Strategic Management
Chapter 2 – Industry analysis

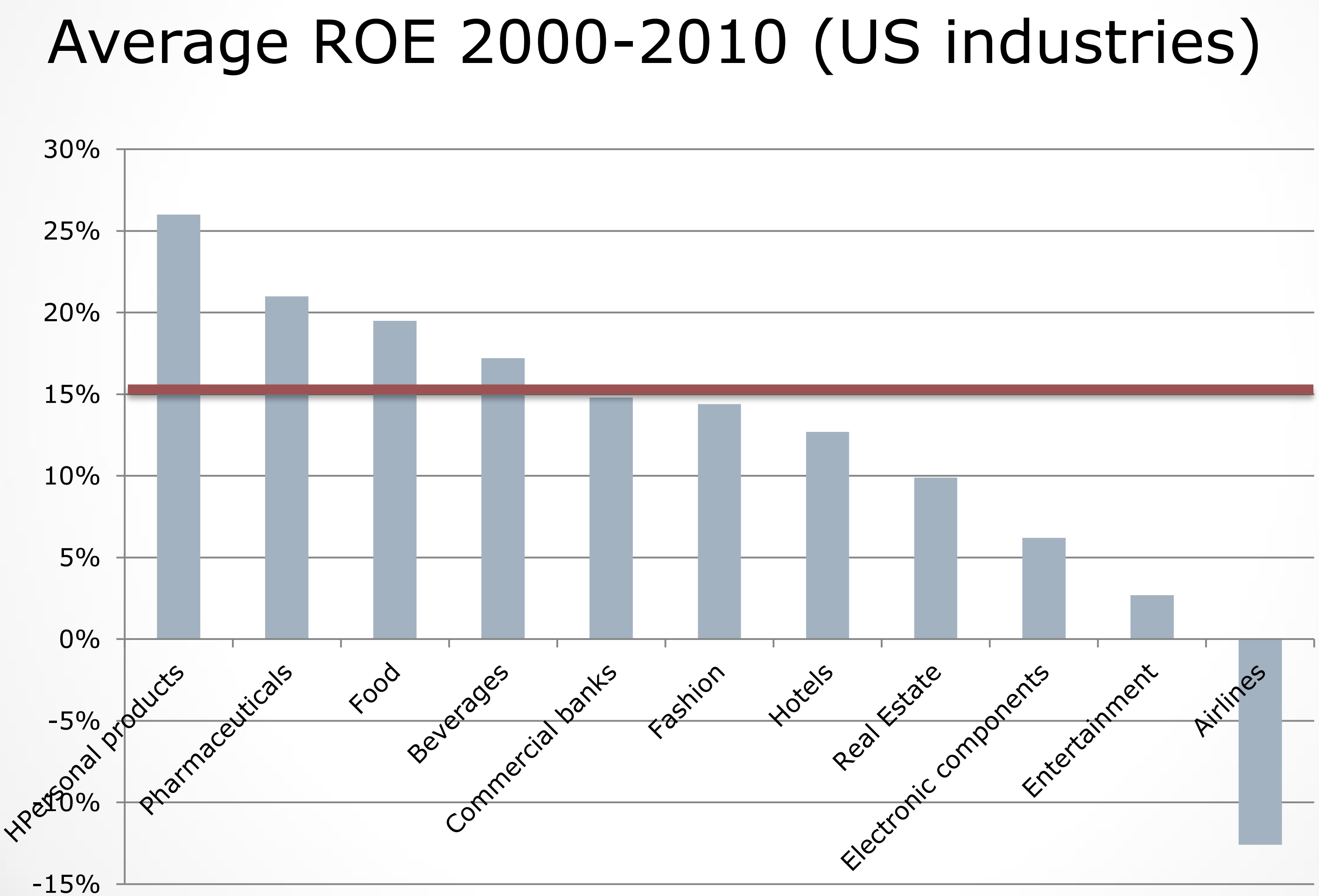
(Chapter nb. 3 of the book by GRANT)

Chapter 2 – Industry analysis

Let's start with a question:
The profitability of different industries:

Average ROE (%)
(p.66)
Why?

