MSc Marketing Management

Pre-course Fall 2007

Corporate Management

Session 2.
Gaining competitive advantage: environmental and internal scanning

Session Objectives

Describe the dimensions of the general environment facing a firm and how this environment can affect a firm’s opportunities and threats.

Describe how the structure-conduct-performance paradigm suggests that industry structure can influence a firm’s competitive choices.

Describe the “five forces model of industry attractiveness” and indicators of when each of these forces will improve or reduce the attractiveness of an industry

Session Objectives

Describe the difference between rivals and substitutes.

Describe the role of complements in analyzing competition within an industry.

Describe the four generic industry structures and specific strategic opportunities in those industries.

Describe the impact of tariffs, quotas, and other non-tariff barriers to entry on the cost of entry into new geographic markets.

Describe the differences between multinational, global, and transnational opportunities.

Understanding a Firm's General Environment

A firm's general environment is defined as follows…

Definition of General Environment

The general environment consists of broad trends in the context within which a firm operates that can have an impact on a firm's strategic choices.

Why Conduct an External Analysis?

External Analysis Allows Firms To:

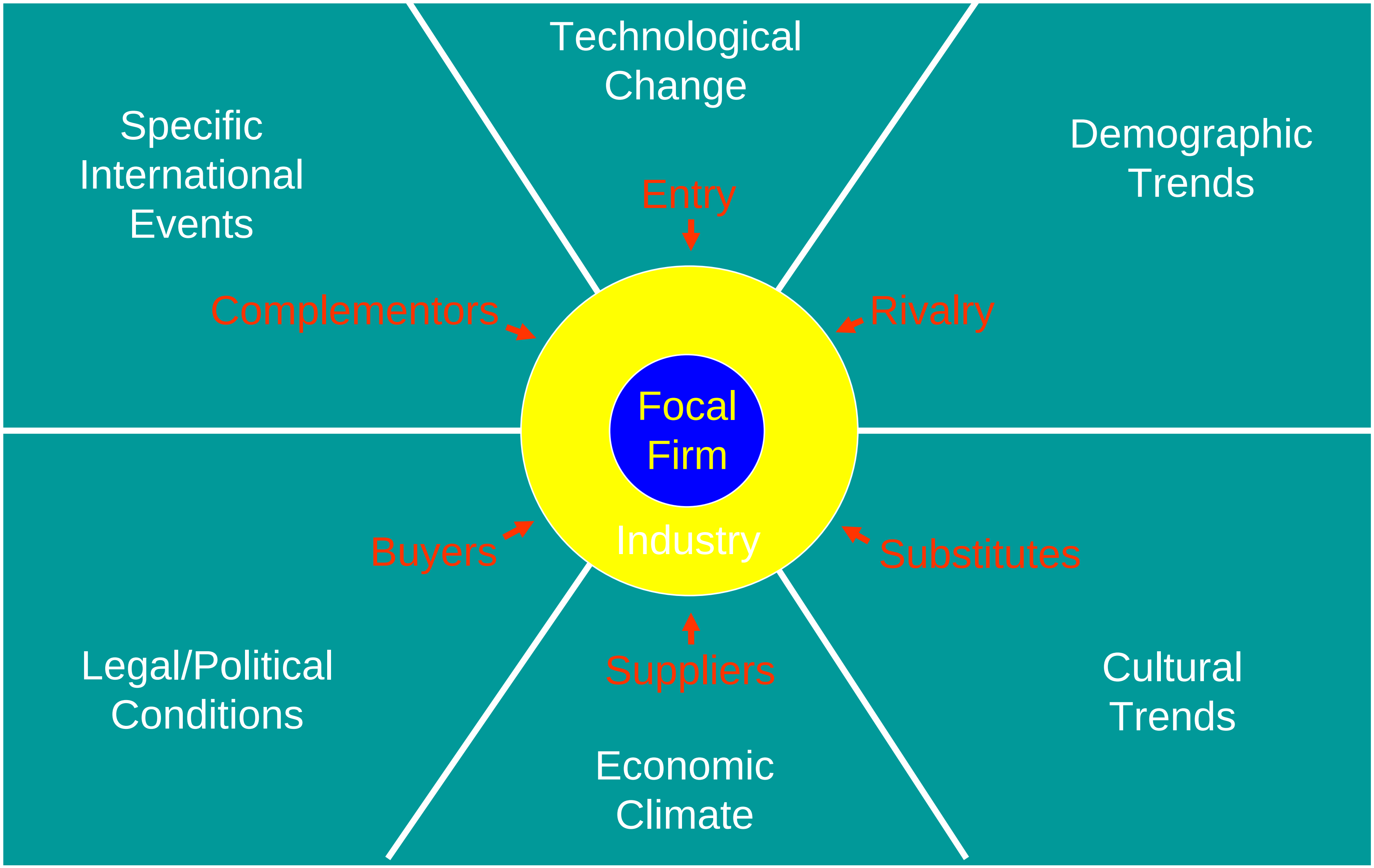
Discover threats and opportunities

See if above normal profits are likely in an industry

Better understand the nature of competition in an industry

Make more informed strategic choices

The General Environment Facing Firms



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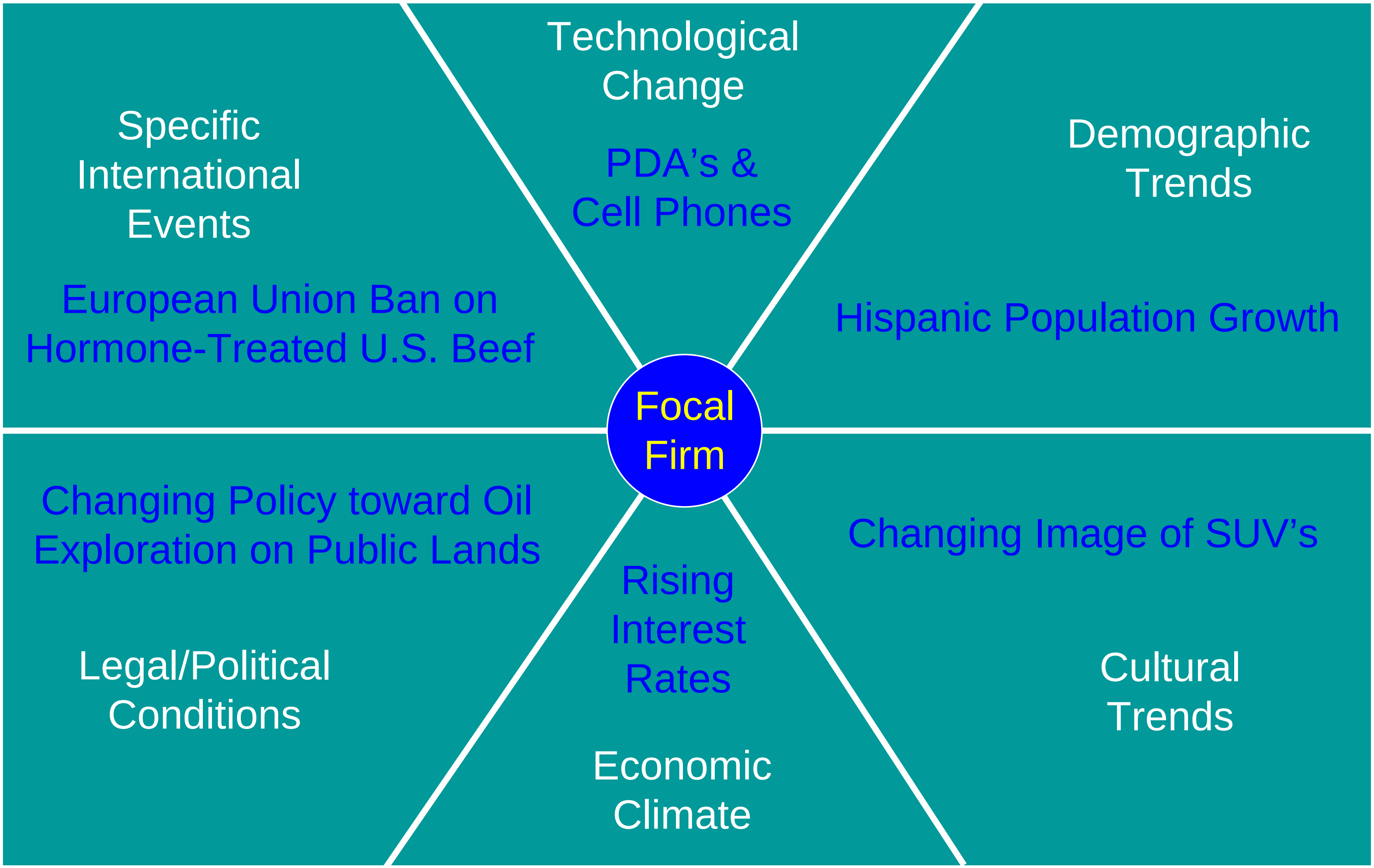


