Organisational Strategy

BMA6104

Strategic Position (2): Industry and Sector Analysis

Learning outcomes

- Use ***Porter's five forces*** analysis in order to define the attractiveness of industries and markets and to identify their potential for change.
- Analyse strategic and competitor positions in terms of ***strategic groups***, ***market segments*** and ***'Blue Oceans'***.
- Use these various concepts and techniques in order to recognise ***threats*** and ***opportunities*** in the market place.

Industries, markets and sectors

An industry is a group of firms producing products and services that are essentially the same. For example, the automobile industry and the airline industry.

A market is a group of customers for specific products or services that are essentially the same (e.g. the market for luxury cars in Germany).

A sector is a broad industry group (or a group of markets) especially in the public sector (e.g. the health sector).

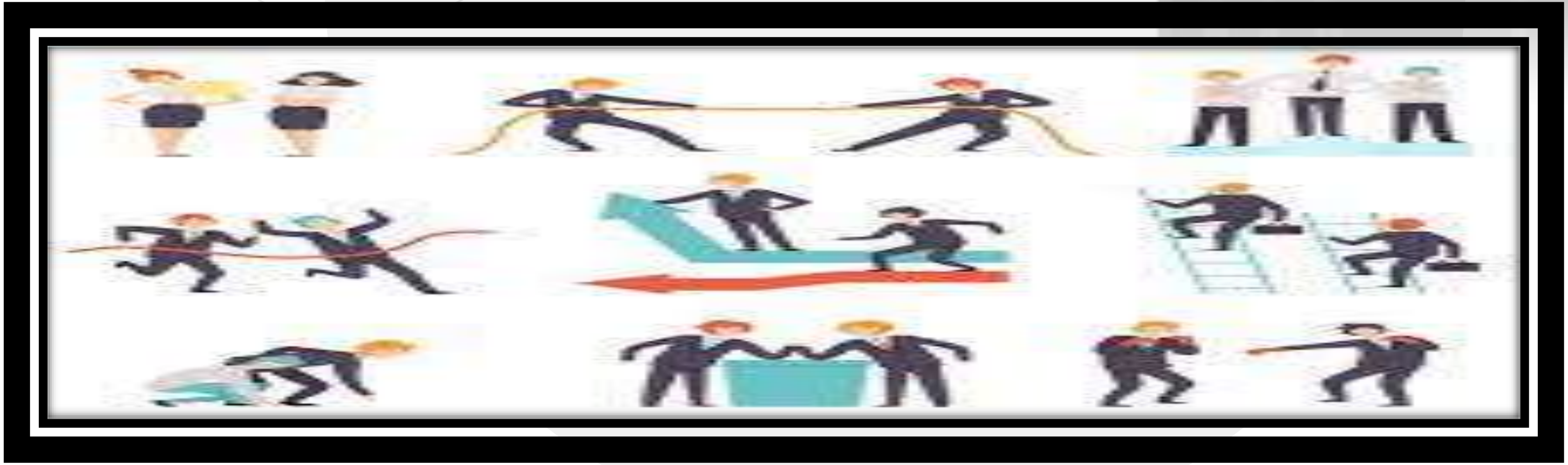
Competitive forces: The Five Forces Framework

Porter's Five Forces Framework helps identify the attractiveness of an industry in terms of five competitive forces:

