Table of Contents

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Porter’s Diamond

Porter’s Diamond looks at regional advantage. The general idea is that companies want no competition, however Porter explains that you should have more competition.

Porter’s diamond consists of:

Firm Strategy & Rivalry: We would think that being around no competition is good. However, being amongst the competition and rivalry allows you to observe competition and opens more opportunities, and also helps to generate innovative ideas. In the eyes of employees, there is more stable employment. Domestic rivalry creates pressure to launch new products, improve quality, reduce costs, and invest in new and advanced technology.

EXAMPLE: Hollywood is home to many stars and talented actors. The competition between each individual is strong but it also allows for opportunities – both with work and also for growth.

Related & Supporting Industries: In these industries, competition should be high as competition is seen as good. You want to be in the competition as you will have the best resources, and therefore the best demand. Related and supporting industries refer to the upstream and downstream industries that facilitate innovation through exchanging ideas. Organisations can benefit from each other’s knowhow and encourage each other by producing complementary products.

EXAMPLE: the adoption of the automobile in the USA took off only after the construction of highways and gas stations.

Factor (Input) Conditions: The resources/inputs you require need to be available in the region. You also need network, social capital, venture capitals etc as well as natural resources such as climate, minerals, and oils. These natural resources could provide an international competitive position.

EXAMPLE: In Silicon Valley, you have the best engineers from the best universities, providing knowledge resources.

EXAMPLE: In Italy, vineyards are located in the Southern region due to climate conditions, producing a better quality product.

Demand Conditions: Demand conditions have an impact on the pace of innovation and development. It is determined by 3 factors: mix of customer needs/wants, their scope and growth rate, and the mechanisms that transmit domestic preferences to foreign markets. The more demanding the customers in the economy, the greater the pressure facing firms to improve their competitiveness through innovative products.

EXAMPLE: Japan’s sophisticated and knowledgeable buyers of cameras helped stimulate the Japanese camera industry to improve product quality and to launch new innovative models.

Industry/Product Lifecycle

All industries go through the same lifecycle, however some firms and industries experience these stages differently and for different periods of time. A firm's strategic plan is likely to be greatly influenced by the stage in the life cycle at which the firm finds itself. The life cycle may decline at the end, or it may begin to decline and then, through new uses for declining products, may be turned back into the growth or competitive turbulence stage.

The specific stages are:

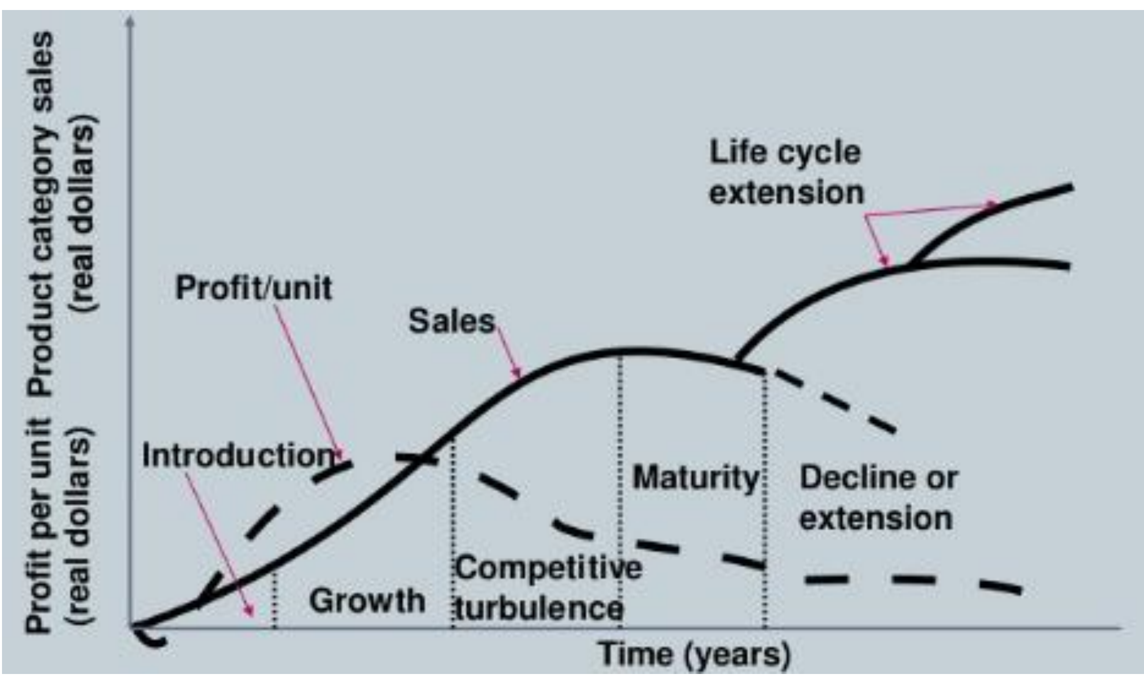
Introduction: A new industry may be begun through the development and patent of a new, unique product offering. A focused strategy may be used to stress the uniqueness of the product to innovators and early adopters. Profits are usually negative or reinvested in the firm.