Industry Analysis

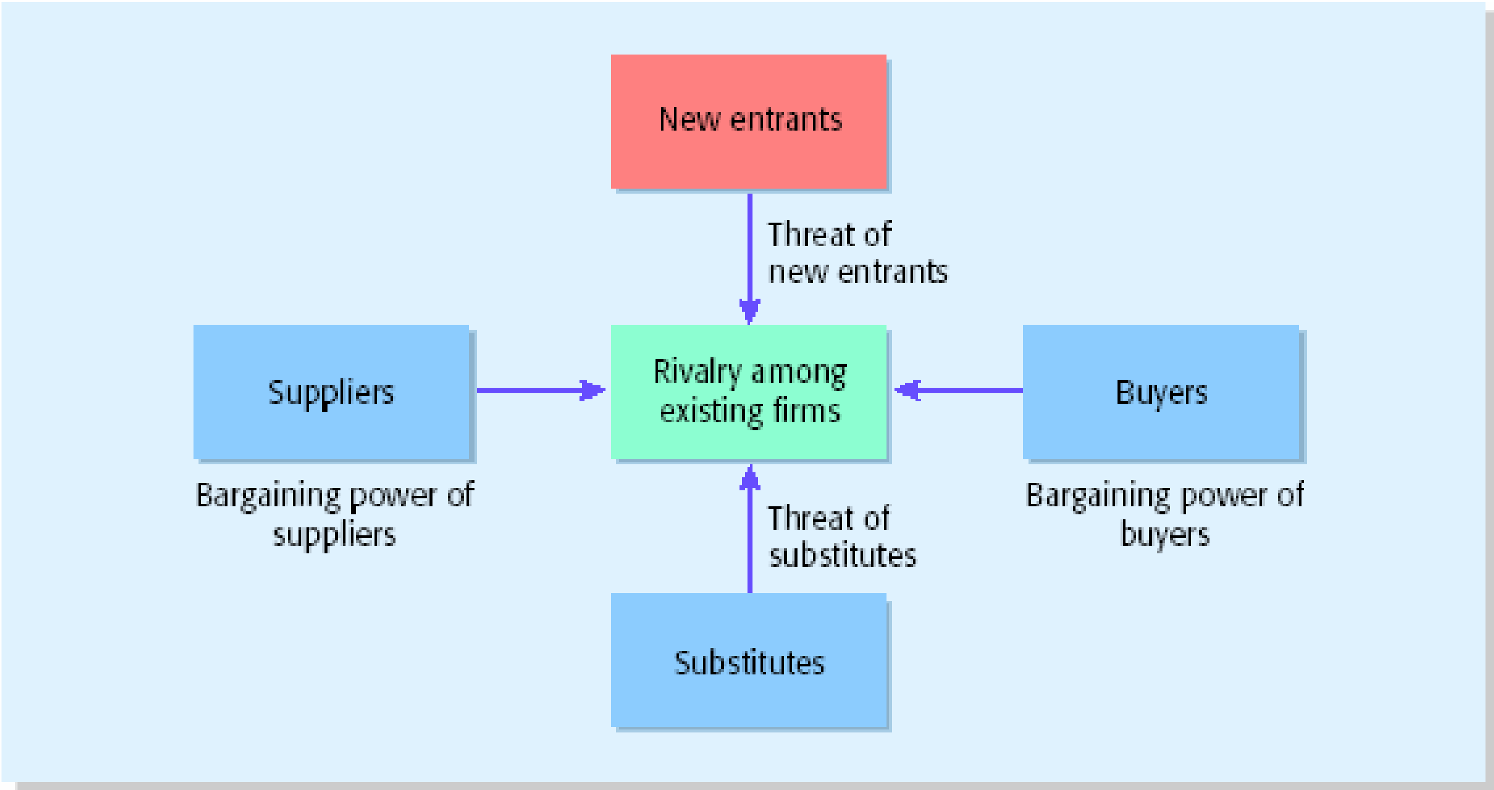
Industry

- An industry is a group of firms producing a similar product or service, such as airlines, fitness drinks, or electronic games.

Industry Analysis

- Is business research that focuses on the potential of an industry.

The Five Forces Model of Environmental Threats



Threat 1:Threat of New Entrants

Threat of New Entrants

- If firms can easily enter the industry, any above normal profits will be bid away quickly.
- Barriers to entry lower the threat of entry.
- The existence of barriers to entry make an industry more attractive
  - This is true whether the focal firm is already in the industry or is thinking about entering it.

Threat 1:Threat of New Entrants

Barriers to Entry

- Economies of Scale
  - Firm that can’t produce the minimum efficient scale will be at a disadvantage.
- Product Differentiation
  - Entrants are forced to overcome customer loyalties to existing products.
- Cost Advantages Independent of Scale
  - Incumbents may have learning advantages, etc.
- Government Policies
  - Governments may impose trade restrictions and/or grant monopolies.

Threat 2: Threat of Rivalry

Rivalry Among Existing Firms

- High rivalry means firms compete vigorously—and compete away above average profits.
- Industry conditions that favor rivalry
  - Large number of competitors
  - Slow or declining growth
  - High fixed costs and/or high storage costs
  - Low product differentiation
  - Industry capacity can only be added in large increments

Threat 3: Threat of Substitutes

Substitutes

- Substitutes fill the same need but in different ways.
  - Coke and Pepsi are rivals, milk is a substitute for both
- Substitutes creates a price ceiling because consumers switch to the substitute if price the price gets too high.
- Substitutes will likely come from outside the industry—be sure to look.

Threat 4: Threat of Suppliers

Threat of Suppliers

- Powerful suppliers can “squeeze” (lower profits) of the focal firm.
- Industry conditions that facilitate supplier power:
  - Small number of firms in supplier’s industry
  - Highly differentiated product
  - Lack of close substitutes for suppliers’ product
  - Supplier could integrate forward
  - Focal firm is an insignificant customer of supplier

