PART 02
Concept and Analytical Tools
Analysing a Company’s External Environment

Crafting and Executing Strategy: Creating Sustainable High Performance in South African Businesses

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Line-of-Sight High Performance Organization
3.1 Introduction

South African managers are not prepared either to steer their companies in a different direction or to alter the company strategy until they have developed a deep understanding of the pertinent factors surrounding the company’s situation. As indicated in the opening paragraph of Chapter 1, one of the central questions that managers must address in evaluating their company’s business prospects is “What’s the company’s present situation?” Two facets of a company’s situation are especially pertinent: (1) the industry and competitive environment in which the company operates and the forces acting to reshape this environment, and (2) the company’s own market position and competitiveness—its resources and capabilities, its strengths and weaknesses vis-à-vis rivals, and its windows of opportunity.

Insightful diagnosis of a company’s external and internal environment is a prerequisite for managers to succeed in crafting and aligning a strategy that is an excellent fit with the company’s situation, is capable of building competitive advantage, and holds out good prospects for boosting sustainable company performance. Thus, depicted in Fig. 3.1, the task of crafting a strategy should always begin with an appraisal of the company’s external and internal situation (as a basis for developing strategic vision of where the company needs to head), should then move toward an evaluation of the most promising alternative strategies and business models, and culminate in choosing a specific strategy.

![Diagram](FIGURE 3.1 From thinking strategically about the company’s situation to choosing a strategy)

This chapter presents the concepts and analytical tools for zeroing in on those aspects of a single-business company’s external environment that should be considered in making strategic choices. Attention centres on the competitive arena in which a company operates, the drivers of market change, and what rival companies are doing. In Chapter 4 we explore the methods of evaluating a company’s internal circumstances and competitiveness.
3.2 The Strategically Relevant Components of a Company’s External Environment

All companies operate in a “macroenvironment” shaped by influences emanating from the economy at large; population demographics; societal values and lifestyles; governmental legislation and regulation; technological factors; and, closer to home, the industry and competitive arena in which the company operates (see Fig. 3.2). Strictly speaking, a company’s macroenvironment includes all relevant factors and influences outside the company’s boundaries; by “relevant”, we mean important enough to have a bearing on the decisions the company ultimately makes about its direction, objectives, strategy, and business model. Strategically relevant influences coming from the outer ring of the macroenvironment can sometimes have a strong impact on a company’s business situation and play a very significant part in the company’s direction and strategy. The strategic opportunities for cigarette producers to grow their business are greatly reduced by anti-smoking ordinances and the growing cultural stigma attached to smoking. Motor vehicle companies must adapt their strategies (especially as concerns the fuel kilometres...
of their vehicles) to customer concerns about petrol prices. The demographics of an ageing population and longer life expectancies and increased self-medication are having a dramatic impact on the business prospects and strategies of healthcare and prescription drug companies. Companies in almost all industries have to craft strategies that are responsive to environmental regulations, growing use of the Internet and broadband technology, and energy prices. Companies in the food-processing, restaurant, sports, and fitness industries have to pay special attention to changes in lifestyles, eating habits, leisure-time preferences, and attitudes toward nutrition and exercise in fashioning their strategies.

Happenings in the outer ring of the macroenvironment may occur rapidly or slowly, with or without advance warning. The impact of outer-ring factors on a company’s choice of strategy can range from big to small. However, even if the factors in the outer ring of the macroenvironment change slowly or have such a comparatively low impact on a company’s situation that only the edges of a company’s direction and strategy are affected, there are enough strategically relevant outer-ring trends and events to justify a watchful eye. As company managers scan the external environment, they must be alert for potentially important outer-ring developments, assess their impact and influence, and adapt the company’s direction and strategy as needed.

However, the factors and forces in a company’s macroenvironment having the biggest strategy-shaping impact typically pertain to the company’s immediate industry and competitive environment—competitive pressures, the actions of rival companies, buyer behaviour, supplier-related considerations, and so on. Consequently, it is on a company’s industry and competitive environment that we concentrate our attention in this chapter.

3.3 Thinking Strategically About a Company’s Industry and Competitive Environment

To gain a deep understanding of a company’s industry and competitive environment, managers do not need to gather all the information they can find and spend lots of time digesting it. Rather, the task is much more focused. Thinking strategically about a company’s industry and competitive environment entails using some well-defined concepts and analytical tools to get clear answers to seven questions:

1. What are the industry’s dominant economic features?
2. What kinds of competitive forces are industry members facing and how strong is each force?
3. What forces are driving industry change and what impacts will they have on competitive intensity and industry profitability?
4. What market positions do industry rivals occupy—who is strongly positioned and who is not?
5. What strategic moves are rivals likely to make next?
6. What are the key factors for future competitive success?
7. Does the outlook for the industry present the company with sufficiently attractive prospects for profitability?

Analysis-based answers to these questions provide managers with the understanding needed to craft a strategy that fits the company’s external situation. The remainder of
this chapter is devoted to describing the methods of obtaining solid answers to the seven questions and explaining how the nature of a company’s industry and competitive environment weighs upon the strategic choices of company managers.

### 3.4 What are the Industry’s Dominant Economic Features?

Because industries differ so significantly, the task of analysing a company’s industry and competitive environment begins with identifying an industry’s dominant economic features and forming a picture of what the industry landscape is like. An industry’s dominant economic features are defined by such factors as market size and growth rate, the number and sizes of buyers and sellers, the geographic boundaries of the market (which can extend from local to worldwide), the degree to which sellers’ products are differentiated, the pace of product innovation, market supply/demand conditions, the pace of technological change, the extent of vertical integration, and the extent to which costs are affected by scale economies (i.e., situations in which large-volume operations result in lower unit costs) and learning/experience curve effects (i.e. situations in which costs decline as a company gains knowledge and experience). Table 3.1 provides a convenient summary of what economic features to look at and the corresponding questions to consider in profiling an industry’s landscape.

<table>
<thead>
<tr>
<th>Economic Feature</th>
<th>Questions to Answer</th>
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<tbody>
<tr>
<td>Market size and growth rate</td>
<td>■ How big is the industry and how fast is it growing?</td>
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<tr>
<td></td>
<td>■ What does the industry’s position in the life cycle (early development, rapid growth and takeoff, early maturity and slowing growth, saturation and stagnation, decline) reveal about the industry’s growth prospects?</td>
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<tr>
<td>Number of rivals</td>
<td>■ Is the industry fragmented into many small companies or concentrated and dominated by a few large companies?</td>
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<tr>
<td></td>
<td>■ Is the industry going through a period of consolidation to a smaller number of competitors?</td>
</tr>
<tr>
<td>Scope of competitive rivalry</td>
<td>■ Is the geographic area over which most companies compete local, regional, national, multinational, or global?</td>
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<td></td>
<td>■ Is having a presence in the foreign country markets becoming more important to a company’s long-term competitive success?</td>
</tr>
<tr>
<td>Number of buyers</td>
<td>■ Is market demand fragmented among many buyers?</td>
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<tr>
<td></td>
<td>■ Do some buyers have bargaining power because they purchase in large volume?</td>
</tr>
<tr>
<td>Degree of product differentiation</td>
<td>■ Are the products of rivals becoming more differentiated or less differentiated?</td>
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<td></td>
<td>■ Are increasingly look-alike products of rivals causing heightened price competition?</td>
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**TABLE 3.1** What to consider in identifying an industry’s dominant economic features
### Economic Feature Questions to Answer

<table>
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<th>Questions to Answer</th>
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| Product innovation               | ■ Is the industry characterized by rapid product innovation and short product life cycles?  
■ How important is R&D and product innovation?  
■ Are there opportunities to overtake key rivals by being first-to-market with next-generation products?                                                                                                                                                                                                                     |
| Supply/demand conditions          | ■ Is a surplus of capacity pushing prices and profit margins down?  
■ Is the industry overcrowded with too many competitors?  
■ Are short supplies creating a seller’s market?                                                                                                                                                                                                                                           |
| Pace of technological change     | ■ What role does advancing technology play in this industry?  
■ Are ongoing upgrades of facilities/equipment essential because of rapidly advancing production process technologies?  
■ Do most industry members have or need strong technological capabilities?                                                                                                                                                                                                                     |
| Vertical integration              | ■ Do most competitors operate in only one stage of the industry (parts and components production, manufacturing and assembly, distribution, retailing) or do some competitors operate in multiple stages?  
■ Is there any cost or competitive advantage or disadvantage associated with being fully or partially integrated?                                                                                                                                                                                            |
| Economies of scale                | ■ Is the industry characterized by economies of scale in purchasing, manufacturing, advertising, shipping, or other activities?  
■ Do companies with large-scale operations have an important cost advantage over small-scale companies?                                                                                                                                                                                                                     |
| Learning/experience curve         | ■ Are certain industry activities characterized by strong learning/experience effects curve effects ("learning by doing") such that unit costs decline as a company’s experience in performing the activity builds?  
■ Do any companies have significant cost advantages because of their learning/experience in performing particular activities?                                                                                                                                                                                                 |

Getting a handle on an industry’s distinguishing economic features not only sets the stage for the analysis to come but also promotes understanding of the kinds of strategic moves that industry members are likely to employ. For example, in industries characterized by one product advance after another, companies must invest in research and development (R&D) and develop strong product innovation capabilities—a strategy of continuous product innovation becomes a condition of survival in such industries as video games, mobile phones, and pharmaceuticals. An industry that has recently passed through the rapid-growth stage and is looking at single-digit percentage increases in buyer demand is likely to be experiencing a competitive shake-out and much stronger strategic emphasis on cost reduction and improved customer service.

In industries like semiconductors, strong learning/experience curve effects in manufacturing cause unit costs to decline about 20 per cent each time cumulative
production volume doubles. With a 20 per cent experience curve effect, if the first million chips cost R100 each, the unit cost would be R80 (80 per cent of R100) by a production volume of 2 million, the unit cost would be R64 (80 per cent of R80) by a production volume of 4 million, and so on. The bigger the learning/experience curve effect, the bigger the cost advantage of the company with the largest cumulative production volume.

Thus, when an industry is characterized by important learning/experience curve effects (or by economies of scale), industry members are strongly motivated to adopt volume-increasing strategies to capture the resulting cost-saving economies and maintain their competitiveness. Unless small-scale companies succeed in pursuing strategic options that allow them to grow sales sufficiently to remain cost-competitive with larger-volume rivals, they are unlikely to survive. The bigger the learning/experience curve effects and/or scale economies in an industry, the more imperative it becomes for competing sellers to pursue strategies to win additional sales and market share—the company with the biggest sales volume gains sustainable competitive advantage as the low-cost producer.