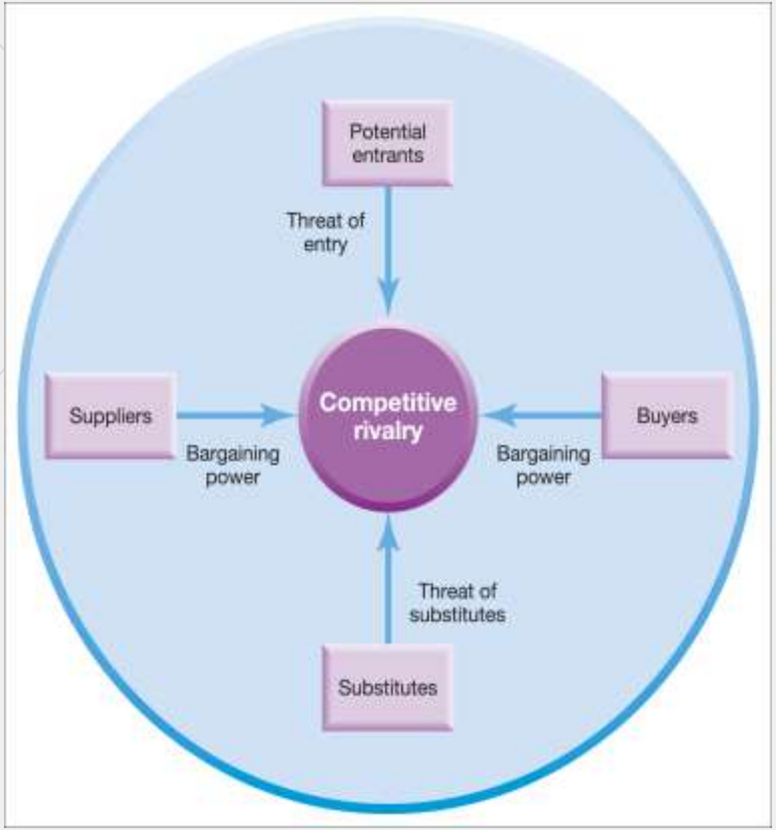
- ***the threat of entry***
- ***the threat of substitutes***
- ***the bargaining power of buyers***
- ***the bargaining power of suppliers and***
- ***the extent of rivalry between competitors.***

The five forces constitute an industry's 'structure'.

What is rivalry



The Five Forces framework



Source: Adapted from *Competitive Strategy: Techniques for Analyzing Industries and Competitors* The Free Press by Michael E. Porter, copyright © 1980, 1998 by The Free Press.

The Five Forces (1): Rivalry between existing competitors

Competitive rivals are organisations with similar products and services aimed at the same customer group and are direct competitors in the same industry/market (distinct from substitutes).

The degree of rivalry increases when:

- Competitors are of roughly equal size
- Competitors are aggressive in seeking leadership
- The market is mature or declining
- There are high fixed costs
- The exit barriers are high
- There is a low level of differentiation.

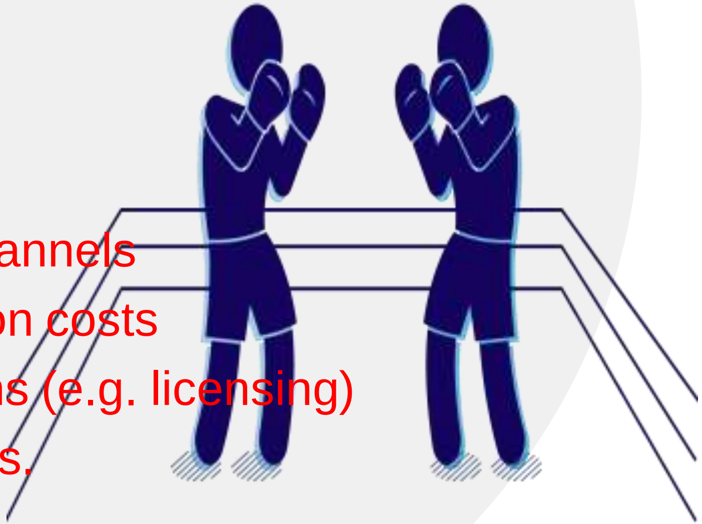
Rivalry Among Existing Firms

Factors that determine the nature and intensity of the rivalry among existing firms in an industry	
Number and balance of competitors	The more competitors there are, the more likely it is that one or more will try to gain customers by cutting its price. Price-cutting occurs more often when all the competitors in an industry are about the same size and when there is no clear market leader.
Degree of difference between products	The degree to which products differ from one product to another affects industry rivalry. For example, the firms in commodity industries (such as paper products) tend to compete on price because there is little difference between one manufacturer's products and another's.

The Five Forces (2):
The threat of new entrants

Barriers to entry are the factors that need to be overcome by new entrants if they are to compete. The threat of entry is low when the barriers to entry are high and vice versa.