Threat 5: Threat of Buyers

Threat of Buyers

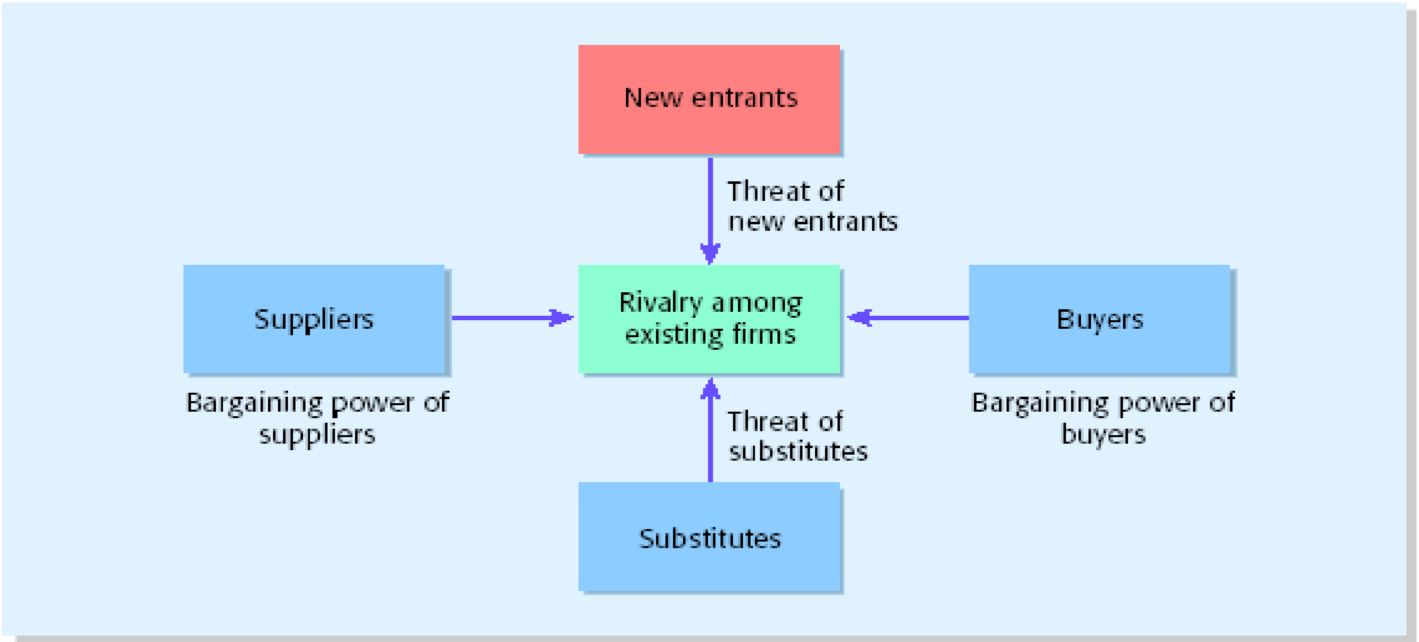
- Powerful buyers can “squeeze” (lower profits) the focal firm by demanding lower prices and/or higher levels of quality and service.
- Industry conditions that facilitate buyer power:
  - Small number of buyers for focal firm’s output
  - Lack of a differentiated product
  - The product is not significant to the buyer

Threat 5: Threat of Buyers

Threat of Buyers

- Industry conditions that facilitate buyer power (continued):
  - Buyers operate in a competitive market—they are not earning above normal profits
  - Buyers can vertically integrate backward
  - Many small buyers can be united around an issue to act as a block

Porter’s Five Forces Model



If all threats are high → Expect normal profits

If all threats are low → Expect above normal profits

Complementors As Another Force

Complementors As Another Force

- Complementors Increase the Value of the Focal Firms Product
  - Customers perceive more value in the focal firm's product when it is combined with the complementor's product
  - Complementors may be found outside the focal firm's industry

Example: Ipod Add-ons

"There is an incredible 'iPod economy' out there," Jobs said. "There are now over 400 accessory products you can get for your iPod. This is unmatched in the industry by a mile."

Responding to Environmental Threats

Neutralizing Threats

- Most firms cannot unilaterally change the threats in an industry.
- By altering relationships in an industry, firms may reduce threats and/or create opportunities, thereby increasing profits.

Example: Telco Industry - unbundling

Porter’s Basic Strategies

Market focus	Competitive factor: Cost	Competitive factor: Differentiation
Whole	**Cost Leadership**	**Differentiation**
Segment	**Focalization (niche)**	

Exploiting Industry Structure Opportunities

Most Common Industry Structures

Fragmented Industry

Mature Industry

Emerging Industry

Declining Industry

Fragmented Industry Structure

