“When an industry with a reputation for difficult economics meets a manager with a reputation for excellence, it is usually the industry that keeps its reputation intact.”

Warren Buffett
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.

PROFITABILITY OF US INDUSTRIES
Median return on equity (%), 1999-2007

Source: Grant (2009)

INDUSTRY ANALYSIS

Industry segmentation/Strategic mapping

- Strategic group characteristics, attractiveness
- Likely impact of macroenvironmental changes
- Implications for strategy
INDUSTRY ANALYSIS

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STRATEGIC GROUPS

INDUSTRY AND THE MACROENVIRONMENT

MACROENVIRONMENT
- DEMOGRAPHICS
- ECONOMIC
- INDUSTRY
- LEGAL
- POLITICAL
- SOCIAL
- TECHNOLOGICAL

Firm
INDUSTRY SEGMENTATION AND STRATEGIC GROUP MAPPING

Strategic Group
Set of firms emphasizing similar strategic dimensions to use a similar strategy. Rival firms with similar competitive approaches and positions in an industry

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

CONSTRUCTING A STRATEGIC GROUP MAP

STEP 1: Identify competitive characteristics that differentiate firms in an industry from one another
STEP 2: Plot firms on a two-variable map using pairs of these differentiating characteristics
STEP 3: Assign firms that fall in about the same strategy space to same strategic group
STEP 4: Draw circles around each strategic group, making circles proportional to size of group’s respective share of total industry sales

U.S. AUTOMOTIVE INDUSTRY
STRATEGIC MANAGEMENT
INDUSTRY ANALYSIS

RETAIL JEWELRY INDUSTRY

PRICE QUALITY

High
Guild Jewelers
Fine jewelry stores/chains (e.g., Tiffany’s and Cartier)

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

Low
Limited-line general merch.
Mass merchandisers

PRODUCT LINE/ MERCHANDISE MIX

MOBILITY BARRIERS

GROUP A

GROUP B

A’S ENTRY COST = C_{AE} = C_{BE} + \Delta A

B’S ENTRY COST = C_{BE} = C_{AE} + \Delta B

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 ANALYSIS

Industry segmentation/Strategic mapping

Strategic group characteristics, attractiveness

Likely impact of macroenvironmental changes

Implications for strategy

RETAIL JEWELRY INDUSTRY
Which group is the most attractive?

PRICE/QUALITY

High

Full-line jewelers

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

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

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

Med

Limited-line general merch.

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

Full-line jewelers

Catalog showrooms (e.g., Service Merchandise, Marshall's)

Limited-line general merch.

Guild Jewelers

Specialty jewelers

LOW

Mass merchandisers

FORCES OF COMPETITION
INDUSTRY/STRATEGIC GROUP
PROFIT PROSPECTS

POTENTIAL ENTRANTS
Three stage vertical chain
SUPPLIERS
COMPETITORS
BUYERS
SUBSTITUTES

INDUSTRY PROFIT PROSPECTS

POTENTIAL ENTRANTS
SUPPLIERS
COMPETITORS
BUYERS
SUBSTITUTES

BARRIERS TO ENTRY

Scale and Scope
Incident Retaliation
Capital
Economies
Requirements
Technology
Switching
Product
Costs
Differentiation
Access to
Government
Channels
policy
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

INDUSTRY/SG PROFIT PROSPECTS

- Potential Entrants
- Threat of New Entrants
- Suppliers
  - Bargaining Power
- Competitors
  - Rivalry
- Buyers
  - Bargaining Power
- Threat of Substitute Products

BARGAINING POWER OF BUYERS

- Undifferentiated products
- Controls access to end consumer
- Large volume of purchases
- Input not key to quality
- Few switching costs
- Access to full information
- Threat of integrating backwards
WHY SUBSTITUTE PRODUCTS MATTER