- The main barriers to entry are:
  - Economies of scale/high fixed costs
  - Experience and learning
  - Access to supply and distribution channels
  - Differentiation and market penetration costs
  - Legislation or government restrictions (e.g. licensing)
  - Expected retaliation from incumbents.



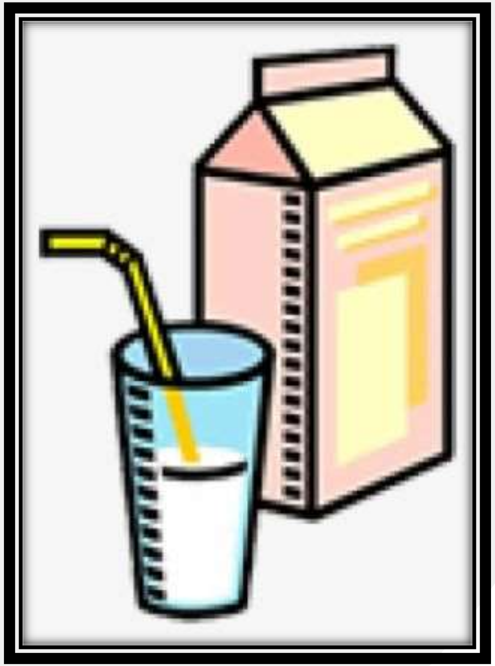
The Five Forces (3)
The threat of substitutes products

Substitutes are products or services that offer a similar benefit to an industry's products or services, but have a different nature i.e. they are from outside the industry.

Customers will switch to alternatives (and thus the threat increases) if:

- ***The price/performance ratio*** of the substitute is superior (e.g. Aluminium is more expensive than steel but it is more cost efficient for car parts)
- The substitute ***benefits from an innovation*** that improves customer satisfaction (e.g. high speed trains can be quicker than airlines from city centre to city centre on short haul routes).

EXAMPLE OF SUBSTITTUTE



Example of Substitute

The Five Forces (4)
The bargaining power of buyers

Buyers are the organisation's immediate customers, not necessarily the ultimate consumers.

If buyers are powerful, then they can demand cheap prices or product/service improvements to reduce profits.

Buyer power is likely to be high when:

- ***Buyers are concentrated***
- ***Buyers have low switching costs***
- ***Buyers can supply their own inputs (backward vertical integration).***

EXAMPLE PORTER'S 5 FORCES FOR NETFLIX

BARGAINING POWER OF BUYERS-HIGH

- WEAK CUSTOMER LOYALTY
- HIGH PRICE- SENSITIVITY
- CUSTOMER-MAJOR REVENUE STREAM
- THEART OF PIRACY SITES

The Five Forces (5): The bargaining power of suppliers

Suppliers are those who supply what organisations need to produce the product or service. Powerful suppliers can reduce an organisation's profits.

Supplier power is likely to be high when:

- ✓ The suppliers are concentrated (few of them)
- ✓ Suppliers provide a specialist or rare input
- ✓ Switching costs are high (it is disruptive or expensive to change suppliers)
- ✓ Suppliers can integrate forwards (e.g. low-cost airlines have cut out the use of travel agents).

Types of industry (1)

- ***Monopolistic industries*** – an industry with one firm and therefore no competitive rivalry. A firm has ‘monopoly power’ if it has a dominant position in the market. For example, Google in the US search engine market.

- ***Oligopolistic industries*** – an industry dominated by a few firms with limited rivalry and in which firms have power over buyers and suppliers. E.g. Boeing and Airbus dominate the market for civil aircraft.

Types of industry (2)

- ***Perfectly competitive industries*** **–** where barriers to entry are low, there are many equal rivals each with very similar products, and information about competitors is freely available. Few markets are 'perfect' but many may have features of highly competitive markets, for example, mini-cabs in London (***'monopolistic competition'***).

- ***Hypercompetitive industries*** – where the frequency, boldness and aggression of competitor interactions accelerate to create a condition of constant disequilibrium and change (e.g. mobile phones).