Industries in which a large number of small or medium-sized firms operate and no small set of firms has dominant market share or creates dominant technologies

Industry Characteristics	Opportunity
- Large number of small firms - No dominant firms - No dominant industries - Commodity type products - Low barriers to entry - Few, if any, economies of scale	Consolidation - Buy competitors - Build market power - Exploit economies of scale

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Emerging Industry Structure

Emerging industries are newly created industries formed by technological innovations, changes in demand, the emergence of new customer needs, and so forth

Industry Characteristics	Opportunity
- New industry based on break through technology or product - No product standard has been reached - No dominant firm has emerged - New customers come from non-consumption not from competitors	First mover advantages - Technology - Locking-up assets - Creating switching costs

Mature Industry Structure

Mature industries are characterized by declining growth in total industry demand

Industry Characteristics	Opportunity
- Slowing growth in industry demand	- Refine current products
- Technology standard exists	- Improve service
- Increasing international competition	- Process innovation
- Industry-wide profits declining	
- Industry exit is beginning	

Declining Industry Structure

A declining industry is an industry that has experienced an absolute decline in unit sales over a sustained period of time

Industry Characteristics	Opportunity
- Industry sales have sustained pattern of decline - Some well-established firms have exited - Firms have stopped investing in maintenance	- Market leadership - Niche - Harvest - Divest

Approaches to International Markets

- International markets present opportunities that vary depending on market characteristics.
- External analysis should include an assessment of international market characteristics.
- Firms can improve the probability of above normal profits by exploiting the opportunities presented by international market conditions.

