Chapter 6

Analysing the industry environment

Learning outcomes

- After reading this chapter, you should be able to:
  - explain what the term industry means
  - analyse the structure and dynamics of different industries, and identify the impact on competition and profitability
  - analyse competitors and customers to determine opportunities for sustainable competitive advantage in an industry.

Overview

This chapter focuses on analysis of the industry environment in the following ways:

1. It discusses the two most important forces: competitors and customers.
2. It examines the nature of industry, and how the various players interact and compete.
3. It focuses on the analysis of competitors and customers as a means of understanding how their perception, actions and reactions influence and shape strategies.

6.1 Introduction

- Industry analysis necessitates defining the industry, understanding industry key success factors, the effects of industry evolution, industry structure, and competitive and co-operative dynamics.
- Intra-industry analysis focuses on the analysis of competitors and customers in the industry to identify opportunities for creating or protecting competitive advantage.

6.2 Industry analysis
6.2.1 Defining the industry

- Broad or narrow definitions can be used, both with advantages and disadvantages.
- Industry convergence constantly changes boundaries.
- Horizontal, vertical and geographic boundaries typically define the industry.

6.2.2 Industry key success factors

- Based on the following questions:
  - On what basis do customers choose between competing brands?
  - What resources and capabilities are required by sellers?
  - What does it take to achieve a competitive advantage?
- Examples of industry key success factors:
  - Asset utilisation (low-cost airline)
  - Rate of approval of new drugs (pharmaceutical company)
  - Monthly average revenue per user (cellular service provider)

6.2.2.1 Industry key success factors in mature and declining industries

Industry key success factors in mature industries:

- Cost advantage
- Profitable market segments
- Differentiation
- Strategic innovation
- End-game key success factors may include the following:
- *Leadership strategy*:
- *Niche strategy*
- *Harvesting an asset*:
- *Withdrawal*

6.2.2.1 Industry key success factors in mature and declining industries (cont.)

Figure 6.1 Strategies for declining industries[12]

	Competitive strengths in attractive niches	No competitive strengths in attractive niches
Favourable	Leadership or niche	Harvest or divest
Unfavourable	Harvest or niche	Quick sale

6.2.2.2 Industry key success factors in technology-intensive industries

- Industry key success factors:
  - Protection of intellectual property
  - Complementary products
  - Codification
  - Lead time

Guidelines to win the industry standards battle

- Assemble allies before you go to war. Enlisting the help of suppliers, customers, complimentors, and even competitors is critical for building the competencies necessary to develop a standard.
- Pre-empting the market – even seeing an industry where none currently exists – can be beneficial when competing for standards.
- Manage expectations, and convince allies that you will emerge victorious. In many instances, this becomes a self-fulfilling prophecy.
- Perseverance may be a key factor in establishing standards – in other words, simply refusing to give up.

6.2.2.3 Industry key success factors in not-for-profit settings

Industry key success factors:

- Strategic piggybacking
- Mergers
- Strategic alliances.

