# Business Management Units 3 & 4

## Chapter 12 — Porter's Generic Strategies



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# Chapter 12 Porter's Generic Strategies — 12A Porter's Generic Strategies: lower cost

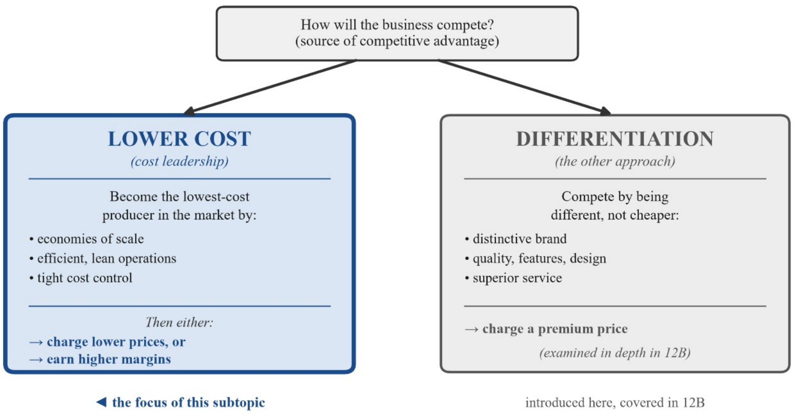
## Theory

To position a business for the future, a manager must decide **how** the business will compete against its rivals — that is, where its **competitive advantage** will come from. In *Competitive Advantage* (1985), Michael Porter argued that, whatever the industry, there are only **two fundamentally different ways** a business can outperform its competitors. This model is known as **Porter's Generic Strategies**, and it sets out **two key approaches to strategic management**:

- **Lower cost** (also called **cost leadership**) — competing by producing at a **lower cost** than rivals, so the business can charge lower prices, earn higher margins, or both.
- **Differentiation** — competing by offering a good or service the market perceives as **unique and valuable** (through brand, quality, features, design or service), so the business can charge a **premium price**.

A business normally **chooses one** of these approaches as its main basis for competing, then aligns its operations, pricing and marketing behind it. This subtopic examines **lower cost** in depth; differentiation is introduced here as the alternative approach and is treated fully in **12B**.

Porter's Generic Strategies (1985): two approaches to competitive advantage




**Lower cost (cost leadership) in depth.** A **lower cost strategy** means the business aims to become the **lowest-cost producer in its market** — to make and deliver its good or service more cheaply than any competitor. The strategy is about the business's own **cost of production per unit**, and it is built on genuine **operational efficiency**, for example:

- **Economies of scale** — producing in **high volume** spreads fixed costs (premises, equipment, administration) across more units, lowering the cost of each unit, and allows **bulk buying** of inputs at lower prices.
- **Efficiency and lean operations** — high productivity, streamlined processes and **minimal waste**, so fewer resources are consumed per unit of output.
- **Tight cost control** — low overheads, standardised (rather than customised) products, and investment in cost-saving **technology and automation** to keep costs down.

Once a business has a **cost advantage** over rivals, it can convert that advantage into a competitive advantage in **two ways**:

1. **Charge lower prices than competitors.** Because its costs are low, the business can undercut rivals on price and **still make a profit**. This attracts **price-sensitive** customers, wins **sales** and can build **market share**.
2. **Match the market price but earn a higher margin.** The business sells at the same price as rivals but, because its costs are lower, keeps a **larger profit on every unit sold**, lifting **net profit**.

**When lower cost suits a business.** A lower cost strategy is most appropriate where:

- customers are **price-sensitive** and choose largely on price, with little brand loyalty;
- the product is **standardised** or close to a commodity, so there is limited scope to differentiate;

- the business can achieve the **high volume** needed for economies of scale, and has access to efficient technology or cheaper inputs;
- competition in the market is **intense** and price is the main battleground.

**Risks of a lower cost strategy.** Competing on cost is not without danger:

- **Price wars.** If a business relies on undercutting rivals, competitors may **cut their own prices** in response, triggering a "race to the bottom" that **erodes margins** for everyone in the market.
- **Being undercut.** The cost advantage may not last: a **new entrant or overseas producer** with even lower costs can become the new low-cost leader, leaving the business unable to compete on price.
- **Quality perception.** A constant focus on cutting costs can **reduce quality** — or make customers *believe* the product is inferior ("cheap and nasty") — damaging reputation and satisfaction.
- **Neglecting change.** Attention fixed on cost can cause the business to overlook **changing customer needs or innovation**, so rivals who differentiate may win customers away over time.

**Key ideas to keep straight.**

- **Lower cost is not low quality.** The strategy is about producing at a **lower cost to the business**, not about making a **poor-quality product**. A cost leader still aims to meet an **acceptable standard** of quality — it simply achieves that standard more cheaply. Deliberately cutting quality to save money is a misuse of the strategy, not the strategy itself.
- **Lower cost is not the same as low price.** "Lower **cost**" describes what it **costs the business** to produce; "low **price**" describes what it **charges customers**. A cost advantage can be used to charge a low price *or* to keep the price at market level and earn a bigger margin. Cost is the strategy; a low price is only **one option** for using it.
- **Cost leadership requires efficiency.** A business cannot become the lowest-cost producer simply by paying suppliers or staff less. Genuine cost leadership comes from **efficiency** — economies of scale, high productivity, lean processes, automation and waste minimisation. It is an **operations-driven** strategy, which is why the two Porter approaches connect closely to how a business manages its operations.
- **Commit to one approach.** Porter's two approaches pull in different directions — lower cost drives standardisation and thrift, while differentiation drives investment in distinctiveness. A business usually **commits to one** as its main way of competing; trying to be both the cheapest **and** the most distinctive at once risks doing neither well.

### *Contemporary example — ALDI Australia, March 2025*

ALDI Australia is a grocery retailer that entered the Australian market in 2001 and trades on a discount, limited-range supermarket format.

On 21 March 2025 the ACCC published the final report of its supermarkets inquiry (the report itself is cover-dated February 2025). The report classified ALDI as a "hard discounter", a category it defined as offering a comparatively limited range of groceries across most categories, focusing on private label products, with an everyday low price strategy. It stated that ALDI operates a low-cost business model that enables it to offer groceries at a materially lower price than Coles and Woolworths, and found ALDI to be an important source of price constraint on those two chains for the more limited range of products it sells. The report recorded that ALDI stores stocked approximately 1,800–2,000 product lines, against roughly 15,000–25,000 in a standard full-service supermarket, that most ALDI products were its own brands, and that it did not offer online shopping and delivery.

What the regulator sets out here are the mechanics of a **lower cost** strategy, described by a third party rather than claimed by the business. A narrow range is **standardisation**; concentrating volume into few lines builds **economies of scale** in buying; own brands and the absence of an online delivery operation are **tight cost control**. Together these lower the **cost per unit**, and the report treats the resulting **cost advantage** as the reason ALDI could price below larger rivals and still trade — the first of the two ways a cost advantage is converted into a competitive advantage.

*Source: ACCC, Supermarkets inquiry — Final report, 21 March 2025 — https://www.accc.gov.au/about-us/publications/serial-publications/supermarkets-inquiry-2024-25-reports/supermarkets-inquiry-final-report-february-2025. Accurate as at July 2026.*

## Worked examples

### *Example 1 — scaffolded*

*Kettleworth Kitchens* manufactures flat-pack kitchen cabinets sold to price-conscious home renovators. Explain how Kettleworth could use Porter's **lower cost** strategy to gain a competitive advantage.

| Working | Comment |
|---|---|
| A lower cost strategy means Kettleworth aims to become the **lowest-cost producer** of flat-pack cabinets in its market. | Start by naming the strategy — cost leadership is about the business's own costs. |
| It could do this by **standardising** its cabinet range, buying materials in **bulk** (economies of scale), **automating** cutting and packing, and cutting **waste** through lean processes. | Show the efficiency mechanisms — cost leadership comes from genuine efficiency, not just paying less. |
| These efficiencies give Kettleworth a **lower cost per cabinet** than rivals — a cost advantage. | Link the mechanisms to the outcome: a cost advantage. |
| It can then **charge lower prices** than competitors to win price-sensitive renovators and grow sales, **or** match rivals' prices and earn a **higher margin** on each cabinet. | Convert the cost advantage into a competitive advantage — the two options. |
| ∴ by producing cabinets more cheaply than its rivals, Kettleworth gains a competitive advantage through lower prices or higher margins. | State the conclusion. |

### *Example 2 — scaffolded*

*Dwellwise* sells no-frills home insurance entirely online. Justify the use of a lower cost strategy for Dwellwise.

| Working | Comment |
|---|---|
| Home insurance is a fairly **standardised** product and customers are highly **price-sensitive**, often comparing quotes on price alone with little brand loyalty. | Begin with the market conditions — appropriateness depends on the market. |
| These conditions **suit a lower cost strategy**: where buyers choose mainly on price, being the cheapest wins customers. | Match the conditions to the strategy. |
| Dwellwise can achieve low costs by operating **online only** (no branches), using **automated** underwriting and running with **lean staffing**, giving it low overheads. | Justify with the source of the cost advantage — efficiency. |
| Its low costs let it offer the **lowest premiums** in the market and still make a profit, so it can **undercut rivals** and grow market share. | Argue *why* the strategy benefits the business — the point of "justify". |
| ∴ a lower cost strategy is well justified for Dwellwise because its standardised, price-sensitive market rewards the cheapest provider, and its low-overhead model lets it be that provider. | Reach a justified conclusion. |

### *Example 3 — unscaffolded*

Distinguish between a **cost advantage** and a **competitive advantage**.

A **cost advantage** exists when a business's **cost of producing each unit** is lower than that of its rivals. It is an **internal** measure — it describes what the business spends to make and deliver its good or service, compared with competitors. A **competitive advantage** is the **market position** a business holds when customers have a reason to choose it over its rivals; it is **external**, describing how the business stands in the eyes of buyers. The key distinction is that a cost advantage is a **means, not an end**: on its own it changes nothing a customer can see. It becomes a competitive advantage only when the business **converts** it — by **charging lower prices** than rivals and still profiting, which wins **price-sensitive** customers and builds **market share**, or by **matching the market price** and keeping a **larger margin**, which lifts **net profit**. ∴ a cost advantage is the lower cost base a business builds through efficiency, whereas a competitive advantage is what it gains once that cost base is used to outperform its rivals.

### *Example 4 — unscaffolded*

Evaluate the use of a lower cost strategy by *Basket & Barrow*, a national chain of budget grocery stores.