Growth: The growth stage sees greater acceptance of the product by the market, leading to increased sales. The peak of sales often occurs during this stage, and profit is spent on infrastructure and machinery to assist with quality and meeting demand.

Competitive Turbulence: Here we see sales begin to slow as competitors release substitute products. New market entrants compete on price and thus engage in price wars. This affects overall market share of an existing company. Money is spent on campaigns to stand out from competitors.

Maturity: Growth begins to slow and competition from late entrants will be apparent. New strategies such as low-cost/low-price strategy to increase sales. There are usually fewer firms, and innovations are less radical than before (I.e. Innovations are now more changes in colour or formulation to stress 'new'). An example is laundry detergent.

Decline: If product innovations are too slow or an industry is obsolete, sales suffer. Competitors leave the market but some still stay to compete in a smaller market. Mergers and acquisitions take place as a new strategy to grow, or also through diversification. Strategies for declining markers looking at a niche strategy should maintain distribution channels, focus on advertising & sales promotion, and continue product and process R&D.



Lead Markets

A lead market is the market of a product it service in a given geographical area, where the diffusion process of a successful innovation first took off and is sustained and expanded through a wide range of different services. It is not necessarily the country or market where the innovation was first developed, or even used for the first time. Lead markets can provide price advantages (first set up cost, define how it is structured, other people try to copy, and you get loyalty towards your products), demand transfer advantage, export advantage, transfer advantage, market structure advantage.

Strategic Groups

Strategic groups are a cluster of companies in an industry. The groups of companies are clustered around a similar competitive approach or strategic position. The companies within a group are similar to each other but different to companies in other groups. Cluster factors are price/quality, technology, standards, and geographic areas.

Strategic groups are about segmenting the firms within an industry, not the customers. Use original vs generic drugs as an example. Companies producing an original drug may patent the drug for 8 years, thus being the only one allowed to make the drug. However, other companies can use the patent after it expires and release a generic brand that is cheaper and just as effective.

Porter’s 5 Forces

Michael Porter was an economist at Harvard university, looking at Industrial Organisations (IO). The goal of IO is to understand how industries operate, understand industry structures and economic welfare, and understand government policy towards these industries (ie. IO does not look at products, it explains differences between industries). IO also looks at excessive profits in industries and tries to minimise them (policy decisions). Porter, however, turned IO upside down and tried to look for excessive profits.

Porter’s 5 Forces assists an organisation to evaluate the characteristics of an industry in order to determine the attractiveness of an industry. If an industry appears to be attractive, the organisation may consider entering the industry. Therefore, the Porter’s 5 Forces Model is an examination of the industry, not the company itself.

Porter’s 5 Forces consists of:

Threat of New Entrants

Threat of new entrants refers to the threat new competitors pose to existing companies in an industry. A profitable industry attracts competitors. Entrance of new competitors can threaten or decrease market share and profitability, resulting in changes to product quality or price.

EXAMPLE: The graphic design industry has low entry barriers and thus may be appealing for new entrants.

