

## Differentiation vs. Low Cost in Romania: The Covid Shock on Generic Strategies Theory

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### Abstract

*The study investigates the possibility of implementing differentiation and low-cost strategies in the Romanian post-pandemic Covid conditions. It starts with the research of the theory related to the two generic strategies. The major problems of using basic concepts whose definitions generate a fragile theoretical structure are reviewed. This theoretical context is then related to the situation of generic strategies in an earlier period of the Romanian economy, in which the share of state property was higher than the current one. Based on the theoretical landmarks and the current situation, a projection is made of the way in which the respective strategies will be articulated in Romania. The conclusions point to doubt about the possibility of finding a concretization of the strategies according to the theoretical landmarks conveyed by the very popular textbooks.*

**Key words:** strategy, competitive strategy, differentiation strategy, low cost strategy

**J.E.L. classification:** M20

### 1. Introduction

The 2020 pandemic has generated in Romania, as in the rest of the world, the need for an adaptive approach of organizations to a new set of "rules of the game". Companies have been placed in a new context, in which the issue of survival has become essential. After the first phase associated with the peak of the pandemic, the following few years, possibly a decade, seems to boost the companies' task to adopt a strategy.

Given the global inner nature of this crisis, States have acquired a key role in coordinating the collective effort at the national and international levels. The consequence at the company level is that the State becomes an active stakeholder, with a significantly amplified role compared to that of a general regulator, and the company's strategy must fall in line with that of the State. In other words, the plan of a private entity must be designed to engage with all other entities, the ensemble being coordinated by the State. In the case of States that are part of structures with a high degree of integration, such as Romania as part of the EU, a company's strategy must be designed in compliance with the additional conditions imposed by the mentioned framework. At stake is the survival of the company, which means the ability to compete, even if the competitive environment is globally reshaped and the State's role is modified.

The rational treatment of the company's behavior molding in reference to the current theory of management requires the use of concepts specific to the economy and associated with the strategy. If the theoretical basis focused on the concept of strategy is narrowed, while applied at the level of companies operating in a competitive context, then the key element becomes the so-called competitive strategy. Its theoretical benchmarks are to be used to create a plan which is supposed to ensure the company's survival in the post-pandemic context.

The first step for such an action is the critical analysis of theoretical landmarks around which the plan is configured, in an abstract construction. The final success will depend on the coherence and consistency of that construction.

## **2. Research methodology**

The study of how shock-event influences the development of strategic alternatives in a particular country starts with the analysis of the theoretical consistency of the respective alternatives. Using the "axis" that starts with the concept of "strategy" and ends in this study with the concepts of "differentiation" and "low cost", I emphasize on the (many) theoretical consistency issues, in order to finally evaluate the coherence of the whole. This critical analysis of the theory serves to evaluate the possibility of generating a theoretical framework for dealing with the changes induced by the shock event.

The analysis consists of a literature review of the main concepts and their reflection in the subsequent works. The elements of interest associated with the definition of the strategy and the misuse of the "strategy" label, then of the "generic strategy", are considered, in order to reach the most well-known and popular labels for these strategies: differentiation and low cost. We have mainly pointed out the elements that mark discordant opinions as opposed to the mass of enthusiasts using the respective labels. At the same time, we highlighted the logic weaknesses associated with ideatic constructions that use generic strategies and axioms related to them.

The assessment of the theoretical basis is then used to measure the outcome of its application in the case of Romanian companies affected by the 2020 pandemic. The assessment we make is marked by corresponding elements that we find in the developed countries' economies, especially the EU, as well as by strategic scenarios reported by large companies operating on a global scale.

The theoretical "matrix", on which we mark the doubtful elements, is then applied to the results of an analysis of the implementation of the differentiation and low-cost strategies in Romania in the first years of this century. This analysis, dated two decades ago, was using the concepts mentioned above, without pointing out the associated theoretical problems, keeping in mind that the Romanian state was a more significant stockholder than it is today, and the competitive environment in all industries included more organizations than it is the case today. The conclusions of the study focus on the assessment of the consistency of a viable approach both in Romania and in several industries or large business groups operating in Romania.

