

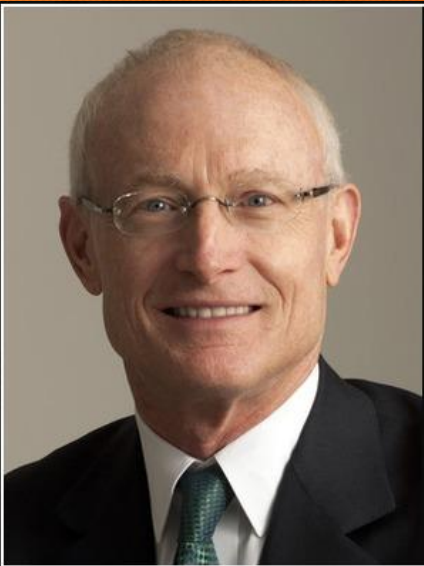
Business and Career Development

Developing Strategy and Competitive Advantage

C1: What happens when you try to Maximize Profit in a Perfectly Competitive Market?



C1: So, you need a Strategy for making Profit



Strategy is about setting yourself apart from the competition. It's not a matter of being better at what you do - it's a matter of being different at what you do.

— *Michael Porter* —

AZ QUOTES



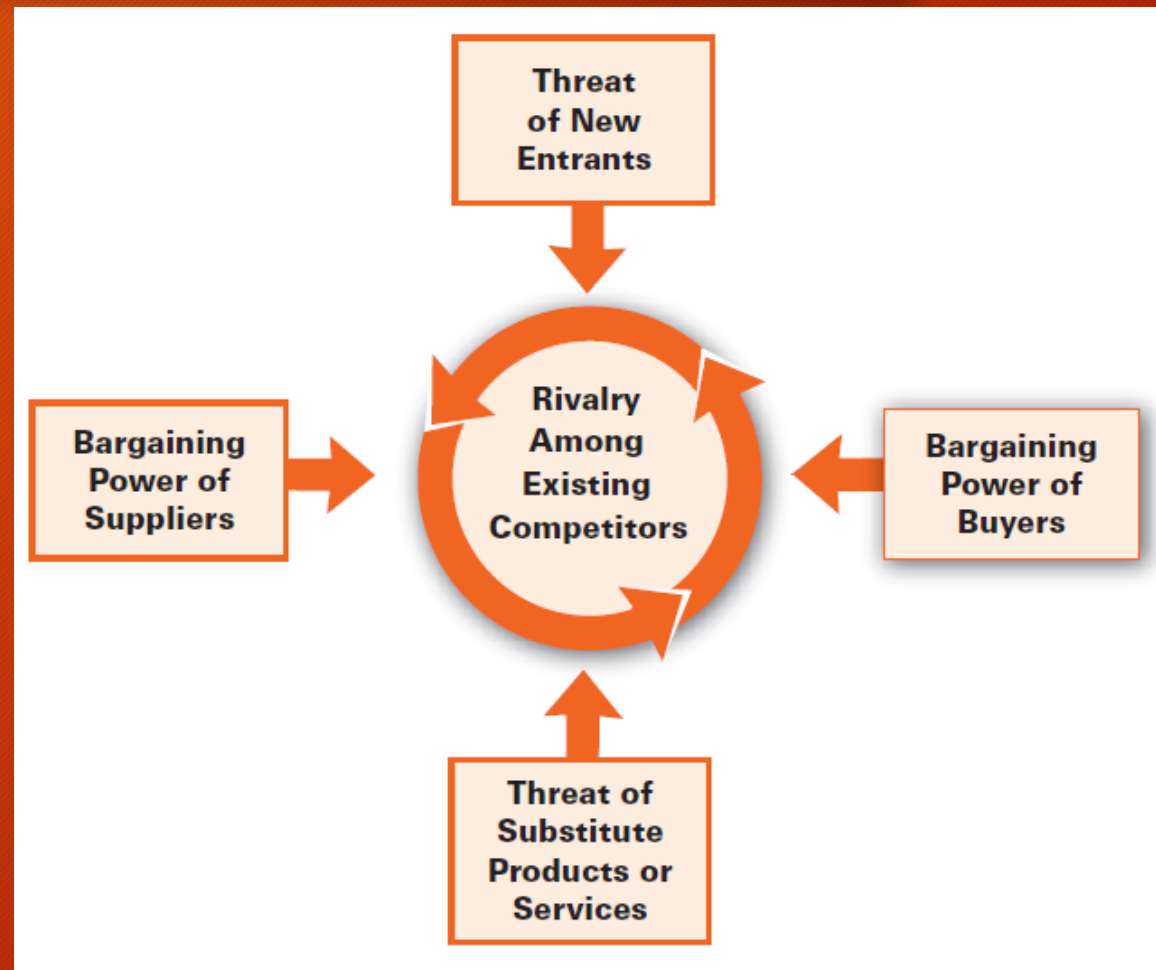
The essential element of successful strategy is that it derives its success from the differences between competitors with a consequent difference in their behavior.