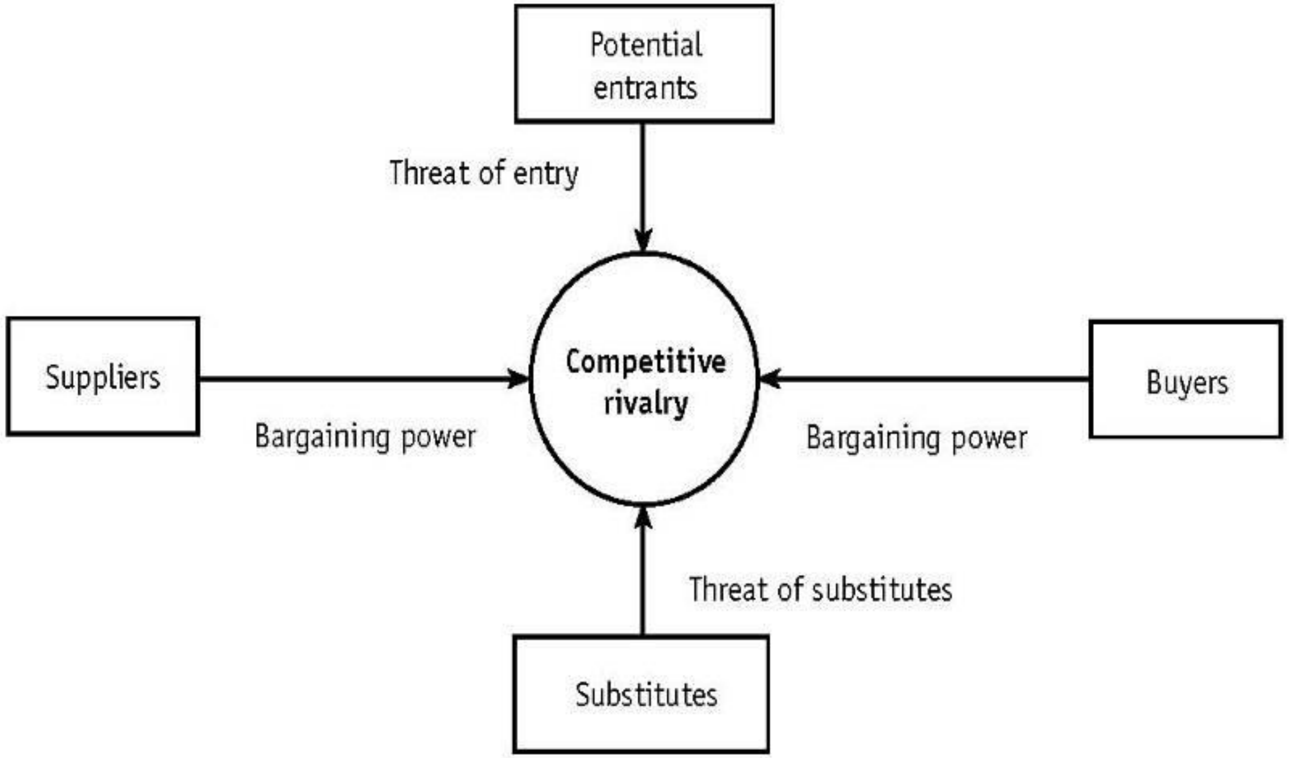
- A key aspect of strategy in not-for-profit organisations is the relative importance of stakeholders.
- Not-for-profit organisations have many stakeholders, often with different expectations. Clients, trustees, donors, volunteers, the government, and management are just some of the stakeholders typically involved in a not-for-profit organisation, all with a certain amount of influence and power.
- The challenge for not-for-profit organisations is not to lose focus since there are so many different stakeholders with influence and power that affect them.

6.2.3 Relationships that shape the industry
6.2.3.1 Competition and industry structure

- Caveats for using industry analysis:
  - Five forces framework useful at the level of strategic business units
  - Important to understand connections between macro-environment and industry forces
  - Industry forces are interrelated
  - Industry forces may be more concerned with disruption rather than with adapting or shaping the industry.

6.2.3.1 Competition and industry structure (cont.)

Figure 6.2 Porter's five forces framework for industry analysis[22]



6.2.3.1 Competition and industry structure (cont.)

- Three basic forms of competition:
  - Monopolistic
  - Perfect competition
  - Oligopolistic.

6.2.3.1 Competition and industry structure (cont.)

- Degree of rivalry:
  - Number and size of competitors
  - Rate of industry growth
  - Differentiation and switching costs
  - Fixed costs or perishable products
  - Expansion
  - High exit barriers
  - Diverse strategies.

6.2.3.1 Competition and industry structure (cont.)

- Threat of new entrants:
  - Economies of scale required
  - Capital cost of entry
  - Control over distribution channels
  - Customers are committed to existing players
  - Time advantages of incumbents
  - Expected retaliation
  - Legal restraints
  - High levels of differentiation.