A lower cost strategy is a **strong fit** for Basket & Barrow. Groceries are largely **standardised** and shoppers are **price-sensitive**, so a business that can offer the **lowest prices** will attract customers and build market share; as a **national chain**, Basket & Barrow can achieve **economies of scale** in buying and distribution and run **lean, efficient** stores, giving it the low costs needed to keep prices low and still profit. **However**, the strategy carries real risks: rivals may respond with their own price cuts, sparking a **price war** that erodes everyone's margins; a **new competitor** with even lower costs could undercut the chain; and if cost-cutting is pushed too far, shoppers may perceive the stores or products as **poor quality**, harming reputation. On balance, because Basket & Barrow operates in a price-driven, standardised market **and** has the scale to be a genuine low-cost producer, a lower cost strategy is **appropriate and likely to be effective** — provided the business keeps quality at an acceptable level and does not rely on price-cutting alone. ∴ the strategy is well suited to Basket & Barrow, but its success depends on protecting quality and defending its cost advantage against rivals.

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## Practice questions

### *Scaffolded*

**Q1.** (a) State the **two** approaches to strategic management identified in Porter's Generic Strategies. (b) Define a **lower cost** (cost leadership) strategy.

**Q2.** (a) Identify **two** ways a business can reduce its costs to become a lower-cost producer. (b) Explain the difference between a business having **lower costs** and charging a **low price**.

**Q3.** *Quillmark Stationery* mass-produces plain, no-brand notebooks sold to schools that order in bulk and choose their supplier mainly on price. (a) Identify whether a lower cost strategy is appropriate for Quillmark. (b) Explain **one** feature of Quillmark's market that makes a lower cost strategy appropriate. (c) Explain how Quillmark could turn a cost advantage into higher profit.

**Q4.** (a) Outline how **economies of scale** can lower a business's costs. (b) Explain why a lower cost strategy relies on **efficiency** rather than simply cutting quality.

**Q5.** (a) Identify the **two** ways a cost leader can use its lower costs to compete. (b) Explain **one** risk of competing mainly by charging low prices.

**Q6.** (a) Explain the difference between Porter's **lower cost** and **differentiation** approaches. (b) Explain why a business usually **commits to one** approach rather than trying to be both the cheapest and the most differentiated.

### *Unscaffolded*

**Q7.** Describe the lower cost approach of Porter's Generic Strategies. *(2 marks)*

**Q8.** Outline **one** difference between a lower cost strategy and a differentiation strategy. *(2 marks)*

**Q9.** Describe how a business could become the lowest-cost producer in its market. *(3 marks)*

**Q10.** Explain how a lower cost strategy can help a business achieve the objective of **making a profit**. *(4 marks)*

**Q11.** Distinguish between a business's **costs** and the **price** it charges customers. *(4 marks)*

**Q12.** Explain **two** ways a business could convert a cost advantage into a competitive advantage. *(4 marks)*

**Q13.** Analyse the relationship between a lower cost strategy and the level of **efficiency** in a business's operations. *(6 marks)*

**Q14.** Discuss the use of a lower cost strategy as a way of competing in a market. *(6 marks)*

**Q15.** Justify the decision of a business with a cost advantage to sell at the **market price** rather than undercut its rivals. *(4 marks)*

**Q16.** Evaluate the view that a business pursuing a lower cost strategy must accept a **lower-quality** product. *(6 marks)*

**Q17.** *Case study.* **Peakline Apparel** manufactures plain, unbranded activewear that it supplies to large discount retailers. Its customers order in high volume and negotiate hard on price, and there is little to distinguish one plain T-shirt from another. Peakline's owner, Sione, wants to secure these contracts for the long term. (a) Describe how Peakline could pursue a lower cost strategy. *(3 marks)* (b) Analyse **one** problem Peakline may face if it competes only by charging the lowest price. *(3 marks)* (c) Justify the use of a lower cost strategy for Peakline. *(4 marks)*

**Q18. Emberfield Coffee** is a specialty roaster known for its distinctive single-origin blends and loyal customers who happily pay a premium. Its manager is considering switching to a lower cost strategy to boost sales volume. Evaluate the use of a lower cost strategy for Emberfield. *(6 marks)*

**Q19.** *Extended response.* Businesses under competitive pressure must decide how they will compete. Evaluate the use of a lower cost strategy as a way for a business to gain a competitive advantage. In your response, refer to:

- how a business achieves and uses a cost advantage;
- the circumstances in which the strategy is, and is not, appropriate. *(10 marks)*

**Q20.** In the final report of its supermarkets inquiry, published on 21 March 2025, the ACCC described ALDI as a "hard discounter" operating a low-cost business model, offering a comparatively limited range of groceries, most of them its own brands. Analyse how the features the ACCC described support a **lower cost** strategy. *(6 marks)*

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## Answers

**Q1.** (a) Lower cost (cost leadership) and differentiation. (b) Competing by becoming the lowest-cost producer in the market, so the business can charge lower prices than rivals and/or earn higher margins. **Q2.** (a) Any two: economies of scale; efficient/lean operations; tight cost control; automation/ cost-saving technology; standardising products; minimising waste; cheaper sourcing of inputs. (b) Lower **cost** = what it costs the business to produce; low **price** = what the business charges customers. A cost advantage can be used to charge a low price *or* to keep price at market level and earn a bigger margin. **Q3.** (a) Yes — appropriate. (b) e.g. customers choose mainly on price / the product is standardised / buyers order in bulk with little brand loyalty. (c) By producing notebooks at a lower cost per unit than rivals and selling at the market price, keeping a higher margin (higher profit) on each notebook. **Q4.** (a) Producing in high volume spreads fixed costs over more units (and allows bulk-buying of inputs), lowering the cost per unit. (b) Because being the lowest-cost producer must come from real efficiency (scale, productivity, lean processes); cutting quality is not the strategy — a cost leader still meets an acceptable quality standard, just more cheaply. **Q5.** (a) Charge lower prices than rivals; or match the market price and earn a higher margin. (b) e.g. rivals cut their prices too (price war) and margins are eroded; or a lower-cost competitor undercuts the business, so the price-based advantage is lost. **Q6.** (a) Lower cost competes by being cheaper to produce (lowest-cost producer → lower prices/higher margins); differentiation competes by being unique/valued (→ premium price). (b) The two approaches pull operations in opposite directions (thrift/standardisation vs investment in distinctiveness); trying to do both risks doing neither well, so a business commits to one. **Q7.** Compete by driving **efficiency** to become the lowest-cost producer, then use that cost advantage to undercut rivals or hold the market price and earn a bigger margin. See solutions. **Q8.** Lower cost competes on **price/cost** (be cheapest); differentiation competes on **distinctiveness** (be unique, charge a premium). See solutions. **Q9.** Economies of scale + efficient/lean operations + tight cost control → lowest cost per unit. See solutions. **Q10.** Lower costs let the business charge low prices (more sales) or hold price and widen the margin — either way lifting profit. See solutions. **Q11.** Cost = what production costs the business; price = what customers pay. See solutions. **Q12.** (1) Charge lower prices to win sales/market share; (2) hold the market price and earn a higher margin. See solutions. **Q13.** Causal relationship: cost leadership *depends on* efficiency (scale, productivity, lean, low waste) to lower unit cost; greater efficiency → lower cost → stronger price/margin advantage. See solutions. **Q14.** Advantages (wins price-sensitive customers, sales/market share, higher margins) and disadvantages (price wars, being undercut, quality perception, neglecting change). See solutions. **Q15.** Holding price keeps the whole cost advantage as a **wider margin on every unit** (lifting net profit), avoids provoking a price war, and leaves the option of cutting price in reserve. See solutions. **Q16.** Evaluation — **not inevitable**: cost pressure *can* cut real or perceived quality (cheaper inputs, standardisation, "cheap and nasty" perception), but genuine cost leadership comes from **efficiency** and still meets an acceptable standard; cutting quality is a misuse of the strategy. See solutions. **Q17.** (a) standardise + high-volume + lean + tight cost control. (b) e.g. price war / being undercut / quality perception — analysed causally. (c) standardised, price-driven, high-volume market suits cost leadership; secures the discount-retailer contracts. See solutions. **Q18.** Evaluation — likely **inappropriate**: Emberfield's advantage is differentiation (distinctive blends, loyal premium-paying customers); switching to lower cost would sacrifice that advantage. See solutions. **Q19.** Model response in solutions. **Q20.** Limited range = standardisation → fewer lines, simpler operations, volume concentrated → economies of scale in buying + tight cost control (own brands, no online delivery) → lower cost per unit → cost advantage used to price below rivals. Note the limit: the constraint applies only across the narrower range stocked. See solutions.

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## Fully-worked solutions

**Q7.** The **lower cost** (cost leadership) approach of Porter's Generic Strategies is a competitive strategy in which a business seeks an advantage by becoming the **lowest-cost producer** in its market, driving its **cost per unit** below that of rivals through genuine operational efficiency (economies of scale, lean operations and tight cost control). It can then use that cost advantage either to **charge lower prices** than competitors or to **earn a higher profit margin** at the market price.

**Q8.** One difference is the **source of competitive advantage**. Under a **lower cost** strategy the business competes on **cost and price** — it becomes the cheapest producer so it can undercut rivals or earn higher margins. Under a **differentiation** strategy the business competes on **distinctiveness** — it offers something the market sees as unique or superior so it can charge a **premium price**. In short, one approach wins customers by being **cheaper**, the other by being **different**.

**Q9.** A business becomes the **lowest-cost producer** by driving genuine efficiency across its operations. It can produce in **high volume** to gain **economies of scale**, spreading fixed costs over more units and buying inputs in bulk at lower prices. It can run **efficient, lean operations** — high productivity with **minimal waste** — and invest in **automation** and cost-saving technology. It can also apply **tight cost control**, keeping overheads low and standardising its product. Together these give the business a **lower cost per unit** than its competitors.

**Q10.** A lower cost strategy helps a business make a **profit** by widening the gap between the price it receives and the cost of producing each unit. Because its costs per unit are **lower than rivals'**, the business has two profitable options. It can **charge lower prices** than competitors to win more **sales** — and, since its costs are low, each of those extra sales still earns a profit — lifting **total profit** through higher volume. Alternatively, it can **sell at the market price** but, with lower costs, keep a **larger margin on every unit**, so profit per sale rises. Either way, the cost advantage flows through to **higher net profit**, which is why cost leadership supports the profit objective.

**Q11.** A business's **costs** are what it must spend to **produce and supply** its good or service — for example wages, materials, rent and equipment — expressed as a cost per unit. The **price** is the amount it **charges customers** for that good or service. The two are distinct: a business with **low costs** does not have to charge a **low price** — it may keep the price at the market level and enjoy a larger margin. Equally, a low price does not mean low costs — a business could be charging little while its costs remain high. The distinction matters because Porter's **lower cost** strategy is about the business's **costs**, and charging a low price is only **one way** of using a cost advantage.