— *Bruce Henderson* —

AZ QUOTES

25 C1: Knowing Your Industry: Five competitive forces defines the industry structure


- Industry structure drives competition and profitability, not whether an industry is emerging or mature, high tech or low tech, regulated or unregulated
- Understanding the competitive forces, and their underlying causes, reveals the roots of an industry's current profitability while providing a framework for anticipating and influencing competition (and profitability) over time



C1: Knowing Your Industry: Threat of New Entrant

- New entrants to an industry bring new capacity and a desire to gain market share that puts pressure on prices, costs, and the rate of investment necessary to compete, particularly when new entrants are diversifying from other markets. e.g., Microsoft introduced Internet Explorer.
- The threat of entry in an industry depends on the height of **Entry Barriers** that are present and on the **Retaliation** entrants can expect from incumbents
- If entry barriers are low and newcomers expect little retaliation from the entrenched competitors, the threat of entry is high and industry profitability is moderated
- Interestingly, It is the threat of entry, NOT whether entry actually occurs, that holds down the profitability

C1: Knowing Your Industry: Threat of New Entrant

- Seven major sources of entry barrier 
 - Supply-side economies of scale (e.g., Walmart)
 - Demand-side benefits of scale (Network effect) (e.g., mobile contract)
 - Customer switching costs (e.g., accounting system)
 - Capital requirements
 - Incumbency advantages independent of size (e.g., location)
 - Unequal access to distribution channels
 - Restrictive government policy

C1: Knowing Your Industry: Threat of New Entrant

- Fear of expected retaliation is high when,
 - Incumbents have previously responded vigorously to new entrants.
 - Incumbents possess substantial resources to fight back, including excess cash and unused borrowing power, available productive capacity, or clout with distribution channels and customers.
 - Incumbents seem likely to cut prices because they are committed to retaining market share at all costs or because the industry has high fixed costs, which create a strong motivation to drop prices to fill excess capacity
 - Industry growth is slow so newcomers can gain volume only by taking it from incumbents.

C1: Knowing Your Industry: The Power of Supplier

- Powerful suppliers capture more of the value for themselves by charging higher prices, limiting quality or services, or shifting costs to industry participants. e.g., Window XP, Windows 7
- A supplier group is powerful if,
 - It is more concentrated than the industry it sells to (e.g. PC Industry was fragmented)
 - Does not depend heavily on the industry for its revenues (e.g., supplies to multiple industries)
 - Industry participants face switching costs in changing suppliers
 - Suppliers offer products that are differentiated (e.g., patented technology)
 - There is no substitute for what the supplier group provides
 - The supplier group can credibly threaten to integrate forward into the industry

C1: Knowing Your Industry: The Power of Buyers

- Powerful customers can capture more value by forcing down prices, demanding better quality or more service and generally playing industry participants off against one another, all at the expense of industry profitability
- A customer group has negotiating leverage if,
 - There are few buyers, or each one purchases in volumes that are large relative to the size of a single vendor
 - The industry's products are standardized or undifferentiated so buyers can always find an equivalent
 - Buyers face few switching costs in changing vendors
 - Buyers can credibly threaten to integrate backward and produce the industry's product themselves if vendors are too profitable

C1: Knowing Your Industry: Threat of Substitute

- When the threat of substitutes is high, industry profitability suffers as substitute products or services limit an industry's profit potential by placing a ceiling on prices
- The threat of a substitute is high if,
 - It offers an attractive price-performance trade-off to the industry's product (e.g., Netflix against Blockbuster)
 - The buyer's cost of switching to the substitute is low
- If an industry does not distance itself from substitutes through product performance, marketing, or other means, it will suffer in terms of profitability and often growth potential.