## **3. Basic theoretical landmarks of the competitive strategy**

The most famous labels related to the so-called competitive strategy are differentiation and low cost, introduced by Porter (1985). Their market success is attested by the significant number of bibliographic references, as well as by the attractiveness they exert on the readers dedicated to the field of company strategy. Nevertheless, that success obscures all criticism on a theoretical level; so does the relative lack of viable, practical landmarks generated by the application of those concepts. Moreover, the labels mentioned and their use as a leitmotif for any strategy discussion affect the soundness of a theoretical basis of a strategy, which would be necessary in the new conditions of the 2020 moment. Starting from the unattainable position of the two mentioned labels, an analysis of the series of concepts that lead to them shows that there are several weaknesses generated by incomplete or inappropriate definitions of those concepts. Problems of applicability in practice, as well as questionable results, are derived from these weaknesses.

The first elementary problem arises when using the concept of strategy. The initial definition referred to an organization, considered to be a whole, with clear demarcation and a distinct mode of action: the army (Quin, 1980; Desreumaux, 1993). Compared to this type of organization, the theory of strategy has developed coherently, with notable milestones, including Sun Tzu with his writing "The Art of War" and Clausewitz with his book "About War". Consistent, practical results of the application of this theory are evident from the consequences of various wars of all time.

The translation of the concept into the world of privately-owned commercial organizations was done in a sustained way based on theory only in the last half of the twentieth century. Paradoxically, the transfer did not mean a stabilization of a reference definition, certified by practice. Not only was there no initial definition, such as the game theory definition given by von Neumann and Morgenstern (1944), or an adaptation of the dictionary definition (e.g. Webster) used by the military, but the approach related to the companies marked a total dispersion.

Whittington (1993), like Porter (1996), does not define the concept, but justifies avoiding the problem. In the absence of convergence on the definition of strategy, when each author uses his own definition, Mintzberg (1987) explains the meaning in which the concept is used, and Hafsi and Toulouse (1996) try a summative approach to opinions at the turn of the century. The major problem that emerges from this theoretical vision is that the strategy can be associated with a reactive and defensive behavior, which excludes the pursuit of a project for a future state of the organization. The idea of the emerging strategy (Mintzberg and Waters, 1985) appears as a theoretical justification for the mentioned behavior. In practical terms, the undesirable result is that many organizations no longer create projections of their future, considering that they will have the ability to adapt over time. Short-term orientation and focus on financial results, lead, with significant probability, to situations that threaten the existence of the company. The Enron case of 2001 is noteworthy for the disappearance of a company, while the situation of Boeing in 2019 signals major problems generated by the same approach.

Therefore, starting with the definition of the concept, the strategy presents a fragility that will affect the consistency of a project aimed at the long-term survival of a company in the conditions of environmental shocks. In the absence of definition and ignoring both the initial meaning of the term and centuries of military practice, emptying the concept of content through the misuse of this label leads to major command and leadership dysfunctions in the organization (Băcanu, 2015). In direct relation to the mentioned use, it can be found that the entity referred to in the concept rarely retains the characteristics of an organization with a clear demarcation, such as the army. In other words, we are talking about the strategy of a part of the company-type organization, in the conditions of a vague definition of the basic concept.

Without discussing the nature of the current company, a good part of the theory of the moment, focused on the strategy of commercial organizations, is dedicated to the so-called business. This is a component of the organization, with some degree of operational autonomy of and a relatively distinct organizational structure. Several strategic management manuals, such as Johnson *et al* (2011), identify a typology of business strategy. In the case of American textbooks, this type of strategy is labeled "competitive strategy", and addresses competition in a given industry or market.

The concept of "competition" was adopted in the theory of the company's strategy in industrial economics, developed in the last century, but without retaining the idea of a stake related to survival as in the case of the military. The current combination of "competitive strategy" has reached its maximum popularity by promoting a typology of strategies created by Porter (1980, 1985). This typology takes into account the typology of Ansoff (1965), who is credited with inventing the concept of "strategic management". In this context of marking pioneering work, it is more difficult to emphasize that focusing the strategy on a lower entity within the organization, the so-called business, will have significant adverse effects. The undesirable effects were amplified by the popularity of the concepts associated with the typologies of competitive strategies, especially that of Porter (1985). This creates a fashion of typologies and taxonomies. Sumer and Bayraktar (2012) inventory almost 30 different "products" created by various authors. It should be mentioned that these typologies mainly target the intermediate segment, of a company, called business, ignoring the reality based on the existence of large industrial groups. In other words, strategies are not discussed for the first two levels, group and company, but are discussed at the level of a part of the company. In the wake of this approach appear then the so-called "functional" strategies, with reference to finance, marketing or operations.

