Porter's Five Generic Strategies; A Case Study from the Hospitality Industry

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1.0 Introduction

In today's highly competitive and turbulent environment, an organization's competitive attitudes and behaviors are considered fundamental topics within all industries. The set of actions carried out by a firm are the concrete expression of the organizational business strategy directed to acquire competitive advantage.

"Strategy is an essential part of any effective business plan. By using an effective competitive strategy, a company finds its industry niche and learns about its customers [38]. Porter [39] asserts there are basic businesses strategies – differentiation, cost leadership, and focus – and a company performs best by choosing one strategy on which to concentrate" [2] (p.434). Porter [38] [39] generic strategies represent a widely accepted theory of strategic options that clearly explain the reasons of firms' behavior.

2.0 Porter's Three Generic Strategies

2.1 Cost Leadership

The first among Porter's five generic strategies is cost leadership [31] and it consist on gaining competitive advantage by reaching the lowest cost in the industry [5] [7] [14] [17] [37] [40] [41]. Porter [39] supports the fact that only one firm in a specific industry can be the cost leader [54] [49]. In order to reach this type of advantage, a company must pursue a cost-leadership mindset and must be willing to discontinue any activities in which they do not have a cost advantage and should consider outsourcing activities to other organizations with a cost advantage [31]. Moreover, the firm is supposed to have a big market share [29]. There are multiple ways to reach cost leadership such as mass production and distribution, economies of scale, technology and product design, access to low-cost raw materials and efficient business processes [54]. Porter [38] suggests that the cost leadership strategy requires a vigorous pursuit of cost reductions, tight cost, overall control and cost minimization in areas such as research and development, sales force and advertising. This strategy aims to outperform competitors through efficiency rather than product quality or service [20], though quality, customer service and other areas cannot be ignored [50]. Industries applying a cost leadership strategy strive to continuously adopt cost saving actions, including building efficient scale facilities, tightly controlling overhead and production costs, and monitoring costs to build their relatively standardized products that offer features acceptable to many customers at the lowest competitive price. A low-cost or cost leadership approach is effectively carried out when the business designs, produces, and markets a comparable product more efficiently than its competitors [3]. Moreover, improvements in cost leadership can be done by pursuing process innovations, product design and type of material selected which may reduce the manufacturing time and cost; by outsourcing part of the production or by buy raw materials and semi-finished product at a lower price than the initial in-house production cost and finally by implementing more advanced knowledge and reengineering the company business processes [2] [19]. However, one of the most difficult areas to handle in terms cost is the distribution logistics. Distributions channels play an important role both for cost saving and value creation [1]. The replenishment logistics has proven to be a considerably effective method for minimizing the distribution cost but the methodology that so far is able to reduce at its minimum the distribution cost is the retail cross docking. This technique eliminates the warehouse costs by immediately sending it from the firm manufacture's receiving dock to the shipping dock where trucks are loaded and ready to deliver goods to the retailers or directly to the customers. This is the system adopted by Wal-Mart and Amazon. Some of the possible cost wise actions that a firm may decide to undergo are:

- Improve the business processes' efficiency (new technology, different plant layout)
- Reduce the number of permanent staff, outsourcing part of the business process or employ staff on a project basis
- Operating economies of scales
- Training staff to improve its efficiency

Firms do not necessarily have to sacrifice revenue to be the cost leader since high revenue is achieved through obtaining a large market share [7] [37] [40] [41]. Lower prices lead to higher demand and, therefore, to a larger market share [26]. This cost leadership approach can present a barrier for the new market entrants because to be competitive and to enter the market they would be required a large capital [29]. However, this strategy can also be considered a double-edged sword because also if the market leader would result insulated from the industry general price reductions [28] [31], if it lowered too much its prices it may lose revenues [14].