C1: Knowing Your Industry: Rivalry among Existing Competitors

- Rivalry is especially destructive to profitability if it gravitates solely to price because price competition transfers profits directly from an industry to its customers
- The intensity of rivalry is greatest if,
 - Competitors are numerous or are roughly equal in size and power
 - Industry growth is slow
 - Exit barriers are high
 - Rivals are highly committed to the business and have aspirations for leadership, especially if they have goals that go beyond economic performance in the particular industry
 - Firms cannot read each other's signals well because of lack of familiarity with one another, diverse approaches to competing, or differing goals.

C1: Knowing Your Industry: Implications for Strategy Development

- Understanding the forces that shape industry competition is the starting point for developing strategy as
 - Strategy can be viewed as building defenses against the competitive forces or finding a position in the industry where the forces are weakest
 - Industry changes bring the opportunity to spot and claim promising new strategic positions if the strategist has a sophisticated understanding of the competitive forces and their underpinnings
 - A firm can lead its industry toward new ways of competing that alter the five forces for the better
 - The five competitive forces also hold the key to defining the relevant industry a company needs a separate strategy for each distinct industry. Mistakes in industry definition made by competitors present opportunities for staking out superior strategic positions.

C2: Develop Complementary Mindset: The Players of the Game

- If your business is a game, then the players are,
 - Customers
 - Suppliers
 - Competitors
 - Complementors
- Complementors are those who provide complementary rather than competing products and services
- Examples
 - Computer Hardware and Software
 - Car and Road
 - Burger and Tomato Sauce

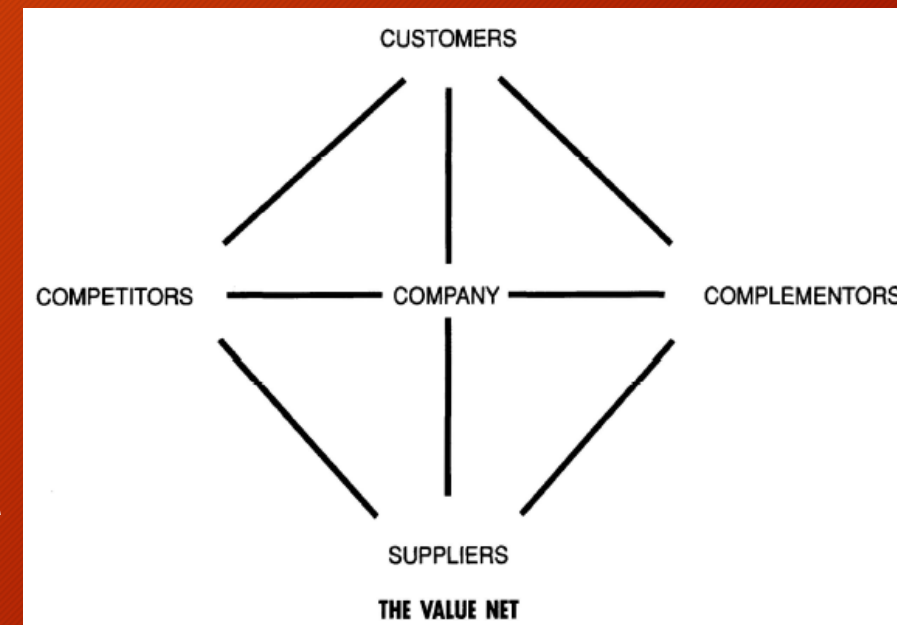
C2: Develop Complementary Mindset: Thinking Complements

25 • Benefits of Complementary Mindset,

- Complements brings reciprocal benefits. e.g., just as auto insurance complements new cars, new cars complement auto insurance
- Without complements, business can fail. e.g., lack of the availability of spare parts and mechanics makes it difficult for car makers other than Toyota to be successful in Bangladesh
- Better complementors can create bigger opportunity. e.g., faster Intel processor gives Microsoft the opportunity to build better OS
- Thinking complements is a different way of thinking about business. It's about finding ways to make the pie bigger rather than fighting with competitors over a fixed pie