Chapter 2 – Industry analysis



Chapter 2 – Industry analysis

- Industry analysis: external assessment of an organization. From PEST to **PESTEL** analysis. Political, economic, sociological, technological, environmental and legal factors as they impact the organization's strategic plan.

- **Porter´s Five Forces Model**.

- **Other topics** not included by Porter

Chapter 2 – Industry analysis - PEST

-**Political** factors, are how and to what degree a government intervenes in the economy. Specifically, political factors include areas such as tax policy, labour law, environmental law, trade restrictions, tariffs, and political stability.

Chapter 2 – Industry analysis - PEST

-**Economic** factors include economic growth, interest rates, exchange rates and the inflation rate. These factors have major impacts on how businesses operate and make decisions.

Chapter 2 – Industry analysis - PEST

- **Social** factors include the cultural aspects and include health consciousness, population growth rate, age distribution, career attitudes, individual tastes and emphasis on safety. Trends in social factors affect the demand for a company's products and how that company operates.

PESTEL

- **Technological** factors include ecological and environmental aspects, such as R&D activity, automation, technology incentives and the rate of technological change. They can determine barriers to entry, minimum efficient production level and influence outsourcing decisions.

PESTEL

- **Environmental** factors include weather, climate, and climate change, which may especially affect industries such as tourism, farming, and insurance.Furthermore, growing awareness to climate change is affecting how companies operate and the products they offer--it is both creating new markets and diminishing or destroying existing ones.

PESTEL

-**Legal** factors include discrimination law, consumer law, employment law, and health and safety law. These factors can affect how a company operates, its costs, and the demand for its products.

-SEE TEMPLATE

Pestel Analysis

• • •

[Video on PESTEL 8 minutes, you can watch it at home…](http://www.youtube.com/watch?v=B7drEvHo7vA)
http://www.youtube.com/watch?v=B7drEvHo7vA

Michael Porter on strategy:
http://www.youtube.com/watch?v=0E0e6NqcT0M

Chapter 2 – Industry analysis PEST

-**Group exercise**.
-Choose one industry
-Analyse it with the PESTEL model template. Present to class.
-Executive women magazine
- Cosmetics producer
- Renewable energy – solar panels producer
- Banking
- Private Business School
- Small business consultant
- E-commerce business
- Restaurant or hotel in BCN
- Congress and Events small new business…