### 3.5 What Kinds of Competitive Forces are Industry Members Facing?

The character, mix, and subtleties of the competitive forces operating in a company’s industry are never the same from one industry to another. Far and away the most powerful and widely used tool for systematically diagnosing the principal competitive pressures in a market and assessing the strength and importance of each is the five-forces model of competition. This model, depicted in Fig. 3.3, holds that the state of competition in an industry is a composite of competitive pressures operating in five areas of the overall market:

1. Competitive pressures associated with the market manoeuvring and jockeying for buyer patronage that goes on among rival sellers in the industry.
2. Competitive pressures associated with the threat of new entrants into the market.
3. Competitive pressures coming from the attempts of companies in other industries to win buyers over to their own substitute products.
4. Competitive pressures stemming from supplier bargaining power and supplier–seller collaboration.
5. Competitive pressures stemming from buyer bargaining power and seller–buyer collaboration.

The way one uses the five-forces model to determine the nature and strength of competitive pressures in a given industry is to build the picture of competition in three steps:

- **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.
Firms in other industries offering substitute products

Competitive pressures coming from the attempts of companies outside the industry to win buyers over to their product

Suppliers of raw materials, parts, components, or other resource inputs

Competitive pressures stemming from supplier bargaining power and supplier–seller collaboration

Rivalry among competing sellers
Competitive pressures created by jockeying for better market position, increased sales and market share, and competitive advantage

Competitive pressures stemming from buyer bargaining power and buyer–seller collaboration

Buyers

Competitive pressures coming from the threat of entry of new rivals

Potential new entrants

**FIGURE 3.3** The five-forces model of competition: a key analytical tool


### 3.5.1 Competitive Pressures Associated with Rival Sellers

The strongest of the five competitive forces is nearly always the market manoeuvring and jockeying for buyer patronage that goes on among rival sellers of a product or service. In effect, a market is a competitive battlefield where there is no end to the jockeying for buyer patronage. Rival sellers are prone to employ whatever weapons they have in their business arsenal to improve their market positions, strengthen their market position with buyers, and earn good profits. The challenge is to craft a competitive strategy that, at the very least, allows a company to hold its own against rivals and that, ideally, produces a competitive edge over rivals. But competitive contests are ongoing and dynamic. When one company makes a strategic move that produces good results, its rivals typically respond with offensive or defensive counter-moves, shifting their strategic emphasis from one combination of product attributes, marketing tactics, and capabilities to another.
This pattern of action and reaction, move and counter-move, adjust and readjust produces a continually evolving competitive landscape in which the market battle ebbs and flows, sometimes takes unpredictable twists and turns, and produces winners and losers. But the winners—the current market leaders—have no guarantees of continued leadership; their market success is no more durable than the power of their strategies to fend off the strategies of ambitious challengers. In every industry, the ongoing jockeying of rivals leads to one or another companies gaining or losing momentum in the marketplace according to whether their latest strategic manoeuvres succeed or fail.

**CORE CONCEPT:** Competitive jockeying among industry rivals is ever changing, as rivals initiate fresh offensive and defensive moves and emphasize first one mix of competitive weapons and then another in efforts to improve their market positions.

Figure 3.4 shows a sampling of competitive “weapons” that companies can deploy in battling rivals and indicates the factors that influence the intensity of their rivalry. A brief
Rivalry intensifies when competing sellers are active in launching fresh actions to boost their market standing and business performance. One indicator of active rivalry is lively price competition, a condition that puts pressure on industry members to drive costs out of the business and threatens the survival of high-cost companies. Another indicator of active rivalry is rapid introduction of next-generation products—when one or more rivals frequently introduce new or improved products, competitors that lack good product innovation capabilities feel considerable competitive heat to get their own new and improved products into the marketplace quickly. Other indicators of active rivalry among industry members include:

- Whether industry members are racing to differentiate their products from rivals by offering better performance features or higher quality or improved customer service or a wider product selection.
- How frequently rivals resort to such marketing tactics as special sales promotions, heavy advertising, rebates, or low-interest-rate financing to drum up additional sales.
- How actively industry members are pursuing efforts to build stronger dealer networks or establish positions in foreign markets or otherwise expand their distribution capabilities and market presence.
- How hard companies are striving to gain a market edge over rivals by developing valuable expertise and capabilities that rivals are hard pressed to match.

Normally, competitive jockeying among rival sellers is active and fairly intense because competing companies are highly motivated to launch whatever fresh actions and creative market manoeuvres they can think of to try to strengthen their market positions and business performance.

Rivalry intensifies as the number of competitors increases and as competitors become more equal in size and capability. Rivalry is not as vigorous in microprocessors for PCs, (where Advanced Micro Devices (AMD) is one of the few challengers to Intel) as it is in fast-food restaurants, where numerous sellers are actively jockeying for buyer patronage. Up to a point, the greater the number of competitors, the greater the probability of fresh, creative strategic initiatives. In addition, when rivals are nearly equal in size and capability, they can usually compete on a fairly even footing, making it harder for one or two companies to win commanding market shares and confront weaker market challenges from rivals.

Rivalry is usually stronger in slow-growing markets and weaker in fast-growing markets. Rapidly expanding buyer demand produces enough new business for all industry members to grow. Indeed, in a fast-growing market, a company may find itself stretched just to keep abreast of incoming orders, let alone devote resources to stealing customers away from rivals. In markets where growth is sluggish or where buyer demand drops off unexpectedly, however, expansion-minded companies and companies with excess capacity often are quick to cut prices and initiate other sales-increasing tactics, thereby igniting a battle for market share that can result in a shake-out of weak, inefficient companies.
3.5 What Kinds of Competitive Forces are Industry Members Facing?

4 Rivalry is usually weaker in industries comprising of so many rivals that the impact of any one company’s actions is spread thinly across all industry members; likewise, it is often weak when there are fewer than five competitors. A progressively larger number of competitors can actually begin to weaken head-to-head rivalry once an industry becomes populated with so many rivals that the impact of successful moves by any one company is spread thinly across many industry members. To the extent that a company’s strategic moves ripple out to have little discernible impact on the businesses of its many rivals, then industry members soon learn that it is not imperative to respond every time one or another rival does something to enhance its market position—an outcome that weakens the intensity of head-to-head battles for market share. Rivalry also tends to be weak if an industry consists of just two or three or four sellers. In a market with few rivals, each competitor soon learns that aggressive moves to grow its sales and market share can have an immediate and adverse impact on rivals’ businesses, almost certainly provoking vigorous retaliation and risking an all-out battle for market share that is likely to lower the profits of all concerned. Companies that have a few strong rivals thus come to understand the merits of restrained efforts to wrest sales and market share from competitors as opposed to undertaking hard-hitting offensives that escalate into a profit-eroding arms race or price war. However, some caution must be exercised in concluding that rivalry is weak just because there are only a few competitors. Thus, although occasional warfare can break out (the fierceness of the current battle between Red Hat and Microsoft and the decades-long war between Coca-Cola and Pepsi are prime examples), competition among the few normally produces a live-and-let-live approach to competing because rivals see the merits of restrained efforts to wrest sales and market share from competitors as opposed to undertaking hard-hitting offensives that escalate into a profit-eroding arms race or price war.

5 Rivalry increases when buyer demand falls off and sellers find themselves with excess capacity and/or inventory. Excess supply conditions create a “buyer’s market”, putting added competitive pressure on industry rivals to scramble for profitable sales levels (often by price discounting).

6 Rivalry increases as it becomes less costly for buyers to switch brands. The less expensive it is for buyers to switch their purchases from the seller of one brand to the seller of another brand, the easier it is for sellers to steal customers away from rivals, but the higher the costs buyers incur to switch brands, the less prone they are to brand switching. Even if consumers view one or more rival brands as more attractive, they may not be inclined to switch because of the added time and inconvenience or the psychological costs of abandoning a familiar brand. Distributors and retailers may not switch to the brands of rival manufacturers because they are hesitant to sever long-standing supplier relationships, incur any technical support costs or retraining expenses in making the switchover, go to the trouble of testing the quality and reliability of the rival brand, or devote resources to marketing the new brand (especially if the brand is less well-known). Apple Computer, for example, has been unable to convince PC users to switch from Windows-based PCs because of the time burdens and inconvenience
associated with learning Apple’s operating system, and because so many Windows-based applications will not run on a MacIntosh due to operating system incompatibility. Consequently, unless buyers are dissatisfied with the brand they are presently purchasing, high switching costs can significantly weaken the rivalry among competing sellers.

7 Rivalry increases as the products of rival sellers become more standardized and diminishes as the products of industry rivals become more strongly differentiated. When the offerings of rivals are identical or weakly differentiated, buyers have less reason to be brand-loyal—a condition that makes it easier for rivals to convince buyers to switch to their offering. Since the brands of different sellers have comparable attributes, buyers can shop the market for the best deal and switch brands at will. In contrast, strongly differentiated product offerings among rivals breed high brand loyalty on the part of buyers—because many buyers view the attributes of certain brands as better suited to their needs. Strong brand attachments make it tougher for sellers to draw customers away from rivals. Unless meaningful numbers of buyers are open to considering new or different product attributes being offered by rivals, the high degrees of brand loyalty that accompany strong product differentiation work against fierce rivalry among competing sellers. The degree of product differentiation also affects switching costs. When the offerings of rivals are identical or weakly differentiated, it is usually easy and inexpensive for buyers to switch their purchases from one seller to another. Strongly differentiated products raise the probability that buyers will find it costly to switch brands.

8 Rivalry is more intense when industry conditions tempt competitors to use price cuts or other competitive weapons to boost unit volume. When a product is perishable, seasonal, or costly to hold in inventory, competitive pressures build quickly any time one or more companies decides to cut prices and dump supplies on the market. Similarly, whenever fixed costs account for a large fraction of total cost, so that unit costs tend to be lowest at or near full capacity, then companies come under significant pressure to cut prices or otherwise try to boost sales whenever they are operating below full capacity. Unused capacity imposes a significant cost-increasing penalty because there are fewer units over which to spread fixed costs. The pressure of high fixed costs can push rival companies into price concessions, special discounts, rebates, low-interest-rate financing, and other volume-boosting tactics.

9 Rivalry increases when one or more competitors become dissatisfied with their market position and launch moves to bolster their standing at the expense of rivals. Companies that are losing ground or in financial trouble often pursue aggressive (or perhaps desperate) turnaround strategies that can involve price discounts, more advertising, acquisition of or merger with other rivals, or new product introductions—such strategies can turn competitive pressures up a notch.

10 Rivalry becomes more volatile and unpredictable as the diversity of competitors increases in terms of vision, strategic intents, objectives, strategies, resources, and countries of origin. A diverse group of sellers often contains one or more mavericks willing to try novel or high-risk or rule-breaking market approaches, thus generating
3.5 What Kinds of Competitive Forces are Industry Members Facing?

