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Competitive Conditions and Industry Attractiveness

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MASTER IN ENTREPRENEURSHIP
INNOVATION MANAGEMENT
IN COLLABORATION WITH MIT SLOAN

UNIVERSITÀ DEGLI STUDI DI NAPOLI
PARTHENOPE

OUTLINE

- Objectives
- Industry analysis
- IO framework
- Porter's FF Framework
- Limits of industry analysis

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The World Automotive Industry
Case Study 1 | Apple

OBJECTIVES

Tools and concepts needed to conduct an external strategic management audit | *industry analysis*

◆ Identify the main structural features of an industry and understand how they impact the intensity of competition and overall level of profitability in the industry.
◆ Apply industry analysis to explain the level of profitability in an industry and predict how profitability is likely to change in the future.
◆ Develop strategies that (a) position the firm most favorably in relation to competition and (b) influence industry structure in order to enhance industry attractiveness.

INDUSTRY ANALYSIS

The core of the firm's business environment is formed by its relationships with three sets of players

suppliers   customers   competitors

INDUSTRIAL ORGANIZATION (I/O) VIEW

The Industrial Organization (I/O) approach to competitive advantage advocates that competitive advantage is determined largely by competitive positioning within an industry.

Proponents of the I/O view, such as Michael Porter, contend that organizational performance will be primarily determined by industry forces.

Porter's Five-Forces Model is an example of the I/O perspective.

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Porter's Five-Forces Model is an example of the I/O perspective.

The I/O view has enhanced our understanding of strategic management. However, it is not a question of whether external or internal factors are more important in gaining and maintaining competitive advantage.

Effective integration and understanding of both external and internal factors is the key to securing and keeping a competitive advantage. Matching key external opportunities/threats with key internal strengths/weaknesses provides the basis for successful strategy formulation

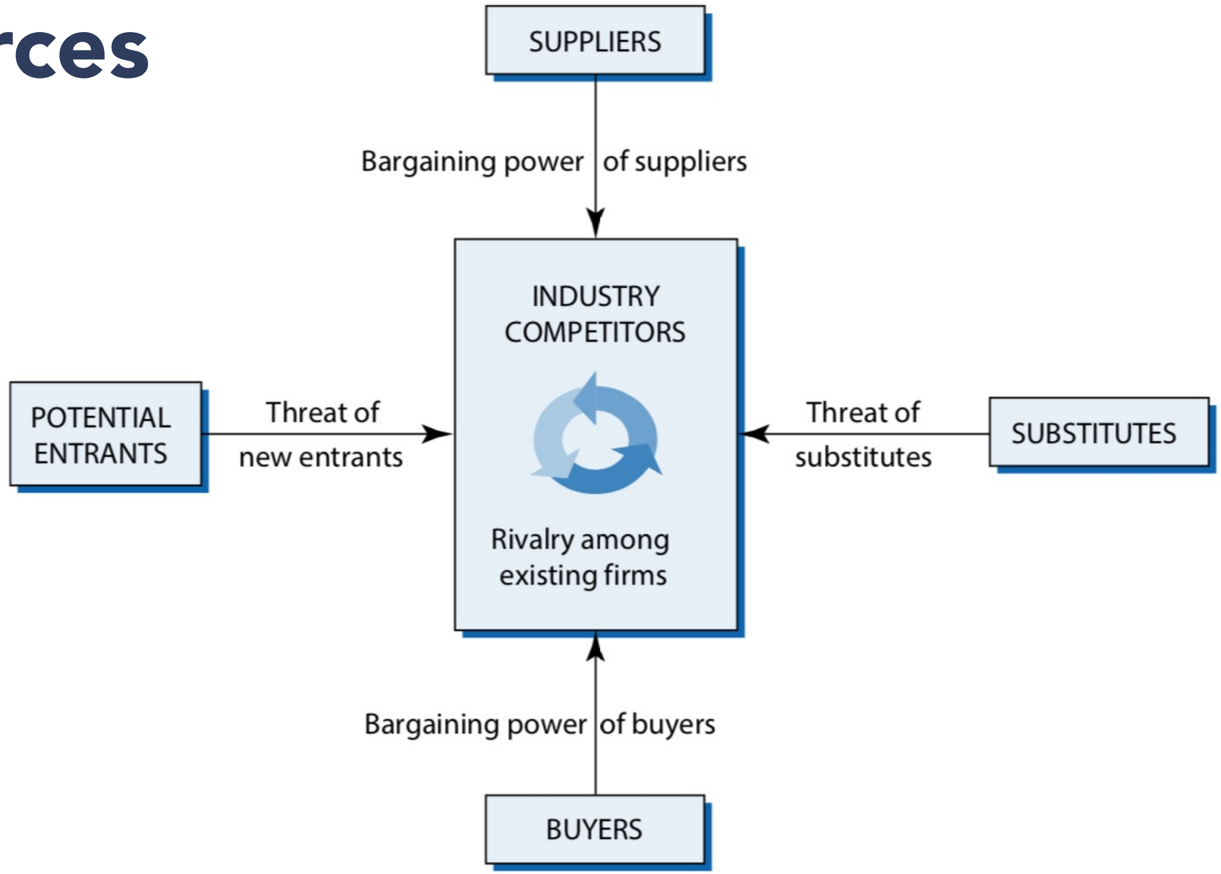
Porter's Five Forces of Competition Framework