Multinational Opportunities

Firms pursuing multinational opportunities in international industries operate simultaneously in several national or regional markets, but these operations are independent of each other and are free to choose how to respond to the specific need of each national or regional market.

Multinational Opportunities

Market Characteristics	Structural Response
- No global product standard - Tastes and preferences vary - Transportation of finished product is cost prohibitive - Governments impose local content rules	- Replicate headquarters functions in multiple markets - Give local managers autonomy to respond - Modify product to local tastes and preferences

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Global Opportunities

Firms pursuing global opportunities seek to optimize production, distribution, and other business functions throughout the world in addressing all the markets in which they operate.

Global Opportunities

Market Characteristics	Structural Response
- Global product standard - Governments allow importation - Significant economies of scale exist - Product development costs are significant	- Minimal replication of headquarters functions - Centralized decision making at headquarters - Centralized manufacturing - Little responsiveness to local tastes & preferences

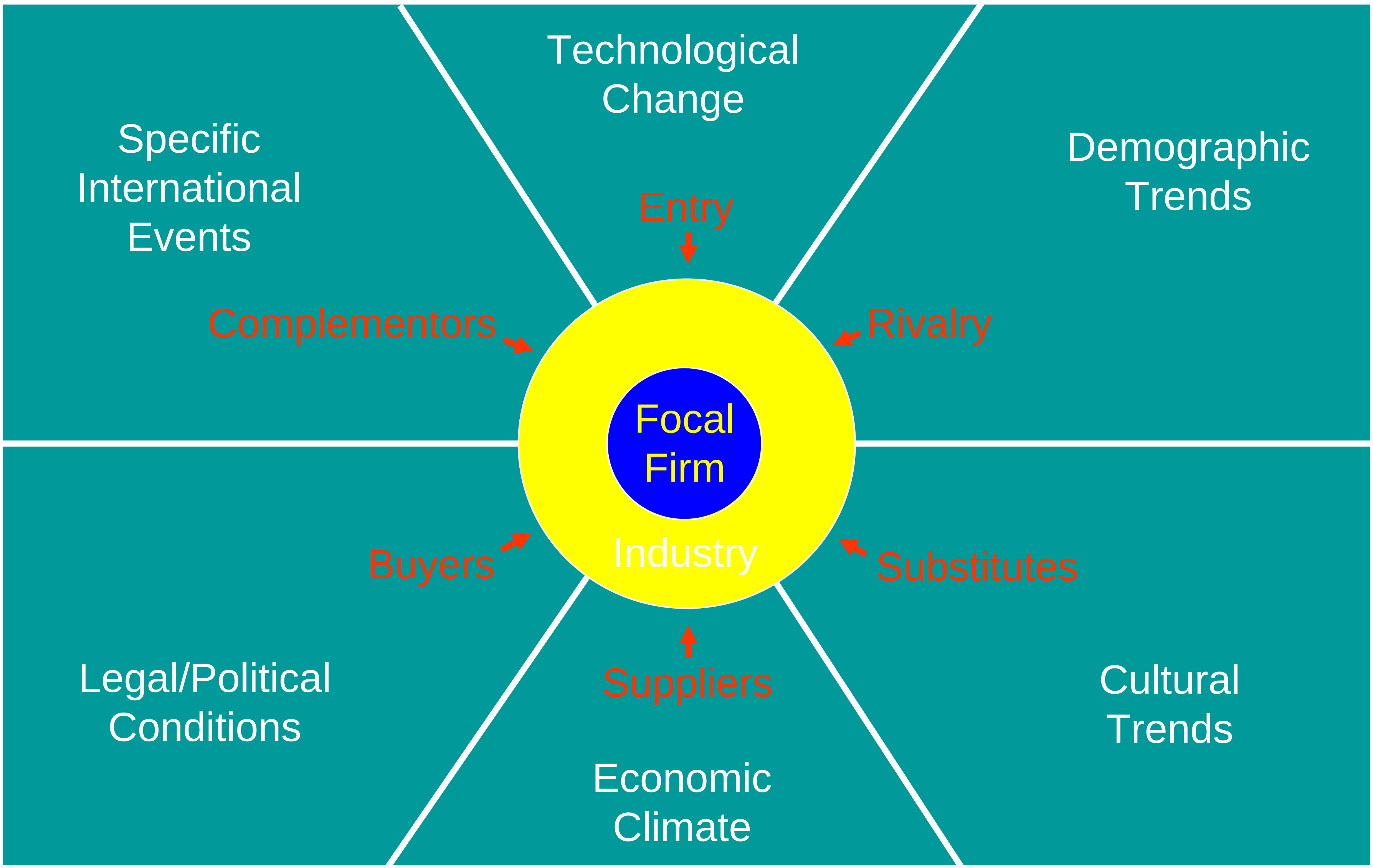
Transnational Opportunities

Firms exploiting a transnational opportunity in an international industry treat their global operations as an integrated network of distributed and interdependent resources and capabilities.

Transnational Opportunities

Market Characteristics	Structural Response
- Product standardization differs from region to region - Government policy varies from region to region - Local tastes and preferences vary from region to region	- Headquarters functions are replicated in some but not all regions - High degree of coordination between regions and headquarters - This is a combination of a multinational and global approach

General External Environment



Summary

External Analysis

- Takes time and effort
