

**STRATEGY** Core Concepts and Analytical Approaches  
Arthur A. Thompson  
The University of Alabama  
3rd Edition (2014-2015)

**CHAPTER 3** Evaluating a Company's External Environment

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*Analysis is the critical starting point of strategic thinking.*

—Kenichi Ohmae,  
consultant and author

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*“Things are always different—the art is figuring out which differences matter.”*

— Laszlo Birinyi,  
investments manager

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**Learning Objectives**

1. To gain command of the basic concepts and analytical tools widely used to diagnose a company's industry and competitive conditions.
2. To become adept in recognizing the factors that cause competition in an industry to be fierce, more or less normal, or relatively weak.
3. To learn how to determine whether an industry's outlook presents a firm with sufficiently attractive opportunities for growth and profitability.
4. To understand why in-depth evaluation of specific industry and competitive conditions is a prerequisite to crafting a strategy well matched to a firm's situation.

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**Chapter 3 Roadmap**

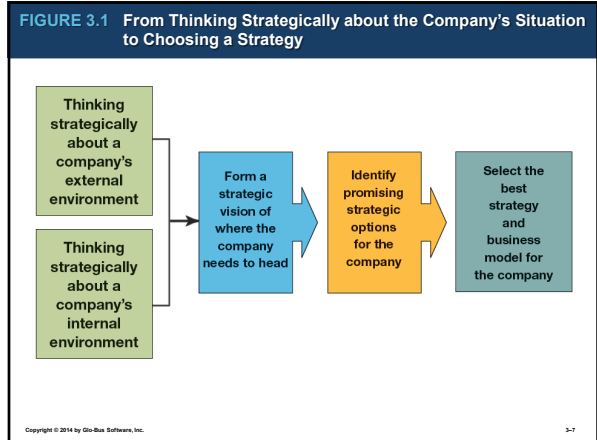
- The Strategically Relevant Factors Influencing a Company's External Environment
- Assessing a Company's Industry and Competitive Environment
  - ▶ Question 1: What Competitive Forces Do Industry Members Face, and How Strong Are They?
  - ▶ Question 2: What Forces Are Driving Changes in the Industry and What Impacts Will They Have on Competitive Intensity and Industry Profitability?
  - ▶ Question 3: What Market Positions Do Rivals Occupy—Who Is Strongly Positioned and Who Is Not?
  - ▶ Question 4: What Strategic Moves Are Rivals Likely to Make Next?
  - ▶ Question 5: What Are the Key Factors for Future Competitive Success?
  - ▶ Question 6: Is the Industry Outlook Conducive to Good Profitability?

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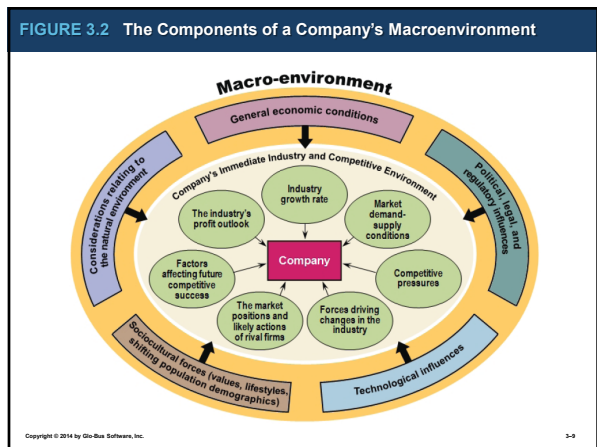
**Understanding a Company's Situation**

- Actions to steer a firm in a different direction or alter its strategy must be predicated on deep understanding of two facets of its situation:
  1. The firm's industry and competitive environment and the forces acting to reshape its environment
  2. The firm's own market position and competitiveness
    - Its resources and capabilities
    - Its strengths and weaknesses vis-à-vis rivals
    - Its windows of opportunity

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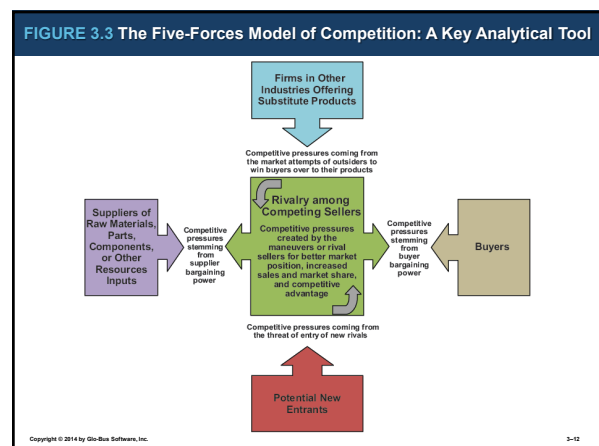