Michael Porter's five forces of competition framework is the most widely used tool for analyzing competition within industries.

It regards the profitability of an industry (as indicated by its rate of return on capital relative to its cost of capital) as determined by five sources of competitive pressure.

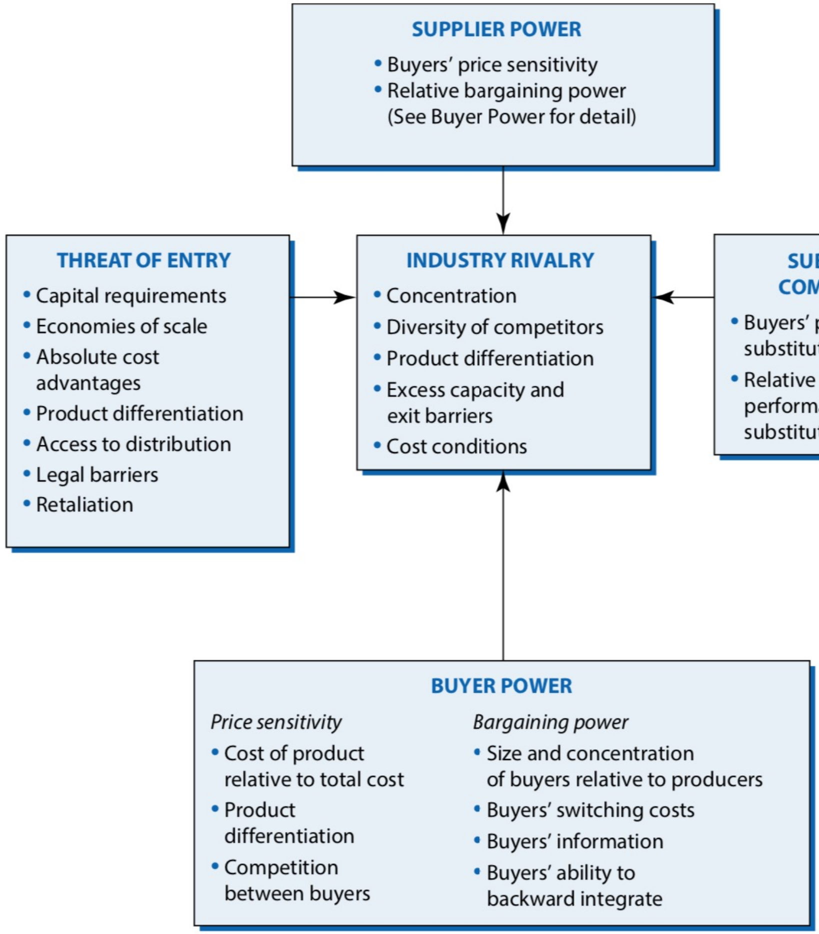
This framework holds that the competitive forces affecting profitability go beyond rivalry among competing firms and includes pressures from other key structural variables.