6.2.3.1 Competition and industry structure (cont.)
Threat of substitutes

- Types of substitution:
  - Product-for-product substitution
  - Substitution of need
  - Generic substitution.

6.2.3.1 Competition and industry structure (cont.)

- Bargaining power of buyers:
  - Buyer concentration
  - Switching costs
  - Threat of backward vertical integration
  - Ratio of purchase price to total cost
  - Buyer more interested in quality than price
  - Level of information buyers have about suppliers and their products.

6.2.3.1 Competition and industry structure (cont.)

- Bargaining power of suppliers:
  - Supplier concentration
  - High switching costs
  - Threat of forward vertical integration
  - Lack of substitutes
  - Industry dependence.

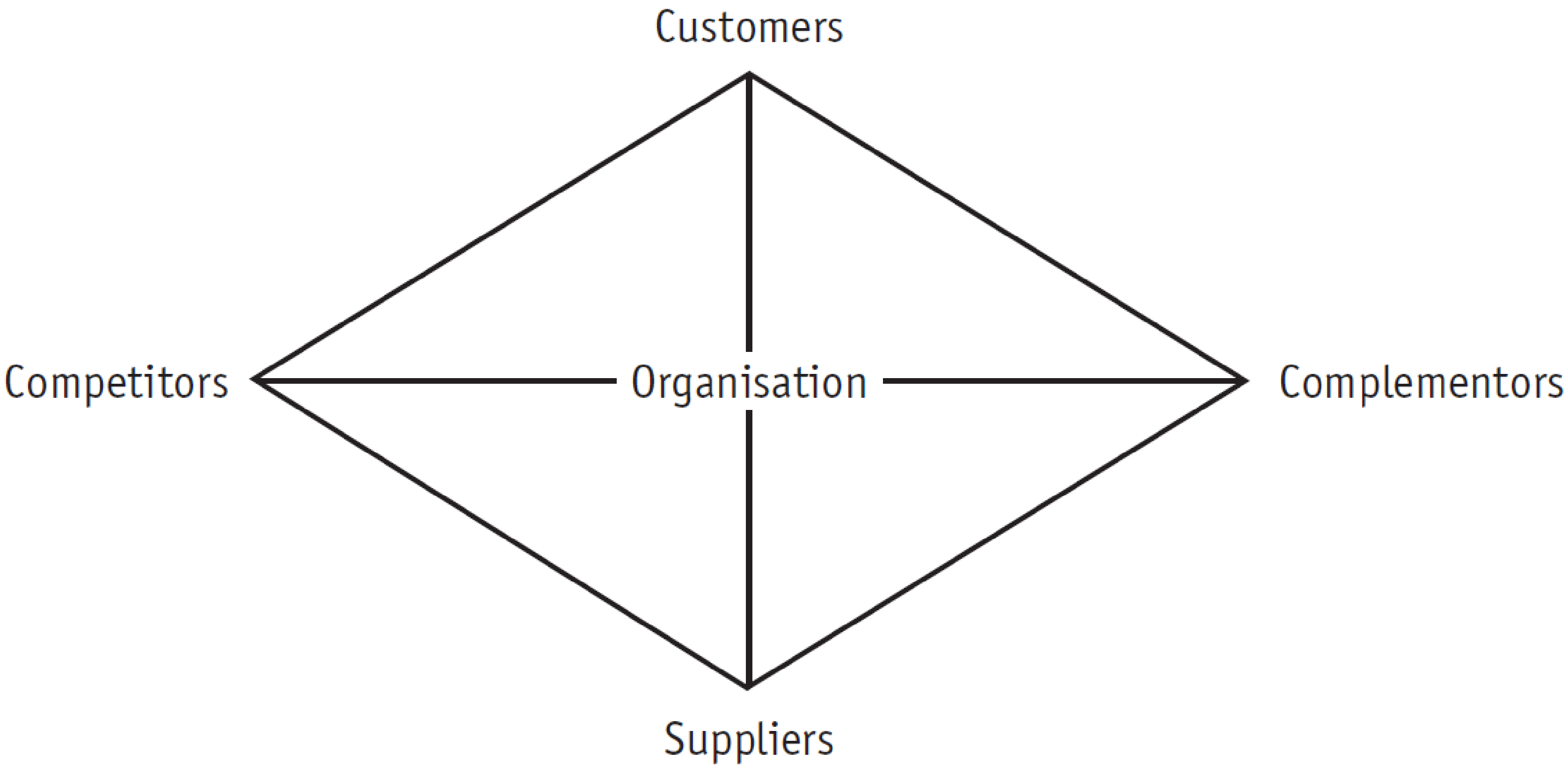
6.2.3.1 Competition and industry structure (cont.)