- Competitively priced substitutes can place CEILING on PRICES industry can charge for its product
- Price ceiling can place a LID on PROFITS industry members can earn
- Availability of substitutes invites customers to make QUALITY and PERFORMANCE comparisons as well as PRICE comparisons
- The lower the SWITCHING COSTS, easier it is for customers to shift to substitute products

RIVALRY

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

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
- Government and social restrictions
PROFITABILITY OF US INDUSTRIES
Median return on equity (%), 1999-2007

<table>
<thead>
<tr>
<th>Industry</th>
<th>Return on Equity (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pharmaceuticals</td>
<td>21.0</td>
</tr>
<tr>
<td>Petroleum refining</td>
<td>20.0</td>
</tr>
<tr>
<td>Tobacco</td>
<td>19.7</td>
</tr>
<tr>
<td>Food Consumer Products</td>
<td>19.5</td>
</tr>
<tr>
<td>Medical Products &amp; Equipment</td>
<td>17.7</td>
</tr>
<tr>
<td>Apparel</td>
<td>14.4</td>
</tr>
<tr>
<td>Computer Software</td>
<td>14.0</td>
</tr>
<tr>
<td>Health Care</td>
<td>13.1</td>
</tr>
<tr>
<td>Hotels, Casinos and resorts</td>
<td>12.7</td>
</tr>
<tr>
<td>Furniture</td>
<td>9.9</td>
</tr>
<tr>
<td>Motor Vehicles &amp; Parts</td>
<td>9.3</td>
</tr>
<tr>
<td>Forest and Paper Products</td>
<td>6.6</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>5.8</td>
</tr>
<tr>
<td>Airlines (negative)</td>
<td>(12.6)</td>
</tr>
</tbody>
</table>

Source: Grant (2009)

INDUSTRY ANALYSIS

Industry segmentation/Strategic mapping
- Strategic group characteristics, attractiveness
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TRENDS INFLUENCING INDUSTRY STRUCTURE

- Shifts in industry growth
- Change in mix between fixed and variable costs
- Industry consolidation
- New entry
- Convergence of suppliers
- Integration of suppliers
- Improvements in supplier information
- Surge in demand/supply

- Decline in economies of scale
- Emergence of switching costs
- Emergence of new distribution channels
- Commoditization
- Regulation/deregulation

- Concentration/fragmentation of buyers
- Improvements in buyer information
- Shifts in customer tastes
- Backward integration
- Surge/decline in demand
APPLYING STRUCTURAL ANALYSIS

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

MACROENVIRONMENT

MACROENVIRONMENT: IMPACT
MACRO-ENVIRONMENTAL ANALYSIS

- Assess importance of macroenvironmental areas
- Assess current state
- Scanning, monitoring and forecasting
- Assessing implications for industry and firm strategy

SECONDARY INFORMATION

- Industry Studies
  - Stock analysts reports, market research reports, trade association studies
- Company sources
  - Annual reports, SEC filings, Press releases, Web sites
- Government sources
  - Department of Labor (BLS), Census data, Patents and Trademarks Office, SEC, Antitrust/regulatory documents
- Miscellaneous
  - Conferences, trade shows
- Business Press
  - FT, WSJ, Business Week, Economist, Fortune, Forbes etc.
- Databases
  - Dow Jones, D&B International, Department of Labor (BLS), Lexis Nexis, Factiva, Bloomberg, Onesource, Compustat, Mergent online

ECONOMIC

- Economic growth
- Inflation
- Monetary and fiscal policies
- Exchange rates
- Income changes and distribution
- Deficits
STRATEGIC MANAGEMENT
INDUSTRY ANALYSIS

SOCI-CULTURAL

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

DEMOGRAPHIC

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

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

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

“TAKE AWAYS”

- Strategic Group mapping – key to segmenting “non-homogeneous” industries
- Structural features of industry influences competition and profitability
- Five forces framework – understanding industry/strategic group profit potential
- Macroenvironmental analysis – key to assessing future attractiveness of industry and industry segments