- Should include consideration of international markets
- Helps firms recognize threats and opportunities
- Provides assessments of likely levels of industry profitability (normal, above, below)
- Can be applied at the individual level to professional and personal environments

Resource-Based Approach

Internal strategic factors:

Critical strengths and weaknesses that are likely to determine if the firm will be able to take advantage of opportunities while avoiding threats.

Resource-Based Approach

Resource:

An asset, competency, process, skill, or knowledge controlled by the corporation.

Evaluating Key Resources

VRIO Framework

Value: ***Does it provide competitive advantage?***

Rareness: ***Do other competitors possess it?***

Imitability: ***Is it costly for others to imitate?***

Organization: ***Is the firm organized to exploit the resource?***

Resource-Based Approach

5-Step approach to strategy analysis:

Identify & classify firm's resources

- ***Strengths & weaknesses***

Combine firm's strengths into capabilities

- ***Core competencies***
- ***Distinctive competencies***

Resource-Based Approach

5-Step approach to strategy analysis:

Profit potential of resources

- ***Sustainable competitive advantage***

Select strategy

- ***Exploits firm's resources relative to external opportunities***

Identify resource gaps

- ***Invest in upgrading weaknesses***

Sustainability of an Advantage

Durability:

***Rate at which a firm's underlying resources and capabilities (core competencies) depreciate or become obsolete*.**

Sustainability of an Advantage

Imitability:

Rate at which a firm’s underlying resources and capabilities (core competencies) can be duplicated by others.

Core Competencies

Imitability of core competencies determined by:

Transparency

Transferability

Replicability

Core Competencies

Explicit Knowledge:

- ***Knowledge that can be easily articulated and communicated.***

Tacit Knowledge:

- ***Knowledge that is not easily communicated because it is deeply rooted in employee experience or in a corporation's culture***

