INDUSTRY AND MACROENVIRONMENTAL ANALYSIS

ENVIRONMENTAL ANALYSIS

Business Policy
COBA
Spring 2005

NOTES

The Strategic Management Process

Strategy Formulation
- Business-Level Strategy
- Corporate-Level Strategy
- International Strategy
- Functional Strategy

Strategy Implementation
- Corporate Governance
- Structure & Control
- Strategic Leadership
- Org. Culture & Innovation

Strategic Intent
- Strategic Mission

Strategic Competitiveness
- Above Average Return

Feedback

FORMULATING STRATEGY

UNDERSTANDING THE GAME
- Industry Structure
- Players, position, and intentions
- Rules of the game, terms of competition

CHOOSING THE WEAPONS
- Value Chain and CSFs
- Organizational Resources
- Core Competencies and Capabilities

STRATEGY
INDUSTRY/MARKET DEFINITION

- Qualitative approach: Two products are in the same market if they are close substitutes
  - Same or similar product performance characteristics
  - Same or similar occasions for use
  - Sold in the same geographic markets
- SIC (Standard Industrial Classification)/NAICS (North American Industry Classification System) Codes
  - Used by U.S. Bureau of Census to analyze and report on U.S. business activity.

ASSESSING PROFIT POTENTIAL

- Value of product or service to customers
- Intensity of competition
- Relative bargaining power

INDUSTRY AND THE MACROENVIRONMENT

- Strategic Management  Fall 2005
- Deepak Datta
INDUSTRY AND MACROENVIRONMENTAL ANALYSIS

INDUSTRY ANALYSIS

Industry segmentation/Strategic mapping

Strategic group characteristics, attractiveness

Likely impact of macroenvironmental changes

Implications for strategy

INDUSTRY SEGMENTATION AND STRATEGIC GROUP MAPPING

Strategic Group
Set of firms emphasizing similar strategic dimensions to use a similar strategy

Possible dimensions:
- Specialization
- Brand identification
- Channel selection
- Product quality
- Technological leadership
- Customer service
- Pricing policy

U.S. AUTOMOTIVE INDUSTRY
INDUSTRY AND MACROENVIRONMENTAL ANALYSIS

RETAIL JEWELRY INDUSTRY

PRODUCT LINE/ MERCHANDISE MIX

PRICE/ QUALITY

High

Full-line jeweler

Fine jewelry stores/chains (e.g., Tiffany and Cartier)

Prestige

department stores (e.g., Saks, Neiman Marcus, Nordstrom’s)

Medium

Limited-line general merch.

National jewelry chains (Carlyle & Co and Gordon’s)

Discounters (e.g., Walmart, Kmart, Target)

Low

Mass merchandisers

Guild Jewelers

Specially jewelers

National retail chains (e.g., JC Penny, Sears)

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NOTES

MOBILITY BARRIERS

GROUP A

C_{BE}

GROUP B

C_{ME}

A’S ENTRY COST = C_{AE} + C_{A} + C^x_{A} \times x_1

B’S ENTRY COST = C_{BE} + C_{B} + C^x_{B} \times x_2

STRATEGIC GROUP CHARACTERISTICS

- Firms in the same SG tend to be affected by and respond similarly to external events
- Profitability levels vary across SGs
- Existence of multiple SGs typically means higher rivalry
- Macroenvironmental changes may have different implications for different SGs
- SGs may have different critical success factors
INDUSTRY AND MACROENVIRONMENTAL ANALYSIS

**NOTES**

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**STRUCTURE-CONDUCT-PERFORMANCE PARADIGM**

**Basic Conditions**
- Basic Supply and Demand Conditions

**Market Structure**
- Number of sellers and buyers, product differentiation, barriers to entry, cost structures etc.

**Conduct**
- Pricing behavior, product strategy, R&D plant investment etc.

**Performance**
- Production and allocative efficiency, full employment, equity

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**INDUSTRY/STRATEGIC GROUP PROFIT PROSPECTS**

**Competitors**

**Suppliers**
- Bargaining Power

**Buyers**
- Bargaining Power

**Substitutes**
- Threat of Substitute Products

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**BARRIERS TO ENTRY**

**Entry Barriers**
- Scale and Scope Economies
- Incumbent Retaliation
- Technology
- Product Differentiation
- Government Policy
- Capital Requirements
- Switching Costs
- Access to Distribution Channels

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INDUSTRY AND MACROENVIRONMENTAL ANALYSIS

ECONOMIES OF SCALE

<table>
<thead>
<tr>
<th>$/Unit</th>
<th>AC</th>
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<tbody>
<tr>
<td>Q</td>
<td>MES</td>
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- Spreading of fixed costs over increasing output
- Lower inventory costs

ECONOMIES OF SCOPE

\[ \text{TC}(Q_x, Q_y) < \text{TC}(Q_x, 0) + \text{TC}(0, Q_y) \]

- Indivisibilities and spreading of fixed costs
- Inputs shared over several products
  - Manufacturing
  - Marketing
    - Spreading advertising costs
    - Reputation effects
  - Research and development

BARRIERS TO ENTRY

- Scale and Scope Economies
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- Capital Requirements
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ENTRY-DETERRING STRATEGIES
- Aggressively seeking cost advantage by moving down the learning curve
- Intensive advertising to create brand loyalty
- Enhancing firm's reputation for predation through signaling
- Limit pricing
- Capacity expansion
- Acquiring patents for all variants of a product

BARGAINING POWER OF BUYERS
- Undifferentiated products
- Controls access to end consumer
- High volume of purchases
- Few switching costs
- Threat of integrating backwards
- Large volume of purchases
- Input not key to quality
- Access to full information