- The Strategically Relevant Components of a Firm's External Environment**
- External factors and influences in the "macro-environment" that influence a firm's decisions about its direction, objectives, strategy, and business model include:
    - ▶ General economic conditions
    - ▶ Political, regulatory, and legal factors
    - ▶ Technological influences
    - ▶ Sociocultural influences (values, lifestyles, and shifting population demographics)
    - ▶ Considerations relating to the natural environment
    - ▶ Its immediate industry and competitive environment
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- Assessing a Company's Industry and Competitive Environment**
- There are six questions that must be asked and answered:
1. What competitive forces do industry members face, and how strong are they? ?
  2. What forces are driving changes in the industry, and how will they impact competitive intensity and profitability?
  3. What market positions do industry rivals occupy—who is strongly positioned and who is not?
  4. What strategic moves are rivals likely to make next?
  5. What are the key factors for future competitive success?
  6. Is the industry outlook conducive to good profitability?
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- Question 1: What Competitive Forces Do Industry Members Face?**
- The state of competition in an industry is a composite of five competitive forces:
1. The market maneuvering and jockeying for buyer patronage among *rival sellers* in the industry
  2. The threat of *new entrants* into the market.
  3. The attempts of companies in other industries to win buyers over to their own *substitute products*
  4. The exercise of *supplier bargaining power*
  5. The exercise of *buyer bargaining power*
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### How to Analyze the Five Competitive Forces

- Step 1** Identify the specific competitive pressures associated with each of the five forces.
- Step 2** Evaluate how strong the pressures comprising each of the five forces are (fierce, strong, moderate to normal, or weak).
- Step 3** Determine whether the collective strength of the five competitive forces is conducive to earning attractive profits.

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### Core Concept

Competitive maneuvering among industry rivals is **ever-changing**, as competing sellers initiate round after round of offensive and defensive moves, emphasizing first one mix of competitive weapons and then another in efforts to improve their market positions and profitability.

*The ongoing maneuvers and jockeying for position create a continually evolving competitive landscape where the market battle ebbs and flows, sometimes takes unpredictable twists and turns, and produces winners and losers.*

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### Competitive Pressures Created by the Rivalry among Competing Sellers

- A market is a **competitive battlefield** where the contest among industry rivals is ongoing and dynamic.
  - ▶ Each rival is motivated to use whatever “weapons” in its business arsenal will attract and retain buyers, strengthen its market position, and yield good profits.
  - ▶ The challenge is to craft a competitive strategy that at the very least allows a firm to hold its own against rivals and, more ideally, produces a competitive edge over rivals.

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### Why Rivalry Is Usually the Strongest of the Five Competitive Forces

- When one competitor deploys a strategy or makes a new strategic move that produces good results, its rivals must respond with offensive or defensive countermoves calculated to preserve their market standing and avoid lower profitability.
- This pattern of move and countermove, adjust and readjust makes the competitive battle among rivals dynamic and fluid, with firms gaining or losing ground in the marketplace according to whether their strategic maneuvers succeed or fail.
- The winners—current market leaders—have no guarantees of continued leadership; their market success is only as durable as the power of their strategies to fend off the strategies of ambitious challengers.

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### FIGURE 3.4 The “Weapons” That a Company Can Use to Battle Rivals

<ul style="list-style-type: none"> <li>• Lower prices</li> <li>• More or different features</li> <li>• Better product performance</li> <li>• Higher quality</li> <li>• Stronger brand name and image</li> <li>• Wider selection of models and styles</li> <li>• Bigger/better dealer network</li> <li>• Low interest rate financing</li> </ul>	<ul style="list-style-type: none"> <li>• Higher levels of advertising</li> <li>• Stronger product innovation capabilities</li> <li>• Better customer-service capabilities</li> <li>• Stronger capabilities to provide buyers with custom-made products</li> <li>• Better warranty coverage</li> <li>• Quicker or cheaper delivery</li> </ul>
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### FIGURE 3.4 The Factors Affecting the Strength of Rivalry Among Competing Sellers

**Rivalry among Competing Sellers**  
How strong are the competitive pressures stemming from rivals' efforts to gain better market positions, higher sales and market shares, and competitive advantages?

**Rivalry is generally stronger when:**

- Competing sellers are making fresh moves to improve their market standing and business performance.
- Buyer demand for industry products is growing slowly.
- Rival sellers have idle capacity and/or excess inventory.
- The number of rivals increases or are of near equal size and competitive capability.
- The products of rival sellers are essentially identical or weakly differentiated.
- Buyers incur low costs in switching to rival brands.
- The industry's product is costly to hold in inventory, perishable, or seasonal.
- One or more rivals are making aggressive moves to attract more customers.
- Rivals have diverse industry outlooks, objectives, or strategies and/or have production facilities in countries where production costs are materially different.
- Outsiders have acquired weak competitors and are intent on turning them into major contenders.
- One or two rivals have powerful strategies and other rivals are scrambling to stay in the game.

**Rivalry is generally weaker when:**

- Industry rivals seldom launch actions to take sales and market share away from rivals.
- Buyer demand is growing rapidly.
- Products of rival sellers are strongly differentiated and brand loyalty of buyers is high.
- Buyers incur high costs in switching to rival brands.
- There are so many rivals that one company's actions have little direct impact on the businesses of rivals.
- Rivals have low fixed costs and low inventory storage costs.
- Sellers have small inventories and/or little idle capacity.
- A few large sellers have the majority of sales and dominant market shares.