**Q12.** A business converts a cost advantage into a **competitive advantage** in two main ways. **First, it can charge lower prices than its rivals.** Because its cost per unit is lower, it can **undercut** competitors and **still make a profit**; the lower price attracts **price-sensitive customers**, winning sales and building **market share**. **Second, it can match the market price but earn a higher margin.** Selling at the same price as rivals while carrying **lower costs** means the business keeps a **bigger profit on every unit**, strengthening its **net profit** and giving it funds to reinvest. Both routes turn the internal cost advantage into a stronger position against competitors.

**Q13.** A lower cost strategy and operational **efficiency** are **causally linked**: cost leadership *depends on* efficiency, and greater efficiency *produces* a bigger cost advantage. To become the **lowest-cost producer**, a business must use its resources so that **fewer inputs are consumed per unit of output** — through **economies of scale**, high **productivity**, **lean** processes and **minimal waste**. As efficiency rises, the **cost per unit falls**, which *widens* the gap between the business's costs and those of its rivals. That larger cost advantage in turn *enables* a **stronger competitive position** — the business can price lower than competitors or earn higher margins. The relationship also runs the other way: because the strategy lives or dies on cost, it **drives the business to keep improving efficiency** (investing in automation, cutting waste) to defend its lead. Efficiency is therefore not a side-effect of cost leadership but the **engine** that creates and sustains it — which is why a business cannot achieve cost leadership by simply cutting quality or paying less, only by producing **more efficiently**.

**Q14.** A lower cost strategy has clear **advantages** and **disadvantages** as a way of competing. *Advantages:* by becoming the lowest-cost producer, a business can **charge lower prices than rivals**, attracting **price-sensitive customers** and winning **sales and market share**; alternatively it can hold the market price and enjoy **higher margins**, lifting **net profit**. Low costs also give the business **resilience** in a price war and room to reinvest. *Disadvantages:* competing on low price can trigger a **price war** in which rivals cut their prices too, **eroding margins** across the market; the cost advantage can be **temporary**, as a new entrant or overseas producer with even lower costs may **undercut** the business; relentless cost-cutting can create a perception of **poor quality**, damaging reputation; and a fixation on cost can lead the business to **neglect innovation and changing customer needs**. Used in the right market — standardised products and price-sensitive buyers — the strategy is powerful; in other markets its risks may outweigh its benefits.

**Q15.** A business with a **cost advantage** is **well justified** in selling at the **market price** rather than undercutting its rivals. Because its **cost per unit** is lower than competitors', holding the price steady means the entire cost advantage is kept as a **wider profit margin on every unit sold**, lifting **net profit** without needing to sell a single extra item — whereas cutting the price hands that advantage to customers and only pays off if the extra **volume** more than replaces the margin given up, which is far from certain. Holding the price also avoids **provoking a price war**: undercutting invites rivals to cut their own prices in response, **eroding margins** across the market and leaving the business no better placed than before. Keeping the cost advantage **in reserve** is itself a defence — the business retains the ability to drop its price later if a competitor attacks, and in the meantime has **stronger profits to reinvest** in the efficiency and technology that sustain its cost lead. Matching the market price is therefore the more profitable and lower-risk way of using a cost advantage, provided the business is not relying on a lower price to win the sales it needs.

**Q16.** The view is **sound as a warning but wrong as a rule**. *In support of the view:* a business whose whole position rests on its **cost per unit** faces constant pressure to spend less, and the easiest savings — **cheaper materials**, fewer quality checks, thinner staffing — genuinely **reduce the standard** of what the customer receives; **standardising** the product to win economies of scale also strips out features that some buyers valued. Even where the standard is maintained, a low price and a no-frills presentation can lead customers to **perceive** the product as "cheap and nasty", so **reputation and satisfaction** fall as though quality really had dropped. *Against the view:* the strategy is about a **lower cost to the business**, not a poorer product. Genuine cost leadership is **efficiency-driven — economies of scale**, higher **productivity**, **lean** processes with **minimal waste** and **automation** — and these lower the cost per unit **without reducing the standard** of the good itself; automation and waste minimisation usually make output **more consistent**, not less. A cost leader also has a commercial reason to protect quality: a product that disappoints will not sell at any price, so the strategy assumes an **acceptable standard** is met **more cheaply**. **On balance**, the view confuses a **misuse** of the strategy with the strategy itself — cutting quality is one way, and the lazy way, to cut costs, but it is not what cost leadership requires, and a business that builds its cost advantage on efficiency can compete on price while holding quality at an acceptable level. ∴ a lower cost strategy does not require a lower-quality product, though the constant pressure to cut costs makes protecting quality an ongoing task for management.

**Q17.** *(a)* Peakline could pursue a lower cost strategy by making itself the **lowest-cost producer** of plain activewear. It could **standardise** its garments to a few simple designs, produce in the **high volume** its discount-retailer contracts require to gain **economies of scale**, run **lean, efficient** production with minimal waste, and apply **tight cost control** over materials and overheads. Together these give Peakline a **lower cost per garment** than competing manufacturers. *(b)* If Peakline competes **only** on the lowest price, it becomes exposed to a **price war**: rival plain-activewear makers can respond by **cutting their own prices**, forcing Peakline to cut further to keep the contracts. Because its advantage rests solely on price, each round of cutting **erodes Peakline's margin**, so its profit per garment shrinks even as it retains the business. Worse, an **overseas manufacturer with even lower costs** could undercut Peakline entirely and take the contracts, since the discount retailers have **no loyalty** beyond price. Competing on price alone therefore threatens Peakline's **profitability and the security of the very contracts** Sione wants to keep. *(c)* A lower cost strategy is **justified** for Peakline because its market rewards exactly what the strategy delivers. Peakline sells a **standardised** product (plain, unbranded activewear) to buyers who **order in high volume and negotiate hard on price**, with little to distinguish one supplier's plain T-shirt from another's — so there is **little scope to differentiate**, and the **cheapest capable supplier wins**. By driving efficiency to become the **lowest-cost producer**, Peakline can offer the discount retailers the **lowest price and still profit**, making it the supplier they keep coming back to. This directly serves Sione's goal of **securing the contracts for the long term**, which is why a lower cost strategy is the appropriate approach for Peakline.

**Q18.** For **Emberfield Coffee**, switching to a lower cost strategy would likely be **inappropriate**. Emberfield's competitive advantage currently rests on **differentiation — distinctive single-origin blends** and a base of **loyal customers who willingly pay a premium**. A lower cost strategy would only be effective if its customers competed on **price**, but Emberfield's customers value **distinctiveness**, not cheapness. *In favour of the switch:* lowering costs and prices might attract **more price-sensitive buyers** and lift **sales volume**, and tighter cost control could improve margins in the short term. *Against the switch:* pursuing lower cost usually means **standardising** the product and cutting costs, which would **undermine the very distinctiveness** that lets Emberfield charge a premium; its loyal customers may feel the coffee is no longer special and **leave**, while it is unlikely to out-compete large, established low-cost roasters that already enjoy **economies of scale** it cannot match. On balance, the strategy would **sacrifice a strong existing advantage for an uncertain one**, so Emberfield should **retain its differentiation approach** rather than adopt lower cost. ∴ a lower cost strategy is not appropriate for Emberfield because it would destroy the premium positioning that is the source of its success.

**Q19.** *Model response (10 marks).* **Porter's Generic Strategies (1985)** identify two ways a business can gain a competitive advantage: **lower cost** and **differentiation**. A **lower cost (cost leadership)** strategy means competing by becoming the **lowest-cost producer** in the market. A business achieves this through genuine **efficiency — economies of scale** that spread fixed costs over high volume, **lean operations** with minimal waste, **automation**, and **tight cost control** — all of which lower its **cost per unit** below that of rivals. It can then **use** this cost advantage in one of two ways: by **charging lower prices** than competitors to win price-sensitive customers, sales and **market share** while still making a profit; or by **matching the market price** and keeping a **higher margin**, lifting **net profit**. Used well, a lower cost strategy is a powerful basis for competing and can strongly position a business for the future.

The strategy's value, however, **depends heavily on the circumstances**. It is **most appropriate** where the product is **standardised** or close to a commodity, where customers are **price-sensitive** and show little brand loyalty, and where the business can reach the **volume** needed for economies of scale and has access to efficient technology or cheap inputs — conditions under which the cheapest capable supplier wins. It is **least appropriate** where customers **value and will pay for distinctiveness**, because there a **differentiation** approach captures more value, and a business chasing low cost may simply **erode the quality or uniqueness** customers want. The strategy also carries **real risks** even where it fits: competing on price invites a **price war** that erodes margins across the market; the cost advantage can be **temporary**, as a new entrant or overseas producer with even lower costs may **undercut** the business; aggressive cost-cutting can create a perception of **poor quality**; and a fixation on cost can cause the business to **neglect innovation and changing customer needs**. It is important to remember that lower cost is **not** low quality and **not** merely a low price — it is an **efficiency-driven** position that a business must keep defending.

**On balance**, a lower cost strategy is a **highly effective** way to gain a competitive advantage **in the right market** — standardised, price-driven industries where the business genuinely has the scale and efficiency to be the lowest-cost producer. Where those conditions are absent, or where the business cannot sustain its cost lead against rivals, the strategy's risks outweigh its benefits and differentiation is the better approach. The judgement therefore turns on **fit**: a lower cost strategy succeeds when the market rewards the cheapest provider and the business can profitably *be* that provider, and fails when it sacrifices distinctiveness or margins it cannot recover. *(Full marks require: an accurate account of how a cost advantage is achieved and used; coverage of when the strategy is and is not appropriate, including its risks; sustained evaluation weighing benefits against risks; and a justified overall judgement.)*

**Q20.** The features the ACCC described are the **efficiency** mechanisms that generate a **cost advantage**. A comparatively **limited range** is **standardisation**: stocking around 1,800–2,000 lines rather than the 15,000–25,000 of a full-service supermarket means fewer supplier relationships, simpler ordering and replenishment, and less handling and shelf space per store, so **overheads per unit fall**. That narrow range also *concentrates* the chain's sales volume into few lines, which **increases economies of scale** in purchasing — a large order of one line is bought at a lower input cost than the same total spread across many. Because most products are **own brands**, the business is not paying for suppliers' national-brand marketing and can specify each product to its own cost target, which is **tight cost control**; declining to run online shopping and delivery removes another layer of cost. Each mechanism lowers the **cost per unit**, and it is that lower cost base which the report identifies as what allows groceries to be sold at a materially lower price than larger rivals **and still return a profit** — the **cost advantage converted into lower prices**, the first of the two conversion routes. The example also shows where the strategy stops: the ACCC found the price constraint operated only across the **more limited range** stocked, so the same standardisation that *creates* the cost advantage also *bounds* the part of the market in which that advantage can be felt.

