IS STRATEGY ,MANAGEMENT

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How Competitive Forces Shape Strategy

- (Harvard business review)The essence of strategy formulation is coping with competition.
- in the fight for market share, competition is not manifested only in the other players. Rather, competition in an industry is rooted in its underlying economics, and competitive forces exist that go well beyond the established combatants in a particular industry.
- suppliers, potential entrants, and substitute products are all competitors that may be more or less prominent or active depending on the industry.

Exhibit
Forces governing competition in an industry

How Competitive Forces Shape Strategy

- Whatever their collective strength, the corporate strategist's goal is to find a position in the industry where his or her company can best defend itself against these forces or can influence them in its favor.
- The collective strength of the forces may be painfully apparent to all the antagonists; but to cope with them, the strategist must delve below the surface and analyze the sources of each.

How Competitive Forces Shape Strategy

- They highlight the critical strengths and weaknesses of the company, animate the positioning of the company in its industry, clarify the areas where strategic changes may yield the greatest payoff, and highlight the places where industry trends promise to hold the greatest significance as either opportunities or threats.

- Understanding these sources also proves to be of help in considering areas for diversification.

Contending Forces

- The strongest competitive force or forces determine the profitability of an industry and so are of greatest importance in strategy formulation.

- For example: even a company with a strong position in an industry unthreatened by potential entrants will earn low returns if it faces a superior or a lower-cost substitute product.

shaping competition

- Different forces take on prominence, of course, in shaping competition in each industry.
- In the ocean-going tanker industry the key force is probably the buyers (the major oil companies), while in tires it is powerful OEM buyers coupled with tough competitors.
- In the steel industry the key forces are foreign competitors and substitute materials.

shaping competition

- Every industry has an underlying structure, or a set of fundamental economic and technical characteristics, that gives rise to these competitive forces. The strategist, wanting to position his or her company to cope best with its industry environment.

- This view of competition pertains equally to industries dealing in services and to those selling products.

Threat of entry

- New entrants to an industry bring new capacity, the desire to gain market share, and often substantial resources.
- Companies diversifying through acquisition into the industry from other markets often leverage their resources.
- The seriousness of the threat of entry depends on the barriers present and on the reaction from existing competitors that entrants can expect.

six major sources of barriers to entry

- There are six major sources of barriers to entry:
- **1. Economies of scale**
- These economies deter entry by forcing the aspirant either to come in on a large scale or to accept a cost disadvantage. Scale economies in production, research, marketing, and service are probably the key barriers to entry in the industry.

six major sources of barriers to entry

- **2. Product differentiation**
- Brand identification creates a barrier by forcing entrants to spend heavily to overcome customer loyalty. Advertising, customer service, being first in the industry, and product differences are among the factors fostering brand identification. It is perhaps the most important entry barrier in soft drinks, over-the-counter drugs, cosmetics, investment banking, and public accounting.

six major sources of barriers to entry

- **3. Capital requirements**
- The need to invest large financial resources in order to compete creates a barrier to entry, particularly if the capital is required for unrecoverable expenditures in up-front advertising.
- Capital is necessary not only for fixed facilities but also for customer credit, inventories, and absorbing start-up losses.
- While major corporations have the financial resources to invade almost any industry, the huge capital requirements in certain fields, such as computer manufacturing and mineral extraction, limit the pool of likely entrants.

six major sources of barriers to entry

- **4. Cost disadvantages independent of size**
- Entrenched companies may have cost advantages not available to potential rivals, no matter what their size and attainable economies of scale.
- These advantages can stem from the effects of the learning curve (and of its the experience curve), proprietary technology, access to the best raw materials sources, assets purchased at preinflation prices, government subsidies, or favorable locations.
- Sometimes cost advantages are legally enforceable, as they are through patents. (For an analysis of the much-discussed experience curve as a barrier to entry.)

six major sources of barriers to entry

- **5. Access to distribution channels**
- The newcomer must, of course, secure distribution of its product or service.
- A new food product, for example, must displace others from the supermarket shelf via price breaks, promotions, intense selling efforts, or some other means.
- The more limited the wholesale or retail channels are and the more that existing competitors have these tied up, obviously the tougher that entry into the industry will be.
- Sometimes this barrier is so high that, to surmount it, a new contestant must create its own distribution channels.

six major sources of barriers to entry

- **6. Government policy**
- The government can limit or even foreclose entry to industries with such controls as license requirements and limits on access to raw materials.
- Regulated industries like trucking and freight forwarding are noticeable examples; more subtle government restrictions operate in fields like ski-area development and coal mining.
- The government also can play a major indirect role by affecting entry barriers through controls such as air and water pollution standards and safety regulations.

Changing conditions

- From a strategic standpoint there are two important additional points to note about the threat of entry.
- First, it changes, of course, as these conditions change. The expiration of Polaroid's basic patents on instant photography, for instance, greatly reduced its absolute cost entry barrier built by proprietary technology.
- Product differentiation in printing has all but disappeared. Conversely, in the auto industry economies of scale increased enormously

Powerful suppliers & buyers

- Suppliers can exert bargaining power on participants in an industry by raising prices or reducing the quality of purchased goods and services.
- Powerful suppliers can thereby squeeze profitability out of an industry unable to recover cost increases in its own prices.
- By raising their prices, soft drink concentrate producers have contributed to the erosion of profitability of bottling companies because the bottlers, facing intense competition from powdered mixes, fruit drinks, and other beverages, have limited freedom to raise *their* prices accordingly.

Strategic action

- A company’s choice of suppliers to buy from or buyer groups to sell to should be viewed as a crucial strategic decision.
- A company can improve its strategic posture by finding suppliers or buyers who possess the least power to influence it adversely.
- Most common is the situation of a company being able to choose whom it will sell to—in other words, buyer selection. Rarely do all the buyer groups a company sells to enjoy equal power.