

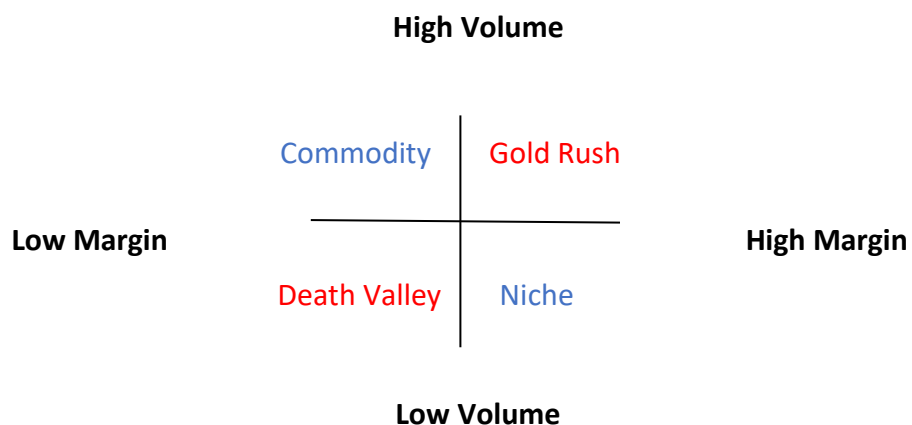


Economic Gardening

CORE STRATEGY

Our contention is that all businesses have one of two core strategies: either commodity (driven by prices) or niche (driven by innovation). It is our experience that core strategy is critical to developing marketing campaigns and setting management objectives.

Consider this idea for a moment. All business can be described as making a profit using the following formula: profit margin per item x total volume of items sold. Using this "volume/margin" approach, we can create this simple diagram:



This elementary volume/margin approach creates four quadrants. Two of these quadrants are not sustainable. Any business that is *high margin and high volume* (we are making a million dollars on everything we sell, and we are selling a million of them) is going to draw a lot of competitors immediately. It's like finding gold--you will be very rich for a short amount of time, but in the morning there will be a lot of people camped up and down the stream.

The *low margin/low volume* strategy is not sustainable either. This is an example of saying "we are not making very much on the things we sell, but don't worry about it because we are not selling very many anyway."

So almost every business ends up making a net profit in one of the two remaining quadrants: either as *high volume/low margin commodity* companies (like Wal-Mart) or as a *low volume/high margin specialized niche* companies (like Nieman Marcus).

The reason core strategy is important is that it affects how you manage a company. **Commodity businesses**, by definition, cannot differentiate their products from their competitors (think of salt, as an extreme example). Since the products are exactly alike, to win in this quadrant a company must consistently reduce costs to have the lowest price. All the focus is on more efficient processes, bigger quantity discounts from suppliers and replacing labor with machines.

The other core strategy option is a **niche business**, which doesn't have the high volume but makes up for that by keeping profit margins high. The key to winning in a niche business is to innovate something new, which the customer wants, and the competitors don't have. In effect, this gives the business a *temporary monopoly* until the competitors close the gap -- at which point you are both offering the same thing (i.e. commodity). The whole focus of management in a niche business is on innovation that gives your company a temporary lead over your competitors.

Companies often get into trouble with strategy drift--and in particular a drift from niche into commodity. It is not unusual for businesses to pursue sales indiscriminately and stumble into commodity markets without realizing that it is doing so. They don't realize that if they stay in the commodity quadrant, they have to shift their management focus to volume and expense reduction. If they don't want to compete that way, then they have to innovate back into the niche quadrant.