Chapter 2: Strategy Analysis
The Importance of Strategy Analysis

• Strategy drives the actions of an organization.

• Studying a firm’s strategy provides:
  – An understanding of what drives risks, profitability, and competitive advantages
  – A basis for future performance to be forecasted
  – An idea of how to measure the success of a firm’s actions
Key Concepts in Chapter 2

- The importance of industry-level analysis
- Porter’s five forces framework for industry analysis
- Competitive strategy analysis of the firm
- Corporate strategy analysis for multi-business organizations
The Importance of Industry-Level Analysis

• A firm’s strategy is heavily influenced by the industry it belongs to.

• Understanding the environment and competitive forces within an industry helps with evaluating the quality of a particular firm’s strategy.

• Porter created a useful framework to evaluate the competitive forces at work in an industry, as seen in figure 2-1.
Industry Structure and Profitability

![Diagram of Industry Structure and Profitability]

- **Rivalry Among Existing Firms**
  - Industry growth
  - Concentration
  - Differentiation
  - Switching costs
  - Scale/Learning economies
  - Fixed-Variable costs
  - Excess capacity
  - Exit barriers

- **Threat of New Entrants**
  - Scale economies
  - First mover advantage
  - Distribution access
  - Relationships
  - Legal barriers

- **Threat of Substitute Products**
  - Relative price and performance
  - Buyers’ willingness to switch

**Industry Profitability**

**Bargaining Power in Input and Output Markets**

- **Bargaining Power of Buyers**
  - Switching costs
  - Differentiation
  - Importance of product for costs and quality
  - Number of buyers
  - Volume per buyer

- **Bargaining Power of Suppliers**
  - Switching costs
  - Differentiation
  - Importance of product for costs and quality
  - Number of suppliers
  - Volume per supplier
Competitive Force 1: Rivalry Among Existing Firms

• Higher degrees of competition among firms:
  – Push prices towards the marginal cost of production.
  – Make non-price dimensions of products or services more important.

• Determinants of the intensity of competition among firms:
  – Industry growth rate.
  – Concentration and balance of competitors.
Rivalry Among Existing Firms, continued

• Determinants of the intensity of competition among firms:
  – Degree of differentiation in products and services and switching costs.
  – Scale/Learning economies and ratio of fixed to variable costs.
  – Excess capacity and exit barriers.
Competitive Force 2: Threat of New Entrants

• The ease which a new firm can enter an industry will affect the profitability of other firms within the industry.

• Factors affecting the barriers to entry are:
  – Economies of scale
  – First mover advantage
  – Relationships with suppliers and customers
  – Legal barriers
Competitive Force 3: Threat of Substitute Products

- The degree to which substitute products or services exist affects the industry’s bargaining power with suppliers and customers, and ultimately profitability.

- The degree to which substitutes exist depends upon the relative price and performance of competing products or services, and the willingness of customers to accept substitutes.
Competitive Force 4: Bargaining Power of Buyers

- Buyer bargaining power can exert downward pressure on prices.

- Factors that can affect this bargaining power are:
  - Buyer price sensitivity to product or service
  - Relative bargaining power of buyers
Competitive Force 5: Bargaining Power of Suppliers

• A mirror image of the bargaining power of buyers.

  – Suppliers have bargaining power when there are few substitutes and/or few suppliers relative to the number of customers demanding a product or service.
Applying Industry Analysis to the Personal Computer Industry

• Despite the sales volume and ubiquity of the product, profitability in the industry was low.
  – Competitive forces
  – Bargaining power of suppliers and buyers
Competitive Strategy Analysis

• Individual firms must choose appropriate strategies to succeed within their industry segment

• Two basic competitive strategies are:
  – Cost leadership
  – Product / service differentiation

• Figure 2-2 conveniently summarizes aspects of cost leadership and differentiation
Strategies for Creating Competitive Advantage

**FIGURE 2-2** Strategies for Creating Competitive Advantage

- **Cost Leadership**
  - Supply same product or service at a lower cost.
  - Economies of scale and scope
  - Efficient production
  - Simpler product designs
  - Lower input costs
  - Low-cost distribution
  - Little research and development or brand advertising
  - Tight cost control system

- **Differentiation**
  - Supply a unique product or service at a cost lower than the price premium customers will pay.
  - Superior product quality
  - Superior product variety
  - Superior customer service
  - More flexible delivery
  - Investment in brand Image
  - Investment in research and development
  - Control system focus on creativity and innovation

- **Competitive Advantage**
  - Match between firm’s core competencies and key success factors to execute strategy
  - Match between firm’s value chain and activities required to execute strategy
  - Sustainability of competitive advantage
Achieving and Sustaining Competitive Advantage

• Choice of strategy is an important first step for a firm. The likelihood of achieving and sustaining competitive advantage must be evaluated.

• Factors to evaluate include:
  – Resources and capabilities to implement strategies.
  – Whether the firm’s activities, infrastructure, and other operating elements consistent with its competitive strategy.
Applying Competitive Strategy Analysis to the TJX Companies

• How was TJX’s growth in income and market share achieved and sustained?

  – Low-cost competitive strategy
  – Distribution channel
  – Mass customization
  – Outsourcing service
  – Cash management
  – Investment in R&D
Corporate Strategy Analysis

• Companies with multiple business segments require an analysis how the separate segments are managed within the corporate governance structure.

• Factors to analyze include:
  – Transaction costs
  – Specific benefits to operating under one corporate umbrella

• The case of Tata Group.
Concluding Comments

• The industry analysis approach has notable strengths and some limitations.
• Porters five forces framework is valuable in evaluating the strategy and actions of firms within an industry.