## Chapter 12 Porter's Generic Strategies — 12B Porter's Generic Strategies: differentiation

### Theory

**Porter's Generic Strategies** — developed by **Michael Porter** — describe the two fundamental approaches a business can take to gain a **sustainable competitive advantage** over its rivals: **lower cost** and **differentiation**. Porter's model is often drawn as a matrix in which the *source* of advantage (low cost versus distinctiveness) is set against the *scope* of the market a business targets (broad or narrow). A **lower cost** approach seeks advantage by becoming the **lowest-cost producer**, so the business can compete on price and/or earn a wider margin on a standard product (covered in depth in 12A). This subtopic examines the second approach — **differentiation**.

A **differentiation** strategy is a competitive approach in which a business seeks advantage by offering a product or service that customers **perceive as unique, distinctive or superior** to those of competitors. Instead of competing on price, the business competes on **perceived value**: it gives customers reasons *other than a low price* to choose it — and reasons to **pay more** for it. The key word is **perceived**. Differentiation works only if customers actually *notice and value* the difference; a difference customers cannot see, or do not care about, delivers no advantage.

**How a business differentiates.** A business can build a point of difference in many ways, and often combines several:

- **Superior quality** — products that perform better, last longer or are more reliable than rivals' (for example, premium materials, tighter tolerances or rigorous testing).
- **Distinctive features or design** — functionality, styling, technology or performance that competitors do not offer.
- **Strong branding and image** — a recognisable, trusted brand that signals status, identity or reliability, so customers choose it partly for what the brand *means* to them.
- **Innovation** — new or leading-edge products that competitors have not yet matched, keeping the business ahead of the market.
- **Exceptional customer service** — expert advice, personalisation, fast delivery, generous warranties or after-sales support that make the overall experience superior.
- **Other sources** — exclusivity or scarcity, convenience, or credible ethical and environmental credentials that particular customers are willing to pay for.

**Why differentiation works — the payoff.** If customers perceive the offering as superior, the business gains two linked advantages. First, it can charge a **premium price** — a price higher than rivals — because customers are **willing to pay** for the perceived value, which **widens the profit margin** on each sale. Second, it builds **brand and customer loyalty**: satisfied customers become **less sensitive to price** and less likely to switch to cheaper rivals, giving the business more **stable, repeat sales and market share**. Through these effects a differentiation strategy can help a business meet objectives such as **making a profit**, **increasing market share** and **meeting shareholder expectations**.

**When differentiation suits a business.** Differentiation is appropriate when:

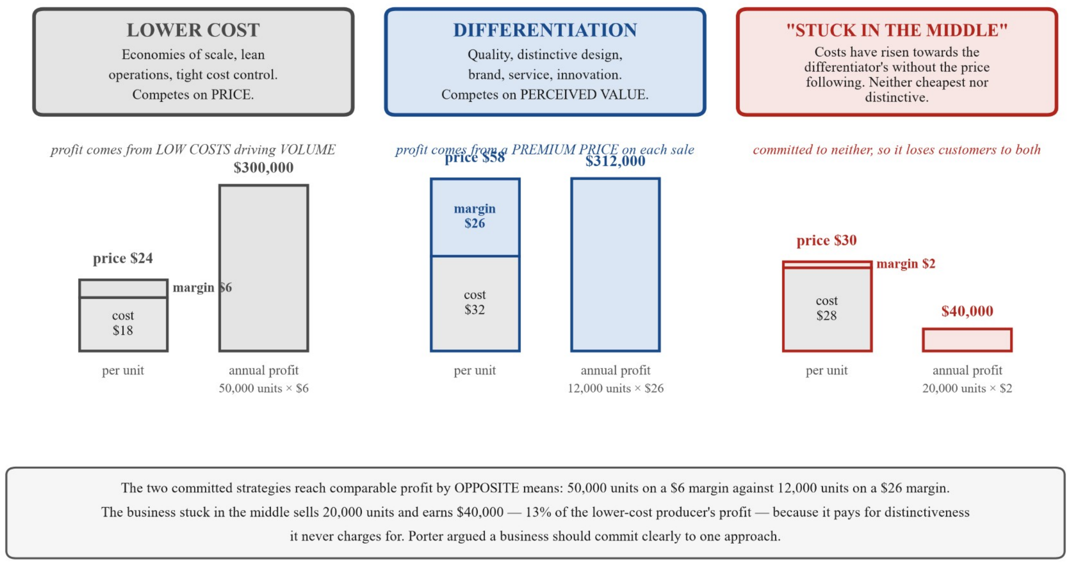
- customers **value more than the lowest price** and are willing to pay for quality, features, service or brand — the market is *not* purely price-driven;
- the business has the **capabilities** to be genuinely distinctive (design skill, research and development, skilled staff, a strong reputation);
- customer needs are **diverse**, so a single cheapest product does not satisfy everyone; and
- the business wants to **move away from price competition** with low-cost rivals — which makes differentiation a common **change strategy** for a business whose sales or market share are falling because its product has become an undistinguished "me-too" offering.

**Risks of a differentiation strategy.** Differentiation is not without danger:

- **The cost of differentiating.** Quality inputs, research and development, branding and marketing, superior service and skilled staff all **raise costs**. The strategy only pays off if the premium price customers pay **exceeds** these extra costs; if it does not, margins are squeezed rather than widened.

- **Imitation.** Competitors may **copy** a successful feature, design or service, eroding the point of difference and the premium — especially where the difference is not protected by a patent or a strong brand.
- **Changing customer tastes.** What customers regard as “superior”, fashionable or desirable can **change over time**; a business that has invested heavily in one point of difference may find demand shifts away from it.
- **Losing price-sensitive customers.** Setting the premium too high, or adding features customers do not value (“over-differentiating”), can price the business out of reach of too many buyers.
- **Failure of perception.** Because the advantage rests on *perception*, a business that does not **communicate** its distinctiveness clearly may find customers never recognise it — and so will not pay the premium.

**Two routes to profit — and what happens to a business that commits to neither**




*Differentiation must be SUBSTANTIVE and PERCEIVED: a difference customers cannot see, or do not value, delivers no premium and no advantage. Figures are illustrative.*

**Reading the arithmetic (the figure above).** The two committed strategies reach a comparable profit by **opposite routes**. The lower-cost producer sells 50,000 units on a $6 margin — $300,000; the differentiator sells only 12,000, but on a $26 margin — $312,000. Roughly the same profit, from a quarter of the volume at more than four times the margin. The third column is the warning: a business whose costs have crept up towards the differentiator’s ($28) without its price following ($30) is left with a $2 margin. Even on 20,000 units that is only $40,000 — about **13%** of the lower-cost producer’s profit. It is paying for distinctiveness it never charges for, which is what Porter meant by being **stuck in the middle**. (The figures are illustrative.)

**Key ideas to keep straight.**

- **Differentiation is not just marketing.** Advertising can *communicate* a point of difference, but genuine differentiation must be **substantive** — a real difference in quality, features, service or innovation that customers perceive as valuable. Promotion on its own, with no real distinctiveness behind it, is not a differentiation strategy.
- **Premium price, not volume.** A differentiator typically earns profit through a **higher margin per sale** (the premium price), *not* by being the cheapest or selling the highest volume. A lower-cost business typically earns profit the opposite way — through **low costs and/or a low price driving volume**. A differentiator does **not** aim to be the cheapest.
- **Differentiation versus lower cost.** Both are Porter’s routes to a competitive advantage and both can improve profit, but they pursue it in **opposite ways**: lower cost competes by being the **cheapest producer** (competing on price), while differentiation competes by being **distinctive** (competing on perceived value and charging a premium). Porter argued a business should **commit clearly to one** approach; a business that tries to be both the cheapest *and* the most distinctive risks being **“stuck in the middle”** — neither, and losing customers to rivals who have committed.

### *Contemporary example — R.M.Williams, April 2024*

R.M.Williams is a footwear and apparel manufacturer founded in South Australia in 1932 and bought by the private investment group Tattarang in 2020.

On 18 April 2024 the business opened an expanded workshop at Salisbury, in Adelaide's northern suburbs, containing a dedicated production line for handcrafted women's boots. Tattarang put the outlay on new equipment at $8 million and the new local manufacturing roles at 70, and said the separate line would let the boots be crafted on site in a wider range and in higher quantities. The expansion was accompanied by an industrial sewing certification course delivered with TAFE South Australia.

Spending $8 million and hiring 70 people to hand-make boots in Australia is not a move towards becoming the **lowest-cost producer** — it is **differentiation** being deliberately paid for. The investment buys **superior quality** and craftsmanship, the **capabilities** (trained sewing machinists) needed to deliver them, and an Australian-made point of difference the business can **communicate** so that customers **perceive** it and are **willing to pay** a **premium price** rather than choose a cheaper imported boot. It equally illustrates the **cost of differentiating**: onshore handcrafting adds cost, so the premium must **exceed** that extra cost if the strategy is to **widen the margin** rather than squeeze it. Producing a women's range on the same site also answers the **diverse customer needs** that make differentiation appropriate.

*Source: Tattarang, "R.M.Williams steps up Australian manufacturing", 18 April 2024 — https://www.tattarang.com/news/2024/r-m-williams-steps-up-australian-manufacturing/. Accurate as at July 2026.*

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## Worked examples

### *Example 1 — scaffolded*

**Lumière Candles** is a small maker of scented candles whose sales are falling as cheap, mass-produced imported candles flood the market. Explain how Lumière could use a differentiation strategy to compete.

| Working | Comment |
|---|---|
| A differentiation strategy means offering something customers perceive as **unique or superior**, rather than trying to be the cheapest. | Define the strategy before applying it. |
| For Lumière, points of difference could include **hand-poured natural soy wax**, **exclusive fragrances**, **premium packaging** and a **recognisable, trusted brand**. | Choose concrete, relevant sources of differentiation. |
| Because customers perceive these candles as superior to cheap imports, Lumière can charge a **premium price** and build **loyalty**, instead of competing on price where the importers would win. | Link the differentiation to its payoff (premium + loyalty). |
| ∴ Lumière should compete on distinctiveness — quality, fragrance and brand — not on price. | State a clear conclusion. |

### *Example 2 — scaffolded*

**Peak Trekking Co.** is an outdoor-equipment retailer. In its market, customers research the quality and reliability of gear carefully and are willing to pay for equipment they trust in remote conditions. Recommend which of Porter's two approaches suits Peak Trekking, with reasons.

| Working | Comment |
|---|---|
| Customers here **value quality and reliability** and are **willing to pay** for trusted gear — the market is not purely price-driven. | Read the market conditions against the two approaches. |
| These conditions favour **differentiation** — superior | Match the conditions to the approach. |

| Working | Comment |
|---|---|
| quality, expert advice and a trusted brand — rather than a lower cost approach. | |
| Differentiation lets Peak Trekking charge a **premium** and build **loyalty** among quality-focused customers, which a price-cutting strategy could not achieve in this market. | Justify by linking the approach to the payoff. |

### *Example 3 — unscaffolded*

**Verdant Skincare** makes its entire range from certified organic ingredients in a solar-powered factory, but its packaging and advertising look much like those of the ordinary supermarket brands beside it on the shelf, and it prices its products in line with them. Its sales and margins have not improved. Analyse why Verdant is not gaining a competitive advantage from its point of difference.