2.2 Differentiation

One of Porter's generic strategies is differentiation [43]. When implementing this approach, a firm concentrates its efforts on creating a unique product or service [7] [14] [29] [37] [40] [41] setting their offerings apart from competitors. Since, the product or service is rare and almost impossible to substitute, this strategy provides high switching costs for the consumers and consequently a wide customer loyalty [14] [28] [39]. This strategy enables organizations to charge a higher price to capture a portion of market share. The differentiation strategy is correctly pursued when the firm provides a superior or unique value to the customer through product value, quality, characteristics, or customer services such as after-sale support [1]. Hence, product differentiation fulfills a customer need and implies product or service customization. For this reason, organizations that follow a differentiation strategy may charge a higher price for their products based on the product features, the delivery system, the quality of service, or the distribution channels without creating any discomfort in the customers who are willing to pay a higher price for a special good or service. In this matter, the quality can be real or more a perception based on fashion, brand name, or on the image and social status that a product can have in a specific social community. Therefore, the differentiation strategy is more appealing to a customer with a sophisticated taste or with a peculiar knowledge on the subject. This customer insight will, more or less consciously, condition the consumer to proceed with the purchase of a product or a service accordingly to its uniqueness regardless of its price [2]. Indeed, during the manufacturing process, the company is aware of the higher price of the materials or of the fact that the final product will reach the customer with a higher price compared to other products on the market, but not for this reason the company will divert its strategy which is based on differentiation and on customer loyalty [28] [54]. Following this logic, the firm needs to be visible and to each its customers in order to deliver its message of uniqueness [9] [32] [42] [43] [48] [50]. Therefore, the company has to pursue a different approach in order to highlight the differences with its competitors. This process can be done by giving customers a particular insight on the manufacturing processes, the quality of work and the delivery system as well as by delivering the firm's heightened brand image, by improving the customer involvement and finally by implementing innovative and target-specific marketing techniques [12] [17] [51]. There are two fundamental ways to develop a differentiation strategy:

1. R&D

- Improving the firm's technology
- Delivering a quality service or create unique products [10] [28]
- Create a product rare and difficult to imitate by other companies
- Propose new features of the same product that result appealing to the customers
- Providing rapid and accessible information of the company; being transparent [12]

2. Marketing
   - Creating high quality advertisement [32]
   - Speaking about the product to select panels, for example during fairs and exhibitions [32]
   - Keeping a newsletter to inform the customers on the news on products and on the company novelties like new technologies and future plans [32]
   - Enhancing the website quality or the product delivery [8]
   - Providing e-commerce on the company website [12]
   - Establishing, in the case of online business, online brand recognition and providing varying levels of service such as singular product customization [6]
   - Becoming involved in the community by organizing corporate social responsibility events [32]
   - Training employees with in-depth product and service knowledge and place them in the marketing department as customer after-sale support or as marketing planners [15]

From an overall perspective, as reported by [53], for a company that pursues a differentiation strategy is important to bend the customer's will to match the company's mission from a differentiation perspective.

In some situations, a business may get "stuck in the middle", in other words the firm is unable to differentiate its product or service from a competitors', often resulting in poor financial performance [13] [38]. According to Porter's generic strategies, a business could still pursue either a differentiation or focus strategy [38].

2.3 Focus

In the focus strategy, a firm targets a specific and often narrow segment of the market [7] [14] [17] [28] [29] [37] [40] [41]. The firm may decide to focus its resources on a select customer group (elders or teenagers) or target niche, a specific range of products, a geographical area (a city, a state or a country accordingly to the dimensions of the company; for example, as reported by Stone [47], some European firms focus solely on the European market), or service line [3] [5] [15] [29] [32] [50] [54]. Focus also is based on adopting a narrow competitive scope within an industry [1].

As Allen and Helms [2] report "focus aims at growing market share through operating in a niche market or in markets either not attractive to, or overlooked by, larger competitors. These niches arise from a number of factors including geography, buyer characteristics, and product specifications or requirements" (p.436).