A livelier and less predictable competitive environment. Globally competitive markets often contain rivals with different views about where the industry is headed and a willingness to employ perhaps radically different competitive approaches. Attempts by cross-border rivals to gain stronger footholds in each other’s domestic markets usually boost the intensity of rivalry, especially when the aggressors have lower costs or products with more attractive features.

11 Rivalry increases when strong companies outside the industry acquire weak companies in the industry and launch aggressive, well-funded moves to transform their newly acquired competitors into major market contenders. A concerted effort to turn a weak rival into a market leader nearly always entails launching well-financed strategic initiatives to dramatically improve the competitor’s product offering, excite buyer interest, and win a much bigger market share—actions that, if successful, put added pressure on rivals to counter with fresh strategic moves of their own.

12 A powerful, successful competitive strategy employed by one company greatly intensifies the competitive pressures on its rivals to develop effective strategic responses or be relegated to also-ran status.

Rivalry can be characterized as cut-throat or brutal when competitors engage in protracted price wars or habitually employ other aggressive tactics that are mutually destructive to profitability. Rivalry can be considered fierce to strong when the battle for market share is so vigorous that the profit margins of most industry members are squeezed to bare-bones levels. Rivalry can be characterized as moderate or normal when the manoeuvring among industry members, while lively and healthy, still allows most industry members to earn acceptable profits. Rivalry is weak when most companies in the industry are relatively well satisfied with their sales growth and market shares, rarely undertake offensives to steal customers away from one another, and have comparatively attractive earnings and returns on investment.

3.5.2 Competitive Pressures Associated with the Threat of New Entrants

Several factors determine whether the threat of new companies entering the marketplace poses significant competitive pressure (see Fig. 3.5). One factor relates to the size of the pool of likely entry candidates and the resources at their command. As a rule, the bigger the pool of entry candidates, the stronger the threat of potential entry. This is especially true when some of the likely entry candidates have ample resources and the potential to become formidable contenders for market leadership. Frequently, the strongest competitive pressures associated with potential entry come not from outsiders, but from current industry participants looking for growth opportunities. Existing industry members are often strong candidates for entering market segments or geographic areas where they currently do not have a market presence. Companies already well established in certain product categories or geographic areas often possess the resources, competencies, and competitive capabilities to hurdle the barriers of entering a different market segment or new geographic area.

A second factor concerns whether the likely entry candidates face high or low entry barriers. High barriers reduce the competitive threat of potential entry, while low barriers make entry more likely, especially if the industry is growing and offers attractive profit
Entry threats are weaker when:
• The pool of entry candidates is small
• Entry barriers are high
• Existing competitors are struggling to earn healthy 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

Entry threats are stronger when:
• The pool of entry candidates is large and some of the candidates have resources that would make them formidable market contenders
• Entry barriers are low or can be readily hurdled by the likely entry candidates
• When existing industry members are looking to expand their market reach by entering product segments or geographic areas where they currently do not have a presence
• Newcomers can expect to earn attractive profits
• Buyer demand is growing rapidly
• Industry members are unable or unwilling to strongly contest the entry of newcomers

FIGURE 3.5 Factors affecting the threat of entry opportunities. The most widely encountered barriers that entry candidates must hurdle include:4

- The presence of significant economies of scale in production or other areas of operation—when incumbent companies enjoy cost advantages associated with large-scale operation, outsiders must either enter on a large scale (a costly and perhaps risky move) or accept a cost disadvantage and consequently lower profitability. Trying to overcome the disadvantages of small size by entering on a large scale at the outset can result in long-term overcapacity problems for the new entrant (until sales volume builds up), and it can so threaten the market shares of existing companies that they launch strong defensive manoeuvres (price cuts, increased advertising and sales promotion, and similar blocking actions) to maintain their positions and make things hard on a newcomer.

- Cost and resource disadvantages not related to scale of operation—aside from enjoying economies of scale, there are other reasons why existing companies may
have low unit costs that are hard to replicate by newcomers. Industry incumbents can have cost advantages that stem from learning/experience curve effects, the possession of key patents or proprietary technology, partnerships with the best and cheapest suppliers of raw materials and components, favourable locations, and low fixed costs (because they have older facilities that have been mostly depreciated).

- **Strong brand preferences and high degrees of customer loyalty**—the stronger the attachment of buyers to established brands, the harder it is for a newcomer to break into the marketplace. In such cases, a new entrant must have the financial resources to spend enough on advertising and sales promotion to overcome customer loyalties and build its own clientele. Establishing brand recognition and building customer loyalty can be a slow and costly process. In addition, if it is difficult or costly for a customer to switch to a new brand, a new entrant must persuade buyers that its brand is worth the switching costs. To overcome switching-cost barriers, new entrants may have to offer buyers a discounted price or an extra margin of quality or service. All this can mean lower expected profit margins for new entrants, which increases the risk to startup companies dependent on sizable early profits to support their new investments.

- **High capital requirements**—the larger the total capital investment needed to enter the market successfully, the more limited the pool of potential entrants. The most obvious capital requirements for new entrants relate to manufacturing facilities and equipment, introductory advertising and sales promotion campaigns, working capital to finance inventories and customer credit, and sufficient cash to cover start-up costs.

- **The difficulties of building a network of distributors or retailers and securing adequate space on retailers’ shelves**—a potential entrant can face numerous distribution channel challenges. Wholesale distributors may be reluctant to take on a product that lacks buyer recognition. Retailers have to be recruited and convinced to give a new brand ample display space and an adequate trial period. When existing sellers have strong, well-functioning distributor or retailer networks, a newcomer has an uphill struggle in squeezing its way in. Potential entrants sometimes have to “buy” their way into wholesale or retail channels by cutting their prices to provide dealers and distributors with higher mark-ups and profit margins or by giving them big advertising and promotional allowances. As a consequence, a potential entrant’s own profits may be squeezed unless and until its product gains enough consumer acceptance that distributors and retailers are anxious to carry it.

- **RestRICTIVE regulatory policies**—government agencies can limit or even bar entry by requiring licences and permits. Regulated industries like cable TV, telecommunications, electric and water agencies, radio and television broadcasting, liquor retailing, and railroads entail government-controlled entry. In international markets, host governments commonly limit foreign entry and must approve all foreign investment applications. Stringent government-mandated safety regulations and environmental pollution standards are entry barriers because they raise entry costs.

- **TARiffs and international trade restrictions**—national governments commonly use tariffs and trade restrictions (anti-dumping rules, local content requirements, quotas, etc.) to raise entry barriers for foreign companies and protect domestic producers from outside competition.
The ability and inclination of industry incumbents to launch vigorous initiatives to block a newcomer’s successful entry—even if a potential entrant has or can acquire the needed competencies and resources to attempt entry, it must still worry about the reaction of existing companies. Sometimes, there is little that incumbents can do to throw obstacles in an entrant’s path—for instance, existing restaurants have little in their arsenal to discourage a new restaurant from opening or to dissuade people from trying the new restaurant. However, there are times when incumbents do all they can to make it difficult for a new entrant, using price cuts, increased advertising, product improvements, and whatever else they can think of to prevent the entrant from building a clientele. Cable TV companies vigorously fight the entry of satellite TV companies; Sony has mounted strong defences to thwart Microsoft’s entry in videogames with its Xbox; existing hotels try to combat the opening of new hotels with loyalty programmes, renovations of their own, the addition of new services, and so on. An entrant like Mango Airlines (SAA’s low-cost airline) can have second thoughts when financially strong incumbent companies send clear signals that they will give newcomers a hard time and when there is an overlap with its own parent company (see Illustration Capsule 3.1).

Illustration Capsule 3.1: Can Mango Give Low-Cost Rivals the Pip in Turbulent Times and Prevent Overlapping?

The launch of SA’s new low-cost carrier, Mango, has sent ripples across the domestic airline market, forcing its competitors to reduce their air fares in a bid to match its prices.-Launched in 2006, the wholly owned SAA subsidiary claims to be “a truly low-cost carrier” based on successful low-cost carriers such as Europe’s Ryanair or America’s Southwest Airlines. “When SAA began to consider the option of introducing a new airline into the South African market, it was immediately clear that what was needed was a truly low-cost option, not simply another no-frills airline,” says Mango chairman Professor Jakes Gerwel. “This airline is all about inexpensive, safe and speedy travel.”

In a deliberate attempt to undercut the fares offered by its more established competitors, Kulula.com and 1time, Mango has started selling its tickets between Johannesburg and the coastal cities of Cape Town and Durban for R169 a trip—including airport charges. Mango CEO Nico Bezuidenhout says the ticket price has elicited “an unprecedented wave of enthusiasm” from consumers, clogging up booking systems. “The high call volumes, web impressions and soaring ticket sales prove that the market is hungry for an airline such as Mango,” says Bezuidenhout. Kulula’s joint CEO, Gidon Novick, says his airline’s fares are still the lowest in the country. He says, although competition is welcome, there is no need for government to enter the airline business as government already owns SAA and SA Express. But everything is not rosy for Mango. There is concern regarding the overlapping of services offered by the three state-owned airlines—SAA, Mango and SA Express. Although, they have the same owner, the Department of Public Enterprise
see them as three different airlines with three different strategies serving three different markets. But in reality the lines are far from defined. That much was clear when SA Express outlined its future plans this week, which were surprisingly similar to those of SAA. While in theory SAA serves the larger, primary cities and SAExpress the smaller, secondary cities, both airlines now seem to be gunning for the same markets.

The two airlines are already tripping over each other, with SAA earlier this year launching 13 flights a week to Gaborone, a destination already served by SA Express. One has to wonder whether either airline is able to make any money with that amount of capacity on the route.

Then there is the Democratic Republic of Congo. Back in December, when former SAA CEO Khaya Ngqula first mentioned plans to expand to Congo, SA Express CEO Siza Mzimela and her team were exploring similar plans. For now, the more nimble and efficient SA Express has outfoxed its ham-handed sibling and from November will increase its four weekly flights between Johannesburg and Lubumbashi to daily flights, with an onward connection to Kinshasa. The strategies of both airlines in west Africa also overlap, with both planning regional hubs there.

While it is not clear who is copying whom, for now SA Express has proved itself to be more deft at implementing its strategies, remaining profitable despite the many challenges facing the industry. However, if Public Enterprises Minister Barbara Hogan does not redefine the boundaries—or reconsider the wisdom of owning three airlines—both SA Express and SAA could be hurt, particularly in the African market, where many governments are already wary of the dominance of SA’s airlines.