Implications of Five Forces analysis

- ***Which industries/markets to enter or leave*** – it helps identify the attractiveness of industries.
- ***What influence can be exerted?*** Identifies strategies that can influence the impact of the five forces. E.g. building barriers to entry by becoming more vertically integrated.
- The forces may have a ***different impact on different organisations***. E.g. large firms can deal with barriers to entry more easily than small firms.

Issues in Five Forces analysis

- ***Defining the 'right' industry.*** Applying the model at the most appropriate level – not necessarily the whole industry. E.g. the European low-cost airline industry rather than airlines globally.
- ***Converging industries*** – particularly in the high tech arenas – where industries overlap (e.g. digital industries – mobile phones/cameras/mp3 players).
- ***Complementary organisations*** – which enhance the attractiveness of a business to customers or suppliers. Microsoft Windows and McAfee computer security systems are complementors. This can almost be considered as a sixth force.

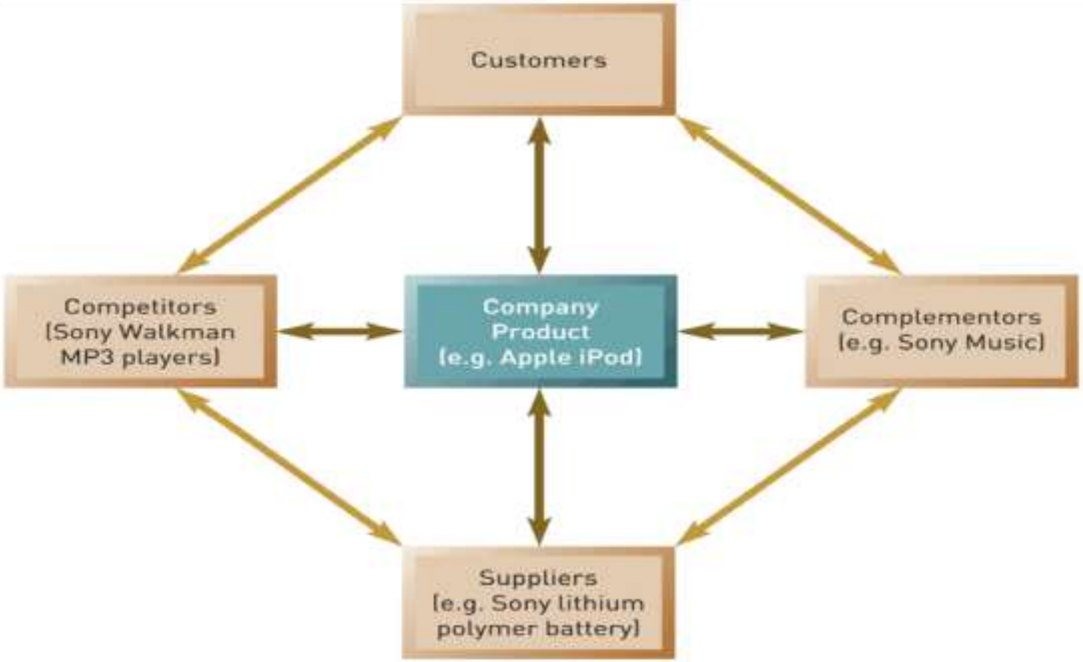
The value net

A value net is a map of organisations in a business environment demonstrating opportunities for value-creating cooperation as well as competition.

An organisation is a ***complementor*** if:

- Customers value your product more when they have the other organisation's product than when they have your product alone (e.g. sausages and mustard)
- It is more attractive for suppliers to provide resources to you when it is also supplying the other organisation than when it is supplying you alone (e.g. Boeing and airlines).