Porter [38] sustains that a successful focus strategy has to be built around serving a particular target very well while exploring a segment related to the specific industry which is large enough to have a positive growth potential but not of core interest to the other major competitors. Directing the firm's resources towards a certain value chain activities is the key to build competitive advantage by exploiting a focus strategy. By focusing the marketing mix on the narrowly defined target markets, the business can position itself to increase brand loyalty and customer satisfaction [13]. Market penetration or market development can be an important focus strategy. As a matter of fact, both In the case of a newly established organization and of a firm that is targeting a new segment of the market, it is advisable to adopt a focus strategy because it prevents a direct competition against more well-established firms in the industry while potentially lowering investment costs and enhancing the ability to customize products to meet a narrowly defined customer base [30]. This supports the "long-tail" theory [4], which proposes that increased profitability can be realized by servicing a small, but demanding customer base, willing to pay a premium price for its unique product desires.

An organization may also choose a combination strategy by mixing one of the generic strategies of low-cost or differentiation with the focus strategy. While small enterprises may adopt since the very beginning a focus strategy, midsize and large firms use focus-based strategies only in conjunction with differentiation or cost leadership generic strategies. However, focus strategies are more compelling when the firm is able to identify and nurture consumers' distinct preferences and when this specific niche market has not been reached or exploited by other rival firms [16].

3.0 Porter's Three Generic Strategies and Davis and Davis Five Generic Strategies

Throughout time, researches supported Porter's [38] [39] original generic strategies [19] [23] [25] [34] [35] [44]. Some examples can be shown as it follows:

- Dess and Davis [19] examined industrial products businesses and suggested performance was achieved through the adoption of a single strategy.
- Hambrick [24] investigated capital goods producers and industrial product manufacturers and found support for generic strategies.
- Ross [45] supported two distinct focus strategies including low-cost and differentiation

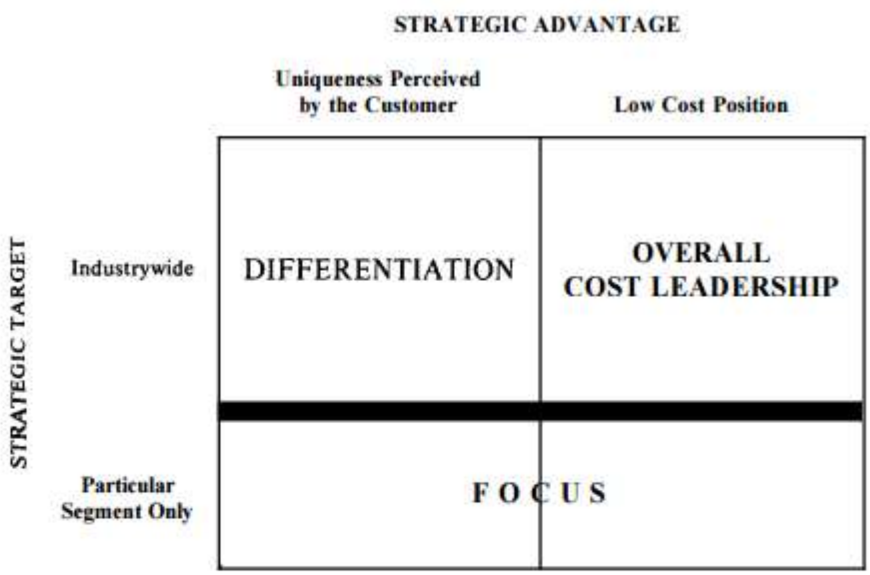

Figure 1 - Three Generic Strategies (p.39) [38]

However, other researchers concluded that combination of strategies was more effective and generally associated with a firms' superior performance [11] [22] [27] [33] [36] [52] [55]. A great number of studies have suggested to simultaneously adopt a low cost and differentiation strategy in a higher performing business context [21] [46]. Helms et al [26], while trying to investigate if low cost and

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differentiation strategies are mutually related or if they automatically exclude each other, found out that under specific circumstances the two strategies are complementary to each other and lead the firm to higher ROI. Therefore, combination strategies are proven to be as effective as singularly implemented generic strategies, what does matter is the company target segment of the market. Accordingly to these findings, additional amplifications of the Three Generic Strategies discussed by Porter [38] were made to explore further possibilities that this strategic approach reserves to the firms looking forward to improve their market share. One of the most popular extension of Porter's Three Generic strategies is the one followed by Davis and Davis [18]. As a matter of facts, these two authors define five different strategies an organization may follow in relation to the segment of market it wants to target.