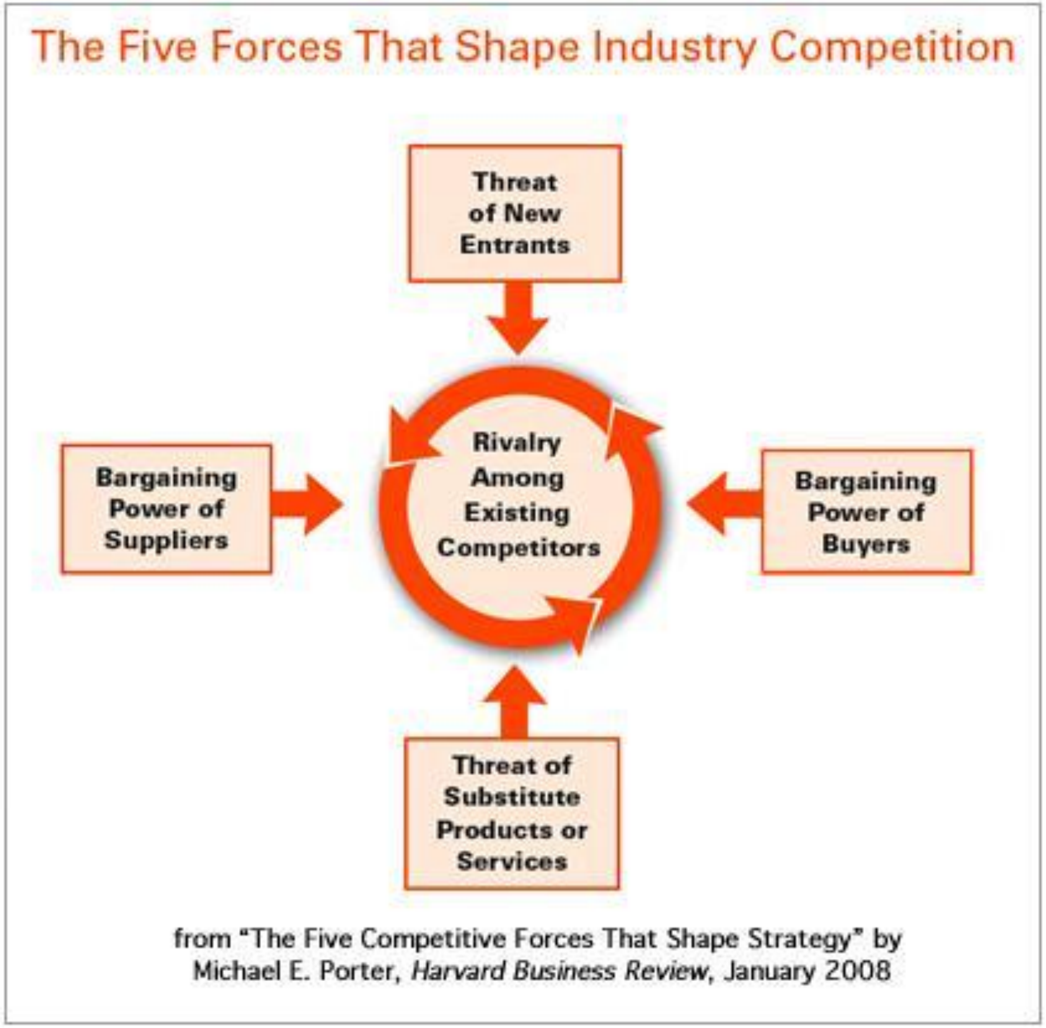
Chapter 2 – Porter´s Five Forces

-A framework to classify and analyse the factors that determine the profitability of an industry

- Michael Porter, Harvard Business School (born 1947)

-Michael Porter's main theory is on **competition and company strategy**. He is generally recognized as the father of the modern strategy field, and his ideas are taught in virtually every business school in the world. Other subjects: competitiveness, economic development, environmental policy and the role of corporations in society.

Chapter 2 – Porter Five Forces



Chapter 2 – Porter Five Forces

Three "horizontal" types of competition: competition from substitutes / from new entrants / from established rivals

Two "vertical" types of competition: the bargaining power of suppliers / the bargaining power of buyers

I. Threat of substitutes

What is the price of a product?
How much customers are willing to pay depends (partly) on the availability of substitute products: cigarretes, petrol, e-commerce and travel agencies…

Buyer propensity to substitute (sensitive to price). When you go to Madrid, do you take the AVE or the plane?

II. Threat of new entries

-If an industry earns a high return: it becomes a magnet for others to come in (EU subsidies, self-help books)

-If there are no barriers to entry (or they are low): many new entrants.

-What are those main barriers?

Threat of new entries

Main barriers? 6 factors

1. Capital requirements. High / low / (franchises), Boeing – Airbus.

2. Economies of scale: cost per unit. When you start, you are really small, so you have very high costs per unit (planes 18Bn and 400 to break even, cars 1.5Bn, high develp. cost). R&D, advertising. Ex. Wine dispenser.

Chapter 2 – Threat of new entries

-Main barriers? Cont.

3. Product differentiation (brand recognition and customer loyalty: cigarretes, mayonnaise, frozen peas… up to 90%! – or 0% private labels- marca blanca)

4. Access to distribution channels (shelf space, reluctant retailers, ex. NL)

5. Gov. And legal barriers: get a license by a public authority. Corruption. Intellectual property: Patents, copyrights. Wine in Tunicia, or in Sweden. Safety standards, Environmental standards. China.

Chapter 2 – Threat of new entries

-Main barriers? Cont.

6. Retaliation: agressive reaction from established firms (price war, increase advertising, sales promotions. Detroit Big Three). Avoid it by going to smaller and more hidden segments.