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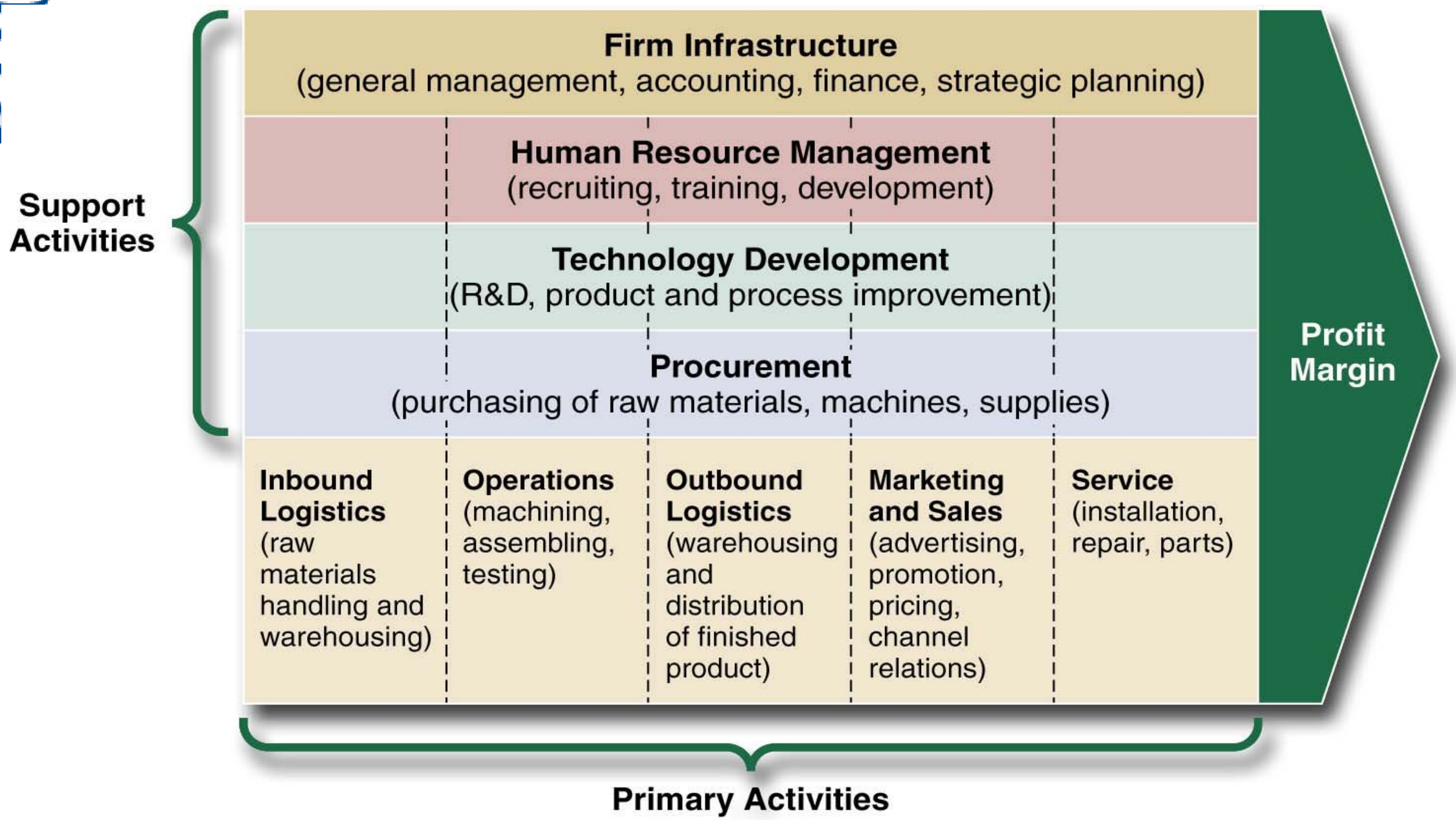
Resource Sustainability

Level of Resource Sustainability

High (Hard to Imitate) ⟷ **Low** (Easy to Imitate)

Slow-Cycle Resources	Standard-Cycle Resources	Fast-Cycle Resources
• Strongly shielded • Patents, brand name • Gilette: Sensor razor	• Standardized mass production • Economies of scale Complicated processes • Chrysler: Minivan	• Easily duplicated • Idea driven • Sony: Walkman

Corporate Value Chain



Corporate Value Chain Analysis

Examine each product line's value chain

- **Core competencies & core deficiencies**

Examine the "linkages" within each product line's value chain

- **Connections between the way one value activity is performed and the cost of performance of another activity**

Examine the synergies among the value chains of different product lines or business units

- **Economies of scope**