GENERIC STRATEGIES

SIZE OF THE MARKET	Cost Leadership	Differentiation	Focus
Large	Type 1 Type 2	Type 3	-
Small	-	Type 3	Type 4 Type 5

Figure 2 – Porter's Five Generic Strategies (p.150) [18]

The Five Generic Strategies discussed by Davis and Davis are:

- **Type 1: Cost Leadership – Low Cost →** This strategy can be implemented only by large companies with a large market share. It is based on economies of scales and on product standardization. As a matter of fact a large organization can produce a good in large quantities reducing the price per unit of the product itself by adopting new technologies, cutting on the R&D expenditures, monitoring the supply chain and invest in low differentiated products. An example for this type of strategy is AirAsia with its low cost fares and basic service.
- **Type 2: Cost Leadership – Best Value →** This strategy can be supported by large firms that want to deliver a low cost product or service but that somehow may decide to partially and in large scale want to differentiate their offer, but by keeping it to a budget price. In this case the company will reach higher revenues by implementing a low cost strategy while also offering the best service in comparison to the other industries on the market. An example for this strategy is given by McDonalds which was able to achieve the lowest delivery time in the whole fast food industry by serving a meal in only ten seconds.
- **Type 3: Differentiation →** As in the differentiation strategy discussed by Porter [38] this third kind of strategy can be implemented by both for large and small market segments and by both large and small firms.
- **Type 4: Focus – Low Cost →** This strategy is a mix of focus and cost strategy and is pursued by firms that aim to achieve operational efficiency while focusing also on specific niche aspects of the product or service presented to the market. However, it is fundamental for the organization to make sure that this niche market is large enough and has a growth

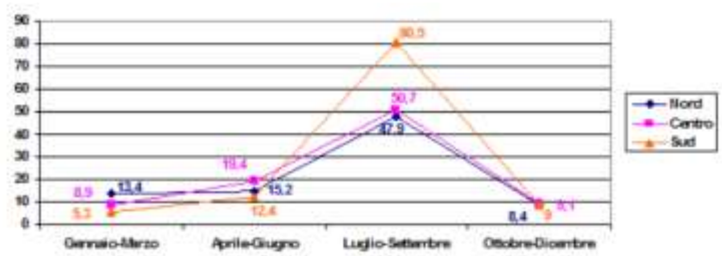
potential, while other firms have left out this market segment. This type of strategy can work well in a particular geographical area, as well as with a specific ethnic minority and money-conscious customers. One example for this type of strategy is, again, McDonalds' which in Philippines serves rice and chicken aside the traditional hamburgers and French fires. By doing so, McDonalds was able to conquer a –very big- niche market by adopting a low cost and focused strategy.

- **Type 5: Focus – Best Value →** a second possible combination sees the focus strategy pairing with the differentiation strategy. Whereas the differentiation strategy goal is building a large share of a broad market, the focus – best value strategy is much more targeted. The significant strategic practices for a focus – best value strategy include producing products or services for high price market segments and providing specialty products and services [2]. For example, the well-known brand Rolex produces only fine watches, using gold and diamonds, for a relatively small market segment willing to pay an exorbitant price for its luxury products. Hence, this strategy may lead to two overall tactics:
    1. Producing exquisite products or high-quality services
    2. Deliver inimitable products or services able to target high price market segments

4.0 Case study – Hotel Corallo, Rimini

Hotel Corallo is a resort sited in the city of Rimini, Italy. Hotel Corallo is limited liability company (LLC) founded in the early 1960s' by the Rivi family which, in its third generation, sees Mr. Rivi as its former owner and manager.
The historical town of Rimini is located along the north-eastern coast of Italy and Hotel Corallo, as many other hotels, is located at just few meters from the Adriatic Sea. The city of Rimini became famous in the '60s for its ability to satisfy the needs of an Italian enriched middle-class looking forward to spending its summer holidays at the beach.
Holtel Corallo follows a seasonality schema based on the Italian four seasons and the number of employees vary from 22-25 in the high season to 7-10 in the low season.