-Main ones??? Opinions? There are two which seem to be most important:

- High capital requirement
- High Advertising requirement

Chapter 2 – III. Industry Rivalry

In some industries firms compete aggressively
In others not so directly…
Six Factors:

1. Concentration
2. Diversity of competitors
3. Product differentiation
4. Excess capacity
5. Exit barriers
6. Cost conditions

Chapter 2 – III. Industry Rivalry

1. **Concentration**: number and size of firms. Is it a market dominated by one firm, monopoly? Two firms (paralelism pricing decisions). Many firms: no price coordination.
2. **Diversity of competitors**: how different are they? Do they coexist in peace – until someone new comes in.
3. **Product differentiation**: is it a commodity – easily substituted – or is the product differentiated.
4. **Excess capacity**. In a recession: demand is low. Excess capacity, prices drop. Is it a mature market / emergent economy.

III. Industry Rivalry

5. **Exit barriers**: Capacity to leave the industry. Is there substantial job protection?
High exit cost: ex. refinery.

6. **Cost conditions**: how high are fixed costs compared to variable costs. Ex. Airlines. Huge fixed costs. If demand goes down, losses can be enormous.

III. Industry Rivalry

So what would be in your opinion the best conditions to be in terms of Industry rivalry?

- I am a huge firm with largest market share
- Competitors are all very different
- Product can be differentiated
- There is no excess capacity
- It's not difficult to leave the industry
- Fixed costs are not great.

IV. Power of Buyers

We refer to "output markets".

Our firm → sells goods + services to customers (who are distributors, consumers, manufacturers)

We create value, how do we share that value?
It depends on the economic power (or bargaining power) of each one of us.

Main factor:
Relative bargaining power

IV. Power of Buyers

Relative bargaining power:

<u>Size of buyers + Concentration of buyers</u> relative to suppliers: If we only have a few buyers and they are large, we cannot afford to lose any of them. They have power over us.

<u>Buyers´information</u>: the better informed buyers are about suppliers, costs and prices, the better they are able to bargain (like when you compare prices before going to a hairdresser, consultant…).

<u>Ability to integrate vertically</u>: can you do it yourself instead of buying it? (a credible threat may be enough).

V. Power of suppliers

The same as with buyers, but in the other position…

We refer to "input markets".

Raw materials
Components $\longrightarrow$ our firm
Financial services
Labour

Again, how do we share that value?
It depends on the economic power (or bargaining power) of each one of us.

Chapter 2 – V. Power of suppliers

Ability to integrate vertically: can you do it yourself instead of buying it? Ex. Heinz or Campbell make their own cans (because they are too important and expensive for final product). So you do not let suppliers to exert power over you.