Marked by this error of concept focus, competitive strategies are treated reductionistically by the authors of typologies. Porter's typology emphasizes that there are only two ways to gain a competitive advantage: differentiation and low cost. In addition, the author argues that the two paths are mutually exclusive. This idea decisively marked not only the academic discussions related to the strategy, but also the approaches of the big companies and the policies of the states.

The way in which Porter defined the differentiation strategy and the cost-lead strategy generated consistent criticism and revealed different points of view, but the publicity associated with the respective strategies blurred the adverse positions. Among these is the opinion expressed by Levitt (1980), who argues that any product, even commodities, can be differentiated, or that expressed by Deming (1986) who argues that superior quality reduces costs.

Clearer criticisms have been leveled at the exclusivity mentioned. Hambrick (1983), Jones and Butler (1988), and Karnani (1984) consider that between the two strategies, differentiation and low cost, there is a continuum of combinations, and Murray (1988) argues that a combination of differentiation and low cost provides a competitive advantage. Miller and Dess (1993) and Johnson *et al* (2011) consider "hybrid" strategies to be feasible and profitable. If Allaire and Farsirotu (1998) notice a confusion of meaning that revolves around Porter's generic strategies, Bowman (2008) considers that the discussion about generic strategies affects the rationality of the strategic approach. In his study, "Generic Strategies: A Substitute for Thinking?", Bowman identifies the following issues: the confusion between "how to compete" and "where to compete," the confusion between corporate and competitive strategy, and the exclusion of other strategic options.

The issues that were mentioned for generic strategies complete the list of theoretical problems encountered by companies and states while trying to coagulate a strategy capable of responding to a catastrophic shock such as the 2020 pandemic.

#### **4. Differentiation vs. low cost in Romania - 20 years after - all through the Covid pandemic**

In order to build a projection of the use of the mentioned strategies, it is useful to review the pre-Covid situation for the respective strategies in Romania. In order to establish a benchmark regarding the decision-maker involved in defining the strategies in question, it should be noted that at the beginning of 2020 approximately 50% of GDP was generated by companies with owners from abroad. Almost all large companies, with some notoriety of products or brand, have a shareholder structure that certifies that the decision is determined by foreign stockholders. From this perspective, it can be concluded that Porter's generic strategies can be associated with the mentioned companies in Romania, because they represent distinct businesses within some holding companies or corporations. On the other hand, the involvement of the state in the competitive shaping of the national market is increasingly reduced under the pressure of EU regulations or signals given by global corporations. De facto state interventions towards a cooperative approach in different industries are limited compared to those in large EU countries. It is noteworthy that the projection related to the differentiation of Levitt (1980) thus materialized in an obvious way. Products with a value of 1 euro are branded and a differentiation strategy is operationalized. Therefore, differentiation, without being associated with exceptional technical characteristics, has become the current approach.

Despite this approach applied to private brands, the year 2020 marks an important restriction of the possibility of using the "made in Romania" brand, under the pressure of EU regulations. The situation disadvantages all producers in Romania, especially those with Romanian ownership and the ones that fall under the SME category. Thus, these producers cannot signal to their markets a cost advantage derived from the use of a domestic low-cost labor force, as well as a series of traditional technical characteristics that would offer an extra attraction for the customer. In the case of Romanian producers with foreign ownership, the outsourcing of the cost advantage generated by the extensive use of local labor would become visible in the absence of EU regulations. The phenomenon would be similar to that revealed by the high prices of textiles produced in Vietnam and sold in German stores in Romania.

A situation that seems to support the idea of a low-cost strategy is that of the industries in the first line of processing natural products, such as oil, wood or a number of agricultural products, especially cereals. However, it should not be overlooked that these products display a differentiation, marked by the country of origin, which gives the specific appeal of the natural product. For example, cereals from a country where the chemization of agriculture is low is preferred to GMO-type cereals.

Summarizing the findings regarding the two generic strategies in the pre-Covid interval, it is worth highlighting the combination of the two, contrary to the initial prescription of Porter (1985). Murray (1988) seems to have generated a more correct vision: the most well-known products in Romania base their success on a differentiation, materialized in a good technical standard, offered at a fair price. For example, we can mention Dacia cars or Arctic refrigerators.

But in Romania, as in the countries where it could be said that manifestations of Porter's generic strategies are observed, the shock of the pandemic blew up the cost advantages based on economies of scale. The complete cessation of activity has disorganized production systems based on a high spatial density of consumers or workers, e.g. showbusiness or assembly lines of complex manufactured products, such as cars or refrigerators.