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### What Causes Rivalry to Become Stronger?

- Rivalry intensifies when competing sellers attempt boost their market standing and business performance through:
  - ▶ Lively price competition
  - ▶ Rapid introduction of next-generation products
  - ▶ Efforts to strongly differentiate their products from those of rivals
  - ▶ Frequent use of marketing tactics: special sales promotions, bursts of advertising, rebates, or low-interest-rate financing to spur sales
  - ▶ Attempts to build stronger dealer networks, increased presence in foreign markets, and expansion of their distribution capabilities
  - ▶ Developments of valuable expertise and capabilities that rivals are hard-pressed to match

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### What Causes Rivalry to Become Stronger? (cont'd)

- Rivalry is *more intense* when:
  - ▶ Buyer costs to switch brands are low
  - ▶ Rivals are dissatisfied with their position and market share make moves to attract more customers
  - ▶ Rivals have diverse objectives and strategies and/or are located in different countries
  - ▶ Outsiders acquire weak competitors and try to turn them into major contenders
  - ▶ One or more rivals have powerful strategies that are forcing other rivals to scramble to stay in the game
  - ▶ Buyer demand is growing slowly (or declining)

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### What Causes Rivalry to Become Weaker?

- Rivalry tends to be *less intense* when:
  - ▶ Industry rivals move infrequently or in a non-aggressive manner to draw sales and market share away from other rivals
  - ▶ Buyer demand is growing rapidly
  - ▶ The products of rival sellers are strongly differentiated and customer loyalty to their preferred rival brand is high
  - ▶ Buyer costs to switch rival brands are high
  - ▶ Industry rivals are so numerous that any one firm's attempt to grow its business has little direct impact on rival businesses and thus provokes little need for retaliation

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### Characterizing Industry Rivalry

<b>Cutthroat or Brutal</b>	When competitors engage in protracted price wars or habitually undertake other aggressive strategic moves that prove mutually destructive to profitability
<b>Fierce to Strong</b>	When the battle for market share is so vigorous that the profit margins of most industry members are squeezed to bare-bones levels
<b>Moderate or Normal</b>	When the maneuvering among industry members, while lively and healthy, still allows most industry members to earn acceptable profits
<b>Weak</b>	When most industry firms are relatively well satisfied with their sales growth and market shares, rarely undertake offensives to steal customers away from one another, and—because of weak competitive forces—earn consistently good profits and returns on investment

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### Competitive Pressures Associated With the Threat of Potential Entry

The increase in competitive pressures faced by industry members due to the threat of market entry of new firms depends on:

- The size of the pool of entry candidates and the resources at their command
- Whether the candidates face high or low entry barriers
- How attractive the industry's growth and profit prospects are to potential entrants

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### Common Barriers to Entry

- Cost advantages held by industry incumbents
- Strong brand preferences and strong customer loyalty
- High capital requirements for market entry
- The difficulties of building a network of distributors or retailers and securing space on retailers' shelves
- Restrictive regulatory policies that limit/bar new entrants
- Tariffs and international trade restrictions
- The likelihood that industry incumbents will strongly resist entrants' efforts to secure a profitable volume of sales

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### The Cost Advantages of Incumbents: An Important Entry Barrier

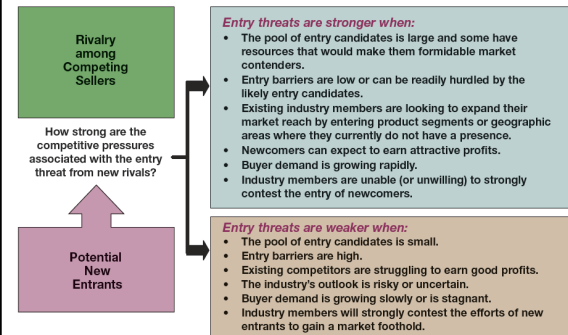
Current industry members may have cost advantages that a new entrant cannot easily overcome:

1. Scale economies in production, distribution, or other activities
2. Learning-based costs savings that accrue from in-industry experience in performing certain activities such as manufacturing or new product development or inventory management
3. Cost-savings accruing from patents or proprietary technology
4. Partnerships with the best and cheapest suppliers of raw materials and components
5. Favorable locations
6. Low fixed costs (because incumbents have older facilities that have been mostly depreciated)

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**FIGURE 3.5** Factors Affecting the Threat of Entry



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### Competitive Pressures Associated with the Threat of New Entrants

- Entry threats are **stronger** when:
  - ▶ The pool of entry candidates is large and some have resources that make them strong market contenders
  - ▶ Entry barriers are low or can be easily hurdled by entry candidates
  - ▶ Industry members can expand their presence into other product segments or geographic areas
  - ▶ Newcomers can expect to earn attractive profits
  - ▶ Buyer demand is growing rapidly
  - ▶ Industry members are unable (or unwilling) to strongly contest the entry of new firms

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### When Is the Threat of Entry Weaker?