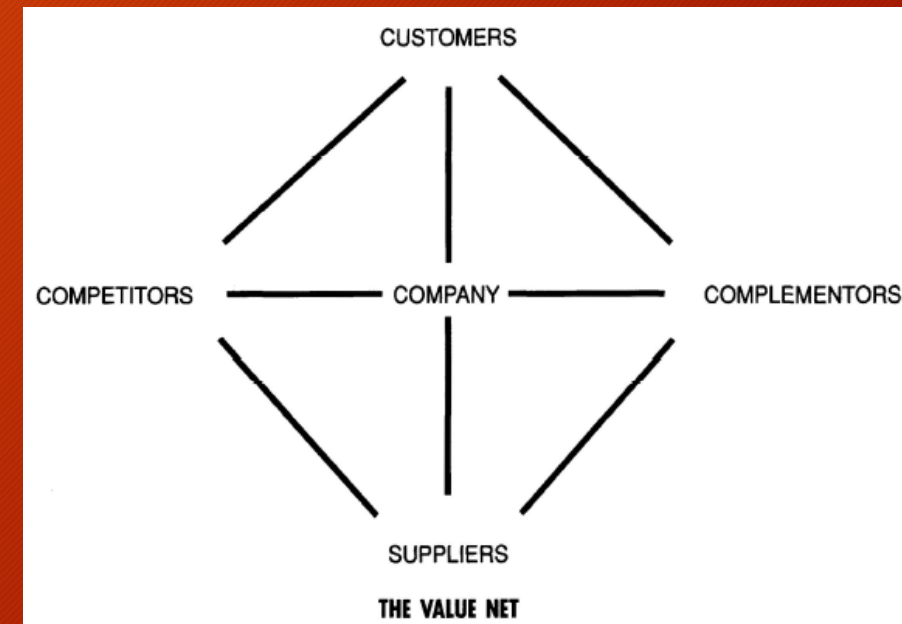
25 C2: Develop Complementary Mindset: The Value Net

- Drawing a Value Net will represent all the players and the interdependencies among them for your business.
- From the Customer Side,
 - A player is your complementor if customers value your product more when they have the other player's product than when they have your product alone
 - A player is your competitor if customers value your product less when they have the other player's product than when they have your product alone.
 - *(The traditional approach defined competitors as the other companies in your industry that make products similar to yours in a manufacturing or engineering sense)*



C2: Develop Complementary Mindset: The Value Net

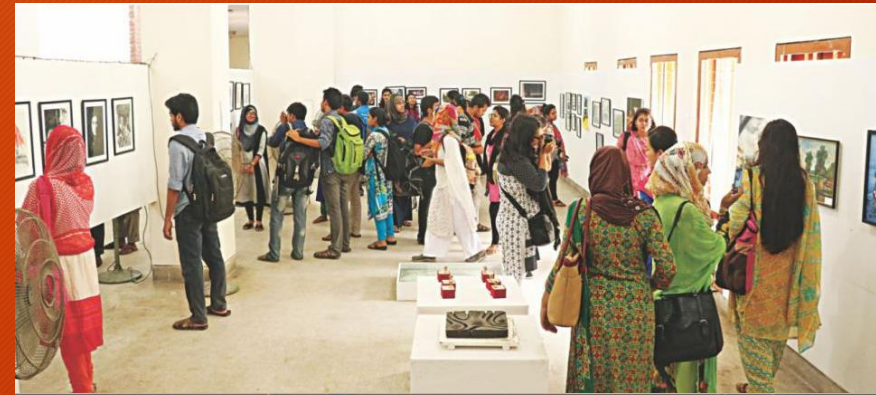
- From the Supplier Side,
 - A player is your complementor if it's more attractive for a supplier to provide resources to you when it's also supplying the other player than when it's supplying you alone
 - A player is your competitor if it's less attractive for a supplier to provide resources to you when it's also supplying the other player than when it's supplying you alone
- The Value Net reveals two fundamental symmetries in the game of business
 - Customers and suppliers play symmetric roles
 - Competitors and complementors play mirror-image roles