- Limitations of Porter’s five forces framework:
  - Static model (snapshot)
  - Assumes that organisations are essentially *selfish* and will always put their own interests first
  - All five forces may not be equal
  - Ignores profit-enhancing relationships
  - Ignores the *human elements* of strategy
  - Predisposed towards a *top-down* approach to strategy
  - Theoretical foundation is outdated.

6.2.3.2 Complementary relationships – the value net

- Customers, competitors, complimentors and suppliers all important in value net framework.
- Relationship with complementors central to value net framework.
- Definition: 'A player is a complementor if a customer values your product more when they have the other player's products than when they have your product alone.'
- Specific relationship enhancing value for both parties.
- Relationships must be managed with regard to distribution of added value.

Figure 6.3 The value net framework



6.2.3.2 Complementary relationships – the value net (cont.)

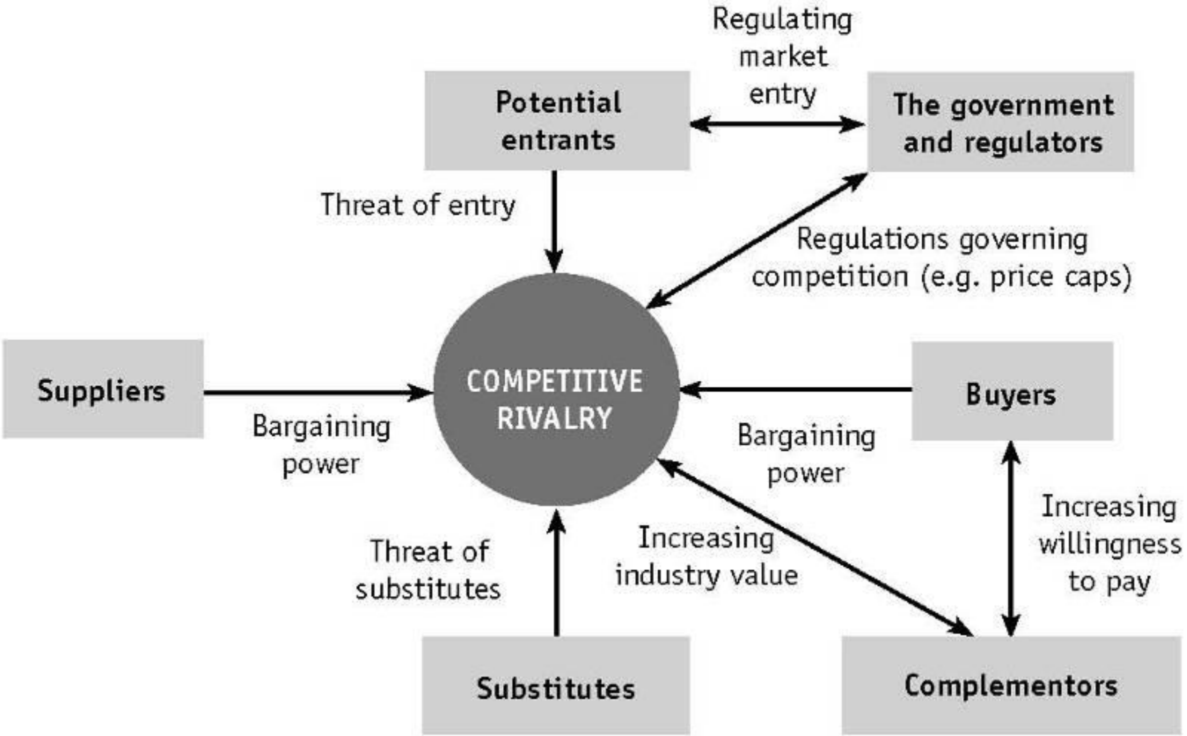
- Forces determining bargaining power of complementors:
  - Complementor concentration
  - Switching costs – may determine ownership of added value
  - Unbundling of complementary products
  - Threat of integration
  - Dependence on single industry – reduces bargaining power
  - Visibility
  - Market growth – affects intensity of competition.