Porter's Five Forces of Competition Framework



Source: Grant, 2018, *Contemporary Strategy Analysis, Wiley*

Porter's Five Forces of Competition Framework



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Porter's Five Forces of Competition Framework

Industry Competitors

Rivalry between Established Competitors

- The intensity of rivalry among competing firms tends to increase as the number of competitors increases, and as competitors become more equal in size
- The ability of rival firms to avoid price competition depends on how similar they are in their origins, objectives, costs, and strategies
- The more similar the offerings among rival firms, the more willing are customers to switch between them and the greater is the inducement for firms to cut prices to boost sales
- Excess capacity may be part of a structural problem resulting from overinvestment and declining demand. Excess capacity together with high exit barriers can devastate industry profitability
- Cost structure is another key variable. Scale economies and fixed costs high relative to variable costs may induce aggressive price competition

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As rivalry among competing firms intensifies, industry profits decline, in some cases to the point where an industry becomes inherently unattractive

Porter's Five Forces of Competition Framework

Potential entrants

Threat of Entry

If entry is unrestricted, profitability will fall toward its competitive level.

In most industries, however, new entrants must surmount **Barriers to Entry**: disadvantages that new entrants face relative to established firms (Incumbents), i.e.:

- large capital requirements, the need to gain economies of scale quickly,
- the need to gain technology and specialized know-how,
- the lack of experience,
- strong customer loyalty, strong brand preferences,
- lack of adequate distribution channels,
- government regulatory policies,
- lack of access to raw material,
- existence of patents,
- expectations of retaliation by established firms (aggressive price-cutting, increased advertising, sales promotion, ...), ...

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Whenever new firms can easily enter a particular industry, the intensity of competitiveness among firms increases

Porter's Five Forces of Competition Framework

Suppliers

Bargaining Power of Suppliers

- The bargaining power of suppliers affects the intensity of competition in an industry, especially when there is a large number of suppliers, when there are only a few good substitute raw materials, or when the cost of switching raw materials is especially costly.

- Capacity for vertical integration: when threat of forward integration is high, the bargainig power of suppliers become stronger

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The ease with which the firms in the industry can switch between different input suppliers and the relative bargaining power of each party affect the industry profitability

Porter's Five Forces of Competition Framework

Buyers

Bargaining Power of Buyers

- When customers are concentrated or large or buy in volume, their bargaining power represents a major force affecting the intensity of competition in an industry.
- Bargaining power of consumers also is higher when the products being purchased are standard or undifferentiated. When this is the case, consumers often can negotiate selling price, warranty coverage, and accessory packages to a greater extent.
- Capacity for vertical integration: when threat of backward integration is high, the bargainig power of buyers become stronger

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The extent to which buyers are sensitive to the prices they are charged and the relative bargaining power of each party affect the industry profitability

The World Automobile Industry

Applying the five forces of competition framework to the industry allows us to understand why profitability of the top eight producers (*Toyota, VW, General Motors, Ford, Nissan, Hyundai, Honda and Fiat Chrysler*) has been low during the last decade.

We can then identify the current trends that are reshaping the industry — the switch to electric vehicles (EVs), autonomous driving, increased shared ownership and ride sharing, internationalization by Chinese auto producers— and show how these trends will impact the five forces of competition in the future (*The direction of the arrow shows the predicted impact of each competitive force on industry profitability*).

Competitive force	Relevant structural features of the industry	Impact on profitability 2013–2018	Changes in industry structure 2019–2028	Impact on profitability 2019–2028
Substitutes	Alternative modes of transportation (bicycles, public transport). Also telecommuting.	Weak ⇓	Congestion and environmental concerns will increase substitute competition	Increasing ⇓
New entry	• Internationalization by domestic producers • New producers of EVs	Moderate ⇓	Increased competition from both sources.	Increasing ⇓
Internal rivalry	• 22 companies with annual output of >1 million cars • Massive excess capacity (global capacity utilization approx. 72%) • High fixed costs and large-scale economies encourage quest for market share	Strong ⇓	• M&A to reduce no. of producers • Continuing excess capacity due to exit barriers (especially government support) and falling demand due to lower personal ownership of cars	Positive impact of M&A offset by negative impact of new entry and of declining demand ⇓
Buyer power	Distribution through franchised dealers	Weak ⇑	No significant change	
Supplier power	• Consolidation among component suppliers • Suppliers control key technologies	Moderate ⇓	Emergence of powerful new suppliers, especially software companies and suppliers of batteries	Increasing ⇓

LIMITS OF INDUSTRY ANALYISIS

BEYOND THE PORTER FF FRAMEWORK

Porter's model was developed in a historical period when competitive dynamics and the general scenario were different from those of today.