- Entry threats are **weaker** when:
  - ▶ The pool of entry candidates is small
  - ▶ Entry barriers are high
  - ▶ Existing competitors are struggling to earn good profits
  - ▶ The industry's outlook is risky or uncertain
  - ▶ Buyer demand is growing slowly or is stagnant
  - ▶ Industry members will strongly contest the efforts of new entrants to gain a market foothold

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### The Best Test of Whether the Entry of New Competitors Is Likely

***Are the industry's growth and profit prospects strongly attractive to potential entry candidates?***

A "Yes" answer = Threat of potential entry is a **strong competitive force**

A "No" answer = Threat of potential entry is a **weak competitive force**

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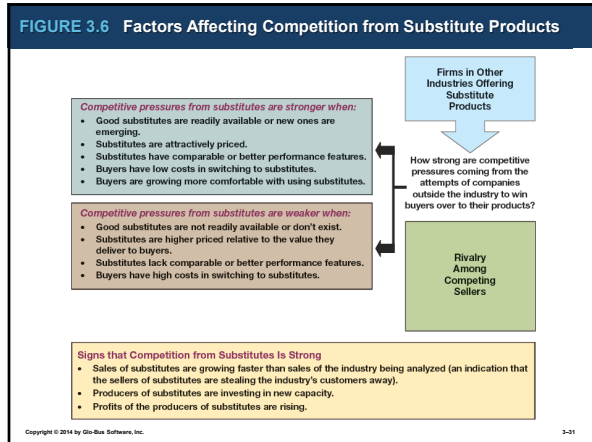
### Competitive Pressures from the Sellers of Substitute Products

- Concept
  - ▶ Substitutes matter when customers are attracted to the products of firms in other industries
- Examples of Substitutes
  - ▶ Gasoline-powered vehicles versus battery-powered vehicles
  - ▶ Cell phones versus phones that use land lines
  - ▶ Movie theaters versus Netflix
  - ▶ Music CDs versus digital music players (iPods)

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### When Are Substitute Products a Strong Competitive Force?

- The strength of competitive pressures from substitute products depends on:
  - ▶ Whether substitutes are readily available and attractively priced
  - ▶ Whether buyers view substitutes as being comparable or better in term of attributes
  - ▶ How much it costs buyers to switch to substitutes

**Rule** The lower the price of substitutes, the higher their quality and performance, and the lower the user's switching costs, the more intense the competitive pressures posed by substitute products.

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### When Is Competition from Substitutes Stronger?

- Competitive pressures from substitutes are **stronger** when:
  - ▶ They are readily available or new ones are emerging
  - ▶ They are attractively priced
  - ▶ They have comparable or better performance features
  - ▶ They come with low switching costs for end users
  - ▶ Users are comfortable with their use

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### When Is Competition from Substitutes Weaker?

- Competitive pressures from substitutes are **weaker** when:
  - ▶ Good substitutes are not readily available or don't exist
  - ▶ Substitutes are higher priced relative to the performance they deliver
  - ▶ End users have high costs in switching to substitutes

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### Three Signs that Substitute Products Are a Strong Competitive Force

1. Sales of substitutes are growing faster than overall sales of the industry in question
  - ▶ An indication that the sellers of substitutes are stealing the industry's customers away
2. The producers of substitute products are adding new production capacity
3. Profits of the producers of substitutes are rising

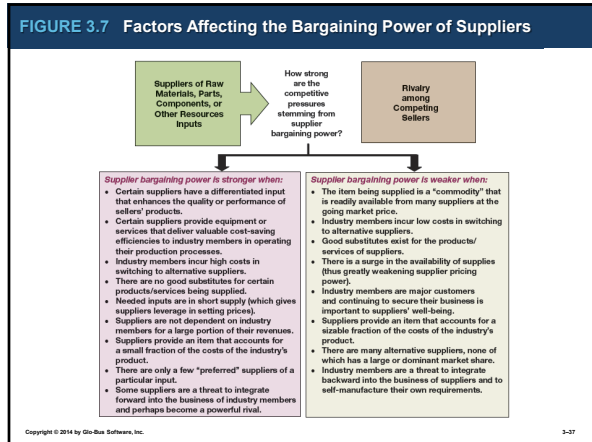
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### Competitive Pressures Stemming from the Bargaining Power of Suppliers

- Whether the relationships between industry members and their suppliers represent a weak, moderate, or strong competitive force depends on the degree to which suppliers can influence the terms and conditions of supply in their favor.
 

*Powerful or influential suppliers can intensify competitive pressures when they have the ability to charge industry members higher prices and/or make it difficult or more costly for industry members to switch to other suppliers.*

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### Factors That Determine the Strength of Supplier Bargaining Power

- Whether the item that industry members are purchasing from suppliers is in short supply or whether ample quantities are readily available from any of several suppliers?
- Do certain suppliers provide a differentiated input that enhances the performance or quality of the industry's product?
- Do certain suppliers provide equipment or services that deliver valuable cost-saving efficiencies to industry members in operating their production processes?
- Is the item being supplied a standardized commodity readily available from many suppliers at the going market price?
- Can industry members easily switch their purchases from one supplier to another or switch to substitute inputs?