The introduction of the so-called social distance in the case of activities that have not stopped, as well as maintaining this condition for the near future, will induce additional costs that add to those of job security and will volatilize the previously reduced cost. As some of the Romanian low-cost industries, such as the textile industry, have already been relocated to Asian areas with low labor costs, businesses that seem to rely on such an advantage are forced to look for an alternative. The scenario is even more plausible as the theoretical consistency of the concept fits into the situation mentioned in the previous chapter.

Given the ownership structure, the large subsidiaries in Romania will follow strategies dictated by the parent company, in close cooperation with the state where it comes from or where the headquarters are located. The logical consequence is that the generic strategy of the subsidiary will be guided by the desideratum of obtaining a positive socio-economic effect in the state associated with the parent company, which excludes a hypothetical and difficult to define competitive advantage of the subsidiary. Stockholder the French state, will shape the strategy of the Romanian subsidiary Dacia to ensure the survival of the group and the preservation of a favorable socio-political context in France. This is all even truer as the French state provides financing for overcoming the Covid shock. A brief search of the signals regarding Renault's strategy does not offer many clarifying elements, which allows us to deduce that the previous strategic line related to differentiation and cost will be kept at Dacia. But a so-called harvesting strategy is also likely, through which resources will be transferred to the parent company. The situation exemplified with "Dacia" is similar to the vast majority of Romanian subsidiaries. Their strategy, established at headquarters based on a debatable theoretical matrix, will not reveal anything concrete that resembles the precepts in the strategic management manuals marked by Porter's axioms.

A different situation is represented by a smaller segment of subsidiaries, represented by banks, for example. They have a preferential regime, to the construction of which the Romanian state contributes through a subsidy program similar to the one practiced by France or Germany for the companies from the respective countries. In the case of banks, the direct impact is constituted by the National Bank of Romania.

For Romanian-owned companies, the adoption of strategies guided by a State cooperation plan can be expected. The cooperation would translate into financial assistance based on a national Covid shock absorption strategy and adaptation to new social conditions. In addition, cooperation would mean reshaping the competitive internal environment, as signaled by the massive involvement of Western states in their national economies, by circumventing EU rules and by failing to provide reasonable support to states on the periphery of the European Union.

The reality shows that the state does not have this plan, which makes it impossible to coagulate viable strategies at the level of companies. The financial support is vaguely outlined, and the cooperation in the mentioned forms is non-existent. What's worse is that there is not even a vague scheme of using EU-permitted safeguards. Thus, it can be noted that the strategic approach guided by the oldest theoretical landmarks that were focused on the survival of the army and the state is non-existent.

The strategy of a Romanian company allows survival as a result only with chance, given that the modern statist component with a supporting role is missing. Maintaining a strategic line reminiscent of Porter's generic strategies is unlikely, given that the additional costs induced by the pandemic affect both the price and the ability to sustain differentiation, based on technical characteristics or own brand.

## 5. Conclusions

Starting from the interest shown by the academic public for the "differentiation" and "low cost" labels used for the company strategies, we analyzed how they materialize as viable organizational solutions in the context in which Romania, like many other states, was affected by the catastrophe of a pandemic.

The study of strategic concepts, starting with the definition of the strategy applicable to a company, showed that the theoretical basis of concrete action is awfully fragile. The situation is the result of dubious and incomplete definitions, of ignoring the experience associated with the original field of strategy and the trap of producing derivative concepts, undermined by inconsistency and encapsulated in axioms that are not found in real-life organizations.

The review of the situation of generic strategies in Romania 20 years ago confirmed the existence of a certain mix of the two generic strategies, given that brand-based differentiation is quasi-generalized, and the low-cost is generated by low labor resources. We also point out that under EU regulations, differentiation based on the label "made in Romania" will be virtually prohibited.

With reference to companies currently operating in Romania, it should be noted that half of GDP is associated with such subsidiaries. Their strategy, decided by the parent companies, responds to the desideratum of the corporation and the originating State. The consequence is that the generic textbook strategy will be difficult to detect in the strategic behavior of these subsidiaries. To depict such a confusing situation, we emphasize on the active intervention of EU large states in their national economies; this completely alters the idea of competition.

Firms with local owners are exposed not only to the lack of a coherent theoretical basis related to strategy, but also to the lack of an integrative approach of the Romanian state. Under such conditions, the articulation of a strategy focused on differentiation or low cost seems illusory.

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