If our industry analysis is to fulfill its potential, it needs to go beyond the confines of the Porter Five Forces framework.

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CASE STUDY_1

| APPLE

CASE STUDY_1

| APPLE

ASSIGNMENT

Q #1: What historically have been Apple's competitive advantage?
Q #2: Analyze the personal computer industry by adopting the Porter's FF framework. Are the dynamics favorable or problematic for Apple?
Q #3: How sustainable was the Apple's competitive position in the PCs?
Q #4: How sustainable is the Apple's competitive position in the smartphones?
Q #5: What's next? What should Tim Cook do to grow Apple beyond the iphone?

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OUTLINE

- Beyond Porter's FF Framework: the role of complementors
- The role of cooperation
- Co-opetition and Value Net Framework

THE ROLE OF COMPLEMENTS

A MISSING FORCE IN THE PORTER FF FRAMEWORK

While the presence of substitutes reduces the value of a product, complements increase its value: without ink cartridges our printer is useless, as is our car without gasoline

How is this value shared?

THE ROLE OF COMPLEMENTS

A MISSING FORCE IN THE PORTER FF FRAMEWORK

While the presence of substitutes reduces the value of a product, complements increase its value: without ink cartridges our printer is useless, as is our car without gasoline

How is this value shared?
It depends...

THE ROLE OF COMPLEMENTS

A MISSING FORCE IN THE PORTER FF FRAMEWORK

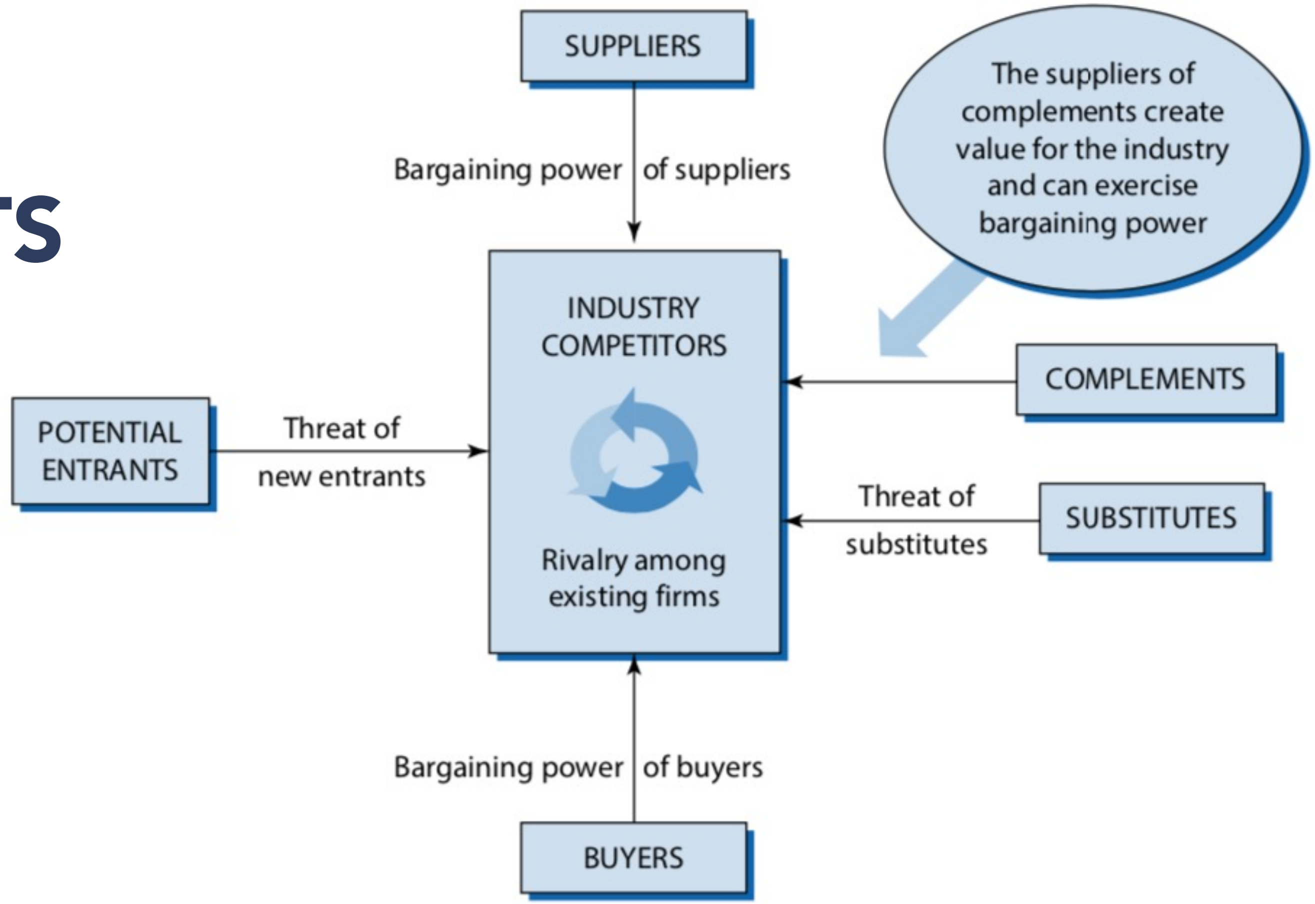
.... During the 1990s, Nintendo earned huge profits from its video game consoles.