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### Factors That Determine the Strength of Supplier Bargaining Power (cont'd)

- Do suppliers provide an item that accounts for a sizable fraction of the costs of the industry's product?
- Are industry members major customers of suppliers?
- Are a few large suppliers regarded as the best and most reliable sources of a particular item?
- Does it make economic sense for industry members to integrate backward to self-manufacture items bought from suppliers?
- Do suppliers have the resources and profit incentive to integrate forward into the businesses of customers they are supplying?

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### When Is Supplier Bargaining Power Stronger?

- Supplier bargaining power is *stronger* when:
  - ▶ Industry rivals incur high costs in switching suppliers
  - ▶ Needed inputs are in short supply, giving suppliers more leverage in setting prices
  - ▶ A supplier has a differentiated input that enhances the quality or performance of sellers' products or is a critical part of sellers' production processes
  - ▶ There are few suppliers of a particular input
  - ▶ A supplier can integrate forward into the business of industry members and become a powerful rival

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### When Is Supplier Bargaining Power Weaker?

- Supplier bargaining power is *weaker* when:
  - ▶ The item supplied is a "commodity" readily available from many suppliers at the going market price
  - ▶ Seller switching costs to alternative suppliers are low
  - ▶ Good substitute inputs exist or new ones have emerged
  - ▶ Supplies are plentiful due to a surge in the availability of supplies, thus weakening supplier pricing power
  - ▶ Industry members are a big fraction of suppliers' total sales and continued high volume purchases are important to suppliers
  - ▶ Industry members can integrate backward into the suppliers' business to self-manufacture their own requirements

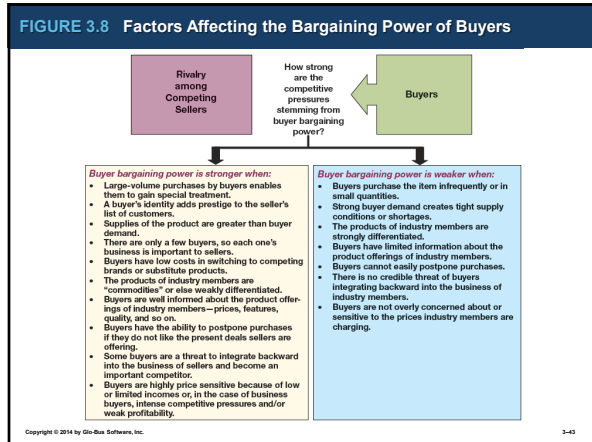
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### Competitive Pressures Stemming from the Bargaining Power of Buyers

- Buyers exert strong competitive pressures on industry members when:
  - ▶ Buyers have bargaining leverage to obtain price concessions and favorable terms and conditions of sale
  - ▶ Many buyers are price sensitive and can act in unison to limit prices that industry members can charge

**Important Point** Not all buyers of an industry's product have equal degrees of bargaining power with sellers, and some are more or less sensitive than others to price, quality, or service differences.

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- ### Factors That Determine the Strength of Buyer Bargaining Power
- The quantity that a buyer is purchasing
  - Whether buyer switching costs are high or low
  - Whether there are many or few buyers
  - Whether a buyer is particularly important to a seller
  - The strength or weakness of buyer demand in relation to the available supplies
  - How well buyers are informed about sellers' products, prices, and costs
  - Whether buyers pose a credible threat of integrating backward into the business of sellers
  - Whether buyers have discretion to delay their purchases or not make a purchase at all
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- ### When Is the Bargaining Power of Buyers Stronger?
- Buyer bargaining power is stronger when:
    - ▶ Large buyers can demand concessions for purchasing large quantities
    - ▶ The buyer adds prestige to the seller's list of customers
    - ▶ Switching costs to competing brands or substitutes are low
    - ▶ Large volume purchases by buyers are important to sellers
    - ▶ Buyer demand is weak or declining
    - ▶ There are few buyers—so that each one is important to sellers
    - ▶ Quantity and quality of information available to buyers improves
    - ▶ Buyers can postpone purchases if they do not like the present deals being offered by sellers
    - ▶ A buyer can integrate backward into the business of sellers
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- ### When Is the Bargaining Power of Buyers Weaker?
- Buyer bargaining power is *weaker* when:
    - ▶ Buyers purchase the item infrequently or in small quantities
    - ▶ Buyer switching costs to competing brands are high
    - ▶ A surge in buyer demand creates a "sellers' market"
    - ▶ A seller's brand reputation is important to the buyer
    - ▶ A particular seller's product delivers quality or performance that is very important to buyers and not matched in other brands
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- ### Why Is the Collective Strength of the Five Competitive Forces Not Conducive to Good Profitability?
- The stronger the collective impact of the five competitive forces, the lower the combined profitability of industry participants.
  - **Worst case scenario**—An industry is very "competitively unattractive" and less profitable when:
    - ▶ Rivalry among industry members is vigorous
    - ▶ Entry barriers are low, making entry likely
    - ▶ Competition from the producers of substitute products is strong
    - ▶ Both suppliers and customers have considerable bargaining power
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- ### When Is the Collective Strength of the Five Competitive Forces Conducive to Good Profitability?
- An industry is "competitively attractive" when industry members can reasonably expect to earn good profits and a good return on investment
  - **Best case scenario**—An industry is "competitively attractive" and more profitable when:
    - ▶ Internal rivalry in the industry is weak to moderate
    - ▶ High barriers block new entrants from the market
    - ▶ Good substitutes do not exist
    - ▶ Both suppliers and customers are in weak bargaining positions
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### Matching Company Strategy to Competitive Conditions