Three additional aspects need to be mentioned specifically in the South African context, namely: the role of competition policy, the pressure to privatize previously state-owned businesses and the onslaught on traditional protection afforded by patent rights as the case involving generic medicine for Aids reflects. These may remove barriers to entry that previously existed.

Whether an industry’s entry barriers ought to be considered high or low depends on the resources and competencies possessed by the pool of potential entrants. Companies with large financial resources, proven competitive capabilities, and a respected brand name may be able to hurdle an industry’s entry barriers rather easily. Small start-up enterprises may find the same entry barriers insurmountable. Thus, how hard it will be for potential entrants to compete on a level playing field is always relative to the financial resources and competitive capabilities of likely entrants.

In evaluating whether the threat of additional entry is strong or weak, company managers must look at (1) how formidable the entry barriers are for each type of potential entrant—start-up enterprises, specific candidate companies in other industries, and current industry participants looking to expand their market reach—and (2) how attractive the growth and profit prospects are for new entrants. Rapidly growing market demand and high potential profits act as magnets, motivating potential entrants to commit the resources
needed to hurdle entry barriers. When profits are sufficiently attractive, entry barriers are unlikely to be an effective entry deterrent. At most, they limit the pool of candidate entrants to enterprises with the requisite competencies and resources and with the creativity to fashion a strategy for competing with incumbent companies.

CORE CONCEPT: High entry barriers and weak entry threats today do not always translate into high entry barriers and weak entry threats tomorrow.

Hence, the best test of whether potential entry is a strong or weak competitive force in the marketplace is to ask if the industry’s growth and profit prospects are strongly attractive to potential entry candidates. When the answer is no, potential entry is a weak competitive force. When the answer is yes and there are entry candidates with sufficient expertise and resources, then potential entry adds significantly to competitive pressures in the marketplace. The stronger the threat of entry, the more that incumbent companies are driven to seek ways to fortify their positions against newcomers, pursuing strategic moves not only to protect their market shares but also to make entry more costly or difficult.

One additional point: the threat of entry changes as the industry’s prospects grow brighter or dimmer and as entry barriers rise or fall. For example, in the pharmaceutical industry the expiration of a key patent on a widely prescribed drug virtually guarantees that one or more drug makers will enter with generic offerings of their own. Growing use of the Internet for shopping is making it much easier for Web-based retailers to enter into competition against such well-known retail chains as Pick ‘n Pay, and Exclusive Books. In international markets entry barriers for foreign-based companies fall as tariffs are lowered, as host governments open up their domestic markets to outsiders, as domestic wholesalers and dealers seek out lower-cost foreign-made goods, and as domestic buyers become more willing to purchase foreign brands.

3.5.3 Competitive Pressures from the Sellers of Substitute Products

Companies in one industry come under competitive pressure from the actions of companies in a closely adjoining industry whenever buyers view the products of the two industries as good substitutes. For instance, the producers of sugar experience competitive pressures from the sales and marketing efforts of the makers of artificial sweeteners. Similarly, the producers of spectacles and contact lenses are currently facing mounting competitive pressures from growing consumer interest in corrective laser surgery. Newspapers are feeling the competitive force of the general public turning to cable news channels for late-breaking news and using Internet sources to get information about sports results, stock quotes, and job opportunities. The makers of videotapes and VCRs have watched demand evaporate as more and more consumers have been attracted to substitute use of DVDs and DVD recorders/players. Traditional providers of telephone service like Telkom are feeling enormous competitive pressure from cell phone providers, as more and more consumers find cell phones preferable to landline phones.
3.5 What Kinds of Competitive Forces are Industry Members Facing?

Just how strong the competitive pressures are from the sellers of substitute products depends on three factors:

1. **Whether substitutes are readily available and attractively priced.** The presence of readily available and attractively priced substitutes creates competitive pressure by placing a ceiling on the prices industry members can charge without giving customers an incentive to switch to substitutes and risking sales erosion. At the same time this price ceiling puts a lid on the profits that industry members can earn unless they find ways to cut costs. When substitutes are cheaper than an industry’s product, industry members come under heavy competitive pressure to reduce their prices and find ways to absorb the price cuts with cost reductions.

2. **Whether buyers view the substitutes as being comparable or better in terms of quality, performance, and other relevant attributes.** The availability of substitutes inevitably invites customers to compare performance, features, ease of use, and other attributes as well as price. For example, ski-boat manufacturers are experiencing strong competition from personal water-ski craft because water sports enthusiasts see personal water skis as fun to ride and less expensive. The users of paper cartons constantly weigh the performance trade-offs with plastic containers and metal cans. Competition from successful substitutes unleashes competitive pressures on industry participants to incorporate new performance features and attributes that makes their product offerings more competitive.

3. **Whether the costs that buyers incur in switching to the substitutes are high or low.** High switching costs deter switching to substitutes, while low switching costs make it easier for the sellers of attractive substitutes to lure buyers to their offering. Typical switching costs include the time and inconvenience that may be involved, the costs of additional equipment, the time and cost in testing the quality and reliability of the substitute, the psychological costs of severing old supplier relationships and establishing new ones, payments for technical help in making the changeover, and employee-retraining costs. High switching costs can materially weaken the competitive pressures that industry members experience from substitutes unless the sellers of substitutes are successful in offsetting the high switching costs with enticing price discounts or additional performance enhancements.

Figure 3.6 summarizes the conditions that determine whether the competitive pressures from substitute products are strong, moderate, or weak.

As a 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. Other market indicators of the competitive strength of substitute products include (1) whether the sales of substitutes are growing faster than the sales of the industry being analysed (a sign that the sellers of substitutes may be drawing customers away from the industry in question), (2) whether the producers of substitutes are moving to add new capacity, and (3) whether the profits of the producers of substitutes are on the rise.
Chapter 03 Analysing a Company’s External Environment

Firms in other industries offering substitute products

Competitive pressures from substitutes are stronger when:
- Good substitutes are readily available or new ones are emerging
- Substitutes are attractively priced
- Substitutes have comparable or better performance features
- End users have low costs in switching to substitutes

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

How strong are competitive pressures coming from the attempts of companies outside the industry to win buyers over to their products?

Rivalry among competing sellers

Signs that competition from substitutes is strong:
- Sales of substitutes are growing faster than sales of the industry being analysed (an indication that the sellers of substitutes are drawing customers away from the industry in question)
- Producers of substitutes are moving to add new capacity
- Profits of the producers of substitutes are on the rise

FIGURE 3.6 Factors affecting competition from substitute products

3.5.4 Competitive Pressures Stemming from Supplier Bargaining Power and Supplier–Seller Collaboration

Whether supplier–seller relationships represent a weak or strong competitive force depends on (1) whether the major suppliers can exercise sufficient bargaining power to influence the terms and conditions of supply in their favour, and (2) the nature and extent of supplier–seller collaboration in the industry.

How Supplier Bargaining Power Can Create Competitive Pressures

Whenever the major suppliers to an industry have considerable leverage in determining the terms and conditions of the item they are supplying, they are in a position to exert competitive pressure on one or more rival sellers. For instance, Microsoft and Intel, both of which supply personal computer (PC) makers with products that most PC users consider essential, are known for using their dominant market status not only to charge PC makers premium prices but also to leverage PC makers in other ways. Microsoft pressures PC makers to load only Microsoft products on the PCs they ship and to position...
the icons for Microsoft software prominently on the screens of new computers that come with factory-loaded software. Intel pushes greater use of Intel microprocessors in PCs by granting PC makers significant advertising allowances on PC models equipped with “Intel Inside” stickers; it also tends to give PC makers that use the biggest percentages of Intel chips in their PC models top priority in filling orders for newly introduced Intel chips. Being on Intel’s list of preferred customers helps a PC maker obtain an allocation of the first production runs of Intel’s latest and greatest chips, thus enabling it to get new PC models equipped with these chips to market ahead of rivals who are heavier users of chips made by Intel’s rivals. The ability of Microsoft and Intel to pressure PC makers for preferential treatment of one kind or another in turn affects competition among rival PC makers.

Several other instances of supplier bargaining power are worth citing. Small-scale retailers must often contend with the power of manufacturers whose products enjoy prestigious and well-respected brand names; the knowledge that a retailer needs to stock the manufacturer’s product because consumers expect to find the product on the shelves of retail stores where they shop gives the manufacturer some degree of pricing power and means that he can also push hard for favourable shelf displays. Motor vehicle manufacturers typically exert considerable power over the terms and conditions with which they supply new vehicles to their independent car dealerships. The operators of franchised units of such chains as McDonald’s, Spar, 7Eleven, and Master Maths must frequently agree not only to source some of their supplies from the franchisor at prices and terms favourable to that franchisor but also to operate their facilities in a manner largely dictated by the franchisor.

Strong supplier bargaining power is a competitive factor in industries where unions have been able to organize the workforces of some industry members but not others; those industry members that must negotiate wages, fringe benefits, and working conditions with powerful unions (which control the supply of labour) often find themselves with higher labour costs than their competitors with non-union labour forces. The bigger the gap between union and non-union labour costs in an industry, the more unionized industry members must scramble to find ways to relieve the competitive pressure associated with their disadvantage on labour costs.

The factors that determine whether any of the suppliers to an industry are in a position to exert substantial bargaining power or leverage are fairly clear-cut:9

- **Whether the item being supplied is a commodity that is readily available from many suppliers at the going market price.** Suppliers have little or no bargaining power or leverage whenever industry members have the ability to source their requirements at competitive prices from any of several alternative and eager suppliers, perhaps dividing their purchases among two or more suppliers to promote lively competition for orders. The suppliers of commodity items have market power only when supplies become quite tight and industry members are so eager to secure what they need that they agree to terms more favourable to suppliers.

- **Whether a few large suppliers are the primary sources of a particular item.** The leading suppliers may well have pricing leverage unless they are plagued with excess capacity and are scrambling to secure additional orders for their products. Major
suppliers with good reputations and strong demand for the items they supply are
darker to wring concessions from than struggling suppliers striving to broaden their
customer base or more fully utilize their production capacity.

- **Whether it is difficult or costly for industry members to switch their purchases from one supplier to another or to switch to attractive substitute inputs.** High switching costs signal strong bargaining power on the part of suppliers, whereas low switching costs and ready availability of good substitute inputs signal weak bargaining power. Soft-drink bottlers, for example, can counter the bargaining power of aluminum can suppliers by shifting or threatening to shift to greater use of plastic containers and introducing more attractive plastic container designs.

- **Whether certain needed inputs are in short supply.** Suppliers of items in short supply have some degree of pricing power, whereas a surge in the availability of particular items greatly weakens supplier pricing power and bargaining leverage.

