

Industry and competitive strategy

INDUSTRY AND COMPETITIVE STRATEGY - EXAM LEVEL

Module 2 at exam level

This level is written for open questions: what you must be able to define, explain, apply, advise on and assess. Use the English technical terms exactly as they appear here. On the sample exam, consistent terminology was explicitly marked for Five Forces.

Five Forces

Purpose. The model explains and helps to understand how profitable an **industry** is on average. So it is about the industry and not necessarily about one firm in it. An **industry** is a group of firms that in essence supply the same product or service. All firms in it are *competitors*, but not all competitors are *rivals*.

The five forces and their drivers.

- **Threat of entry.** High **barriers to entry** keep entrants away. Sources: economies of scale and experience, customer switching costs, capital requirements, access to supply and distribution channels and other incumbency advantages of established players (patents, brand).
Perspective: high barriers make the industry more attractive for the firms already in it ("the perspective of the guard").
- **Threat of substitutes.** The substitute comes from *outside* the industry. Stronger with a favourable **price/performance ratio** and low switching costs for the customer.
- **Buyer power.** Strong with concentrated buyers or large purchasing volumes, low switching costs and a credible threat of **backward integration**. Addition by the lecturer: also price sensitivity of the buyer.
- **Supplier power.** Strong with few suppliers, high switching costs, differentiated inputs and the threat of **forward integration**. Decide which suppliers matter: labour and financiers can also be suppliers.
- **Rivalry.** Stronger with low concentration or equal size, little differentiation, low growth, high fixed costs and high **exit barriers**.

Common thinking error. The five forces are mutually independent. The arrow figure in the book suggests that they press on rivalry, but each force works directly on profit. Never use "competition" as a synonym for *rivalry*: it is confusing, because the other four forces are also competition in Porter's eyes.

Six steps. (1) Define the industry: vertical, product/service, geographic. (2) Identify the players per force. (3) Determine the underlying factors and the strength per force. (4) Determine the overall attractiveness. (5) Analyse changes (trends). (6) Determine your position: exploit, neutralise or influence. The lecturer says steps 5 and 6 are more important than the overall judgement.

Applying in a case. Always point out the force, name the driver, and say whether the effect becomes stronger or weaker. Example from the sample exam: supermarkets merge and purchase together, so the **buyer power** of the buyers rises (concentration, large volume). Then name the other four forces by their correct names.

Industry life cycle

Stages: **development, growth, shake-out, maturity, decline.**

- *Development:* few customers, uncertainty, high costs.
- *Growth:* demand grows; the lecturer calls it most important that **rivalry** may be low because there is room for everyone.
- *Shake-out:* growth levels off and weak players disappear.
- *Maturity:* barriers to entry rise, standardisation and cost competition increase, **buyer power** becomes larger and the **experience curve** plays a big role.
- *Decline:* demand shrinks; with high exit barriers rivalry becomes extreme.

Use the model to reason how the forces change (step 5 of the industry analysis).

Strategic groups and market segments

A **strategic group** consists of organisations with similar strategic characteristics (scope and resource commitment). Use: understand who the direct competitors are, find strategic spaces and analyse **mobility barriers**, the counterpart of entry barriers between groups. A **market segment** is a group of customers with similar needs; segmentation can be based on customer needs, buying behaviour or value. Strategic groups are about suppliers, market segments about buyers.

Generic strategies

According to Porter a firm is either a **cost leader** or a **differentiator**, or it uses a **focus** on a narrow segment.

Cost leadership. Systematically the lowest costs and sufficient quality. Four cost drivers: **input costs, economies of scale, experience curve** and **product/process design**. The lecturer stresses: a cost leader is not necessarily the cheapest in the market and not necessarily a price fighter. Lower costs can also be used as a higher margin.

Differentiation. Being unique on what customers value, so that you can charge a **price premium**. Sources: product features, customer relationships, complements. The logic runs via switching costs: the customer stays because switching costs something or loses value.

Parity and proximity (cost leadership). With **parity** the cost leader offers as much of what customers value as the average competitor: it charges the same price and puts the cost advantage fully into extra profit (CSN, a Brazilian steel producer). With **proximity** it is close to competitors on

features; a small price cut compensates for the slightly lower quality and it still earns better profit than the average.

Focus. Limit yourself to a segment with deviating needs. *Cost focus* (Ryanair, Iceland) or *differentiation focus* (Ecover, ARM). Three conditions: deviating needs, deviating value chains and a viable segment.

Relation to Five Forces. A well-executed generic strategy protects against the five forces *relative to the average competitor*. The cost leader is protected against rivalry and buyer power because it still makes a profit when others do not; the differentiated player has no rivalry with the average player, because it offers something different or better. The lecturer notes that the umbrella of the cost leader protects all players in the industry. He also puts question marks on how "generic" these strategies are. From the formative quiz: high barriers to entry do not lower profitability.

Calculating with costs. A calculate question is usually about the experience curve or economies of scale. With the experience curve, cost per unit falls by a fixed percentage with each doubling of cumulative volume. With economies of scale, fixed costs are spread over more units. Always write down the intermediate steps: the partial points are in the calculation, not only in the answer.

Pitfall: costs are not price. The cost leader does not have to pass on its lower costs. It can charge the same price as the rest and make more margin, or lower the price to force rivals out. In a case, always assess which of the two happens.

Business ecosystems and complementors

Porter mainly sees competition. A **business ecosystem** shows that firms also create value together. A **complementor** increases the value of your product (apps for a phone). Cooperation between competitors is called **coopetition**. Important are *non-generic unique complementarities*: additions that specifically belong together and are not easily replaced. An **ecosystem leader** (Nespresso, Apple App Store) coordinates the partners. **Network effects** reinforce this: the more users, the more value, which raises customers' **switching costs**.

Comparative industry structure analysis (Figure 3.4). With an ecosystem you analyse **complementors** next to suppliers, distributors and substitutes: customers value your product more when they also have the complementor's product (Krupps at Nespresso). This extends the industry structure.

Business models

A **business model** describes how an organisation **creates** value (value creation), **delivers** it (configuration) and **keeps** part of it (value capture) (Teece). It is not a synonym for strategy: strategy is about choices and position relative to competitors, the business model about the logic of value creation.

Business Model Canvas (nine blocks): customer segments, value proposition, channels, customer relationships, revenue streams, key resources, key activities, key partners, cost structure.

Requirement: the elements must **fit together logically**. The lecturer: use the canvas as a diagnostic tool.

Patterns. *Razor and blade* (cheap device, expensive refill); *freemium* (free basic, paid extra); *peer-to-peer* (platform connects users); *multi-sided platform* (several groups, such as creators, viewers and advertisers at YouTube).

How you use models in a case

1. Read the question: which model is asked, and which form (define, explain, apply, advise, assess)?
2. Name the term in English and give a one-sentence definition.
3. Link to a fact from the case; never write theory alone.
4. Finish with the conclusion (stronger or weaker, advice, judgement).

Common mistakes

- Writing "competition" where *rivalry* is meant.
- Assuming that a cost leader always charges the lowest price.
- Judging the forces from the perspective of the wrong party.
- Confusing industry with one firm or with a market segment.
- Mistaking a business model for a strategy.