Verdant has built a **substantive** point of difference — certified organic ingredients and renewable manufacturing — so the foundation of a differentiation strategy is genuinely there. What is missing is **perception**. Differentiation delivers an advantage only if customers **notice and value** the difference, and because Verdant's packaging, advertising and pricing are indistinguishable from the ordinary brands beside it, customers have no way to recognise that the product is superior. A difference customers cannot see delivers no advantage: they have no reason to pay a **premium price**, and no **loyalty** forms to protect the business from cheaper rivals. Meanwhile Verdant is still bearing the **cost of differentiating** — organic inputs and renewable manufacturing raise its costs above those of the brands it sits beside — so it carries the higher costs of the strategy without the higher margin meant to offset them, which is why its margins have not improved. ∴ Verdant must **communicate** its distinctiveness through its packaging, branding and promotion so that customers perceive and value it, and then price at the premium the strategy depends on.

### *Example 4 — unscaffolded*

A manager claims, "Differentiation is always the better approach because you can charge more for your product." Evaluate this statement.

The claim has some merit but is **too absolute**. Differentiation *can* be highly effective: by offering a product customers perceive as superior, a business can charge a **premium price**, widen its **margin** and build **loyalty** that shields it from cheaper rivals, which can strongly support profit and market share. **However**, differentiation is **not always better**. It **raises costs** — through quality inputs, research, branding and service — so it only pays off if the premium **exceeds** those extra costs; the point of difference can be **imitated** by competitors; **customer tastes can change**; and in a market of **highly price-sensitive** customers a premium simply drives buyers to cheaper rivals, making a **lower cost** approach more appropriate. Whether differentiation is "better" therefore depends on the **market and the business's capabilities**, not on the ability to charge more alone. ∴ differentiation is a powerful approach in the right conditions, but the statement is an over-generalisation — the appropriate approach depends on the situation.

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## Practice questions

### *Scaffolded*

**Q1.** Define the term *differentiation* as an approach in Porter's Generic Strategies.

**Q2.** List **four** ways a business could differentiate its product or service.

**Q3.** For each of the following, state whether it is an example of **differentiation** or **lower cost**: (a) a manufacturer relentlessly cuts its production costs so it can undercut every rival on price; (b) a coffee brand builds a reputation for ethically sourced beans and expert baristas, and charges more than the café next door; (c) an airline strips out extras to offer the lowest fares in the market.

**Q4.** A business differentiates its product successfully. (a) State **one** pricing benefit it gains. (b) Explain why customers are willing to accept that price.

**Q5.** Explain the difference between competing on a **premium price** (differentiation) and competing on a **low price** (lower cost).

**Q6.** Consider a business pursuing a differentiation strategy. (a) Identify **two** risks it faces. (b) Briefly outline **one** way it could reduce **one** of those risks.

### *Unscaffolded*

**Q7.** Describe the differentiation approach of Porter's Generic Strategies. *(2 marks)*

**Q8.** Explain how a business could use **branding** to pursue a differentiation strategy. *(3 marks)*

**Q9.** Explain how a differentiation strategy could help a business achieve the objective of increasing market share. *(3 marks)*

**Q10.** Explain **two** risks of pursuing a differentiation strategy. *(4 marks)*

**Q11.** Explain why a differentiation strategy earns profit through a **higher margin on each sale** rather than through being the cheapest and selling the highest volume. *(4 marks)*

**Q12.** Explain why a differentiation strategy involves more than simply advertising a product. *(3 marks)*

**Q13.** Analyse the relationship between a differentiation strategy and customer loyalty. *(4 marks)*

**Q14.** Discuss the use of a differentiation strategy by a business that is facing strong low-cost competitors. *(6 marks)*

**Q15.** *Case study.* **Wildgrain Bakery** is a suburban bakery that has been losing market share since a large discount supermarket chain began selling cheap bread and pastries nearby. Wildgrain currently sells standard loaves at prices close to the supermarket's, and its owner is unsure how to respond. (a) Identify the competitive problem Wildgrain Bakery currently faces. *(2 marks)* (b) Analyse **one** way that failing to differentiate is affecting Wildgrain's performance. *(4 marks)* (c) Propose and justify a differentiation strategy Wildgrain could adopt to respond to the supermarket chain. *(4 marks)*

**Q16.** Justify the use of a differentiation strategy for a business selling a premium, luxury product. *(4 marks)*

**Q17.** Evaluate the appropriateness of a differentiation strategy for a business operating in a market where most customers are highly price-sensitive. *(6 marks)*

**Q18.** Analyse how changing customer tastes could threaten a business that has invested heavily in a single point of difference. *(4 marks)*

**Q19.** *Extended response.* **Aurora Audio** manufactures headphones. For years it sold mid-range headphones at prices similar to many competitors, but its market share and net profit have steadily declined as almost identical products from overseas have undercut it on price. The owner is considering repositioning Aurora as a maker of superior, distinctive headphones. Evaluate the use of a differentiation strategy to position Aurora Audio for the future, with reference to how it compares with a lower cost approach. *(10 marks)*

**Q20.** *Contemporary example.* In April 2024, **R.M.Williams** opened an expanded workshop at Salisbury in Adelaide containing a dedicated production line for handcrafted women's boots, reported to involve $8 million of new equipment and 70 new local manufacturing jobs. Analyse this investment as part of a differentiation strategy, including **one** risk it creates for the business. *(6 marks)*

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## Answers

**Q1.** A competitive approach in which a business seeks an advantage by offering a product or service that customers perceive as unique or superior to those of competitors, so that it can charge a premium price and/or build loyalty. **Q2.** Any four of: superior quality; distinctive features or design; strong branding/image; innovation; exceptional customer service; exclusivity; ethical/environmental credentials; convenience. **Q3.** (a) lower cost; (b) differentiation; (c) lower cost. **Q4.** (a) It can charge a premium price (a higher price than rivals), widening its margin. (b) Because they perceive the product as unique or superior and value that difference enough to pay more. **Q5.** Premium price (differentiation) means charging *more* than rivals because customers value a perceived point of difference; low price (lower cost) means charging *less* than rivals, relying on being the lowest-cost producer to win price-sensitive customers. **Q6.** (a) Any two of: high cost of differentiating; imitation by competitors; changing customer tastes; over-pricing/losing price-sensitive customers; customers not perceiving the difference. (b) e.g. protect against imitation via patents/strong branding; or communicate the point of difference clearly to secure the premium. **Q7.** Compete by offering a product perceived as unique/superior so as to charge a premium and build loyalty. See solutions. **Q8.** A trusted, recognisable brand makes customers perceive the product as superior/distinctive, so they will pay a premium. See solutions. **Q9.** Perceived superiority attracts and retains customers/builds loyalty, drawing sales from rivals → market share rises. See solutions. **Q10.** Any two of: cost of differentiating may exceed the premium; imitation erodes the difference; tastes change. See solutions. **Q11.** Perceived superiority lets the business charge a premium, so profit comes from a wider margin per sale; a premium reduces volume rather than maximising it, and the margin must also cover the higher costs of differentiating. See solutions. **Q12.** Differentiation must be substantive (real quality/features/service/innovation), not just a promotional message. See solutions. **Q13.** Perceived superiority → satisfaction → loyalty → reduced price-sensitivity and repeat sales. See solutions. **Q14.** Advantages (escape price competition, premium, loyalty) and disadvantages (higher costs, imitation, may lose price buyers). See solutions. **Q15.** (a) Losing market share by competing on price against a lower-cost rival. (b) Analyse falling sales/margin/loyalty. (c) e.g. artisan sourdough, specialty products, premium service/brand. See solutions. **Q16.** Argue why differentiation suits luxury: customers pay for status/quality; premium funds the distinctiveness. See solutions. **Q17.** Evaluation — likely inappropriate where price dominates; weigh both sides, reach a judgement. See solutions. **Q18.** Causal chain: tastes shift → the point of difference loses its value → premium/loyalty erode → sales fall. See solutions. **Q19.** Model response in solutions. **Q20.** Differentiation, not lower cost — the spending buys superior quality/craftsmanship, the capabilities to deliver it and an Australian-made point of difference customers perceive, so a premium can be charged. Risk: the cost of differentiating — the premium must exceed the higher cost of onshore handcrafting (or: imitation; changing tastes; losing price-sensitive buyers). See solutions.

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## Fully-worked solutions

**Q7.** The **differentiation** approach of Porter's Generic Strategies is a competitive strategy in which a business seeks an advantage by offering a product or service that customers **perceive as unique or superior** to those of competitors (through quality, features, branding, service or innovation), so that it can charge a **premium price** and build **customer loyalty** rather than compete on price.

**Q8. Branding** supports differentiation by shaping how customers *perceive* the product. By building a **recognisable, trusted brand** — through a consistent name, image, reputation and values — a business makes customers associate its product with **quality, status or reliability** that rivals' products lack. Because customers perceive the branded product as **superior or more desirable**, they are willing to **pay a premium** for it and to **remain loyal** rather than switch to cheaper alternatives. The brand therefore becomes the point of difference that lets the business compete on perceived value instead of price.

**Q9.** A differentiation strategy can lift **market share** because a product customers perceive as **unique or superior** gives them a reason to **choose it over rivals**. Superior quality, distinctive features or a strong brand can **attract new customers** away from competitors and **retain existing ones** by building loyalty, so the business wins a **larger proportion of total industry sales**. As loyal customers make repeat purchases and recommend the product to others, the business's share of the market grows relative to competitors selling less distinctive products.

**Q10.** One risk is the **cost of differentiating**: achieving genuine distinctiveness requires spending on **quality inputs, research and development, branding and superior service**, which raises the business's costs — so if the premium price does not **exceed** these extra costs, margins are squeezed rather than widened. A second risk is **imitation**: if a point of difference proves successful, **competitors may copy it** (a feature, design or service), eroding the product's uniqueness and the premium the business could charge — particularly where the difference is not protected by a patent or a strong brand. Both risks mean differentiation can fail to deliver the expected advantage.