C2: Develop Complementary Mindset: Implications for Strategy Development

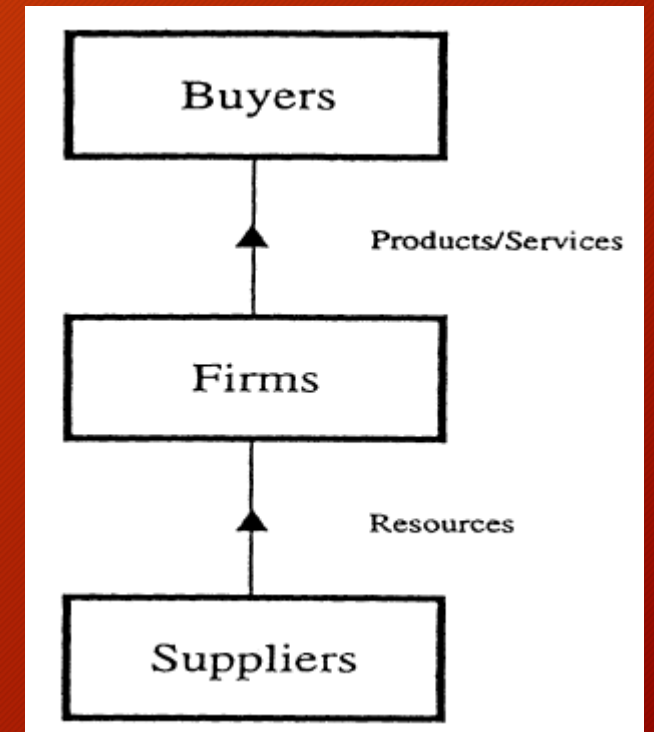
- People are so accustomed to viewing the business world in warlike terms that even when other players are both competitors and complementors, they tend to see them as only competitors and fight ,against them. They focus on the evil Mr. Hyde and overlook the good Dr. Jekyll. So, look for Complimentarily opportunities as well as competitive threats.
- Though companies as competitors divide up markets, but also work a complementor in the first place to making up markets. e.g., restaurants in food court acts as complementors to make the market before acting as competitors to dividing it up.