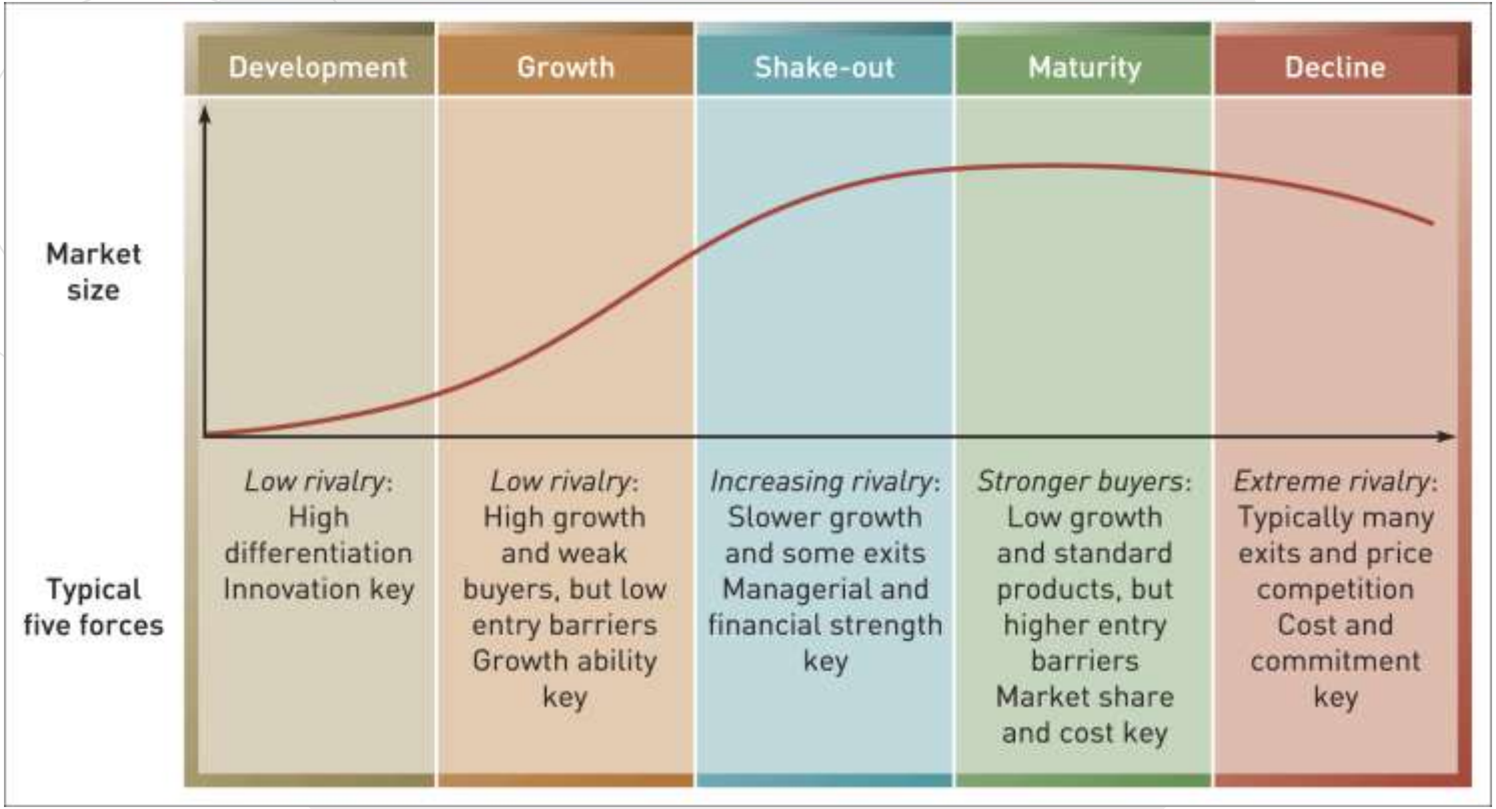
The value net



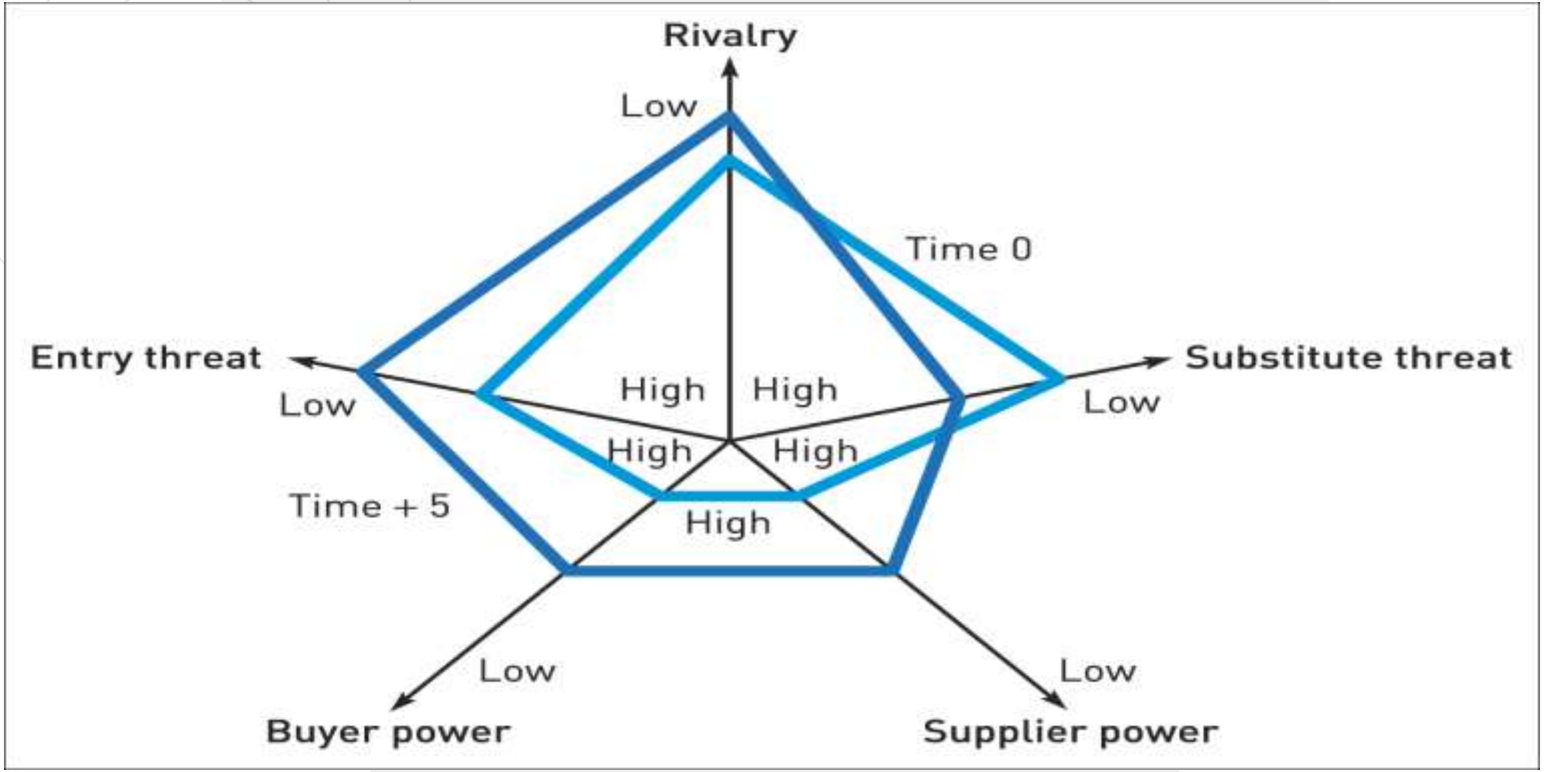
Note: Organisations can play more than one role. Thus Sony Music (publisher of AC/DC, Sade etc) is a complementor to Apple's iPod; Sony is also a supplier of batteries to the iPod; Sony also competes with its own MP3 players.

Source: Reprinted by permission of *Harvard Business Review*. From 'The Right Game' by A. Brandenburger and B. Nalebuff, July–August 1996, pp. 57–64.

The industry life cycle



Comparative industry structure analysis



Strategic groups

Strategic groups are organisations within an industry or sector with similar strategic characteristics, following similar strategies or competing on similar bases.

- These characteristics are different from those in other strategic groups in the same industry or sector.
- There are many different characteristics that distinguish between strategic groups.
- Strategic groups can be mapped on to two-dimensional charts – maps. These can be useful tools of analysis.