Low season	16 October – 14 April
Mid-season	15 April – 14 June 16 September – 15 October
High season	15 June – 15 September



Picture 1 – Personal elaboration based on "Viaggi e Vacanze", Istat Quarterly Enquiry [56]

The life cycle of the tourism industry in the city of Rimini has already reached a maturity stage and in the close future will enter the decline phase. In this kind of environment, the large number of firms operating in this industry are striving for their survival while coping with the country increasing inflation. Under this stagnant economy, strategic planning plays a fundamental role for an organization that wants to survive. One of the first sub-industry that is suffering from this recession is the hospitality industry, the one Hotel Corallo belongs to.

Hotel Corallo in its over 50 years of activity went through many different phases of the local tourism industry life cycle and adopted time to time different strategies to cope with the contingently different requirements. As before mentioned, nowadays the whole hospitality industry is suffering but, Hotel Corallo still manages to navigate in this market instability by proposing a multi-layered strategic plan.

4.1 Cost Strategy

Type 1: Cost Leadership – Low Cost

Hotel Corallo is the only 3-star superior hotel directly facing the sea in the whole city of Rimini. In fact, all the hotels that have the same privileged position are 4 stars, 4-star superiors or 5 stars. Commonly this strategy is reserved to large companies but, if carefully examined Hotel Corallo, can be considered in the local hospitality industry a medium-large company. As a matter of fact, 25 employees during the high season is a quite considerable number compared to other smaller enterprises which are located just a few hundred meters behind Hotel Corallo and count an average of 5-8 employees in the high season. Moreover, this lower class hotels close during the low season and their prices are way lower than the one proposed by Hotel Corallo. Hotel Corallo could simply upgrade its status from 3-star superior to 4 star hotel. The Italian government has regulated the ranking of the hospitality industry and accordingly to the current status of the hotel an investment of about 50.000-75.000€ would be enough to allow the hotel to switch to another category and apply higher fares to the guests. However, in this times of crisis, Hotel Corallo decided to keep its status to a lower grade and to pursue a low cost strategy to be able to reach a higher segment of the market compared to its direct competitors while investing the additional revenues in other strategies. This choice leads to a great competitive advantage because it can offer, in terms of location, the same service as the other hotels, but at a way cheaper price.

- **All-inclusive formula** → an example of Hotel Corallo ability to achieve this cost leadership – low cost position is the fact that the hotel is offering an all-inclusive formula that can be purchased by the guests from the beginning of May until the end of September and that guaranties the guests with:
  - Breakfast, lunch and dinner at the hotel
  - Open bar (no-alcohol included) from 10 AM to 8 PM
  - Access to the beach resort No35, it includes one private cabin, one umbrella and two beach chairs
  - (Entertainment at the beach and back to the hotel provided by a group of 4-5 animators hired by Hotel Corallo)

  all-inclusive competitors' formula

  This all-inclusive formula is quite common in the industry, but Hotel Corallo is able to deliver it with a lower-cost compared to its competitors because of the long term business relationship with beach resort No35, which gives a particular discount to Hotel Corallo. This is an exemplar case of backward integration with the suppliers in the service industry.

Type 2: Cost Leadership – Best Value

Hotel Corallo also offer a cost leadership – best value strategy and it is quite a unique case because it is barely impossible to find a firm able at the same time to offer a cost leadership –low cost strategy along with a cost leadership – best value strategy. However, this rare opportunity is offered by Hotel Corallo because of the local industry seasonality base and the need of continuous changes in the overall hospitality offer.