C2: Develop Complementary Mindset: Example

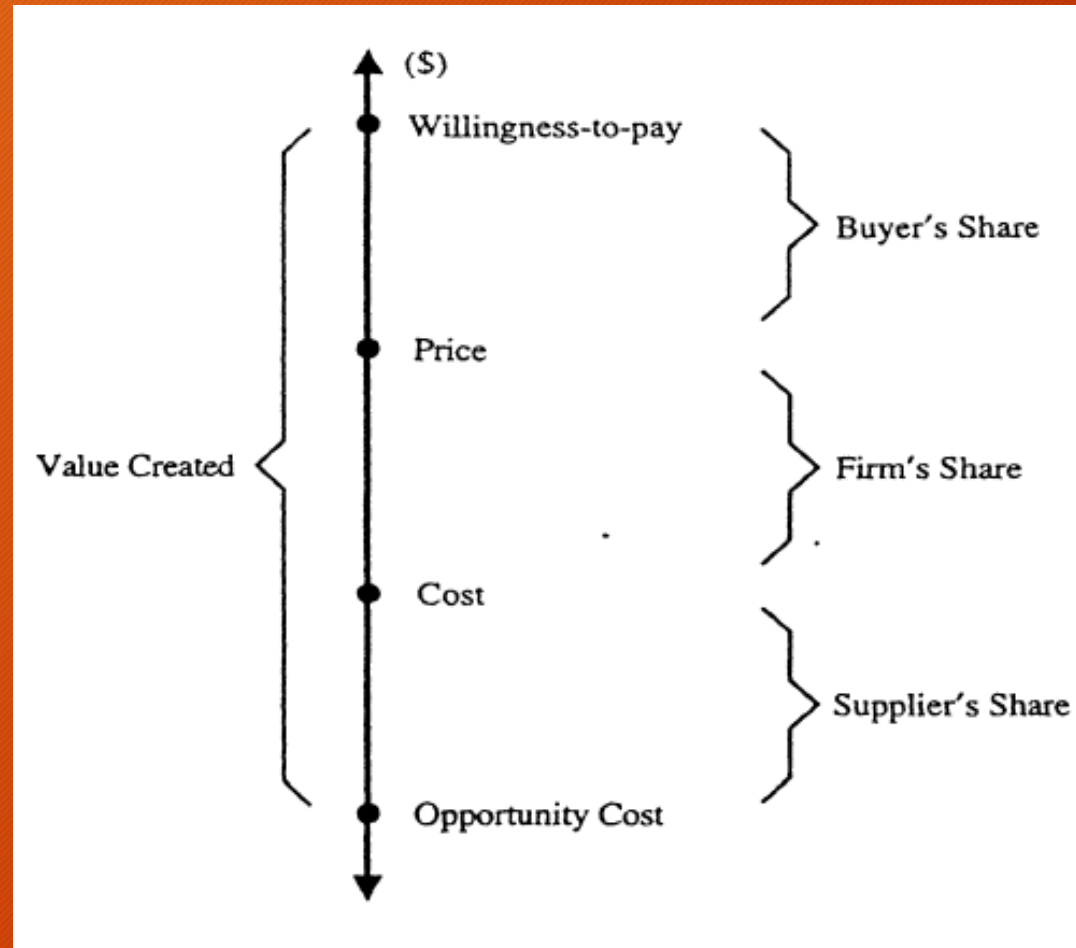


C3: Understanding Value: Value Creation

- Firms acquire resources, such as capital, labor, and raw materials, from suppliers and transform these resources into products and services, which are then sold to buyers
- The value created by the chain of players is defined as the "willingness-to-pay" of the buyer minus the "opportunity cost" of the supplier
- "willingness-to-pay" of the buyer is the amount of money buyer willing to pay for the product or service
- "opportunity cost" of the supplier is the benefit (from other opportunity) that he/she could have received, but gave up to acquire the resource