- **Whether certain suppliers provide a differentiated input that enhances the performance or quality of the industry’s product.** The more valuable a particular input is in terms of enhancing the performance or quality of the products of industry members or of improving the efficiency of their production processes, the more bargaining leverage its suppliers are likely to possess.

- **Whether certain suppliers provide equipment or services that deliver valuable cost-saving efficiencies to industry members in operating their production processes.** Suppliers who provide cost-saving equipment or other valuable or necessary production-related services are likely to possess bargaining leverage. Industry members that do not source from such suppliers may find themselves at a cost disadvantage and thus under competitive pressure to do so (on terms that are favourable to the suppliers).

- **Whether suppliers provide an item that accounts for a sizable fraction of the costs of the industry’s product.** The bigger the cost of a particular part or component, the more opportunity there is for the pattern of competition in the marketplace to be affected by the actions of suppliers to raise or lower their prices.

- **Whether industry members are major customers of suppliers.** As a rule, suppliers have less bargaining leverage when their sales to members of this one industry constitute a big percentage of their total sales. In such cases, the well-being of suppliers is closely tied to the well-being of their major customers. Suppliers then have a big incentive to protect and enhance their customers’ competitiveness via reasonable prices, exceptional quality, and ongoing advances in the technology of the items supplied.

- **Whether it makes good economic sense for industry members to integrate backward and self-manufacture items they have been buying from suppliers.** The make-or-buy issue generally boils down to whether suppliers who specialize in the production of a particular part or component and make them in volume for many different customers have the expertise and scale economies to supply as good or better component at a lower cost than industry members could achieve via self-manufacture. Frequently it is difficult for industry members to self-manufacture parts and components more economically than suppliers who specialize in making such
3.5 What Kinds of Competitive Forces are Industry Members Facing?

items. For instance, most producers of outdoor power equipment (lawn mowers, rotary tillers, leaf blowers, etc.) find it cheaper to source the small engines they need from outside manufacturers who specialize in small-engine manufacture rather than make their own engines, because the quantity of engines they need is too small to justify the investment in manufacturing facilities, mastering the production process, and capturing scale economies. Specialists in small-engine manufacture, by supplying many kinds of engines to the whole power equipment industry, can obtain a big enough sales volume to fully realize scale economies, become proficient in all the manufacturing techniques, and keep costs low. As a rule, suppliers are safe from the threat of self-manufacture by their customers until the volume of parts a customer needs becomes large enough for the customer to justify backward integration into self-manufacture of the component. Suppliers also gain bargaining power when they have the resources and profit incentive to integrate forward into the business of the customers they are supplying and thus become a strong rival.

Figure 3.7 summarizes the conditions that tend to make supplier bargaining power strong or weak.

**FIGURE 3.7 Factors affecting the bargaining power of suppliers**
How Seller–Supplier Partnerships Can Create Competitive Pressures

In more and more industries, sellers are forging strategic partnerships with select suppliers in efforts to (1) reduce inventory and logistics costs (e.g. through just-in-time deliveries), (2) speed the availability of next-generation components, (3) enhance the quality of the parts and components being supplied and reduce defect rates, and (4) squeeze out important cost savings for both themselves and their suppliers. Numerous Internet technology applications are now available that permit real-time data sharing, eliminate paperwork, and produce cost savings all along the supply chain. The many benefits of effective seller–supplier collaboration can translate into competitive advantage for industry members that do the best job of managing supply chain relationships.

US-based Dell Computer has used strategic partnering with key suppliers as a major element in its strategy to be the world’s lowest-cost supplier of branded PCs, servers, and workstations. Because Dell has managed its supply chain relationships in ways that contribute to a low-cost, high-quality competitive edge in components supply, it has put enormous pressure on its PC rivals to try to imitate its supply-chain management practices. Effective partnerships with suppliers on the part of one or more industry members can thus become a major source of competitive pressure for rival companies.

The more opportunities that exist for win–win efforts between a company and its suppliers, the less their relationship is characterized by who has the upper hand in bargaining with the other. Collaborative partnerships between a company and a supplier tend to last so long as the relationship is producing valuable benefits for both parties. Only if a supply partner is falling behind alternative suppliers is a company likely to switch suppliers and incur the costs and trouble of building close working ties with a different supplier.

3.5.5 Competitive Pressures Stemming from Buyer Bargaining Power and Seller–Buyer Collaboration

Whether seller–buyer relationships represent a weak or strong competitive force depends on (1) whether some or many buyers have sufficient bargaining leverage to obtain price concessions and other favourable terms and conditions of sale, and (2) the extent and competitive importance of seller–buyer strategic partnerships in the industry.

How Buyer Bargaining Power Can Create Competitive Pressures

As with suppliers, the leverage that certain types of buyers enjoy in negotiating favourable terms can range from weak to strong. Individual consumers, for example, rarely have much bargaining power in negotiating price concessions or other favourable terms with sellers; the primary exceptions involve situations in which price haggling is customary, such as the purchase of new and used motor vehicles, homes, and certain big-ticket items like luxury watches, jewellery, and pleasure boats. For most consumer goods and services, individual buyers have no bargaining leverage—their option is to pay the seller’s posted price or take their business elsewhere.

In contrast, large retail chains like Pick ’n Pay, Checkers and Spar convenience stores typically have considerable negotiating leverage in purchasing products from manufacturers because of manufacturers’ need for broad retail exposure and the most appealing shelf locations. Retailers may stock two or three competing brands of a product.
but rarely all competing brands, so competition among rival manufacturers for visibility on the shelves of popular multi-store retailers gives such retailers significant bargaining strength. Major supermarket chains like Safeway (US), and Royal Ahold (Netherlands), which provide access to millions of grocery shoppers, have sufficient bargaining power to demand promotional allowances and lump-sum payments (called “sloting fees”) from food products manufacturers in return for stocking certain brands or putting them in the best shelf locations. Motor vehicle manufacturers have strong bargaining power in negotiating to buy original equipment tyres from Goodyear, Michelin, Bridgestone/Firestone, Continental, and Pirelli not only because they buy in large quantities but also because tyre makers believe they gain an advantage in supplying replacement tyres to vehicle owners if their tyre brand is original equipment on the vehicle. “Prestige” buyers have a degree of clout in negotiating with sellers because a seller’s reputation is enhanced by having prestige buyers on its customer list.

Even if buyers do not purchase in large quantities or offer a seller important market exposure or prestige, they gain a degree of bargaining leverage in the following circumstances:10

- **If buyers’ costs of switching to competing brands or substitutes are relatively low.** Buyers who can readily switch brands or source from several sellers have more negotiating leverage than buyers who have high switching costs. When the products of rival sellers are virtually identical, it is relatively easy for buyers to switch from seller to seller at little or no cost and anxious sellers may be willing to make concessions to win or retain a buyer’s business.

- **If the number of buyers is small or if a customer is particularly important to a seller.** The smaller the number of buyers, the less easy it is for sellers to find alternative buyers when a customer is lost to a competitor. The prospect of losing a customer not easily replaced often makes a seller more willing to grant concessions of one kind or another.

- **If buyer demand is weak and sellers are scrambling to secure additional sales of their products.** Weak or declining demand creates a “buyer’s market”; conversely, strong or rapidly growing demand creates a “seller’s market” and shifts bargaining power to sellers.

- **If buyers are well-informed about sellers’ products, prices, and costs.** The more information buyers have, the better bargaining position they are in. The mushrooming availability of product information on the Internet is giving added bargaining power to individuals. Buyers can easily use the Internet to compare prices and features of holiday packages, shop for the best interest rates on mortgages and loans, and find the best prices on items such as digital cameras. Bargain-hunting individuals can shop around for the best deal on the Internet and use that information to negotiate a better deal from local retailers; this method is becoming commonplace in buying new and used motor vehicles. Furthermore, the Internet has created opportunities for manufacturers, wholesalers, retailers, and sometimes individuals to join online buying groups to pool their purchasing power and approach vendors for better terms than could be obtained individually. A multinational manufacturer’s geographically scattered purchasing groups can use Internet technology to pool their orders with parts and components suppliers and bargain for volume discounts. Purchasing agents
at some companies are banding together at third-party websites to pool corporate purchases to get better deals or special treatment.

- **If buyers pose a credible threat of integrating backward into the business of sellers.** Companies like SABMiller and Heinz have integrated backward into facilitating transport and metal-can manufacturing in order to gain bargaining power in obtaining the balance of their can requirements from otherwise powerful metal-can manufacturers. Retailers gain bargaining power by stocking and promoting their own private-label brands alongside manufacturers’ name brands.

- **If buyers have discretion in whether and when they purchase the product.** Many consumers, if they are unhappy with the present deals offered on major appliances or hot tubs or home entertainment centres, may be in a position to delay purchase until prices and financing terms improve. If business customers are not happy with the prices or security features of bill-payment software systems, they can either delay purchase until next-generation products become available or attempt to develop their own software in-house. If university students believe that the prices of new textbooks are too high, they can purchase used copies.

Figure 3.8 highlights the factors causing buyer bargaining power to be strong or weak.

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**FIGURE 3.8 Factors affecting the bargaining power of buyers**

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Buyer bargaining power is stronger when:
- Buyer switching costs to competing brands or substitute products are low
- Buyers are large and can demand concessions when purchasing large quantities
- Large-volume purchases by buyers are important to sellers
- Buyer demand is weak or declining
- There are only a few buyers—so that each one’s business is important to sellers
- Identity of buyer adds prestige to the seller’s list of customers
- Quantity and quality of information available to buyers improves
- Buyers have the ability to postpone purchases until later if they do not like the present deals being offered by the sellers
- Some buyers are a threat to integrate backward into the business of sellers and become an important competitor

Buyer bargaining power is weaker when:
- Buyers purchase the item infrequently or in small quantities
- Buyer switching costs to competing brands are high
- There is a surge in buyer demand that creates a “seller’s market”
- A seller’s brand reputation is important to a buyer
- A particular seller’s product delivers quality or performance that is very important to buyer and that is not matched in other brands
- Buyer collaboration or partnering with selected sellers provides attractive win–win opportunities
A final point to keep in mind is that not all buyers of an industry’s product have equal degrees of bargaining power with sellers, and some may be less sensitive than others to price, quality, or service differences. For example, independent tyre retailers have less bargaining power in purchasing tyres than Honda, Ford, and Toyota (which buy in much larger quantities), and they are also less sensitive to quality. Motor vehicle manufacturers are very particular about tyre quality and tyre performance because of the effects on vehicle performance, and they drive a hard bargain with tyre manufacturers on both price and quality.