Nintendo's dominance over the games developers allowed it to appropriate most of the profits of the entire system.

In personal computers there is similar complementarity between hardware and software, but here power has lain with the software suppliers—Microsoft in particular.

IBM's adoption of open architecture meant that Microsoft Windows became a proprietary standard, while PCs were gradually reduced to commodity status.

THE ROLE OF COMPLEMENTS



THE ROLE OF COOPERATION

- Porter's five forces framework fails to address competitive interaction among firms and «win-win» situations.

- Firms often cooperate with suppliers, distribuitors, clients, even with competitors.

- Different types of cooperative relationships (more or less formal) can shape the dinamics of competition

- Networks of firms often arise (I.e. Normann, Ramirez)

- Clients can play co-productors role

CO-OPETITION

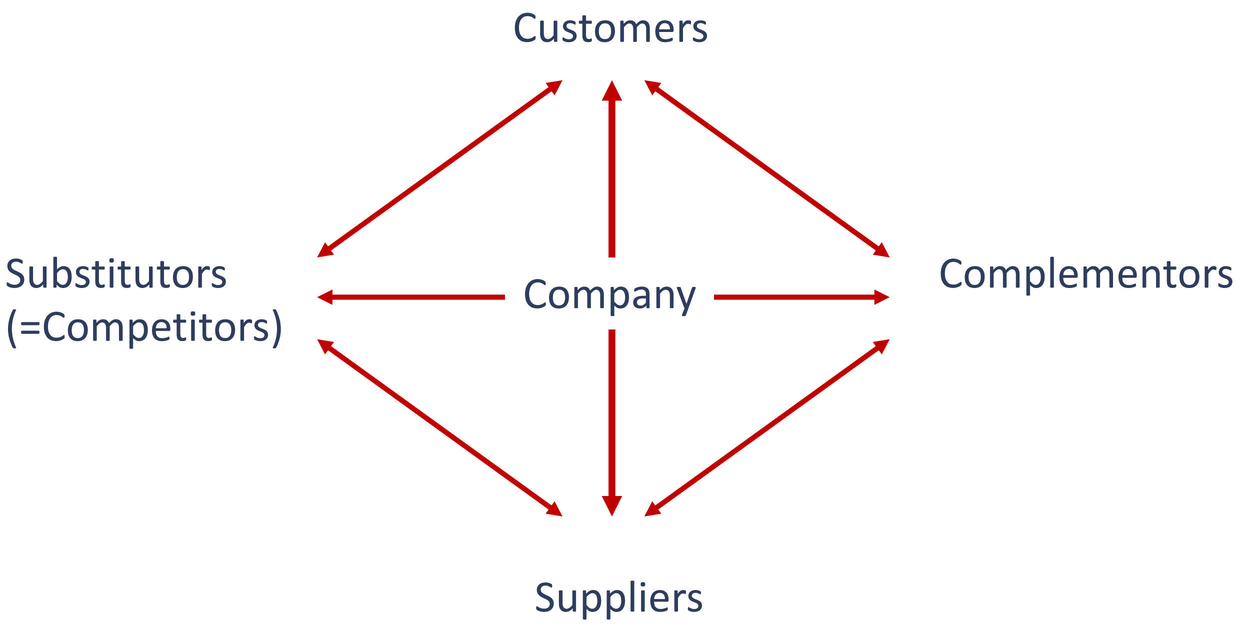
«Co-opetition» recognizes the competitive/cooperative duality of business relationships *(Brandenburger & Nalebuff).*