C3: Understanding Value: Value Appropriation

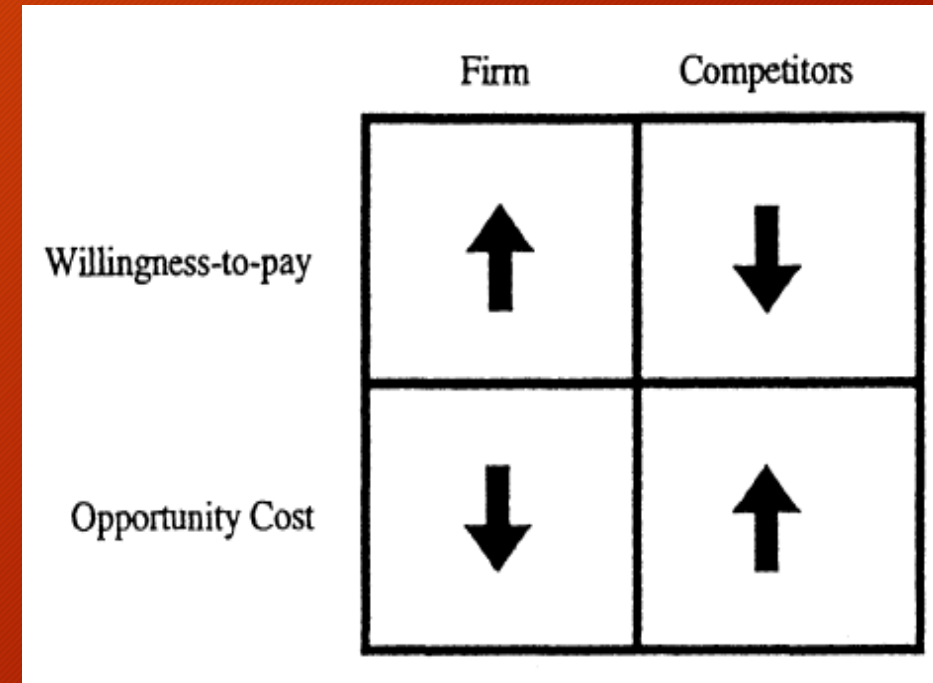


C3: Understanding Value: Zero Added Value

- What happens when a firm has a large number of competitors that are "identical" to it? (Identical competitor means another firm that commands the same willingness-to-pay on the part of buyers and the same opportunity cost on the part of suppliers as does the firm in question) - The firm will not be able to capture any value in such circumstances
- Example,
 - Consider a situation of four suppliers, three firms, and two buyers. Each supplier can transact with at most one firm, and vice versa. Similarly, each buyer can transact with at most one firm, and vice versa. Each supplier has an opportunity cost of \$10 and each buyer has a willingness-to-pay of \$100 for a firm's product. Although apparently the created value is \$90, it will add zero value to the firm in a competitive situation (value will be transferred to the Buyer)

C3: Understanding Value: Routes for Positive Added Value

- Four routes for Positive Added Value are,
 - Raising the willingness-to-pay of buyers for the firm's product. e.g., differentiation
 - Lowering the opportunity cost to suppliers. e.g., reducing a supplier's costs of doing business or offering employees nonsalary benefits
 - Lowering the willingness-to-pay of buyers for other firms' products. e.g., through negative advertising
 - Raising the opportunity cost to suppliers of providing resources to other firms. e.g., creation of switching costs for suppliers



C3: Understanding Value: Implications for Strategy Development

- A firm to have a positive added value it must be "different" from its competitors
- The key to a firm's achieving a positive added value was seen to be the existence of a favorable asymmetry between the firm and its competitors
- There are four routes that lead to the creation of such asymmetries

C3: Understanding Value: Example



	Firm	Competitors
Willingness-to-pay	↑	↓
Opportunity Cost	↓	↑

C4: Developing Strategy: Intended vs Realized

“Strategy is a pattern in a stream of decisions”

H. Mintzberg, 1978



C4: Developing Strategy: Finding Answers

Which will be our speed and movements sequence?

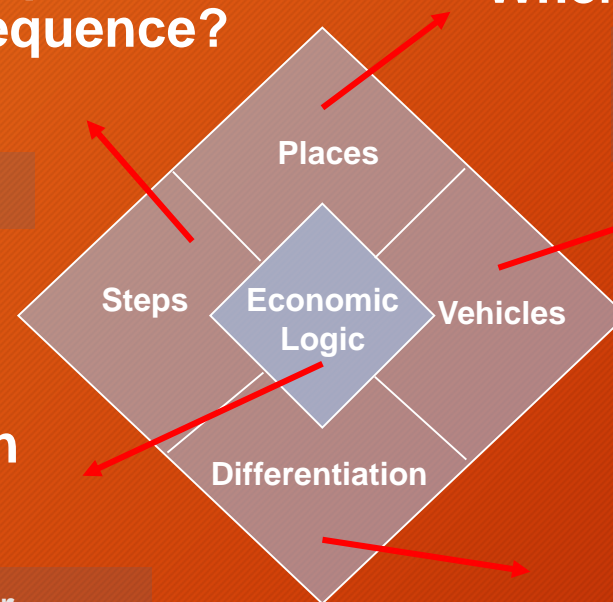
Steps, plans

Where do we want to be ?

Industries, segments, geographic zones

How will we obtain profits?

Business model for value creation



How will we arrive there?

