to achieve a low cost position (Hill 1988). These conditions are: when the firm’s ability to differentiate the product is high; when the market is fragmented; when economies of scope exist; when the production process is new and complex; and finally, when consumer’s commitment to the product of rival firms is low.

In conclusion an organization with a differentiation as a strategy seeks to be unique to its industry along attributes that are widely valued by buyers (Porter 1985). Critical to the success of this strategy is that the premium achieved for the product exceeds the accumulation of additional costs. A firm cannot ignore its cost position as excessive costs can easily reverse the premium prices gained. The pursuit of both differentiation strategy and low cost strategy therefore appears to be a compatible mix.

2. OBJECTIVES OF THE STUDY

To study impact of Differentiation strategy on organizational performance

3. DATA ANALYSIS

Statement wise analysis of Differentiation strategy

State - ment Code	***Airtel***		***BSNL***		***Vodafone***		***Aircel***		***RComm***		***Idea***	
	Mean score	***S.D***	***Mean score***	***S.D***	***Mean score***	***S.D***	***Mean score***	***S.D***	***Mean score***	***S.D***	***Mean score***	***S.D***
D1	3.55	0.611	2.49	0.412	3.71	0.313	1.63	0.544	2.48	0.881	1.81	0.624
D2	3.51	0.412	2.91	0.557	3.65	0.711	1.71	0.252	2.75	0.735	2.13	0.811
D3	3.77	0.716	2.53	0.481	3.73	0.473	1.6	0.311	2.78	0.761	1.85	0.363
D4	3.48	0.532	2.47	0.721	3.64	0.631	1.65	0.481	2.55	0.591	1.91	0.682
D5	3.49	0.979	2.51	0.359	3.57	0.394	1.66	0.221	2.37	0.691	1.83	0.511
D6	3.41	0.675	2.59	0.634	3.71	0.414	1.63	0.398	2.15	0.815	1.93	0.615
D7	3.64	0.653	2.58	0.524	3.65	0.491	1.65	0.365	2.01	0.746	1.89	0.601
D	***3.55***	*.654*	*2.58*	*.527*	***3.67***	*.489*	*1.64*	*.367*	*2.43*	*.745*	*1.91*	*.601*

***D** = Differentiation*

Statement wise analysis reported in Table above shows the mean scores for all the statements measuring differentiation strategy of the six mobile telecommunication service providers. The mean score of differentiation for the six service providers is between 1.64 and 3.67 where the highest mean score relates to Vodafone followed by Airtel implying that both the service providers lay a very high emphasis on differentiation strategy as can be seen from the mean values for their statements of differentiation strategy. Again BSNL has a mean score of falling short of median value of 3.00 as it did in case of cost leadership strategy, with the mean score for differentiation strategy being 2.58 implying that it has a low emphasis on the strategy of differentiation. The remaining three service providers vizAircel, Reliance communication, and Idea cellular have a mean score of 1.64, 2.43 and 1.91 respectively implying that they don’t lay any emphasis on differentiation strategy. Therefore from the above table it can be concluded that Vodafone and Airtel use differentiation strategy to compete in the telecommunication industry.

IJARSE
ISSN: 2319-8354

Perception of Customers regarding Organizational Performance (N=818)

Construct	Mean Score*	Standard Deviation	% of mean score
1. Customer loyalty	**3.39**	0.453	67.80
2. Customer satisfaction	**3.36**	0.352	66.20
3. Company image	**3.15**	0.364	63.00
Overall Organizational Performance	**3.30**		66.00

Note:*Scoring Scale: 1→ Strongly Disagree 2→ Disagree 3→ Neither Agree nor Disagree 4→ Agree 5→ Strongly Agree.*

Further, in order to identify the strength of the impact of the independent variables (differentiation) on the dependent variable (organizational performance), regression analysis was utilised.

Differentiation and Organizational Performance; Regression Analysis

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.613 [a]	.375	.369	.37304
a. Predictors: (Constant): **Differentiation**				

ANOVA[b]						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	17.044	1	17.044	116.170	.000[a]
	Residual	30.669	90	.143		
	Total	47.713	91			
a. Predictors: (Constant): **DIFFERENTIATION**						
b. Dependent Variable: **ORGANIZATIONAL PERFORMANCE**						

The value of R^2 = 0.223 shows that 22.3% variance is explained by independent variable (focus strategy) in dependent variable (organizational performance)

4. RESULTS

The ANOVA table indicates that the dependent variable (organizational Performance) is statistically significantly predicted by the regression models ($p<.05$).The regression analysis for differentiation strategy indicates that the differentiation adopted by the firm (independent variable) has a significant positive impact on their performance (dependent variable). The value of $R^2 = 0.375$ shows that 37.5% variance is explained by independent variable (differentiation strategy) in dependent variable (organizational performance). An overall mean score = 3.30 (% of mean score = 66%) indicates that the customers of the sample organizations are fairly satisfied with their service providers.

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