**How Seller–Buyer Partnerships Can Create Competitive Pressures**

Partnerships between sellers and buyers are an increasingly important element of the competitive picture in *business-to-business relationships* (as opposed to business-to-consumer relationships). Many sellers that provide items to business customers have found it in their mutual interest to collaborate closely on such matters as just-in-time deliveries, order processing, electronic invoice payments, and data sharing. Wal-Mart (the global US retailer) provides the manufacturers with which it does business (like Procter & Gamble) with daily sales at each of its stores so that the manufacturers can maintain sufficient inventories at Wal-Mart’s distribution centres to keep the shelves at each Wal-Mart store amply stocked. Another US company (Dell Computer) has entered into partnerships with its largest PC customers to create online systems for over 50,000 corporate customers, providing their employees with information on approved product configurations, global pricing, paperless purchase orders, real-time order tracking, invoicing, purchasing history, and other efficiency tools. Dell loads a customer’s software at the factory and installs asset tags so that customer set-up time is minimal; it also helps customers upgrade their PC systems to next-generation hardware and software. Dell’s partnerships with its corporate customers have put significant competitive pressure on other PC makers.

**3.5.6 Is the Collective Strength of the Five Competitive Forces Conducive to Good Profitability?**

Scrutinizing each of the five competitive forces one by one provides a powerful diagnosis of what competition is like in a given market. Once the strategist has gained an understanding of the specific competitive pressures comprising each force and determined whether these pressures constitute a strong, moderate, or weak competitive force, the next step is to evaluate the collective strength of the five forces and determine whether the state of competition is conducive to good profitability. Is the collective impact of the five competitive forces stronger than “normal”? Are some of the competitive forces sufficiently strong to undermine industry profitability? Can companies in this industry reasonably expect to earn decent profits in light of the prevailing competitive forces?

**Is the Industry Competitively Attractive or Unattractive?**

As a rule, the stronger the collective impact of the five competitive forces, the lower the combined profitability of industry participants. The most extreme case of a competitively unattractive industry is when all five forces are producing strong competitive pressures: rivalry among sellers is vigorous, low entry barriers allow new rivals to gain a market foothold, competition from substitutes is intense, and both suppliers and customers are
able to exercise considerable bargaining leverage. Fierce to strong competitive pressures coming from all five directions nearly always drive industry profitability to unacceptably low levels, frequently producing losses for many industry members and forcing some out of business. Nevertheless, an industry can be competitively unattractive even when not all five competitive forces are strong. Intense competitive pressures from just two or three of the five forces may suffice to destroy the conditions for good profitability and prompt some companies to exit the business. The manufacture of disk drives, for example, is brutally competitive: IBM recently announced the sale of its disk drive business to Hitachi, taking a loss of over $2 billion on its exit from the business. Especially intense competitive conditions seem to be the norm in tyre manufacturing and apparel, two industries where profit margins have historically been thin.

**CORE CONCEPT:** The stronger the forces of competition, the harder it becomes for industry members to earn attractive profits.

In contrast, when the collective impact of the five competitive forces is moderate to weak, an industry is competitively attractive in the sense that industry members can reasonably expect to earn good profits and a nice return on investment. The ideal competitive environment for earning superior profits is one in which both suppliers and customers are in weak bargaining positions, there are no good substitutes, high barriers block further entry, and rivalry among present sellers generates only moderate competitive pressures. Weak competition is the best of all possible worlds for also-ran companies because even they can usually eke out a decent profit—if a company can’t make a decent profit when competition is weak, then its business outlook is indeed grim.

In most industries, the collective strength of the five competitive forces is somewhere near the middle of the two extremes of very intense and very weak, typically ranging from slightly stronger than normal to slightly weaker than normal and typically allowing well-managed companies with sound strategies to earn attractive profits.

**Matching Company Strategy to Competitive Conditions**

Working through the five-forces model step by step not only aids strategy makers in assessing whether the intensity of competition allows good profitability but also promotes sound strategic thinking about how better to match company strategy to the specific competitive character of the marketplace. Effectively matching a company’s strategy to prevailing competitive conditions has two aspects:

1. Pursuing avenues that shield the firm from as many of the different competitive pressures as possible.
2. Initiating actions calculated to produce sustainable competitive advantage, thereby shifting competition in the company’s favour, putting added competitive pressure on rivals, and perhaps even defining the business model for the industry.

Making headway on these two fronts, however, first requires identifying competitive pressures, gauging the relative strength of each of the five competitive forces, and gaining
3.6 What Factors are Driving Industry Change and What Impacts Will They Have?

An industry’s present conditions do not necessarily reveal much about the strategically relevant ways in which the industry environment is changing. All industries are characterized by trends and new developments that gradually or speedily produce changes important enough to require a strategic response from participating companies. A popular hypothesis states that industries go through a life cycle of take-off, rapid growth, early maturity and slowing growth, market saturation, and stagnation or decline. This hypothesis helps explain industry change—but it is far from complete. There are more causes of industry change than an industry’s normal progression through the life cycle—these need to be identified and their impacts understood.

3.6.1 The Concept of Driving Forces

While it is important to track where an industry is in the life cycle, there is more analytical value in identifying the other factors that may be even stronger drivers of industry and competitive change. The point to be made here is that industry and competitive conditions change because forces are enticing or pressuring certain industry participants (competitors, customers, suppliers) to alter their actions in important ways. The most powerful of the change agents are called driving forces because they have the biggest influences in reshaping the industry landscape and altering competitive conditions. Some driving forces originate in the outer ring of the company’s macroenvironment (see Fig. 3.2), but most originate in the company’s more immediate industry and competitive environment.

Driving-forces analysis has three steps: (1) identifying what the driving forces are; (2) assessing whether the drivers of change are, on the whole, acting to make the industry more or less attractive; and (3) determining what strategy changes are needed to prepare for the impacts of the driving forces. All three steps merit further discussion.
3.6.2 Identifying an Industry’s Driving Forces

Many developments can affect an industry powerfully enough to qualify as driving forces. Some drivers of change are unique and specific to a particular industry situation, but most drivers of industry and competitive change fall into one of the following categories:13

- **Emerging new Internet capabilities and applications.** Since the late 1990s, the Internet has woven its way into everyday business operations and the social fabric of life all across the world. Mushroming Internet use, growing acceptance of Internet shopping, the emergence of high-speed Internet service and Voice over Internet Protocol (VoIP) technology, and an ever-growing series of Internet applications and capabilities have been major drivers of change in industry after industry. Companies are increasingly using online technology (1) to collaborate closely with suppliers and streamline their supply chains, and (2) to revamp internal operations and squeeze out cost savings. Manufacturers can use their websites to access customers directly rather than distribute exclusively through traditional wholesale and retail channels. Businesses of all types can use Web stores to extend their geographic reach and vie for sales in areas where they formerly did not have a presence. The ability of companies to reach consumers via the Internet increases the number of rivals a company faces and often escalates rivalry by pitting pure online sellers against combination brick-and-click sellers against pure brick-and-mortar sellers. The Internet gives buyers unprecedented ability to research the product offerings of competitors and shop the market for the best value. The mounting ability of consumers to download music from the Internet via either file sharing or online music retailers has profoundly reshaped the music industry and the business of traditional brick-and-mortar music retailers. Widespread use of e-mail has forever eroded the business of providing fax services and the first-class mail delivery revenues of government postal services worldwide. Videoconferencing via the Internet can erode the demand for business travel. Online course offerings at universities have the potential to revolutionize higher education. The Internet of the future will feature faster speeds, dazzling applications, and over a billion connected gadgets performing an array of functions, thus driving further industry and competitive changes. But Internet-related impacts vary from industry to industry. The challenges here are to assess precisely how emerging Internet developments are altering a particular industry’s landscape and to factor these impacts into the strategy-making equation.

- **Increasing globalization.** Competition begins to shift from what is primarily a regional or national focus to an international or global focus when industry members begin seeking out customers in foreign markets or when production activities begin to migrate to countries where costs are lowest. Globalization of competition really starts to take hold when one or more ambitious companies precipitates a race for worldwide market leadership by launching initiatives to expand into more and more country markets. Globalization can also be precipitated by the growth of consumer demand in more and more countries and by the actions of government officials in many countries to reduce trade barriers or open up once-closed markets to foreign competitors, as is occurring in many parts of Europe, Latin America, and Asia. Significant differences in labour costs among countries give manufacturers a strong
incentive to locate plants for labour-intensive products in low-wage countries and use these plants to supply market demand across the world. Wages in South Africa, China, India, Singapore, Mexico, and Brazil, for example, are about one-fourth those in the United States, Germany, and Japan. The forces of globalization are sometimes such a strong driver that companies find it highly advantageous, if not necessary, to spread their operating reach into more and more country markets. Globalization is very much a driver of industry change in such industries as credit cards, cell phones, digital cameras, golf and ski equipment, motor vehicles, steel, petroleum, personal computers, video games, public accounting, and textbook publishing.

- Changes in an industry’s long-term growth rate. Shifts in industry growth up or down are a driving force for industry change, affecting the balance between industry supply and buyer demand, entry and exit, and the character and strength of competition. An upsurge in buyer demand triggers a race among established companies and newcomers to capture the new sales opportunities; ambitious companies with trailing market shares may see the upturn in demand as a golden opportunity to launch offensive strategies to broaden their customer base and move up several notches in the industry standings. A slowdown in the rate at which demand is growing nearly always portends mounting rivalry and increased efforts by some companies to maintain their high rates of growth by taking sales and market share away from rivals. If industry sales suddenly turn flat or begin to shrink after years of rising at double-digit levels, competition is certain to intensify as industry members scramble for the available business and as mergers and acquisitions result in industry consolidation to a smaller number of competitively stronger participants. Stagnating sales usually prompt both competitively weak and growth-oriented companies to sell their business operations to those industry members who elect to stick it out; as demand for the industry’s product continues to shrink, the remaining industry members may be forced to close inefficient plants and retrench to a smaller production base—all of which results in a much-changed competitive landscape.

- Changes in who buys the product and how they use it. Shifts in buyer demographics and new ways of using the product can alter the state of competition by opening the way to market an industry’s product through a different mix of dealers and retail outlets; prompting producers to broaden or narrow their product lines; bringing different sales and promotion approaches into play; and forcing adjustments in customer service offerings (credit, technical assistance, maintenance, and repair). The mushrooming popularity of downloading music from the Internet, storing music files on PC hard drives, and burning custom discs has forced recording companies to re-examine their distribution strategies and raised questions about the future of traditional retail music stores; at the same time, it has stimulated sales of disc burners and blank discs. Longer life expectancies and growing percentages of relatively well-to-do retirees are driving changes in such industries as healthcare, prescription drugs, recreational living, and vacation travel. The growing percentage of households with PCs and Internet access is opening opportunities for banks to expand their electronic bill-payment services and for retailers to move more of their customer services online.
Product innovation. Competition in an industry is always affected by rivals racing to be first to introduce one new product or product enhancement after another. An ongoing stream of product innovations tends to alter the pattern of competition in an industry by attracting more first-time buyers, rejuvenating industry growth, and/or creating wider or narrower product differentiation among rival sellers. Successful new product introductions strengthen the market positions of the innovating companies, usually at the expense of companies that stick with their old products or are slow to follow with their own versions of the new product. Product innovation has been a key driving force in such industries as digital cameras, golf clubs, video games, toys, and prescription drugs.