Characteristics for identifying strategic groups

It is useful to consider the extent to which organisations *differ* in terms of **characteristics** such as:

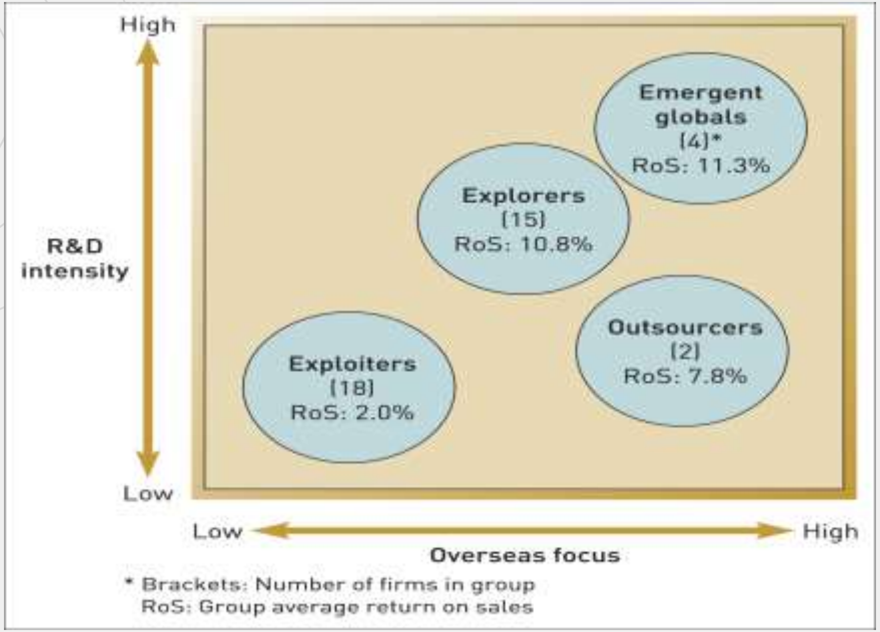
Scope of activities

- Extent of product (or service) diversity
- Extent of geographical coverage
- Number of market segments served
- Distribution channels used

Resource commitment

- Extent (number) of **branding**
- **Marketing effort** (e.g. advertising spread, size of salesforce)
- Extent of **vertical integration**
- Product or service **quality**
- **Technological leadership** (a leader or follower)
- **Size** of organisation

Strategic groups in the Indian pharmaceutical industry



Source: Developed from R. Chittoor and S. Ray, 'Internationalisation paths of Indian pharmaceutical firms: a strategic group analysis', *Journal of International Management*, vol. 13 (2009), pp. 338–55.

Uses of strategic group analysis

- ***Understanding competition*** – enables focus on direct competitors within a strategic group, rather than the whole industry. (E.g. Tesco will focus on Sainsburys and Asda.)
- ***Analysis of strategic opportunities*** – helps identify attractive 'strategic spaces' within an industry.
- ***Analysis of 'mobility barriers'*** – i.e. obstacles to movement from one strategic group to another. These barriers can be overcome to enter more attractive groups. Barriers can be built to defend an attractive position in a strategic group.

Critical success factors (CSFs)

- ***Critical success factors*** are those factors that are either particularly valued by customers or which provide a significant advantage in terms of cost.
- Critical success factors are likely to be an important source of competitive advantage if an organisation has them (or a disadvantage if an organisation lacks them).
- Different industries and markets will have different critical success factors (e.g. in low-cost airlines the CSFs will be punctuality and value for money whereas in full-service airlines it is all about quality of service).

Blue Ocean thinking

- **'Blue Oceans'** are new market spaces where competition is minimised.
- **'Red Oceans'** are where industries are already well defined and rivalry is intense.
- Blue Ocean thinking encourages entrepreneurs and managers to be different by finding or creating market spaces that are not currently being served.
- A **'strategy canvas'** compares competitors according to their performance in order to establish the extent of differentiation.