- Working through the five-forces model step-by-step:
  - ▶ Aids strategy makers in assessing whether the intensity of competition allows good profitability
  - ▶ Promotes sound strategic thinking about how to better match the firm's strategy to the competitive character of the marketplace
- Effectively matching a firm's strategy to competitive conditions requires:
  - ▶ Pursuing strategic avenues that shield the firm from as many different competitive pressures as possible
  - ▶ Initiating actions that produce sustainable competitive advantage, put more competitive pressure on rivals, and help define the optimal business model for the industry

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### Question for Simulation Company Co-Managers

- Which one of the five competitive forces is strongest in your company's industry?
- Are the competitive pressures your company experiences likely to grow stronger, grow weaker, or remain about the same in the upcoming decision rounds? Why?

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### Question 2: What Forces Are Driving Industry Change and What Impact Will They Have?

- Industry conditions are often fluid because certain forces are enticing or pressuring industry rivals, their customers, or their suppliers to alter their actions in important ways
- These important change agents are **driving forces** that have permanently reshape the industry landscape and its competitive conditions
- Where do driving forces originate?
  - ▶ Outer ring of macroenvironment (Figure 3.2)
  - ▶ Inner ring of macroenvironment (Figure 3.2)

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### Core Concept

Industry conditions change because important forces are driving industry participants (competitors, customers, or suppliers) to alter their actions.

*The driving forces in an industry are the major underlying causes of changing industry and competitive conditions—they have the biggest influence on how the industry landscape will be altered.*

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### Analyzing an Industry's Driving Forces

- Driving-forces analysis has three steps:
  1. Identifying what the driving forces are
  2. Assessing whether the drivers of change are acting to make the industry more or less attractive
  3. Determining what strategy changes are needed to prepare for the impacts of the driving forces

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### Identifying an Industry's Driving Forces

- Developments that can affect an industry powerfully enough to drive industry and competitive change include:
  - ▶ Changes in an industry's long-term growth rate
  - ▶ Increasing globalization
  - ▶ Emerging new Internet capabilities and applications
  - ▶ Changes in who buys the product and how they use it
  - ▶ Product innovation
  - ▶ Technological change and manufacturing process innovation
  - ▶ Marketing innovation
  - ▶ Entry or exit of major firms

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### Identifying an Industry's Driving Forces (cont'd)

- Developments that can affect an industry powerfully enough to drive industry and competitive change include:
  - ▶ Diffusion of technical know-how across more companies and more countries
  - ▶ Changes in cost and efficiency
  - ▶ Growing buyer preferences for differentiated products instead of a commodity product (or for a more standardized product instead of strongly differentiated products)
  - ▶ Reductions in uncertainty and business risk
  - ▶ Regulatory influences and government policy changes
  - ▶ Changing societal concerns, attitudes, and lifestyles

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### Assessing the Impact of an Industry's Driving Forces

- Answers to three questions are needed:
  1. Are the driving forces collectively acting to cause demand for the industry's product to increase or decrease?
  2. Is the collective impact of the driving forces making competition more or less intense?
  3. Will the combined impacts of the driving forces lead to higher or lower industry profitability?

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### Key Point

The most important part of driving-forces analysis is to determine whether the collective impact of the driving forces will be to increase or decrease market demand, make competition more or less intense, and lead to higher or lower industry profitability.

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### Adjusting Strategy to Prepare for the Impacts of Driving Forces

- The third step of driving-forces analysis—the payoff for strategy-making—is for managers to decide on the strategy adjustments required to deal with the impacts of the driving forces.
  - ▶ If management's diagnosis of the impact of the industry's driving forces is muddled or flawed, the chance of making proper strategy adjustments is slim.
  - ▶ Insightful driving forces analysis leads to better managerial judgments about where the industry is headed and how to prepare for the changes ahead.

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### Question 3: What Market Positions Do Rivals Occupy—Who Is Strongly Positioned and Who Is Not?

- Industry rivals can occupy stronger (or distinguishably different) market positions than other rivals because they have opted to
  - ▶ Incorporate product features appealing to different types of buyers
  - ▶ Charge widely differing prices for products of widely differing quality or performance
  - ▶ Emphasize different distribution channels
  - ▶ Compete in different geographic areas
  - ▶ Or otherwise stake out a different market position from rivals
- The best technique for revealing the market positions of industry competitors is *strategic group mapping*

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### Core Concept

A **strategic group** is a cluster of industry rivals that employ similar competitive approaches, have product offerings that appeal to similar types of buyers, and thus occupy similar market positions.