6.2.3.3 Industry regulation as a competitive force

- Maintaining barriers to entry
- Price control
- Direct restrictions on practices
- Scrutiny and control of mergers and acquisitions
- Legislation

6.2.3.4 An extended framework of industry competition

Figure 6.3 An extended model of industry competition[43]



6.2.3.5 Cooperative relationships

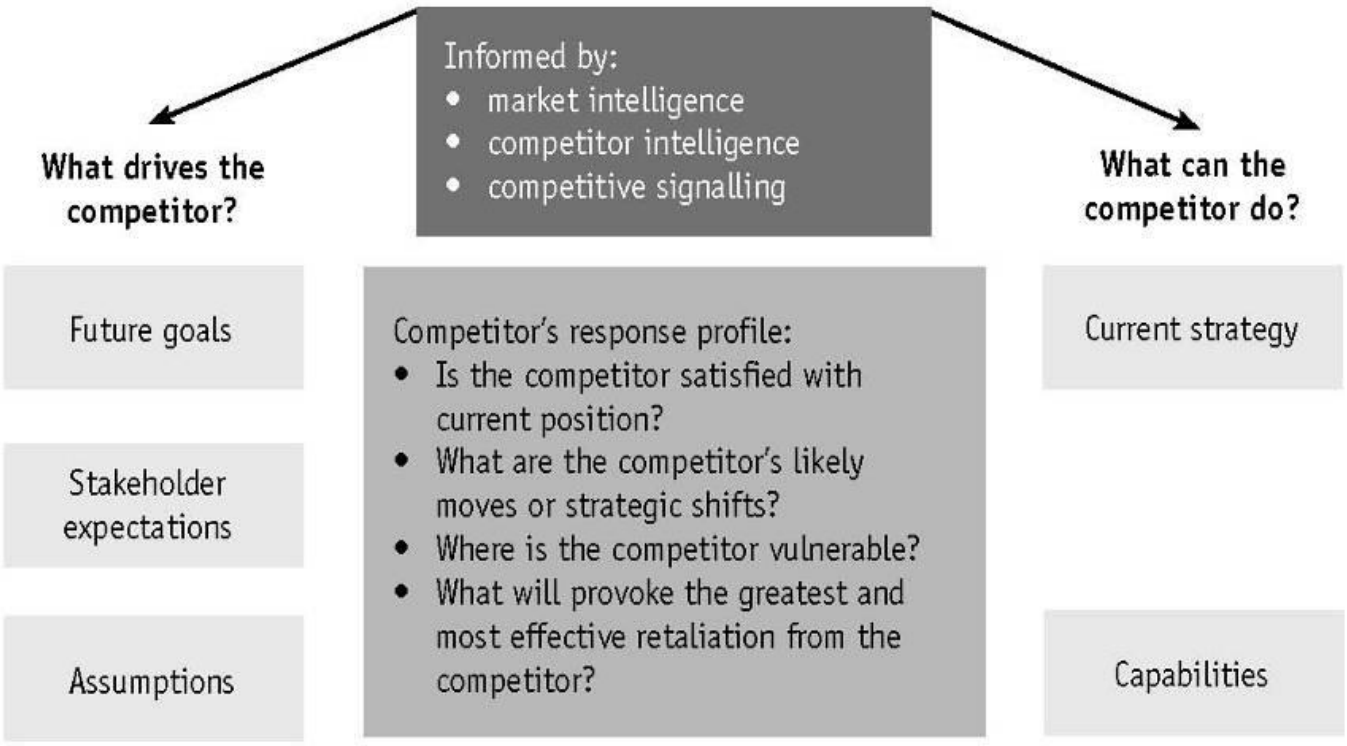
- Brandenburger and Nalebuff introduced and expanded on another key idea in the context of complementary relationships, namely the idea of ‘coopetition’.
- This is the notion that organisations may choose to cooperate in certain markets or circumstances, and compete in others.
- For example, telecommunications companies may cooperate to establish capital-intensive infrastructure such as undersea cables or fibre-optic networks, but will then compete in packaging and selling this infrastructure to end-users.
- Organisations such as Dell and Apple are also more likely to cooperate with the ‘best in class’ component manufacturers to develop and manufacture their products than to manufacture every component themselves.