**Q11.** A differentiator earns profit through a **higher margin on each sale** because that is the return its point of difference is designed to generate. Customers who perceive the product as **unique or superior** are **willing to pay more** for it, so the business can set a **premium price** — a price above rivals' — and the gap between that price and the cost of each unit is **wider** than a competitor's. Profit is therefore made on **each sale** rather than on the number of sales. Selling the **highest volume** is not open to it: a premium price deliberately **narrows** the market to those customers who value the difference, so a differentiator normally sells **fewer** units than a business competing on the lowest price. Nor can it be **the cheapest**, because achieving genuine distinctiveness — quality inputs, research and development, branding and superior service — **raises its costs**, so it could not undercut a lower-cost producer and would destroy its premium positioning if it tried. The wide margin is also **necessary** rather than merely preferred: the premium must **exceed** those extra costs, or the strategy squeezes margins instead of widening them. **Customer loyalty** then makes those higher-margin sales **repeat and more stable**, so a differentiator's profit is built on **margin and retention**, not volume.

**Q12.** A differentiation strategy involves more than advertising because the point of difference must be **substantive**, not merely claimed. Advertising can **communicate** a difference, but if there is **no real difference** in quality, features, service or innovation, customers will eventually recognise that the product is ordinary, and the premium — and any loyalty — will collapse. Genuine differentiation requires the business to actually **build something customers value**, such as superior quality or expert service; advertising then plays the supporting role of **making customers aware** of that real distinctiveness. Marketing without a genuine point of difference is therefore not differentiation, only promotion.

**Q13.** A differentiation strategy and customer loyalty are **causally linked**. When a business offers a product customers perceive as **superior or distinctive**, customers who value that difference gain a reason to **prefer it and return to it**, which **builds loyalty**. This loyalty in turn makes those customers **less sensitive to price** and **less likely to switch** to cheaper rivals, so the business enjoys **repeat sales, more stable revenue and protection from price competition**. The relationship also reinforces itself: loyal customers may **recommend** the product, strengthening the brand and attracting more customers, which deepens the differentiation advantage. Differentiation therefore *creates* loyalty, and loyalty *sustains* the differentiation advantage.

**Q14.** *Advantages.* For a business facing strong **low-cost competitors**, a differentiation strategy offers a way to **escape a price war it would probably lose**. By competing on **perceived value** rather than price, the business can **charge a premium** and protect its **margin**, and by building **loyalty** it can hold onto customers who might otherwise defect to cheaper rivals; it appeals to the segment of customers who **want more than the lowest price**. *Disadvantages.* However, differentiation **raises costs** (quality, branding, service), so the premium must cover them; the point of difference can be **imitated**; **customer tastes can change**; and the strategy **will not retain the most price-sensitive customers**, who will still choose the cheaper competitor. The approach also depends on the business having the **capability** to be genuinely distinctive. Overall, differentiation is a **strong response** to low-cost competition *where enough customers value distinctiveness and the business can deliver it*, but it is not a guaranteed solution and carries real costs and risks.

**Q15.** (a) Wildgrain Bakery faces the problem of **losing market share to a lower-cost competitor**: by selling standard products at prices close to a large discount supermarket, it is **competing on price against a rival with far lower costs** — a competition it cannot win. (b) Because Wildgrain has **not differentiated**, its bread and pastries are seen as **interchangeable** with the supermarket's cheaper products, so customers have **no reason to choose Wildgrain other than price**. As the supermarket undercuts it, Wildgrain **loses sales and market share**; and if it cuts its own prices to keep up, its **margins shrink** because its costs as a small bakery are higher — so falling volume *and* thinner margins together **erode its profit**, threatening its viability. (c) Wildgrain should adopt a **differentiation strategy** built on what a small artisan bakery can do that a supermarket cannot: for example, **hand-crafted sourdough and specialty breads**, **premium or locally sourced ingredients**, **fresh-baked-on-the-premises quality**, and **personal customer service and a distinctive local brand**. This is justified because it moves Wildgrain **off price competition**, where it cannot beat the supermarket, and onto **perceived value**, where it can: customers who value freshness, quality and craft will **pay a premium** and become **loyal**, restoring sales and margin. Differentiation plays to Wildgrain's genuine strengths and neutralises the supermarket's cost advantage.

**Q16.** A differentiation strategy is **well justified** for a premium, luxury product because such products **compete precisely on perceived superiority**, not price. Luxury customers deliberately seek **exclusivity, superior quality, craftsmanship or status**, and are **willing to pay a high premium** for it — indeed a low price could *undermine* the product's prestige. Differentiation therefore lets the business **charge a premium that funds the very distinctiveness** (fine materials, design, service and brand) the customers are paying for, while building **strong loyalty** and shielding the business from price-based competition. Because the target customers value distinctiveness over cost and will pay for it, differentiation is the **only approach consistent with a luxury positioning** — a lower cost approach would contradict what makes the product desirable. Differentiation is thus not merely an option but the **appropriate strategy** for this business.

**Q17.** Where **most customers are highly price-sensitive**, a differentiation strategy is likely to be **largely inappropriate**, though not without some value. *In its favour:* even in a price-driven market there is usually a **minority of customers** who will pay for quality or service, and differentiating could let the business **serve that niche** and avoid a direct price war. *Against it:* the defining feature of this market is that customers **choose mainly on price**, so a **premium** will drive the **majority** of them to cheaper rivals; meanwhile the **higher costs** of differentiating (quality, branding, service) must still be paid, squeezing margins on a shrinking customer base. In such a market a **lower cost** approach — competing on price as the lowest-cost producer — usually fits customer behaviour far better. *Judgement:* on balance, differentiation is **inappropriate as the main strategy** for a business whose customers are highly price-sensitive; it could only be justified for a **small niche segment** willing to pay more, and even then the business must ensure the premium covers the added cost. The appropriateness of differentiation depends on customers valuing distinctiveness — which, by definition, most in this market do not. *(Full marks require: both sides weighed and a clear, evidence-based judgement.)*

**Q18.** Changing customer tastes threaten a heavily differentiated business through a clear **causal chain**. Differentiation depends on customers **perceiving a particular point of difference as superior or desirable**. If **tastes shift** — for example, a style falls out of fashion, or customers begin to value sustainability over the feature the business emphasised — then the point of difference **loses the value customers once placed on it**. As that perceived superiority fades, customers become **less willing to pay the premium** and **less loyal**, so **premium pricing and repeat sales decline** and revenue falls. The threat is magnified because the business has **invested heavily in a single point of difference**: its costs are committed to something customers no longer want, and it cannot quickly redirect them, so a change in tastes can turn a former advantage into a costly liability. This is why differentiators must **monitor customer preferences and be willing to renew their point of difference**.

**Q19.** *Model response (10 marks).* Repositioning **Aurora Audio** as a maker of **superior, distinctive headphones** means adopting the **differentiation** approach of Porter's Generic Strategies — seeking a competitive advantage by offering a product customers **perceive as unique or superior** rather than competing on price. This directly addresses Aurora's problem: its mid-range headphones are **almost identical to cheaper overseas products**, so customers currently have **no reason to choose Aurora except price**, a competition it is losing — reflected in its **declining market share and net profit**. By differentiating — through **superior sound quality, distinctive design, innovative features, a premium brand and strong customer service** — Aurora could give customers a genuine reason to prefer it, allowing it to charge a **premium price** that **widens its margin** and to build **loyalty** that protects it from the price-cutting rivals. This could reverse the decline in profit and share by moving Aurora **off price competition**, where it cannot beat overseas manufacturers, and onto **perceived value**, where it can compete.

However, the strategy carries **real risks and costs** that must be weighed. Differentiation would **raise Aurora's costs** — investment in research, design, quality components, branding and service — so the premium must **exceed** those costs to be worthwhile; the point of difference could be **imitated** by competitors; and **customer tastes in audio can change**. Differentiation also depends on Aurora having the **capability** to be genuinely distinctive and to **communicate** that distinctiveness so customers perceive it. The **alternative — a lower cost approach —** would mean competing as the **lowest-cost producer** on price; but this appears **unsuitable** for Aurora, because the overseas manufacturers already have a **cost advantage** it is unlikely to beat, so a price war would probably deepen its losses. Compared with lower cost, differentiation **plays to a strength Aurora can build** (a distinctive premium product) rather than one it lacks (rock-bottom costs), and Porter warns Aurora should **commit clearly to one** approach rather than be "stuck in the middle".

*Judgement.* On balance, a **differentiation strategy is the more appropriate way to position Aurora Audio for the future**, because it offers an escape from the price competition Aurora is losing and suits a market segment willing to pay for superior headphones — provided Aurora can deliver a **genuine, well-communicated point of difference** whose premium covers the added costs, and can **renew** it as tastes and rivals evolve. If it cannot achieve real distinctiveness, neither approach will save it; but given that lower cost is effectively closed to it, differentiation is Aurora's **strongest available strategy**. *(Full marks require: accurate explanation of differentiation applied to Aurora; a two-sided evaluation covering benefits and risks; a correct comparison with the lower cost approach; and a clear, justified judgement.)*

**Q20.** The Salisbury investment is an application of the **differentiation** approach rather than a **lower cost** one. Committing $8 million of equipment and 70 skilled manufacturing roles to **handcrafting** boots in Australia **raises** the cost of each pair, so it cannot be a move towards becoming the **lowest-cost producer**; its purpose is to make the product one customers **perceive as unique or superior**. The spending buys the two things differentiation requires: the **capabilities** to be genuinely distinctive — trained sewing machinists, supported by the industrial sewing course run with TAFE South Australia — and a substantive point of difference in **superior quality and craftsmanship**. Because the difference is **real** rather than merely advertised, the business can **communicate** it as an Australian-made, hand-finished boot, and customers who value that are **willing to pay a premium price** instead of buying a cheaper imported alternative, **widening the margin** on each sale and building **loyalty** that makes those customers **less sensitive to price**. Bringing a women's line on site also serves **diverse customer needs**, which a single cheapest product could not. *Risk:* this is a clear case of the **cost of differentiating** — the premium customers pay must **exceed** the extra cost of onshore handcrafting, or the strategy squeezes margins rather than widening them, and the investment is difficult to reverse if tastes shift. ∴ the investment pursues competitive advantage through **perceived value**, accepting higher costs as the price of distinctiveness. *(Full marks require: identification of differentiation and why it is not lower cost; developed links to premium price and/or loyalty via perception; application to the example; and one developed risk.)*

## Topic 4 Test A — Section A: short-answer and extended-answer questions

*Reading time: 5 minutes. Writing time: 55 minutes. Total 40 marks. No calculator. Answer all questions in the spaces provided. Cumulative over Chapters 10–12.*

**Question 1** (5 marks)

**a.** Define the term *business change*. 2 marks

**b.** Explain how one *external* source of change could create a need for a business to change. Use an example in your answer. 3 marks

**Question 2** (5 marks)

Corner Post News is a suburban newsagency that sold the same range of newspapers, magazines and stationery for more than a decade. As customers increasingly read the news on their phones and bought stationery online, Corner Post's sales fell for two years before its owner finally added a coffee counter and an online click-and-collect service in response.