Internal development, alliances, acquisitions

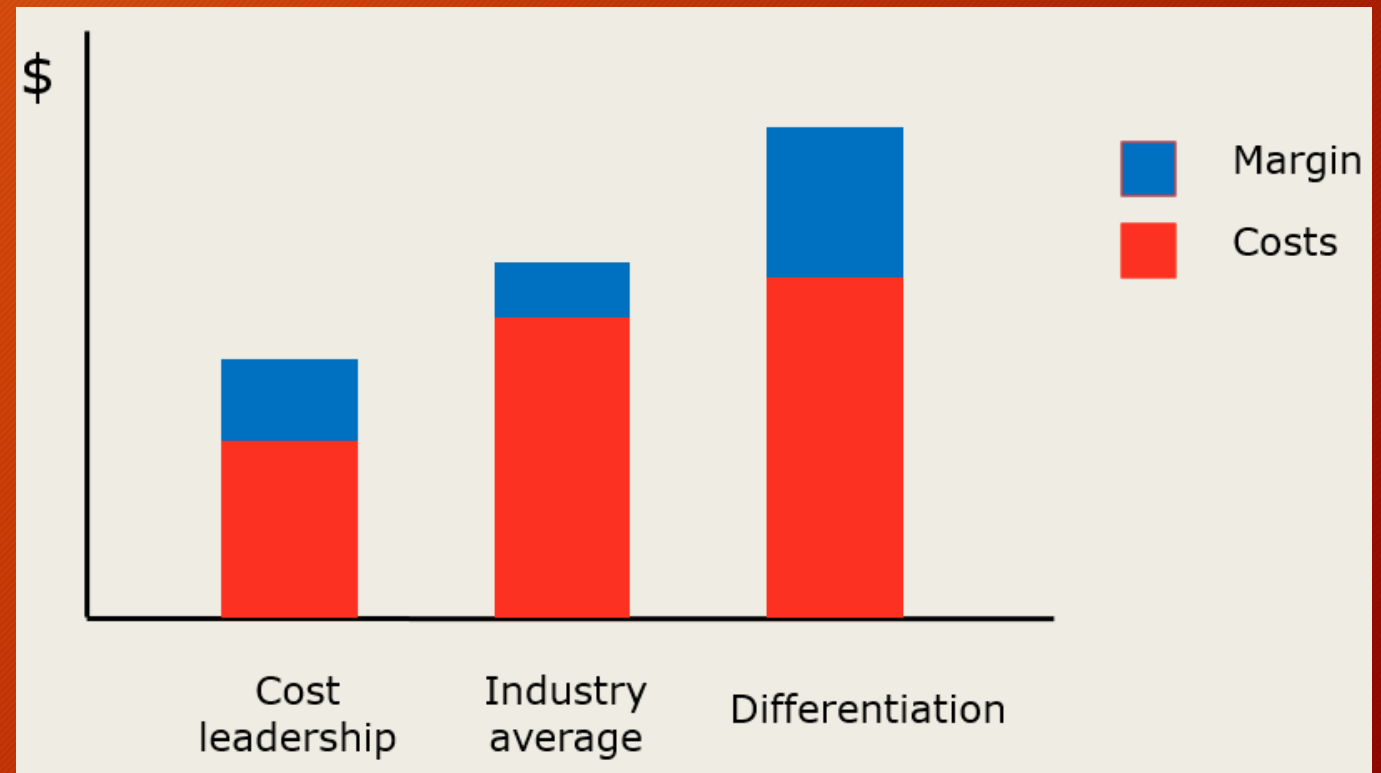
How will we beat our competitors?

Brand, price, customer adaptation

C4: Developing Strategy: Positioning, Tradeoffs and Fit

- Strategy is the creation of a unique and valuable position, involving a different set of activities compared with your competitors.
- Strategy requires you to make tradeoffs in competing and create the need for choice and purposefully limit your offers.
- Strategy involves creating “fit” among a company’s activities. Fit has to do with the ways a company’s activities interact and reinforce one another.

C4: Developing Strategy: Generic Strategies and Source of Competitive Advantage



C4:Developing Strategy: Operational Excellence Strategy - Cost Leadership

- Continuous effort to reduce costs over any other consideration to attract price sensitive customers
- Only high overall operational effectiveness is not enough to compete as a cost leader
- Each activity and its links with other activities need to be analyzed (or eliminated) to reduce final costs
- There can only be one cost leader that achieves superior performance through its lower costs
- Cost leadership is very hard to sustain in the long run

C4:Developing Strategy: Product Leadership Strategy - Differentiation

- Differentiation is in the mind of the customer who have some preference for your product or service and they are willing to pay extra for your firm's product or service
- Various differentiation strategies can be sustained in a given industry in the long run. Though it's difficult, anything can be differentiated
- Generally, there is a strong relationship between differentiation and firm performance

C4:Developing Strategy: Customer Intimacy Strategy - Customer Centricity

- Customer centricity means aligning a company's development and delivery of its product or service around the current and future needs of a select set of customers
- Customer centricity requires the company to change its organizational structure and employee incentives to focus on the fulfillment of customer needs

C4: Developing Strategy: Example



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