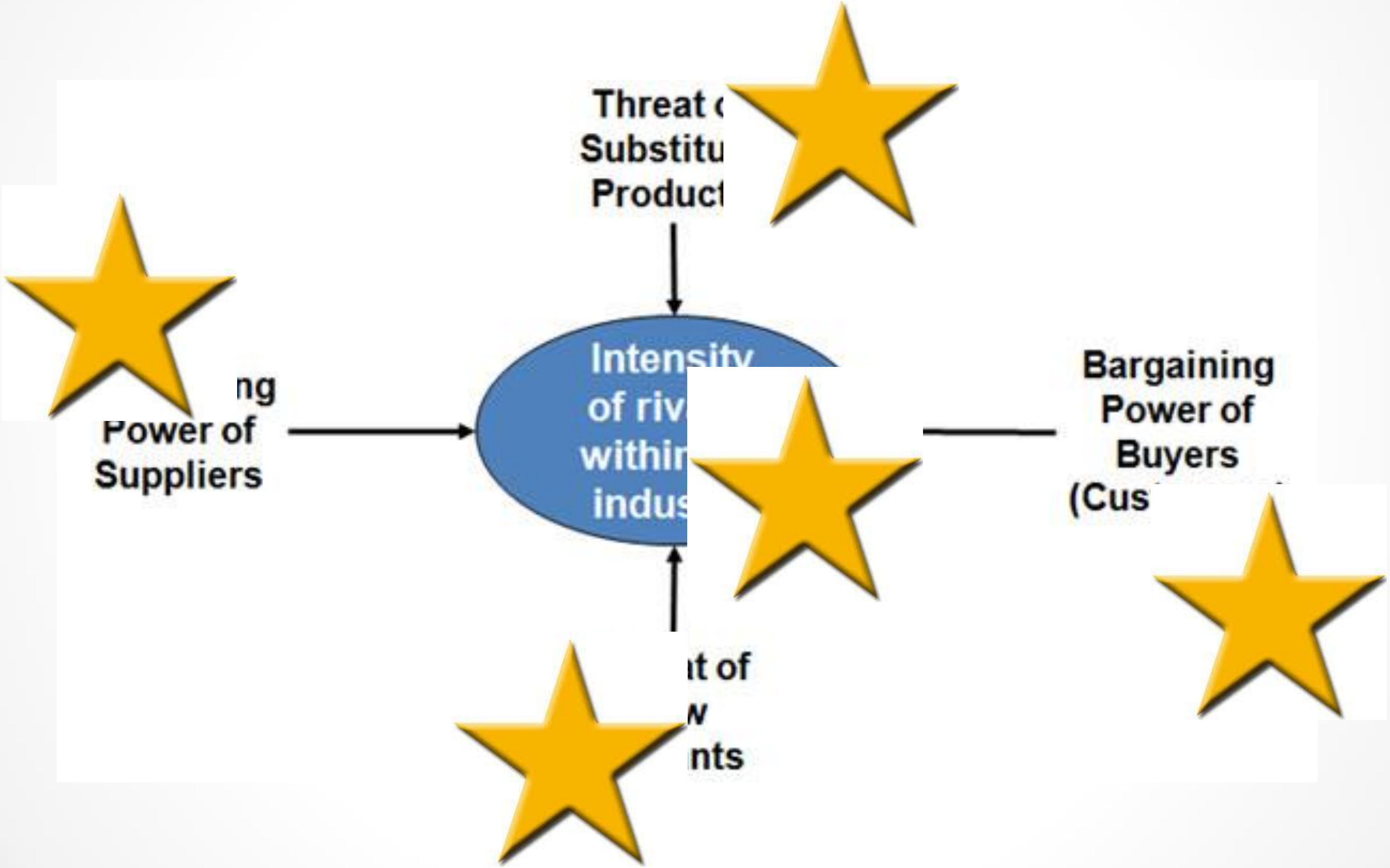
Raw materials: can be switched to another supplier. No bargaining power.

Suppliers of complex components: can exert bargaining power over customers. Ex. Intel with microprocessors.

Chapter 2 – V. Power of suppliers

Now you are a farmer and need to get a good price for your tomatoes…

Five Forces Model- Conclusion



Chapter 2 – Conclusion 5 forces

<u>It is a very powerful tool to analyse an industry. When?</u>

- When we want to go in a new industry (start a new company).
- To analyse some changes that are going on.
- When we are in an industry and we need to re-establish our strategy.

<u>Put it into practise</u>: From table in slide 3 select a high profit industry or a low profit industry. Use the five forces framework to explain why profitability has been low or high.

Competitive advantage: identify key sucess factors - KSFs

A firm must meet two criteria:

- Must supply what customers want (analysis of demand)
- Must survive competition (analysis of supply)

→ key success factors

Key Sucess Factors - KSFs

Two questions we must answer to:

What do customers want?

Who are they
What do they want

How does the firm survive competition?

What drives competition
How intense is competition
How can we improve comp. position

KSFs

Key Sucess Factors - KSFs

Airlines:

What do customers want?

How does the firm survive competition?