6.2.4 Industry evolution – competition over time

- The industry life cycle, as illustrated in Figure 6.5, suggests that any product or industry moves through several growth phases:
  - *Development phase*: During the development phase, mostly early adopters will buy the product on offer, and there will be few competitors.
  - *Growth phase*: During the growth phase, early followers will begin to purchase the product, and competitors will start entering the market to profit from market growth.
  - *Shake-out phase*: While growth rate starts declining, competitors are entering the market during this phase, weaker competitors out of the market. This phase is the early phase of industry maturity.
  - *Maturity*: During maturity, growth peaks and may even start declining somewhat. Repeat sales are likely to fuel revenues.

6.3 Intra-industry analysis
6.3.1 Competitor analysis

Figure 6.5 A framework for competitor analysis[55]

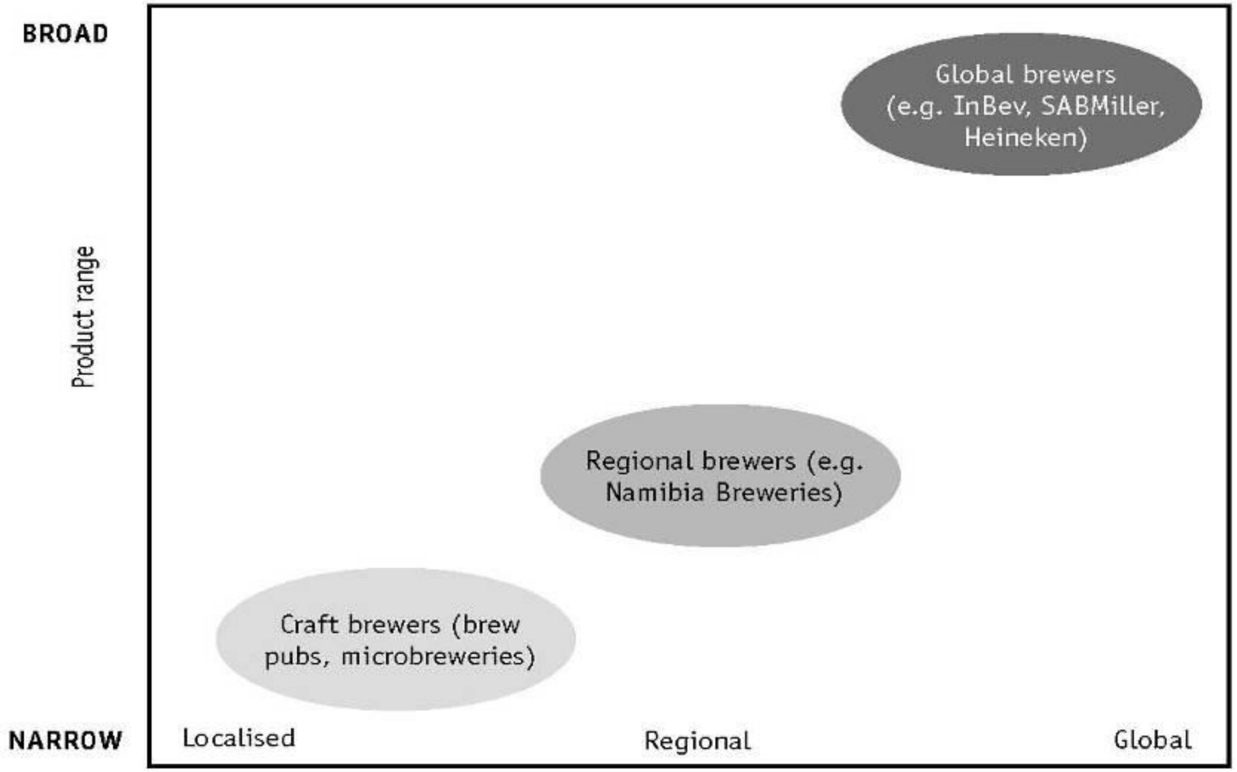


6.3.1.2 Strategic groups

- Factors driving strategic group analysis:
  - Mobility barriers
  - Competition within groups
  - Impact of bargaining power of buyers and suppliers
  - Impact of substitution on different strategic groups
- Organisations can use strategic group analysis in the following ways:
  - *To identify their most direct competitors*
  - *To consider where to compete*
  - *To identify opportunities and threats*

6.3.1.2 Strategic groups (cont.)

Figure 6.6 Strategic group map of the global beer market



Note that this example is purely for illustrative purposes and is not based on rigorous analysis.

6.3.2 Customer analysis

- The success or failure of organisations is closely linked to the extent to which they understand customer needs, and the extent to which they address those needs.
- This depends on an understanding of the various segments in the industry and customer commitment.
- A market segment is a group of customers that has similar needs that are different from the needs of customers in other parts of the market.

6.3.2.3 Some principles for market segmentation methodology

- *Segment uniqueness*: Segmentation should assist in identifying segments that respond uniquely to the strategic positioning of the organisation.
- *Segment attractiveness*: It is important to understand the various segments' relative attractiveness.