While some relationships are predominantly competitive (Coca-Cola and Pepsi) and others are predominantly cooperative (Intel and Microsoft), there is no simple dichotomy between competition and cooperation: all business relationships combine elements of both.

For all their intense rivalry, Coca-Cola and Pepsi cooperate on multiple fronts, including common policies on sales of soda drinks within schools, environmental issues, and health concerns. They may also coordinate their pricing and product introductions

The VALUE NET framework

The Value Net Framework identify four types of players that every company faces and could directly influence it.

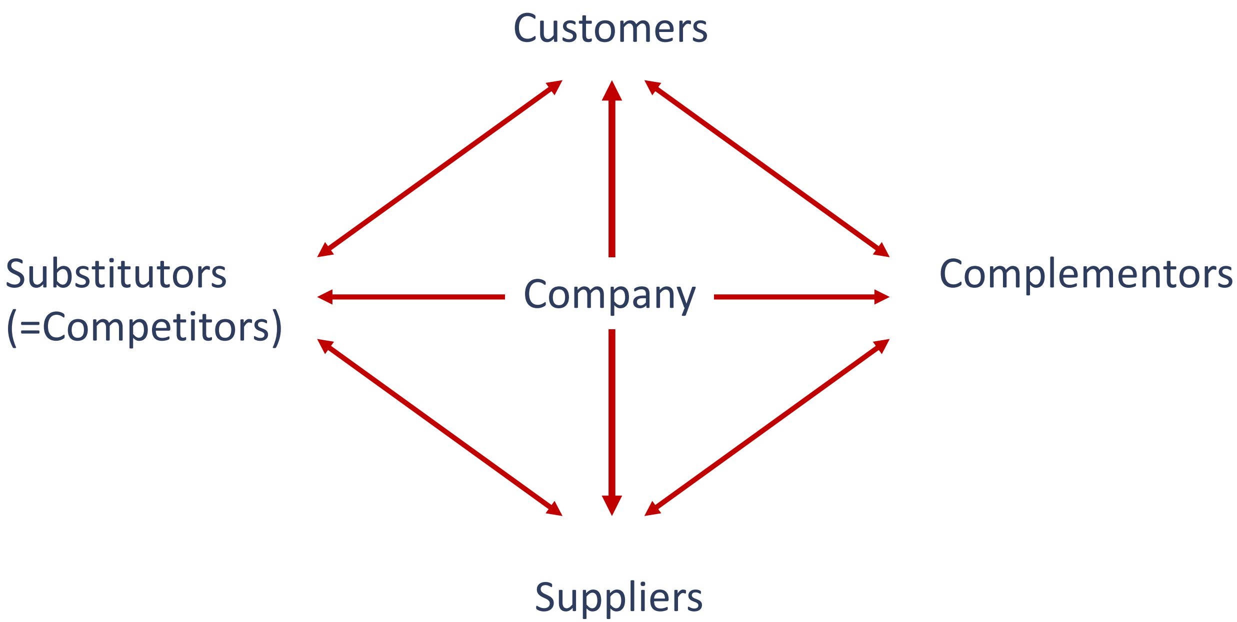


Brandenburger & Nalebuff, 1996.

The VALUE NET framework

When companies in a certain industry work together, they can create a larger and more valuable market than they could ever achieve working alone.

This means players in the industry should focus more on the total market potential and allow it to grow rather than on dividing the market potential and trying to win individual market share.



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