Low fares
Convenience
Safety

Very intense competition
Price wars

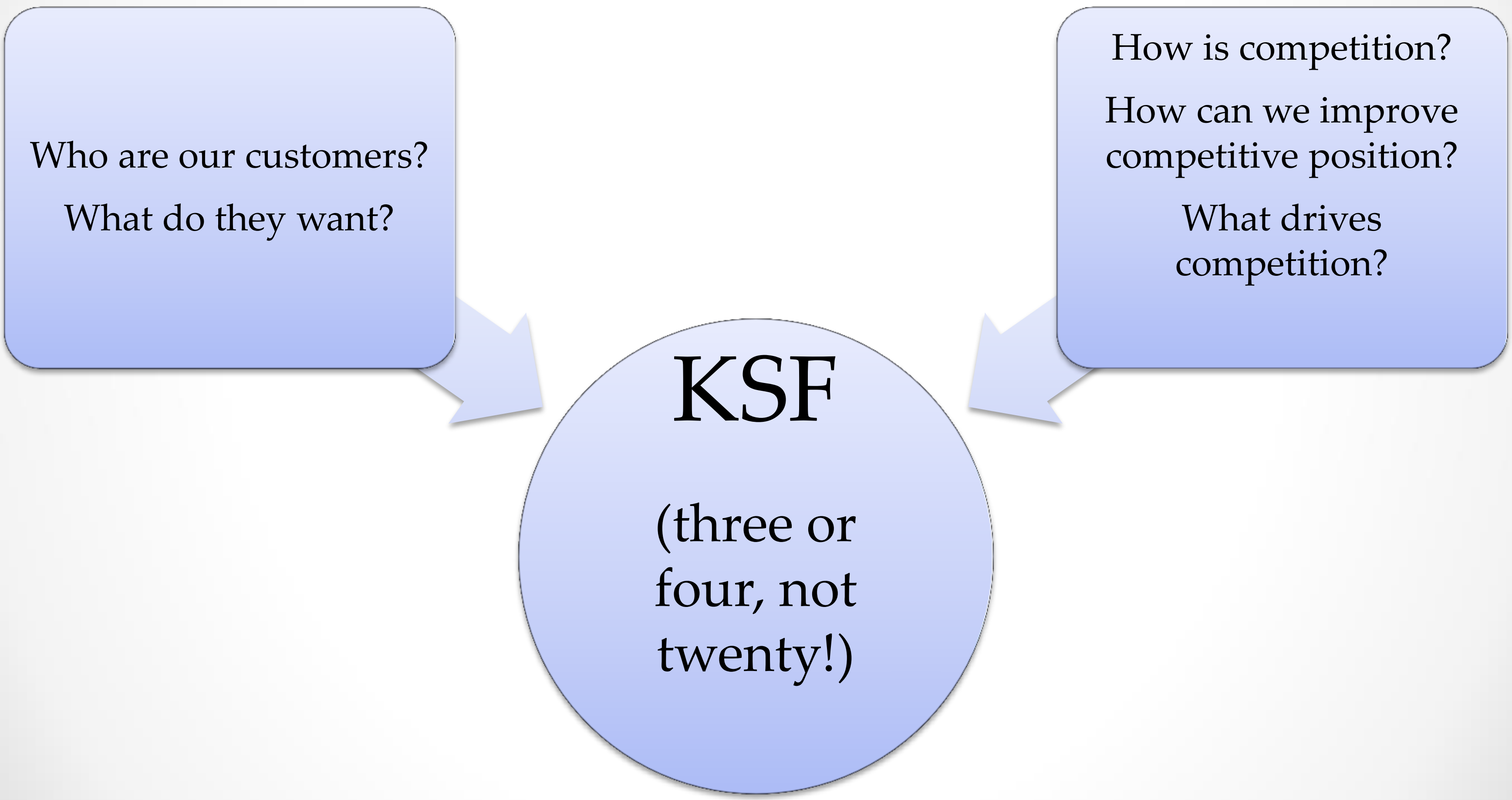
KSFs: sufficient financial strength to weather intense price competition

Key Sucess Factors - KSFs

Identifying KSFs: steel, fashion and supermarkets (reading page 89).

Now do your KSFs for the car industry.

Key Sucess Factors - KSFs



KSFs Mobile phones for Teens

Teenagers with parents' money
Great design
Battery durability
Security
Apps
Internet access