Technological change and manufacturing process innovation. Advances in technology can dramatically alter an industry’s landscape, making it possible to produce new and better products at lower cost and opening up whole new industry frontiers. For instance, Voice over Internet Protocol (VoIP) technology has spawned low-cost, Internet-based phone networks that are stealing large numbers of customers away from traditional telephone companies worldwide (whose higher-cost technology depends on hardwired connections via overhead and underground telephone lines). Flat-screen technology for PC monitors is killing the demand for conventional cathode-ray tube (CRT) monitors. Liquid crystal display (LCD), plasma screen technology, and high-definition and 3-D technology are precipitating a revolution in the television industry and driving use of cathode-ray technology (CRT) into the background. MP3 technology is transforming how people listen to music. Digital technology is driving huge changes in the camera and film industries. Satellite radio technology is allowing satellite radio companies with their largely commercial-free programming to draw millions of listeners away from traditional radio stations whose revenue streams from commercials are dependent on audience size. Technological developments can also produce competitively significant changes in capital requirements, minimum efficient plant sizes, distribution channels and logistics, and learning/experience curve effects. In the steel industry ongoing advances in electric arc minimill technology (which involve recycling scrap steel to make new products) have allowed steelmakers with state-of-the-art minimills to gradually expand into the production of more and more steel products, steadily taking sales and market share from higher-cost integrated producers (which make steel from scratch using iron ore, coke, and traditional blast furnace technology). Nucor Corporation, the leader of the minimill technology revolution in the United States, began operations in 1970 and has ridden the wave of technological advances in minimill technology to become the biggest US steel producer (as of 2004) and to rank among the lowest-cost producers in the world. In a space of 30 years, advances in minimill technology have changed the face of the steel industry worldwide.

Marketing innovation. When companies are successful in introducing new ways to market their products, they can spark a burst of buyer interest, widen industry demand, increase product differentiation, and lower unit costs—any or all of which can alter the competitive positions of rival companies and force strategy revisions. Online marketing is shaking up competition in electronics (where there are dozens of online electronics retailers, often with deep-discount prices) and office supplies
(where small businesses are using their websites to market office supplies to big corporates, other small businesses, schools and universities, and government agencies). Increasing numbers of music artists are marketing their recordings at their own websites rather than entering into contracts with recording studios that distribute through online and brick-and-mortar music retailers.

- **Entry or exit of major companies.** The entry of one or more foreign companies into a geographic market once dominated by domestic companies nearly always shakes up competitive conditions. Likewise, when an established domestic firm from another industry attempts entry either by acquisition or by launching its own start-up venture, it usually applies its skills and resources in some innovative fashion that pushes competition in new directions. Entry by a major firm thus often produces a new ball game, not only with new key players but also with new rules for competing. Similarly, exit of a major firm changes the competitive structure by reducing the number of market leaders (perhaps increasing the dominance of the leaders who remain) and causing a rush to capture the exiting firm’s customers.

- **Diffusion of technical know-how across more companies and more countries.** As knowledge about how to perform a particular activity or execute a particular manufacturing technology spreads, the competitive advantage held by companies originally possessing this know-how erodes. Knowledge diffusion can occur through scientific journals, trade publications, on-site plant tours, word of mouth among suppliers and customers, employee migration, and Internet sources. It can also occur when those possessing technological knowledge license others to use that knowledge for a royalty fee or team up with a company interested in turning the technology into a new business venture. Quite often, technological know-how can be acquired by simply buying a company that has the wanted skills, patents, or manufacturing capabilities. In recent years, **rapid technology transfer across national boundaries has been a prime factor in causing industries to become more globally competitive.** As companies worldwide gain access to valuable technical know-how, they upgrade their manufacturing capabilities in a long-term effort to compete head-on with established companies. Cross-border technology transfer has made the once domestic industries of automobiles, tyres, consumer electronics, telecommunications, computers, and others increasingly global.

- **Changes in cost and efficiency.** Widening or shrinking differences in the costs among key competitors tend to dramatically alter the state of competition. The low cost of fax and e-mail transmission has put mounting competitive pressure on the relatively inefficient and high-cost operations of the postal services in South Africa and all over the world—sending a one-page fax is cheaper and far quicker than sending a first-class letter; sending e-mail is faster and cheaper still. In the steel industry, the lower costs of companies using electric-arc furnaces to recycle scrap steel into new steel products has forced traditional manufacturers that produce steel from iron ore using blast furnace technology to overhaul their plants and to withdraw totally from making those steel products where they could no longer be cost competitive. Shrinking cost differences in producing multi-featured mobile phones is turning the mobile phone market into a commodity business and causing more buyers to base their purchase decisions on price.
Growing buyer preferences for differentiated products instead of a commodity product (or for a more standardized product instead of strongly differentiated products). When buyer tastes and preferences start to diverge, sellers can win a loyal following with product offerings that stand apart from those of rival sellers. In recent years, beer drinkers have grown less loyal to a single brand and have begun to drink a variety of domestic and foreign beers; as a consequence, beer manufacturers have introduced a host of new brands and malt beverages with different tastes and flavours. Buyer preferences for motor vehicles are becoming increasingly diverse, with few models generating sales of more than 250,000 units annually. When a shift from standardized to differentiated products occurs, the driver of change is the contest among rivals to cleverly out-differentiate one another.

However, buyers sometimes decide that a standardized, budget-priced product suits their requirements as well as or better than a premium-priced product with lots of snappy features and personalized services. Online brokers, for example, have used the lure of cheap commissions to attract many investors willing to place their own buy–sell orders via the Internet; growing acceptance of online trading has put significant competitive pressures on full-service brokers whose business model has always revolved around convincing clients of the value of asking for personalized advice from professional brokers and paying their high commission fees to make trades. Pronounced shifts toward greater product standardization usually spawn lively price competition and force rival sellers to drive down their costs to maintain profitability. The lesson here is that competition is driven partly by whether the market forces in motion are acting to increase or decrease product differentiation.

Reductions in uncertainty and business risk. An emerging industry is typically characterized by much uncertainty over potential market size, how much time and money will be needed to surmount technological problems, and what distribution channels and buyer segments to emphasize. Emerging industries tend to attract only risk-taking entrepreneurial companies. Over time, however, if the business model of industry pioneers proves profitable and market demand for the product appears durable, more conservative companies are usually enticed to enter the market. Often, these later entrants are large, financially strong companies looking to invest in attractive growth industries. Lower business risks and less industry uncertainty also affect competition in international markets. In the early stages of a company’s entry into foreign markets, conservatism prevails and companies limit their downside exposure by using less risky strategies like exporting, licensing, joint marketing agreements, or joint ventures with local companies to accomplish entry. Then, as experience accumulates and perceived risk levels decline, companies move more boldly and more independently, making acquisitions, constructing their own plants, putting in their own sales and marketing capabilities to build strong competitive positions in each country market, and beginning to link the strategies in each country to create a more globalized strategy.

Regulatory influences and government policy changes. Government regulatory actions can often force significant changes in industry practices and strategic approaches. Deregulation has proved to be a potent pro-competitive force in the
3.6 What Factors are Driving Industry Change and What Impacts Will They Have?

airline, banking, natural gas, telecommunications, and electric utility industries. Government efforts to reform medical care and health insurance have become potent driving forces in the healthcare industry. In international markets host governments can drive competitive changes by opening their domestic markets to foreign participation or closing them to protect domestic companies. Note that this driving force is spawned by forces in a company’s macroenvironment.

- **Changing societal concerns, attitudes, and lifestyles.** Emerging social issues and changing attitudes and lifestyles can be powerful instigators of industry change. Growing anti-smoking sentiment has emerged as a major driver of change in the tobacco industry; concerns about terrorism are having a big impact on the travel industry. Consumer concerns about salt, sugar, chemical additives, saturated fat, cholesterol, carbohydrates, and nutritional value have forced food producers to revamp food-processing techniques, redirect R&D efforts into the use of healthier ingredients, and compete in developing nutritious, good-tasting products. Safety concerns have driven product design changes in the car, toy, and outdoor power equipment industries, to mention a few. Increased interest in physical fitness has spawned new industries in exercise equipment, biking, outdoor apparel, sports gyms and recreation centres, vitamin and nutrition supplements, and medically supervised diet programmes. Social concerns about air and water pollution have forced industries to incorporate expenditures for controlling pollution into their cost structures. Shifting societal concerns, attitudes, and lifestyles alter the pattern of competition, usually favouring those players that respond quickly and creatively with products targeted to the new trends and conditions. As with the preceding driving force, this driving force springs from factors at work in a company’s macroenvironment.

Table 3.2 lists these 14 most common driving forces.

| 1 | Emerging new Internet capabilities and applications |
| 2 | Increasing globalization |
| 3 | Changes in an industry’s long-term growth rate |
| 4 | Changes in who buys the product and how they use it |
| 5 | Product innovation |
| 6 | Technological change and manufacturing process innovation |
| 7 | Marketing innovation |
| 8 | Entry or exit of major companies |
| 9 | Diffusion of technical know-how across more companies and more countries |
| 10 | Changes in cost and efficiency |
| 11 | Growing buyer preferences for differentiated products instead of a commodity product (or for a more standardized product instead of strongly differentiated products) |
| 12 | Reductions in uncertainty and business risk |
| 13 | Regulatory influences and government policy changes like Black Economic Empowerment and Employment Equity |
| 14 | Changing societal concerns, attitudes, and lifestyles |

**TABLE 3.2 The most common driving forces**
That there are so many different potential driving forces explains why it is too simplistic to view industry change only in terms of moving through the different stages in an industry’s life cycle and why a full understanding of all types of change drivers is a fundamental part of industry analysis. However, while many forces of change may be at work in a given industry, no more than three or four are likely to be true driving forces powerful enough to qualify as the major determinants of why and how the industry is changing. Thus, company strategists must resist the temptation to label every change they see as a driving force; the analytical task is to evaluate the forces of industry and competitive change carefully enough to separate major factors from minor ones.

South African issues that are particular strategic from a government policy-intervention point are broad-based Black Economic Empowerment (BEE) and Employment Equity (EE) or affirmative action. The BEE legislation defines this intervention as the economic empowerment of all black people including women, workers, youth, people with disabilities, and people living in rural areas, through diverse but integrated socio-economic strategies. Illustration Capsule 3.2 explains how SABMiller dealt with this issue.