Strategies for staying ahead of the competition include:

- Economies of Scale
- Brand Identity
- Access to Necessary Inputs
- Access to Distribution

Threat of Substitute Products

The threat of substitute products refers to the availability of a product that a consumer can purchase instead of the industry’s product. It is from another industry that offers similar benefits to the customer as the product produced by the firms in an industry. The availability of close substitutes can lead to an increase in competitiveness and decrease in potential profit, but a lack of substitutes can decrease competitiveness and increase profit potential.

EXAMPLE: The beverage industry has many competitors.

Strategies for staying ahead include:

- Relative Price Substitutes
- Switching Costs
- Quality of Substitutes

Bargaining Power of Buyers

The bargaining power of buyers refers to the pressures buyers exert on businesses to get them to provide increased quality, customer service and decrease profits. A strong buyer can make an industry more competitive and decrease profit potential. If a consumer is price sensitive and well educated on the product, buyer power is high. Low buying power leads to an attractive industry and increased profit potential.
Strategies include:

- Buyer Volume
- Switching Costs
- Product Differences
- Buyer Information
- Substitute Products
- Price/Total Purchases

Bargaining Power of Suppliers

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Summary:

	Innovators	**Early Adopters**	**Early Majority**	**Late Majority**	**Laggards**
Motivation	To learn about technology for their own sake	To gain competitive advantage through revolutionary breakthrough	To gain sustainable productivity improvements through evolutionary change	To stay even with competition and avoid competitive disadvantage	To maintain the status quo
Characteristics	- Strong aptitude for technical information - Like to take risks & alpha test new products - Have closest contact with scientific sources	- Great imaginations for strategic applications - Attracted by high-risk high-reward propositions - Not price sensitive - Have a higher social status - Have more financial resources	- Understanding of real world issues and trade offs - Focus on proven applications - Like to go with the market leader	- Better with people than technology - Risk adverse - Price sensitive - Have a lower social status	- Tend to be focused on traditions - Are good at debunking marketing hype - Older than all other adoptors - Have lowest social status and financial fluidity
Challenges	They want unrestricted access to top technical people and want free pricing	They want rapid time to market, and demand high customization & support	They insist on good references from trusted colleagues, and they want to see the solution in production at the reference site	They need pre-assembled solutions and would benefit from value added services – but they don't want to pay for it!	They are not a customer, and can be a frightening opposition to early adoption

Levels of Strategy

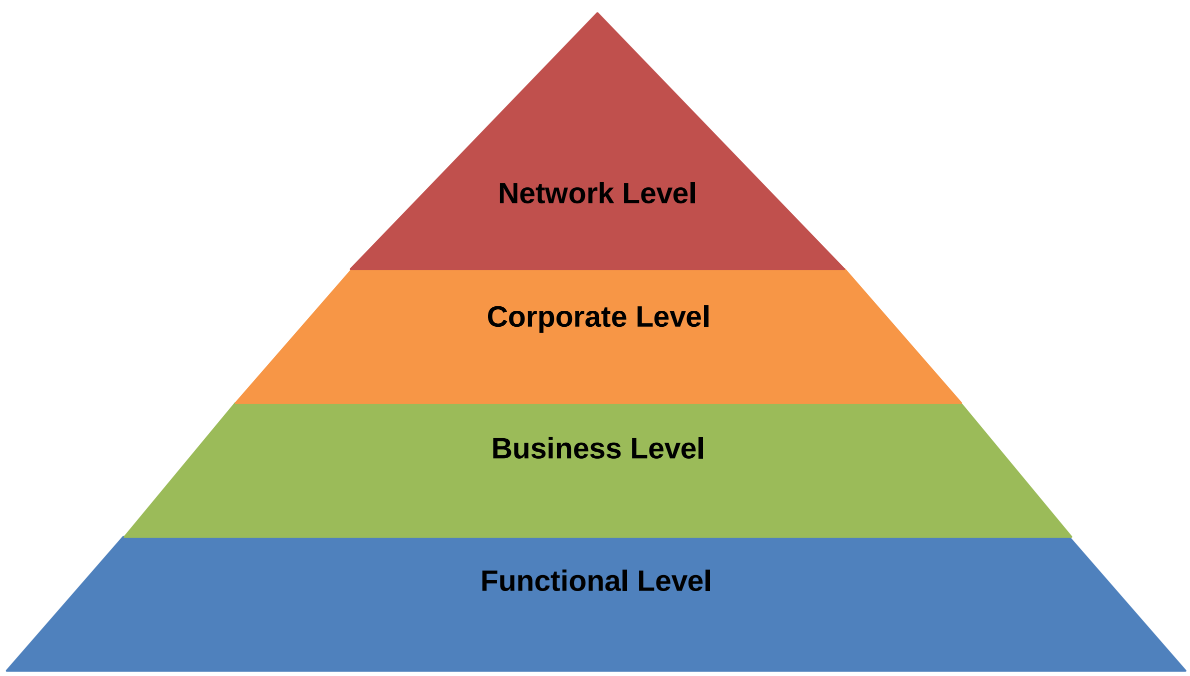
There are four different levels of strategy:

Network Level Strategy: Define the boundaries of the firm and the interaction with its environment. It shows alliances and partnerships with other firms, such as LUFTHANSA → an entire airline industry and how they operate. Essentially, your entire network competes against another entire network, such as Skyteam and Star Alliance within the airline industry.

Corporate Strategy: asks the question "in which business do we want to compete and how do we coordinate this business?" You look to see if you should be in one or multiple businesses, and whether they're related or not. A marketing perspective relates to branding, whereas a strategy perspective looks at synergies in a larger scale (e.g. can resources be shared/transferred?).

Business Strategy: focuses on how to compete in each business. It looks at how we operate in certain businesses and how we compete with direct competition. For example, Volkswagon and the various models of cars it sells to tackle competition.

Functional Strategy: looks at how to implement strategies in the functional areas of the business. These include the marketing strategies implemented on a day-to-day basis, and includes things like brand portfolio. Nestle is a great example!



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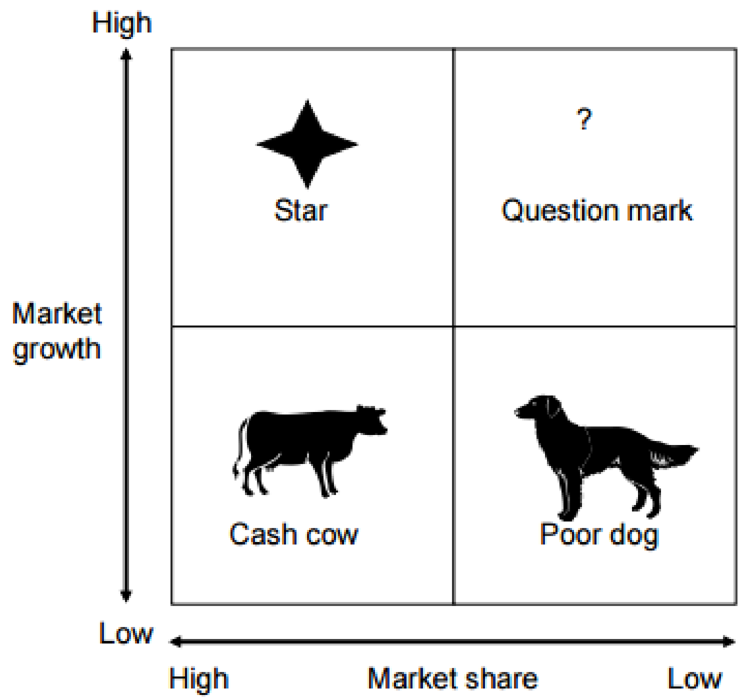
Brands

A brand is an identification of an organisation, product or service and has a connection with the customer. It is a promise to and a contract with customers, and is a reflection of a customer's entire experience with a company. A brand is a mix of tangible and intangible characteristics of a product or service, not a trademark, logo, slogan, or advertising (these things are part of a brand).