- **Conference room →** during the low season the number of guests dramatically decreases and also some of the biggest hotels in the local industry are forced to close and wait until the arrival of the mid-season. However, Rimini municipality tries to revamp the tourism industry by hosting big events in the newly built Rimini Fiera (fair center) and Rimini Palacongressi (conference center). Normally, 4 or 5-stars hotels are providing only one big conference hall to host conventions and meetings but sometimes the number of participant to these meetings is not so high to rent a room that can host more than 200 guests and to face a very high cost. Hotel Corallo takes advantage of these circumstances and, thanks to a movable wall design technology implemented in the '90s, it can create "on the spot" <u>two</u> conference halls, separating the former breakfast and dinner hall, and fill them with office chairs.
    1. "Cavalluccio Marino Hall" (Seahorse Hall) is the primary conference room which can host up to 200 people
    2. "Scoiattolo Hall" (Squirrel Hall) is the secondary room that can host up to 100 people and that can also be quickly split in other three independent rooms

  This easy system allows to offer to the Hotel customers looking for a conference hall to choose the one that best suits their need and at the same time to reserve it at a lower price compared to 4-stars hotels, lower cost at a better value.

4.2 Differentiation Strategy

Type 3: Differentiation

Hotel Corallo in the past fifteen years worked particularly hard to implement a differentiation strategy able to attract more and more customers and create loyal customer who would come back to the hotel every year. This strategy is now manifested in various ways:

- **Hotel entertainment →** Hotel Corallo decided to differentiate its all-inclusive formula by adding to an option including beach and hotel entertainment. Entertainment in the local tourism industry is perceived only as an option related to the beach life (muscle toning, group dance, aqua gym and baby club) and for this reason every beach resort hires its own animation staff to offer an expected service to its own customers and to the customers that a few hotels, partnering with the beach resort, send.

  However, the entertainment service has not been explored by the hospitality industry. For this reason Hotel Corallo decided to differentiate its offer by providing animation not only at the beach but also in the hotel. Every day from 9 to 11.30 PM 4-5 animators hired by Hotel Corallo amuse the customers by proposing different programs such as live music, karaoke, magic shows, quiz games and much more.
- **A walk in Rimini city center →** Once a week, Hotel Corallo organizes once or twice a week (accordingly to the customer demand) free city tours to let the vacationers knowing more about a city that was founded over 2000 years ago during the Roman Empire. Cristian, a friend of Hotel Corallo, walks the guests through the city's most fascinating monuments such as the Roman amphitheater, the Arch of August and Malatesta temple. This kind of visit is not commonly organized by hotels, but it is an activity that the tourist can decide to do through tourist agency. This is another attempt of Hotel Corallo to differentiate its offer and to provide a free valuable and rare service to its customers. The only restrictions of this service are that Cristian only speaks Italian and that is an easily imitable strategy.

4.3 Focus Strategy

Type 5: Focus – Best Value

The latest strategy that Hotel Corallo started adopting is the focus – best value strategy. This strategy for Hotel Corallo means to target and attract a niche market of customers with a specific taste or need which differs from the larger population.

- **Pet Friendly** → Since 2016, Hotel Corallo offers the chance to who has a pet at home to bring it along during vacations. Although the need to travel with a pet is very close to many travelers, it is still a rare feature that hotels in Rimini and surroundings offer to their guests. Hotel Corallo has a few soundproof rooms and tries to allocate there the guest that are carrying with them a pet. The room is also provided with a wide dog basket and a couple of bowls for feeding the dog. Moreover, a special area in the dining room is now assigned to host the furry guests and the staff can also provide them with an appropriate meal. During the summer vacations, Hotel Corallo guests can go the beach resort 33 (instead of going to beach resort 35) with their dog because the structure is properly arranged to welcome them. However, there are few rules that guests with pets has to undertake during their staying at Hotel Corallo in order to guarantee the well-being of other customers. These norms are very basic and include, no littering, limited barking and dogs have to be carried with the dog leash.
- **Disabled Facilities** → Since the late '90s, Hotel Corallo is free from architectural barriers to allow also people with physical disabilities to have pleasant holidays. The hotel was equipped of adequate structures and six of the thirty-six rooms were recently renovated and specific features were added to the furniture:
  1. Higher mattress
  2. Special WC seats — In-room facilities
  3. Additional handles in the toilet
  4. Big elevator
  5. Main entrance ramp — Hotel facilities
  6. Stair lift to access the dining area