Strategy canvas

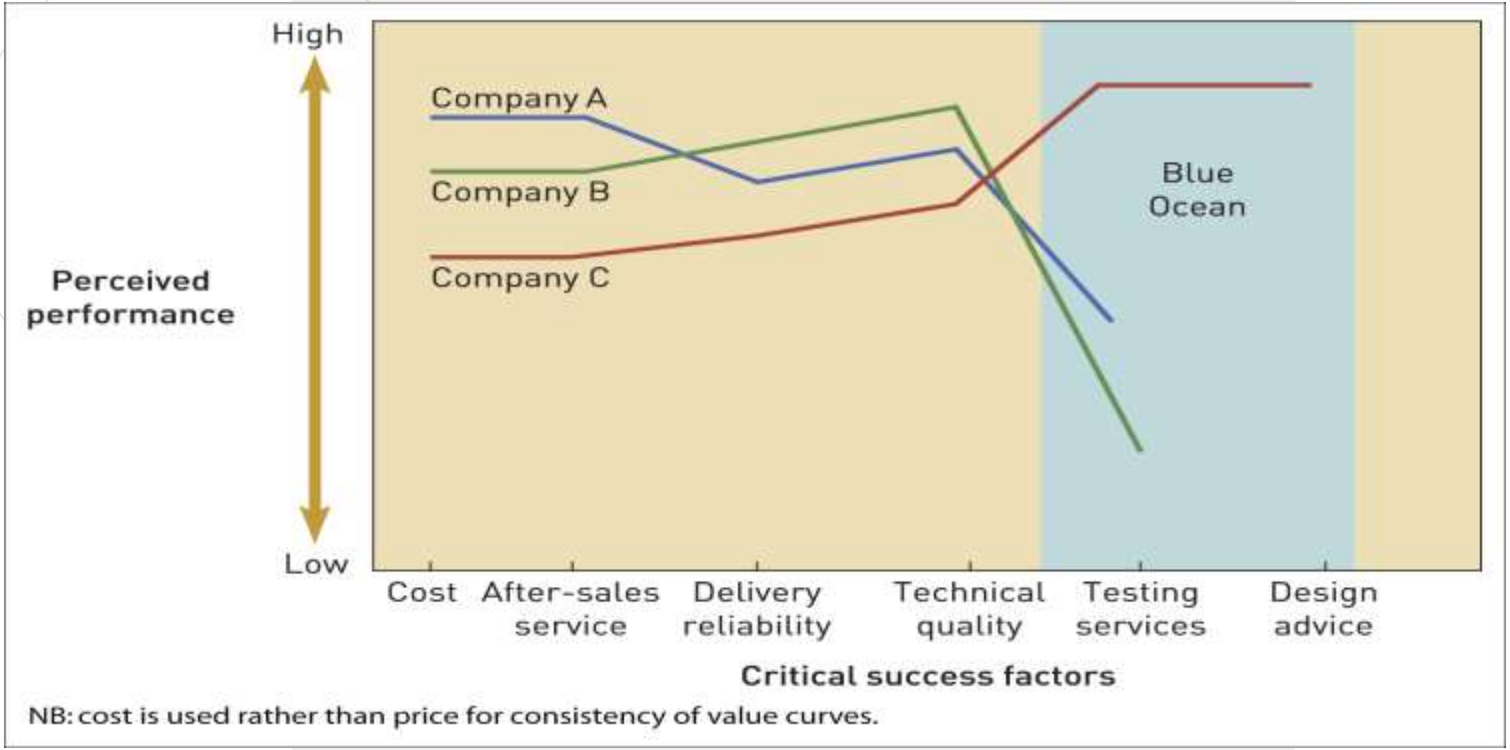


Figure 2.10 Strategy canvas for electrical components companies

Source: Developed from W.C. Kim and R. Mauborgne, *Blue Ocean Strategy*, Harvard Business School Press, 2005.

Summary

- Industries and sectors can be analysed in terms of ***Porter's five forces*** – barriers to entry, substitutes, buyer power, supplier power and rivalry. Together, these determine ***industry or sector attractiveness***.
- ***Industries and sectors are dynamic***, and their changes can be analysed in terms of the ***industry life cycle, comparative five forces radar plots.*** In the inner layer of the environment, ***strategic group analysis***, ***market segment analysis*** and the ***strategy canvas*** can help identify strategic gaps or opportunities.
- ***Blue Ocean strategies*** characterised by low rivalry are a better means of avoiding ***Red Ocean*** with many similar rivals and low profitability.

Thanks!