Brand Portfolio

A brand portfolio is the collection of brands under a company's control. Its strategy is the effective creation, deployment and management of brand assets. When a company runs each brand separate from one another, confusion and inefficiency will occur. Additionally, brand portfolios allow a company to focus on the big picture, causing resources to be better allocated, creating value. It is important to note that each brand has its own separate trade mark and operates as its own individual entity.

The goal of the BCG Matrix is a balanced portfolio in terms of cash-flow allocation/generation, and a predescribed strategy for each role/segment. Limitations include market share requires an appropriate market definition; results depend on high market growth, validity of the experience curve, and the fact that no interdependencies between the SBU's exist; and it ignores resources, capabilities and interdependencies except cash flow.



***** A good way of remembering the BCG Matrix:***

- Cows and dogs are on land → therefore they are at the bottom (in alphabetical order)
- Stars and question marks are up high (stars in the sky and question marks high on a lined page) → therefore they are at the top in reverse alphabetical order
- Market growth is on the y axis because it grows taller
- Market share is on the x axis as you share things around
- From top left to bottom right, the axis labels are high, low, high low

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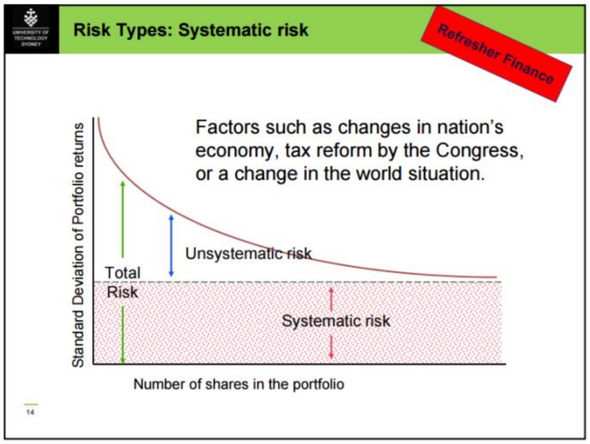
Risk Reduction (Diversification of Unsystematic Risk - Uncertainty That One Receives within an Industry)



Companies may also wish to diversify to minimise the overall risk it is exposed to within a particular industry or market, particularly during times of economic uncertainty. Diversification gives companies the opportunity to also reduce unsystematic risk, **BUT NOT systematic risk** within an industry.

It is cheaper for a shareholder to individually diversify their own portfolio, as opposed to a company diversifying itself

Porter’s 5 Forces vs Barney’s RBV

<table>
<tr><th><u>Porter</u></th><th><u>Barney</u></th></tr>
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Sustainable Competitive Advantage (SCA) comes from analyzing the external environment

Threat of new entrants
Threat of substitute products
Bargaining power of suppliers
Bargaining power of buyers
Rivalry among existing competitors

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SCA comes from within the firm, through things such as resources.
Implement a strategy not being implemented by another that can’t be duplicated
VRIO – Valuable, Rare, Imperfectly Imitable, Organisationally Sustainable
Firm Resources:

Physical Capital
Human Capital
Organisational Capital

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READING: “Firm Resources & Sustained Competitive Advantage” – Jay Barney (1991)

Firm Resources

Firm Resources	Assets, capabilities, organizational processes, firm attributes, information and knowledge, that allow a firm to implement strategies that increase effectiveness.
Physical Capital Resources	Physical technology, plant and equipment, geographic location and access to raw materials.
Human Capital Resources	Training, experience, judgement, intelligence, relationships and insights of individual managers and workers in a firm.
Organisational Capital Resources	A firms formal reporting structure, formal and informal planning, controlling, and coordinating systems, as well as informal relations among groups within a firm and between a firm and those in it’s environment.

*** Firm resources are strengths that firms can use to conceive of and implement their strategies.

Competitive Advantage (CA) and Sustained Competitive Advantage (SCA)

- CA = when a firm implements a value creating strategy not simultaneously being implemented by current or potential competitors.
- SCA = when a firm has a CA, and other firms are unable to duplicate the benefits of the strategy.
  - It is only sustained if it continues to exist after efforts to duplicate the advantage has ceased.

Resource Homogeneity & Mobility & SCA

- When firms have the exact same resources and strategies implemented, you cannot get SCA.