INDUSTRY/SG PROFIT PROSPECTS
- Potential entrants
- Threat of new entrants
- Suppliers
- Bargaining power
- Competitors
- Rivalry
- Buyers
- Bargaining power
- Substitutes
- Threat of substitute products
INDUSTRY AND MACROENVIRONMENTAL ANALYSIS

NOTES

RIVALRY

- Numerous equally balanced competitors
- Undifferentiated products
- Slow industry growth
- Diverse competitors
- Few switching costs
- High exit barriers
- Excess capacity
- High fixed costs

EXIT BARRIERS

- Task specific assets which have low resale value.
- Fixed costs of exit (e.g., severance pay)
- Emotional attachment
- Image and potential impact on other businesses
- Obligations and warranties
- Legal and political constraints

SUSTAINABILITY OF COOPERATIVE PRICING

- Market concentration
- Structural conditions that affect reaction speeds and detection lags
  - Buyer concentration
  - Lumpy orders
  - Secret price terms
- Asymmetries among firms
APPLYING STRUCTURAL ANALYSIS

- Identify immediate and potential competitors
- Forecast profit potential
- Develop strategies for coping with forces
  - Position themselves to outperform rivals through strategy that insulates them from the five forces
  - Identify profitable industry segment
  - Change forces

NEUTRALIZING BUYER POWER

INTERMEDIARIES
- Leap frog over them
- Coopt them
- Eliminate them
- Vertical integration

END CUSTOMERS
- Differentiate the product
- Create switching costs
- Choose the “right” buyers

INTERNET AND FORCES OF COMPETITION

- More price based competition
- Widens geographic market – increases number of competitors

SUPPLIERS
- May increase firm’s bargaining power over their traditional suppliers
- Supplier power can increase because they can access more customers
- Can reach end customer directly

POTENTIAL ENTRANTS
- Reduced barriers to entry
- Applications difficult to keep proprietary

COMPETITORS

RIVALRY

BUYERS
- Eliminates / reduces power of powerful channels
- Shifts bargaining power to consumers
- Reduces switching costs

SUBSTITUTES
- Increased threat of substitutes
INDUSTRY AND MACROENVIRONMENTAL ANALYSIS

MACROENVIRONMENT: IMPACT

COMPETITIVE SUCCESS

MACRO-ENVIRONMENTAL ANALYSIS

NOTES
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ECONOMIC

- Economic growth
- Inflation
- Monetary and fiscal policies
- Exchange rates
- Income changes and distribution
- Deficits

SOCIO-CULTURAL

- Changing career expectations
- Life style changes
- Social responsibility
- Social values and norms
- Environmental concerns
- Workforce diversity
- Quality of work life

DEMOGRAPHIC

- Population size and growth
- Population shifts
- Composition changes (e.g., ethnic mix)
- Income distribution
- Aging of population

WORLD POPULATION
INDUSTRY AND MACROENVIRONMENTAL ANALYSIS

NOTES

POLITICAL/LEGAL

- Attitude towards business
- Legislation
  - Environment protection
  - Product safety
  - Antitrust
  - Regulation and deregulation
  - Tax
- Trade regulations/
  protectionism
- Political risk

TECHNOLOGICAL

- New technology evolution
  - Process innovations
  - Product innovations
- Technological substitutes
- New information technologies
- Knowledge transfer
- Impact of the Internet

“FORECASTING” THE FUTURE

- “This telephone has too many shortcomings to be seriously considered as a means of communication” -- Western Union Memo 1876
- “Who the hell wants to hear actors talk?” -- H.M. Warner, Warner Brothers, 1927
- “The problem with television is that the people must sit and keep their eyes glued on a screen; the average American family hasn’t time for it.” New York Times article about TV’s debut at the 1939 World Fair.
- “I think there is a market for maybe five computers.” -- Thomas Watson, Chairman of IBM, 1943.
- “640K ought to be enough for anybody.” -- Bill Gates, 1981

Lawrence Journal World, January 2, 2001
MACROENVIRONMENTAL TRENDS

- Key macroenvironmental areas/sub-areas
  - Importance varies across industries
- Trends/forecasts
  - May have different effects on various industries
- Impact on industry subgroups
  - Impact may vary across strategic groups within an industry

STRATEGIC INTELLIGENCE SYSTEM

Determining user needs and intelligence issues
Surfacing existing intelligence
Developing an intelligence collection strategy
Storing and analyzing data
Reporting and using intelligence

SECONDARY INFORMATION

- Databases
  - Dow Jones, D&B International, ABI Inform, Lexis Nexis
- Libraries
  - Corporate, University, Public
- Government sources
  - Department of Labor, Office of Technology Assessment, SEC
  - Patent and Trademark Office, Census
- Other sources
  - Internet/WWW
  - Banks, brokerage houses, etc.
**INDUSTRY AND MACROENVIRONMENTAL ANALYSIS**

**PRIMARY INFORMATION**

- **Internal Sources**
  - Employees with boundary spanning roles (purchasing, public relations, salespeople)
  - Managers
- **External Sources**
  - Suppliers, distributors and customers
  - Governmental staff, Security analysts
  - Industry experts
  - University faculty etc.

**FORECASTING TECHNIQUES**

**QUANTITATIVE**
- Statistical/econometric models
- Trend extrapolation
- Simulation models

**QUALITATIVE**
- Scenarios
- Judgmental techniques
- Delphi

Forecasting is difficult, especially, about the future. Chinese proverb

**REPORTING AND USING INFORMATION**

- Tailor to individual needs
- Articulate implications/ recommend strategic alternatives
- Link reports to users’ responsibilities and decision-making needs