  These hotel facilities are really close to that small number of customers that every year decides, despite of the disability, to choose the beach as summer vacation. Targeting this niche market, which is actually growing thanks to the overall politics of barrier-free public places, not only enables people with disability to enjoy their holidays, but also to feel part of the society. Clearly, Hotel Corallo new mission is to cater people with physical imparities and starting from differently-able people reflect the management willing of making the difference.
- **"0 km food"** → Since 2012, Hotel Corallo purchases its product only from local producers in order to allow its guests to taste the real flavor of the local cuisine and to be more environmental-friendly. "0 km food" literally means from the farm to the table, so only fresh products are served to the customers and this has a lower impact on the environment because there is no logistic expense in terms of fuel. For Hotel Corallo this choice doesn't only mean providing a higher quality food, for which the hotel is famous for, but also to cater a growing niche of customer who are health-conscious and environmental friendly.
- **Gluten-free kitchen** →Although Rimini is well-known for its hospitality and ability to continuously renew itself throughout time proposing cutting-edge attraction, Hotel Corallo is one of the only three hotels in the range of about 50 km to offer a gluten-free kitchen approved by AICA – Associazione Italiana Celiachia (Italian Association for Celiac Disease). To be considered in line with the legal standards Hotel Corallo in 2009 built a

separate kitchen to prepare specific dishes that people suffering from celiac disease could eat in complete safety. At the same time, also the hotel main cafeteria was equipped to provide beverages without gluten by separating the coffee machine and the barley coffee (which contains gluten) and purchasing separate packaged beverages such as fruit juices and soft drinks [es. Coca-Cola contains traces of gluten, while Pepsi doesn't]. To be constantly updated Hotel Corallo subscribed with AIC to get weekly/monthly updates on the food and beverage that can or cannot be served to their special guests. AIC yearly provides Hotel Corallo with few copies of its updated handbook which can be consulted bot by the employees and guests. This special consideration from the management towards celiac disease rose when Mr. Fabio discovered to suffer from this health condition. In the past few years, the celiac disease has become more and more popular because this sickness wasn't well-known in Italy and the number of people aware of being affected by celiac disease has been increasing. Therefore, the gluten-free option became a key for the hotel sustainability and also for gaining competitive advantage over competitors who haven't targeted yet this growing niche market. Thanks to this new allergy-focused approach, Hotel Corallo manages to attract not only tourists during the summer season but also guests interested in the gluten-free kitchen throughout the whole year. As previously mentioned, the options available for people affected by celiac disease aren't many and these customers are willing to travel from other cities just to have a lunch out or to host their wedding party.

- **Ozone Machine** → In 2015, Hotel Corallo decided to pursue its nearly unique battle in the field of allergies by adopting an ozone machine. Ozone has been proven to be more effective than chorine in purifying also large-sized rooms and with its action it gets rid of dust mites and other kind of bacteria guaranteeing a higher service quality to customer affected by allergic rhinitis. Therefore, the resort rooms that are reserved by guests with dust mites and spore allergies are preventively cleaned with the ozone machine and it is left in the room for the guest for personal use.

4.4 Conclusion

Hotel Corallo management is continuously working to implement the quality of the service provided implementing every time different strategies. Throughout time Hotel Corallo demonstrated to be able to endure hard times and to find new ways to increase its market share by being customer conscious. Different decades required from Hotel Corallo different and every time more elaborated strategies. However, while suggesting new services the management improved the old ones and, with from over 50 years from its foundation, Hotel Corallo boasts a complex and variegated strategy that still leaves room for improvements.

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