Huge rivalry

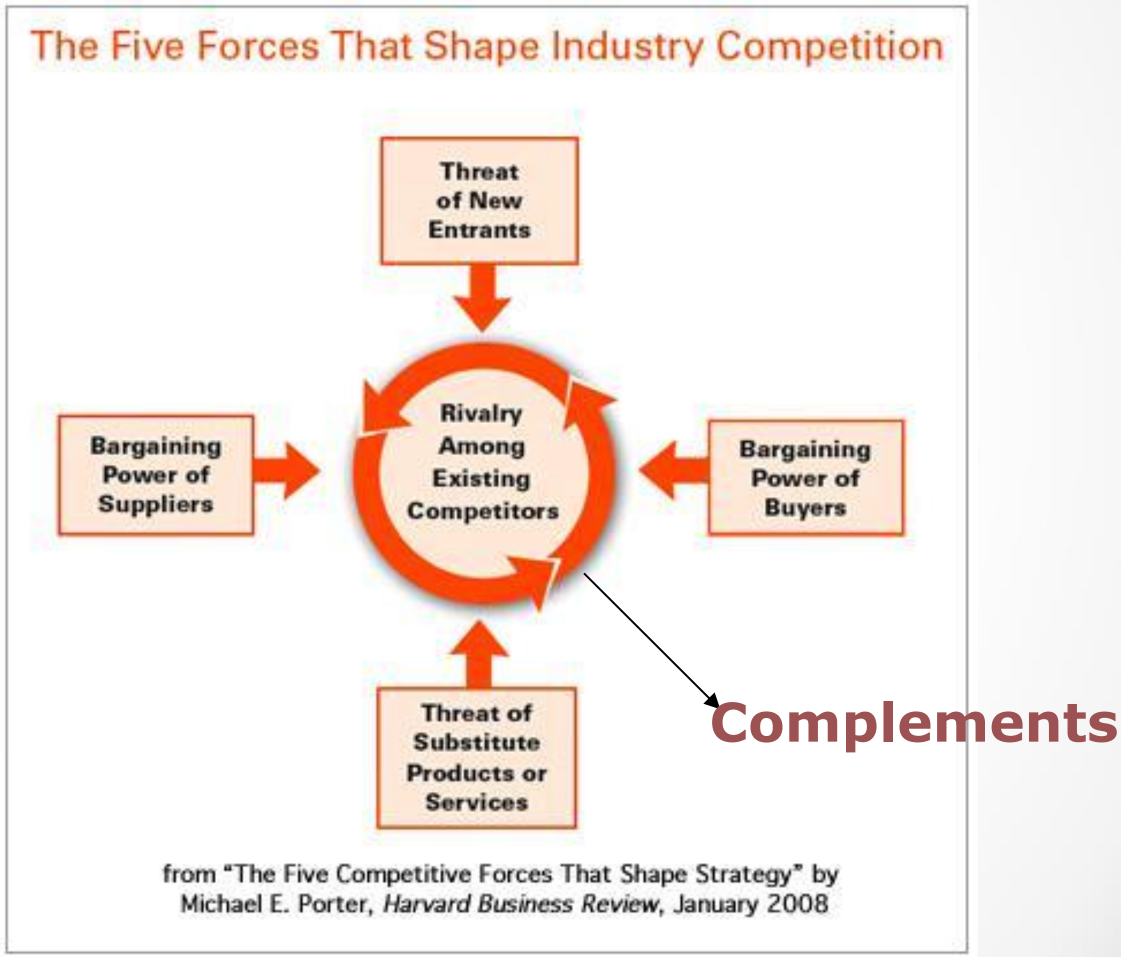
Constant innovation
Well-known brand
Battery one than half a day
Control costs

Beyond Porter – A 6th Force.

Is there a missing force?

The opportunity of **complements.** Linked sales.

Ex. Labels and printers.



Beyond Porter – Game theory

Game theory is a branch of applied mathematics that is used in the social sciences, most notably in economics. Game theory attempts to mathematically capture behavior in *strategic situations*, in which an individual's success in making choices depends on the choices of others.

Beyond Porter – Game Theory

Traditional applications of game theory attempt to find equilibria in these games. In an equilibrium, each player of the game has adopted a strategy that they are unlikely to change. Until something happens… and the balance is broken.

Ex. Think of businesses as children playing: two kids are playing happily. A third one comes in and they all start fighting… You give them some sweets and they fight over them until they find a way to share. Then peace comes back until…

Beyond Porter – Conclusion.

Porter´s Five Forces is an extremely powerful tool to analyse the attractiveness of an industry. However, there are limitations.

Three main sources of criticism:

1. We should go beyond Porter and analyse our KSFs, focusing on our customers and our competitors.
2. Porter misses one force: 6th Force, the complements.
3. Porter is static. The Game Theory adds a very valuable perspective.