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### Defining a Strategic Group

- Firms in the same strategic group resemble one another in any of several ways:
  - ▶ Comparable product-line breadth
  - ▶ Sell in the same price/quality range
  - ▶ Emphasize same distribution channels
  - ▶ Use same product attributes to appeal to similar types of buyers
  - ▶ Use identical technological approaches
  - ▶ Offer buyers similar services
  - ▶ Cover same geographic areas

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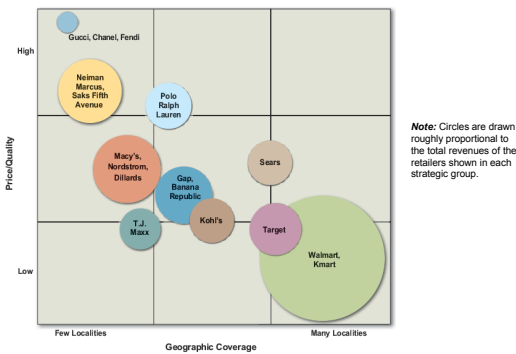
### How to Construct a Strategic Group Map

- 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 group, making circles proportional to size of group's respective share of total industry sales.

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**FIGURE 3.9** Comparative Market Positions of Selected Retail Chains: An Example of a Strategic Group Map



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### Guidelines for Constructing a Strategic Group Map

- Variables used as axes must not be highly correlated
  - ▶ If they are, then all circles will fall along a diagonal and reveal nothing more about the relative positions of rivals than would be revealed by comparing the rivals on one of the variables
- Variables should reveal big differences in how rivals compete
  - ▶ When rivals differ on both variables, locations of the rivals will be scattered, showing how they are positioned differently
- Drawing sizes of circles proportional to combined sales of firms in each strategic group allows the map to reflect relative market share sizes of each strategic group
- If three or more good competitive variables can be used for the two axes of the map, it is best to draw several maps

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### What Can Be Learned from Strategic Group Maps?

- Group maps identify:
  - ▶ Which industry members are close rivals and which are distant rivals. Firms in the same strategic group are the closest rivals; the next closest rivals are in the immediately adjacent groups
  - ▶ Firms in strategic groups that are far apart on the map may hardly compete with one another at all
- Not all positions on the map are equally attractive:
  - ▶ Prevailing competitive pressures and driving forces often favor some strategic groups and hurt others
  - ▶ Profit potential of different strategic groups varies due to strengths and weaknesses in each group's market position

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### Questions for Simulation Company Co-Managers

- Have you studied the strategic group maps for each geographic region shown in the Competitive Intelligence Report?
- Based on these maps, which rival firms are your closest competitors in each geographic region?
- Which rival firms are distant competitors?
- Do any of the four regional strategic group maps indicate that there are many rival firms grouped very close together, signaling they are members of an "overcrowded" strategic group?
- Is the financial performance of firms in overcrowded strategic groups suffering because of the tough competitive battle taking place among similarly-positioned strategic group members?
- Are there "open spaces" in any of the four regional strategic group maps that present good opportunities (because competition is weak)?

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### Question 4: What Strategic Moves Are Rivals Likely to Make Next?

- Knowledge of rivals' strategies, financial performance, resource strengths and weaknesses, actions and announced plans, and the thinking and leadership styles of their executives is valuable for:
  - ▶ Predicting or anticipating the likely strategic moves of competitors.
  - ▶ Crafting a firm's strategy with confidence about what market maneuvers to expect from rivals
  - ▶ Being poised to capitalize on opportunities stemming from competitors' missteps or strategy flaws.

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### What Kind of Competitive Intelligence Is Needed?

- To predict what rival firms are likely to do next, one needs to look at:
  - ▶ How well rivals' strategies are working (weaker firms are certain to change elements of their strategies)
  - ▶ Rivals under pressure to take strategic actions improve their financial performance
  - ▶ Rivals with important problems/issues they must address with corrective adjustments is a sign that change initiatives are coming
  - ▶ The actions and plans that rivals have announced
  - ▶ The thinking and leadership styles of their executives

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### Questions to Consider in Predicting the Likely Actions of Rivals

- Which rival's strategy is producing good results and thus is likely to make only minor strategic adjustments?
- Which rivals are losing in the marketplace or struggling to come up with a good strategy—and thus are strong candidates for altering prices, improving product offerings, moving to a different part of the strategic group map, and otherwise adjusting important elements of their strategy?
- Which competitors are poised to gain market share, and which ones seem destined to lose ground?

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### Questions to Consider in Predicting the Likely Actions of Rivals (cont'd)

- Which competitors are likely to rank among the industry leaders five years from now? Do any of the up-and-coming competitors have strategies and sufficient resource capabilities to overtake the current industry leader?
- Which rivals badly need to increase their unit sales and market share? What strategic options are they most likely to pursue: lowering prices, adding new models and styles, expanding dealer networks, entering additional geographic markets, boosting advertising to build brand-name awareness, acquiring a weaker competitor, placing more emphasis on direct sales via the Web, or .....?