**a.** Distinguish between a proactive and a reactive approach to change. 2 marks

**b.** Explain how Corner Post News's reactive approach to change has affected its performance. 3 marks

**Question 3** (8 marks)

Meadowfield Dairy manufactures tubs of yoghurt. The table below shows four of its key performance indicators over two years.

| Key performance indicator | Year 1 | Year 2 |
|---|---|---|
| Number of sales (tubs per month) | 84,000 | 71,000 |
| Number of customer complaints (per month) | 45 | 160 |
| Level of wastage (% of milk input) | 5% | 11% |
| Number of website hits (per month) | 38,000 | 59,000 |

**a.** For each of the following key performance indicators from the table, state whether its movement from Year 1 to Year 2 is favourable or unfavourable: (i) number of sales; (ii) number of website hits. 2 marks

**b.** Interpret the relationship between the change in the number of customer complaints and the change in the number of sales, and explain what it suggests about the need for change at Meadowfield Dairy. 4 marks

**c.** Explain why the rise in the number of website hits does not, on its own, show that Meadowfield Dairy is performing well. 2 marks

**Question 4** (6 marks)

Talloway Tools, a hand-tool manufacturer, is deciding whether to automate part of its production line. Its manager has identified the following driving and restraining forces and given each a weight from 1 (weak) to 5 (very strong).

| Force | Type | Weight |
|---|---|---|
| Reduction of costs | Driving | 5 |
| Competitors adopting automation | Driving | 4 |
| Pursuit of profit | Driving | 3 |
| Employee resistance | Restraining | 4 |

| Force | Type | Weight |
|---|---|---|
| Cost of the machinery | Restraining | 3 |
| Organisational inertia | Restraining | 2 |

**a.** Using the weights in the table, state the total weight of the driving forces and the total weight of the restraining forces, and state whether the proposed change is likely to succeed. 2 marks

**b.** Propose one response Talloway Tools could take to improve the likelihood that the change will succeed, and justify it with reference to Lewin's Force Field Analysis. 4 marks

**Question 5** (6 marks)

Compare the lower cost and differentiation approaches to strategic management identified in Porter's Generic Strategies.

**Question 6** (10 marks)

Peppertree Pantry is a chain of 25 delicatessen-style food stores known for its friendly, personal in-store service. Facing rising labour costs, and watching two competitors introduce app-based ordering and self-service checkouts, the board wants Peppertree to install self-service checkouts and launch an online ordering platform. Several long-serving staff fear the change will cost jobs, the investment would be expensive, and the chain has operated the same in-store service model since it opened.

Analyse the driving and restraining forces acting on Peppertree Pantry's proposed change, and evaluate whether the change is likely to proceed.

*End of Topic 4 Test A*

## Topic 4 Test A — Solutions

**Question 1.**

**a.** *(2 marks.)* Business change is any alteration to a business's internal or external environment, structures, processes or behaviours — a movement from a current state ("where the business is now") to a new, desired state ("where it wants to be"). *(Award 2 marks for a two-element definition: the idea of an alteration to the business AND the idea of moving from a current to a new/desired state. A one-element or circular answer earns 1 mark.)*

**b.** *(3 marks.)* An external source of change originates outside the business, in its operating or macro environment, and is largely beyond the business's control, so the business can only respond to it. When such a source shifts, the approaches that previously achieved the business's objectives stop working, which opens a gap between what conditions now demand and what the business does — and this gap creates a need to change. For example, if a competitor launches a cheaper product, the business begins to lose sales and market share; to remain competitive it is pushed to change, such as by re-pricing or improving its own product. *(Award 1 mark for identifying a valid external source, 1 mark for the causal link to a need for change, and 1 mark for a developed relevant example. Accept any valid external source, e.g. competitors, customers/changing market preferences, suppliers, technology, legislation, economic conditions, globalisation or societal attitudes.)*

**Question 2.**

**a.** *(2 marks.)* A proactive approach means the business anticipates change and initiates it before the need arises, acting on forecasts of future trends and opportunities on its own timetable. A reactive approach means the business responds to change only after a problem or external force has already arisen. The difference is timing relative to the need — proactive acts before it, reactive acts after it. *(Award 1 mark for each approach correctly characterised; the distinguishing feature of timing must be clear.)*

**b.** *(3 marks.)* Corner Post News took a reactive approach, changing only after its sales had already fallen for two years. Because it waited until the problem had taken hold, the shift to phone-based news and online stationery had already drawn customers away before the business responded, so its sales and profit declined and it lost ground it must now try to win back. Adding the coffee counter and click-and-collect service is therefore a catch-up effort made under pressure rather than a planned move, which makes it harder for the newsagency to restore the sales and profit objectives it had already missed. *(Award marks for linking the late/reactive timing to a deterioration in performance — e.g. lost sales/customers/market share before responding — with clear cause and effect, applied to Corner Post News. A general answer with no link to the business caps at 2.)*

**Question 3.**

**a.** *(2 marks.)* (i) Number of sales — **unfavourable** (it fell from 84,000 to 71,000 tubs per month; for sales, higher is favourable). (ii) Number of website hits — **favourable** direction (it rose from 38,000 to 59,000; for website hits, higher is the favourable movement). *(1 mark each.)*

**b.** *(4 marks.)* The number of customer complaints rose sharply (from 45 to 160 per month, more than tripling) while the number of sales fell (from 84,000 to 71,000 tubs). Both movements are unfavourable, and the two are likely to be causally related: the rising complaints indicate growing customer dissatisfaction — plausibly with product quality, which is consistent with the level of wastage climbing from 5% to 11% and pointing to problems in production — and dissatisfied customers stop buying Meadowfield's yoghurt or switch to competitors, which drives the fall in sales. Read together, the indicators show performance is deteriorating and give a clear need for change, most likely by investigating and fixing the source of the complaints in the operations/quality of the product. *(To earn full marks the response must read the data AND state the causal relationship — rising complaints leading to falling sales — not merely note that both moved. An answer that only observes a correlation without explaining how one affects the other caps at 2 marks. The link to the need for change is required.)*

**c.** *(2 marks.)* Website hits measure only the traffic or interest a site attracts; they do not measure whether visitors actually buy anything. Meadowfield's hits rose to 59,000 while its sales fell, which shows the extra visitors are not converting into purchases, so reading the hits alone would give a misleadingly positive picture. To judge performance the manager must read website hits alongside outcome KPIs such as the number of sales and net profit. *(Award marks for explaining that hits measure interest not purchases, and linking this to the fact that sales fell despite the rise.)*

**Question 4.**

**a.** *(2 marks.)* Total driving forces = 5 + 4 + 3 = **12**. Total restraining forces = 4 + 3 + 2 = **9**. Because the driving forces (12) outweigh the restraining forces (9), the proposed change is **likely to succeed**. *(1 mark for the two correct totals; 1 mark for the correct conclusion consistent with the totals.)*

**b.** *(4 marks.)* Talloway Tools should respond by reducing its strongest restraining force — employee resistance (weight 4) — for example by clearly communicating the reasons and benefits of automation and offering affected staff retraining or redeployment. This is justified because, under Lewin's Force Field Analysis, a manager can shift the balance towards change either by strengthening the driving forces or by reducing the restraining forces, and Lewin argued that reducing restraining forces is usually more effective: adding pressure to change tends to increase tension and resistance, whereas removing an obstacle lowers opposition without raising tension. By targeting the highest-weighted restraint, Talloway lowers the force most threatening the change and widens the gap between the driving and restraining totals, further improving the likelihood of success. *(Award 1 mark for a valid, specific response, 1 mark for targeting a genuine restraining force (ideally the strongest), and 2 marks for a justification grounded in Lewin's theory — the benefit of reducing restraining forces rather than merely describing the response. Accept a response that strengthens a driving force if correctly justified, but the stronger answer reduces the restraint.)*

**Question 5.** *(6 marks.)*

**Similarities.** Both lower cost and differentiation are Porter's Generic Strategies — deliberate approaches to strategic management that a business uses to gain a competitive advantage over its rivals and position itself for the future. Both require the business to commit its operations, pricing and marketing behind a chosen way of competing, and both are ultimately aimed at winning customers and improving performance and profit.

**Differences.** They differ in the source of competitive advantage. Under a lower cost (cost leadership) approach the business competes by becoming the lowest-cost producer in its market — through economies of scale, efficiency and tight cost control — so that it can charge lower prices than rivals or earn a higher margin at the market price; its advantage comes from being cheaper to run. Under a differentiation approach the business competes by offering a good or service the market perceives as unique or superior — through quality, features, design, branding or service — so that it can charge a premium price and build loyalty; its advantage comes from being distinctive rather than cheaper. They also suit different markets: lower cost fits standardised, price-sensitive markets, whereas differentiation fits markets where customers value, and will pay for, difference. In short, both are Porter approaches to competitive advantage, but one competes by being the cheapest and the other by being the most distinctive.

*(A "compare" answer must present BOTH similarities AND differences — an answer giving only differences, or that merely defines the two approaches without comparing them, cannot earn full marks. Award marks globally for at least one developed similarity and clearly signposted differences in the source of advantage, with the price/cost-versus-distinctiveness contrast made explicit.)*

**Question 6.** *(10 marks.)*

Peppertree Pantry faces a set of driving forces pushing it towards installing self-service checkouts and launching an online ordering platform, and a set of restraining forces working against the change; analysing how they interact, and weighing them, shows whether the change is likely to proceed.

**Driving forces.** Several forces push for the change. The **reduction of costs** is a strong internal driver: rising labour costs mean that automating checkouts and taking orders online would lower Peppertree's wage bill per sale, cutting operating costs. **Competitors** are a major external driver — two rivals have already introduced app-based ordering and self-service checkouts, so Peppertree risks losing customers and market share to more convenient competitors unless it matches them. **Technology** enables and encourages the change, because self-service and online-ordering systems now offer a faster, cheaper way of operating. Finally, the **owners/managers** (the board) are themselves a driving force, since they are initiating the change to protect performance, and the underlying **pursuit of profit** — lower costs and retained customers both lift profit — reinforces the others. These forces interact: the competitive threat and the rising labour costs together make the technology investment look increasingly necessary rather than optional.

**Restraining forces.** Opposing the change, **employees** are a significant restraint: several long-serving staff fear the change will cost jobs, and this resistance could show up as low morale or refusal to cooperate, slowing implementation. **Financial considerations** restrain the change because the checkouts and platform "would be expensive", so the cost and funding of the investment hold the business back. **Organisational inertia** also works against it: Peppertree has run "the same in-store service model since it opened" and is known for personal service, so there is a built-in momentum — a "we have always done it this way" attachment — that resists moving to a more automated model. These restraints reinforce one another, as staff fear of job loss deepens the attachment to the traditional service model.