- *Key success factors*: In addition to understanding whether segments are attractive, it is important to understand customer preferences and how the organisation is or could be positioned based on those preferences.
- *Scope of segmentation*: The number of segments to use is a matter of choice. The scope of segmentation is normally decided by two factors. First, the similarities of key success factors, and second, the presence of shared costs.

Summary

- The section on industry analysis focused on defining the industry as a unit of analysis and the analysis of industry structure.
- The importance of complementors as a means of increasing the value of the products and services of the organisation was stressed.
- Key success factors were discussed, as well as the idea that different industries and industries in different phases of the life cycle require different approaches to strategy.

Summary (cont.)

- Merely understanding industry structure and competitive forces may not be sufficient.
- The organisation needs a good understanding of individual competitors and groups of competitors, which allows for exploiting specific opportunities and identifying and dealing with specific threats.
- In order to target the most valuable customers, the market has to be segmented, and each segment has to be assessed and specifically targeted.
- Industry analysis is an ongoing task, not an event undertaken only every year or two.
- Industry analysis is multi-dimensional.
- Organisations must understanding the initiatives undertaken by the most obvious competitors are up to, but must also develop a complete picture of the competitive threats and co-operative opportunities in the industry.

Discussion questions

1. Visit the website: www.youtube.com/watch?v=mYF2_FBCvXw and watch the interview with Michael Porter on the five forces. Has watching the video modified your thinking about the five forces in any way?
2. Contrast and compare Porter's five forces framework (Section 6.2.3.1) with Brandenburger and Nalebuff's value net (Section 6.2.3.2). List the key differences and similarities.
3. Consider the extended framework for industry analysis (Section 6.2.3.4). Do you agree with the inclusion of the regulator as an industry force? Motivate your answer.
4. Identify key success factors for each of the demand growth phases in the industry life cycle.
5. Summarise the industry forces that reduce and enhance profits and depict this in a diagram.