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### Questions to Consider in Predicting the Likely Actions of Rivals (cont'd)

- Which rivals will likely enter new geographic markets or make major moves to increase their sales and market share in a particular geographic region?
- Which rivals are candidates to expand their product offerings and enter new product segments where they currently have no presence?
- Which rivals are candidates to be acquired? Which rivals are looking to make an acquisition and are financially able to do so?

*Scouting competitors to anticipate their next moves allows managers to launch countermoves and to take rivals' probable moves into account in crafting a firm's own best course of action.*

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### Question 5: What Are the Key Factors for Future Competitive Success?

- Key Success Factors (KSFs)
  - Are competitive factors that most affect industry members' ability to compete successfully and profitably
  - Can relate to particular strategy elements, product attributes, resource strengths, competencies or competitive capabilities, and/or market achievements
  - Why do industry KSFs matter?
    - ▶ Because how well a firm's strategy elements, product attributes, resources, and capabilities measure up against the industry's KSFs is a big determinant of how financially and competitively successful it will be.

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### Core Concept

**Key success factors** are the strategy elements, product attributes, resource strengths, competitive capabilities, and market achievements with the greatest impact on future competitive success in the marketplace.

*KSFs are so important to competitive success that how well a firm measures up on each industry KSF can spell the difference between being a strong competitor and a weak competitor—and sometimes between profit and loss.*

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### Example: KSFs for Bottled Water Industry

- **Access to distribution** to get a firm's brand stocked and favorably displayed in retail outlets.
- **Image** to induce consumers to buy a particular firm's product (brand name and attractiveness of packaging are key deciding factors).
- **Low-cost production capabilities** to keep selling prices competitive.
- **Sufficient sales volume** to achieve scale economies in marketing expenditures.

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### Example: KSFs for the Ready-to-Wear Apparel Industry

- **Appealing designs and color combinations** to create buyer appeal
- **Low-cost manufacturing efficiency** to keep selling prices competitive
- **Strong network of retailers/company-owned stores** to allow stores to keep best-selling items in stock
- **Clever advertising** to effectively convey a specific image to induce consumers to purchase a particular label

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### Identifying Industry Key Success Factors

- KSFs are specific to an industry, however they can vary over time within the industry as driving forces and competitive conditions change.
- An industry rarely has more than five KSFs
- Questions that help identify industry's KSFs:
  - ▶ On what crucial product or service attributes do an industry's buyers choose between competing brands of rival sellers?
  - ▶ Given an industry's competitive rivalry and its prevailing competitive forces, what resources and capabilities must a firm have to be competitively successful?
  - ▶ What KSF shortcomings will put a firm at a significant competitive disadvantage in its industry?

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### Using KSFs in Crafting a Winning Strategy

- Strategists seek to create a strategy that both allows the firm to compete favorably with rivals on the industry's future KSFs and that aims at *being distinctly better* than rivals on one or more of the KSFs.
- Firms that excel on a KSF enjoy a stronger market position—*being distinctly better than rivals on one or two key success factors often translates into competitive advantage.*

*Using the industry's KSFs as cornerstones for the firm's strategy and trying to gain sustainable competitive advantage by excelling at one particular KSF is a fruitful competitive strategy approach.*

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### Question 6: Is the Industry Outlook Conducive to Good Profitability?

- Factors that determine an industry's prospects for attractive profitability:
  - ▶ The industry's growth potential
  - ▶ The effect of the industry's driving and competitive forces on both industry profitability and the firm's ability to earn good profits despite the expected strength of those forces
  - ▶ The position of the firm on its industry's strategic group map
  - ▶ How well the firm's strategy, product offering, and capabilities match up to its industry's KSFs
  - ▶ The degree and amount of risk and uncertainty in the industry's future if severe competitive and economic problems arise

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### Core Concept

The anticipated industry environment is fundamentally **attractive** if it presents a firm with good opportunity for above-average profitability.

The industry outlook is fundamentally **unattractive** if a firm's profit prospects are unappealingly low.

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### Factors to Consider in Assessing Industry Attractiveness

- Future industry conditions are not equally attractive to all industry participants and all potential entrants
  - ▶ In an unattractive industry, a favorably situated and competitively capable firm will see ample opportunity to outcompete weaker rivals and significantly grow its revenues and profits
  - ▶ Weak competitors in an attractive industry find battling stronger rivals holds no promise of market success or even average profitability
  - ▶ Industry outsiders with resources can hurdle an industry's entry barriers while other outsiders find the same industry unattractive due to the industry's stronger competitors

*An industry's attractiveness depends in large part on whether a firm has the resource strengths and competitive capabilities to be competitively successful and profitable in that environment.*

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### What Should a Current Competitor Decide about Investing in Its Industry?

- A strong competitor in an attractive industry should invest aggressively to capture opportunities to improve its long-term competitive position
- A strong competitor in an unattractive industry should try to protect its position by investing cautiously and looking for opportunities in other industries
- The best option for a competitively weak firm in an unattractive industry is often to find a buyer, perhaps a rival, to acquire its business

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