**Evaluation.** On balance, the change appears **likely to proceed**, but only if the restraining forces are managed. The driving forces are strong and, importantly, partly unavoidable — the competitors' move and rising labour costs are external pressures that will keep worsening if Peppertree does nothing, and the change has the backing of the board that controls the resources and decisions. Against this, the restraints are real but more manageable: employee resistance can be reduced by communicating the reasons for the change and offering retraining or redeployment, and finance can be staged. Under Lewin's logic, a change proceeds when the driving forces outweigh the restraining forces, and here the combination of a genuine competitive threat, clear cost savings and committed owners looks stronger than the opposition — provided management reduces the largest restraint (employee resistance) rather than forcing the change through. The change is therefore likely to proceed, but its success depends on Peppertree lowering the restraining forces first.

*(Full marks require: several driving and restraining forces accurately identified and applied to Peppertree; genuine analysis of how the forces cause pressure and interact — not a bare list; a sustained, two-sided evaluation of whether the change will proceed; and a justified overall judgement. Reward reference to the balance of forces (Lewin) but note that AoS 1 focuses on the forces and the decision, not on implementation models.)*

## Topic 4 Test B — Case study

*Reading time: 5 minutes. Writing time: 40 minutes. Total 30 marks. Answers must apply to the case study.*

**Case study**

Highgrove Chocolates Pty Ltd is a family-owned manufacturer of premium boxed chocolates, founded fifteen years ago in regional Victoria and now employing 90 staff. For most of its history Highgrove sold steadily through department stores and its own website, and its owners rarely changed the way the business operated. Over the past two years, however, Highgrove has come under growing pressure. A large overseas confectioner has entered the Australian market, selling cheaper chocolates online; a local rival has launched a popular monthly chocolate-subscription app; and customers increasingly want ethically sourced, lower-sugar products. Rising cocoa and energy costs have added to the strain. Only after two years of falling results did the chief executive, Nadia Rossi, begin to consider change. She is weighing whether to reposition Highgrove around distinctive, ethically sourced "single-estate" chocolate, or to cut its costs and compete on price. Several long-serving production staff have said the business "has always done well by doing things the traditional way", the factory still uses much of its original equipment, and finance for new machinery is limited.

| Key performance indicator | Two years ago | This year |
|---|---|---|
| Percentage of market share | 14% | 9% |
| Net profit | \$3.2 million | \$1.8 million |
| Number of customer complaints (per month) | 30 | 95 |
| Level of staff turnover | 9% | 22% |
| Rate of productivity growth | +5% | −2% |

**Question 1** (2 marks)

Identify evidence from the case study that Nadia Rossi has taken a reactive approach to change.

**Question 2** (4 marks)

Interpret the relationship between the fall in percentage of market share and the fall in net profit shown in the case study, and explain what this suggests about the need for change at Highgrove.

**Question 3** (4 marks)

Other than the pursuit of profit, explain how two driving forces have contributed to the pressure for change at Highgrove.

**Question 4** (4 marks)

Explain how two restraining forces could make it difficult for Nadia to implement change at Highgrove.

**Question 5** (4 marks)

Distinguish between the lower cost and differentiation approaches of Porter's Generic Strategies, and identify which approach Highgrove appears to be leaning towards.

**Question 6** (6 marks)

Explain how Nadia could apply the key principles of Lewin's Force Field Analysis before deciding whether to reposition Highgrove.

**Question 7** (6 marks)

Evaluate whether adopting a differentiation strategy would be an appropriate way to position Highgrove Chocolates for the future.

## Topic 4 Test B — Solutions

**Question 1.** *(2 marks.)* The evidence that Nadia has taken a reactive approach is that "only after two years of falling results did she begin to consider change" — she responded to the problem after it had already arisen and performance had already declined, rather than anticipating and initiating change before the need became apparent. *(Award 2 marks for identifying the specific evidence AND showing it demonstrates responding after the event. Simply writing "she was reactive" without the case-study evidence earns 1 mark.)*

**Question 2.** *(4 marks.)* Both indicators moved unfavourably: Highgrove's percentage of market share fell from 14% to 9%, and its net profit fell from $3.2 million to $1.8 million (a fall of roughly 44%). The two are causally related. As the cheaper overseas confectioner and the rival's subscription app drew customers away, Highgrove's share of total industry sales shrank; selling to fewer customers reduced its sales revenue, and — combined with rising cocoa and energy costs squeezing its margins — this flowed through to a substantial fall in net profit. In other words, the loss of market share is a plausible driver of the fall in profit. Together the two deteriorating KPIs show performance is declining and give Highgrove a clear need for change, such as repositioning the business to win customers back. *(To earn full marks the answer must interpret the data AND state the causal relationship — falling share leading to falling profit — applied to Highgrove, not merely note that both fell. A correlation stated without a causal explanation caps at 2 marks; the link to the need for change is required.)*

**Question 3.** *(4 marks.) (Any two of the following, other than the pursuit of profit, each explained as a push for change and applied to Highgrove.)* **Competitors:** the large overseas confectioner selling cheaper chocolates online, and the local rival's popular subscription app, threaten Highgrove's sales and market share, pushing it to change — for example by repositioning its product or improving its online offer — in order to stay competitive. **Societal attitudes:** customers increasingly want ethically sourced, lower-sugar products, so this shift in community values pushes Highgrove to change its ingredients and range to keep meeting customer expectations or risk losing them. *(Other creditworthy forces evident in the case include reduction of costs — rising cocoa and energy costs push the business to change how it operates to lower costs; globalisation — the overseas entrant reflects a more global market; and technology — the rival's app. Award 2 marks per force: 1 for correctly naming a driving force evident in the case, 1 for explaining how it pushes Highgrove to change. Do not credit "pursuit of profit", which the question excludes.)*

**Question 4.** *(4 marks.) (Any two of the following, each explained and applied to Highgrove.)* **Employees:** several long-serving production staff believe the business "has always done well by doing things the traditional way", so they are likely to resist change — through low morale or reluctance to adopt new methods — which would make a repositioning or new processes harder for Nadia to implement. **Organisational inertia:** the factory still uses much of its original equipment and the business has operated the same way for years, creating a built-in momentum and "we have always done it this way" attitude that resists a new direction. **Financial considerations:** finance for new machinery is limited, so the cost of changing (new equipment, ethical sourcing, retooling) may be more than Highgrove can readily afford, holding the change back. *(Award 2 marks per force: 1 for naming a restraining force evident in the case, 1 for explaining how it would make change difficult, applied to Highgrove. Note that time is not clearly evidenced here; reward forces grounded in the stimulus.)*

**Question 5.** *(4 marks.)* Under a **lower cost (cost leadership)** approach a business competes by becoming the lowest-cost producer in its market, using economies of scale, efficiency and tight cost control, so that it can charge lower prices than rivals or earn a higher margin — its advantage comes from being cheaper. Under a **differentiation** approach a business competes by offering a product the market perceives as unique or superior — through quality, features, branding or ethical credentials — so that it can charge a premium price and build loyalty; its advantage comes from being distinctive rather than cheaper. The key difference is the source of competitive advantage: low cost/price versus perceived distinctiveness. Highgrove appears to be leaning towards a **differentiation** approach, since it is considering repositioning around distinctive, ethically sourced "single-estate" chocolate. *(Award up to 3 marks for a genuine distinction — both approaches characterised and the difference in the source of advantage made clear — and 1 mark for correctly identifying differentiation as the approach Highgrove is leaning towards. A one-sided answer that describes only one approach caps at 2.)*

**Question 6.** *(6 marks.)* Before deciding whether to reposition Highgrove, Nadia could work through the key principles of Lewin's Force Field Analysis. **Weighting:** she would first identify the driving forces for the repositioning (such as the competitor pressure, changing societal attitudes towards ethical products, and the goal of restoring profit and market share) and the restraining forces against it (such as employee attachment to the traditional way, limited finance and ageing equipment), then give each force a numerical value reflecting its strength and total the two sides. If the driving total exceeds the restraining total, the change is more likely to succeed. **Ranking:** she would then place the forces in order of their weights to see which matter most — for example, whether employee resistance or limited finance is the largest restraint — so she knows where to concentrate her effort rather than spreading it across minor forces. **Implementing a response:** guided by the ranking, she would develop strategies to strengthen the key driving forces and, especially, reduce the strongest restraining forces — for instance, communicating the reasons for repositioning to reduce staff resistance, or staging the investment to ease the finance constraint. **Evaluating the response:** as those responses take effect — and before any repositioning begins — she would **re-weigh the driving and restraining forces** to judge whether her response has actually shifted the balance: has communicating the reasons brought employee resistance down from, say, a 4 to a 2, and has staging the investment eased the finance restraint? She would decide to reposition only once the driving forces clearly outweigh the restraining forces; if the restraints still dominate, she responds further and evaluates again. All four principles are therefore worked through **before the change begins**, because Force Field Analysis determines whether and when Highgrove should reposition — judging whether the repositioning itself worked is a separate, later task done with key performance indicators. *(Award marks globally for correctly explaining the four principles — weighting, ranking, implementing a response and evaluating the response — in order and applied to Highgrove. A response that only lists the steps without applying them to the case, or that misplaces "implementing" and "evaluating" as being about the change itself rather than the response — e.g. treating "evaluating the response" as reviewing KPIs after the repositioning — cannot earn full marks.)*

**Question 7.** *(6 marks.)* A differentiation strategy appears **largely appropriate** for positioning Highgrove for the future, though it carries risks that must be weighed. **In favour:** Highgrove's problem is that a large overseas confectioner is undercutting it on price — a price war Highgrove, with its limited finance and small scale, is unlikely to win against a bigger, cheaper producer. Differentiation offers an escape from that competition: by repositioning around distinctive, ethically sourced "single-estate" chocolate, Highgrove could give customers a reason other than price to choose it, charge a premium that widens its margin, and build loyalty that protects it from cheaper rivals. This also aligns with the shift in societal attitudes towards ethical, lower-sugar products and plays to Highgrove's existing premium, department-store positioning, which could help recover the lost market share and profit. **Against:** differentiation would raise Highgrove's costs — ethical sourcing, product development and stronger branding are expensive — so the premium customers pay must exceed those extra costs, which is a concern given finance is already limited; the point of difference could be imitated; some customers remain price-sensitive and would still leave for the cheaper overseas brand; and the strategy depends on Highgrove genuinely delivering and clearly communicating the distinctiveness. **Judgement:** on balance, because a lower cost approach is effectively closed to Highgrove (it cannot out-scale the overseas entrant) and its market includes customers who value and will pay for ethical, premium chocolate, differentiation is the more appropriate strategy for its future — provided the premium it can charge covers the higher costs and it can fund and communicate a real point of difference. *(Full marks require: a two-sided evaluation weighing the benefits and the risks/costs of differentiation for Highgrove, a comparison of context with the lower cost alternative, and a clear judgement based on evidence from the case study — not a generic "advantages outweigh disadvantages". Answers must apply to Highgrove throughout.)*