Resource Homogeneity & Mobility & First Mover Advantage

- First firm in an industry to implement a strategy can obtain an SCA over other firms.
- Firms may gain access to distribution channels, develop goodwill, or develop a positive reputation before others implement their strategies.
  - A first-mover must have insights about the opportunities associated with implementing a strategy that are not possessed by other firms in the industry, or entering firms.

Resource Homogeneity & Mobility & Entry/Mobility Barriers

- Even if firms are perfectly homogenous, if there are strong barriers to entry or mobility barriers, these firms may be able to get an SCA compared to firms not in their industry.
  - This will lead to above normal economic performance for firms protected by entry or mobility barriers.
- Barriers will be a source of SCA when firm resources are not homogenously distributed across competing firms and when these resources re not perfectly mobile.

Firm Resources & SCA

For a firm to have SCA, it must have VRIO attributes.

- *Valuable*
  - Resources are valuable when they enable a firm to conceive of or implement strategies that improve its efficiency and effectiveness.
  - Attributes must be valuable to be considered resources.
- *Rare*
  - If a particular valuable firm is possessed by large numbers of firms, then each of these firms have the capability of exploiting that resource in the same way
    - Implementing a common strategy does not equal CA

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Changing Added Value

- You can increase your added value by meeting customer needs, build a brand, or work with competitors to reduce costs.
  - E.g. Airlines can increase leg room on planes and therefore increase their added value.

Changing Rules

- If a new comer enters the market with a price lower than the incumbents, the incumbent can match the price or stay as is and give up share.
  - For incumbent, it is better to give up 10% market share than sacrificing profit margins. If the incumbent is too greedy with stealing market share, the established player will give up profit margins in order to regain market share.

READING: “The Five Competitive Forces That Shape Strategy” – Michael Porter (2008)

*** If forces are intense in an industry (e.g. Airline industry), almost no company can gain an attractive ROI.
*** If forces are benign (e.g. soft drinks), many companies are profitable.
*** Porter’s Five Forces is industry focused.

Rivalry Among Existing Competitors

- Increased rivalry leads to decreased industry profitability.
- The intensity and basis of competition between companies determines the degree of profit decrease.
- It can be in the form of discounts, new product introductions, or service improvements.
- Intensity is greatest if:
    - Exit barriers are high
    - There are many competitors, or competitors are roughly equal in size and power
    - Industry growth is slow
        - This precipitates fight for market share
    - Businesses have high commitment levels
        - If businesses have high goals and aspire for leadership, then they will fight for it and therefore increases rivalry
    - There is a lack of familiarity between firms
        - Lack of familiarity with one another leads to increased rivalry as unexpected signals appear. They therefore need to analyse and understand the market.
- The strength of rivalry reflects how competition takes place, and whether rivals compete similarly.
- Other dimensions such as product features, support services, delivery time, or brand image are less likely to decrease profitability as it increases customer value.

Threat of New Entrants

- New entrants have the capacity and desire to gain market share, therefore putting pressure on prices and costs.
- The threat of entry is what puts the cap on potential profit, not the actual entrance itself.
- There are 7 sources of barriers to entry:
    - *Supply-Side Economies of Scale*
        - New entrants must be large or else they will have a cost disadvantage.
    - *Demand-Side Benefits of Scale*
        - Existing firm discourages newcomers as they need to build up a large customer base and have competitive prices.
    - *Customer Switching Costs*
        - Larger switching costs means it is harder to gain customers.
    - *Capital Requirements*
        - Large investments makes it harder for newcomers. If industry returns are high, investors provide firms with funds.
    - *Incumbency Advantages Independent of Size*
        - Incumbents have cost/quality advantages from propriety technology, preferential access to raw materials.
    - *Unequal Access to Distribution Channels*
        - Established brands block up channels making it hard for entrants to use them.
    - *Restrictive Government Policy*
        - Nullify entry by licensing requirements; amplify entry by funding research.
        - You must anticipate how entrants may come and how they may overcome barriers.
    - *Expected Retaliation*
        - A company must observe and anticipate what other existing firms will do when a new entrant comes into the industry.

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