Illustration Capsule 3.2: SABMiller’s BEE Deal Shuns the Fashionable Recipients

SABMILLER’s black economic empowerment deal announced yesterday follows the pattern of recent broad-based deals, but deviates in some crucial respects.

The deal follows the broad parameters by being focused on the retail portion of the company’s downstream supply chain and employees, with a smaller “worthy causes” portion added on, thereby shunning high-profile politicians and former politicians who were once the fashionable recipients of BEE largesse. MD of SABMiller SA, Norman Adami, makes a point of underlining this issue, stressing the “truly broad-based and tangible benefits” that will flow from the deal.

The deal implicitly rejects the notion that BEE is partly meant to create a class of patriotic business leaders. In fact, the leaders or trustees of the different entities created by the R6 billion deal were not even named at the function yesterday. The deal is different as it is internally funded and so not reliant on bank funding, which would be a sensitive issue in this credit-challenged environment.

SABMiller Group CEO Graham Mackay underlines this, saying it “places no reliance on external bank funding, and requires only a relatively small, and hence affordable, cash investment from retail participants”. In effect, the deal is vendor-financed, but surely this would result in a big hit on the company’s income statement? SABMiller argues this is not the case.

The deal will have no effect on earnings next year, although 2011 earnings will be affected. The “economic cost” will be 220 million in total. The actual cost will be between 1 per cent and 3 per cent of earnings, taken mainly in 2011.

How is this miracle of financial engineering—a US $750 million (R5.8 billion) deal which costs only US $220 million (R1.7 billion)—achieved? Through time, luck and
3.6 What Factors are Driving Industry Change and What Impacts Will They Have?

dividends. About 30 per cent of the value of the deal will ultimately derive from a solid flow of dividends, a peculiar advantage of large, mature and cash-generating companies. The company has been specific that it is a share-price-sensitive deal, hence much of the upside, it is hoped, will derive from an increase in the share price. In this sense, it is well timed, initiated while markets are depressed. The other unusual aspect of the deal is the role management hopes it will play in developing and solidifying the supply chain.

Not only will liquor retailers participate, but also “applicants or legal entities who can provide evidence that a liquor licence application has been lodged”. In other words, if shebeen owners get their act together, they participate too. There is a slight question mark over whether structuring your BEE deal in this way constitutes anti-competitive behaviour. By including retailers in their deal, SABMiller does not exclude others from doing the same.

But does the warm and fuzzy feeling retailers will get from being invested in the company effectively reduce the likelihood they will stock competitors’ products? Hard to say, but it’s a borderline issue.

Overall, the local company will get about 60 000 new shareholders, 95 per cent of whom will be blacks or black majority-owned enterprises, helping to spread and solidify relationships with the company. The local company is a “level five” contributor to broad-based empowerment.


Most forward-looking companies in South Africa are committed to introducing EE into the workplace in such a way as to create an environment in which individuals of ability and application can develop rewarding careers at all levels, regardless of their background, race, or gender. Illustration Capsule 3.3 is a practical example of how the global mining company De Beers is busy implementing their EE policy in South Africa.

Illustration Capsule 3.3: Harnessing-and-Developing-Talent

There is a close link between driving improved business performance and attracting, recruiting, developing and retaining talented people.

Talent management also contributes to empowerment by providing employees with skills that benefit them directly, that benefit the family of companies and that build the skills base of our host countries. It enables us to better serve and reflect the markets and producer countries within which we operate. We also promote a culture that respects and harnesses the richness of different ideas, cultures and viewpoints as a key ingredient in the long-term success of our business.

Talent Management

Our Talent Management Policy supports the recruitment, development, succession and retention of talent across the family of companies. It requires that we develop and implement a common talent management approach.
This common approach includes shared information and standardized processes to enable talent succession and deployment across the family of companies. It also enables us to systematically map individual skills against business requirements and understand our current talent bench strength. This allows us to determine and address capability gaps and promote career management and development. The Talent Management Policy mandates the appointment of the best-qualified internal or external candidates in line with job requirements and national legislation relating to employment equity. It also ensures employee performance is gauged against a defined set of key performance indicators, through regular dialogue and feedback.

The percentage of employees receiving regular performance and career development reviews is monitored across most grades. This includes Patterson grades CL to EU. We also monitor the training provided to all employees by category of employment. A talent management scorecard is in place and is used to track and ensure high potential employees have appropriate access to development opportunities. The scorecard also enables effective succession planning and coverage. We also monitor the internal fill rate, vacancies, regretted losses and diversity indicators. The latter are legal requirement as part of the South African broad-based Black Economic Empowerment (BEE) legislation.

Talent management is formally assessed and reported on across the family of companies through our annual Organisation and Capability Reviews. This enables us to ensure appropriate people with the appropriate skills are focused on activities that deliver value for the organization now and into the future.

**Professional Development**

All of our operations have internal courses to assist employees in their personal development, enable them to be more productive and improve their contribution to business goals. These include mentoring and coaching systems, e-learning, part-time and full-time training courses. We believe in the underlying philosophy of life-long learning.

**Equity in Development Opportunities**

This strong focus on skills development is also supported by legislation such as the South African Employment Equity Act 1998 and broad-based BEE Act 2003. De Beers Consolidated Mines has a well-established bursary scheme that more than delivers on these expectations. Additional learning interventions are available to fast track Historically Disadvantaged South Africans (HDSAs) and designated groups. This includes the Women in Mining Programme, which is facilitated by the DME through the Da Vinci Institute of Technology.

This commitment is most evident in the establishment of the Lesedi Centre for Human Capital Development in Kimberley, South Africa. Lesedi focuses on developing technical and non-technical skills for DBCM, its partners and the broader Northern Cape community. Employees who are affected by any down-scaling, retrenchment or redundancy also have access to employment agencies sourced by the company in order to find alternative employment. Lower-skilled employees often have the option of one year of paid training. Significant programmes are in place at Kimberley and other operations nearing “end of production” to provide training to employees in anticipation of mine closure.

Another driving force of change is regulatory influences. As far as the healthcare industry in South Africa is concerned, the state is in the position that private enterprise cream the top and the state has to provide for a growing number that cannot afford basic care. At present the state is putting in tremendous effort to increase the number of private individuals able to get treatment in state facilities. There is already a restriction on the issue of licences for new private medical care facilities in most provinces. The regulatory restrictions may in future be extended.

3.6.3 Assessing the Impact of the Driving Forces

Simply identifying the driving forces is not sufficient, however. The second, and more important, step in driving-forces analysis is to determine whether the prevailing driving forces are, on the whole, acting to make the industry environment more or less attractive. Answers to three questions are needed here:

1. Are the driving forces collectively acting to cause demand for the industry’s product to increase or decrease?
2. Are the driving forces acting to make competition more or less intense?
3. Will the combined impacts of the driving forces lead to higher or lower industry profitability?

Getting a grasp of the collective impact of the driving forces usually requires looking at the likely effects of each force separately, since the driving forces may not all be pushing change in the same direction. For example, two driving forces may be acting to spur demand for the industry’s product while one driving force may be working to curtail demand. Whether the net effect on industry demand is up or down hinges on which driving forces are the more powerful. The analyst’s objective here is to get a good grip on what external factors are shaping industry change and what difference these factors will make.

CORE CONCEPT: An 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.

3.6.4 Developing a Strategy That Takes the Impacts of the Driving Forces into Account

The third step of driving-forces analysis—where the real pay-off for strategy making comes—is for managers to draw some conclusions about what strategy adjustments will be needed to deal with the impacts of the driving forces. The real value of doing driving-forces analysis is to gain better understanding of what strategy adjustments will be needed to cope with the drivers of industry change and the impacts they are likely to have on market demand, competitive intensity, and industry profitability. In short, the strategy-making challenge that flows from driving-forces analysis is what to do to prepare for the industry and competitive changes being wrought by the driving forces. Indeed, without understanding the forces driving industry change and the impacts these forces will have on the character of the industry environment and on the company’s business over the
next one to three years, managers are ill-prepared to craft a strategy tightly matched to emerging conditions. Similarly, if managers are uncertain about the implications of one or more driving forces, or if their views are incomplete or off target, it will be difficult for them to craft a strategy that is responsive to the driving forces and their consequences for the industry. So, driving-forces analysis is not something to take lightly; it has practical value and is basic to the task of thinking strategically about where the industry is headed and how to prepare for the changes ahead.

**CORE CONCEPT:** The real benefit of driving-forces analysis is to help managers understand what strategy changes are needed to prepare for the impacts of the driving forces and when done properly, pushes company managers to think about what’s around the corner and what the company needs to be doing to get ready for it.

### 3.7 What Market Positions Do Rivals Occupy—Who is Strongly Positioned and Who is Not?

Since competing companies commonly sell in different price/quality ranges, emphasize different distribution channels, incorporate product features that appeal to different types of buyers, have different geographic coverage, and so on, it stands to reason that some companies enjoy stronger or more attractive market positions than other companies. Understanding which companies are strongly positioned and which weakly is an integral part of analysing an industry’s competitive structure. The best technique for revealing the market positions of industry competitors is **strategic group mapping.** This analytical tool is useful for comparing the market positions of each firm separately or for grouping them into like positions when an industry has so many competitors that it is not practical to examine each one in depth.

**CORE CONCEPT:** Strategic group mapping is a technique for displaying the different market or competitive positions that rival companies occupy in the industry.

### 3.7.1 Using Strategic Group Maps to Assess the Market Positions of Key Competitors

A **strategic group** consists of those industry members with similar competitive approaches and positions in the market. Companies in the same strategic group can resemble one another in any of several ways: they may have comparable product-line breadth, sell in the same price/quality range, emphasize the same distribution channels, use essentially the same product attributes to appeal to similar types of buyers, depend on identical technological approaches, or offer buyers similar services and technical assistance. An industry contains only one strategic group when all sellers pursue essentially identical strategies and have comparable market positions. At the other extreme, an industry may contain as many strategic groups as there are competitors when each rival pursues a distinctively different competitive approach and occupies a substantially different market position.
CORE CONCEPT: A **strategic group** is a cluster of industry rivals that have similar competitive approaches and market positions.

The procedure for constructing a **strategic group map** is straightforward:

- Identify the competitive characteristics that differentiate companies in the industry. Typical variables are price/quality range (high, medium, low); geographic coverage (local, regional, national, global); degree of vertical integration (none, partial, full); product-line breadth (wide, narrow); use of distribution channels (one, some, all); and degree of service offered (no-frills, limited, full).
- Plot the companies on a two-variable map using pairs of these differentiating characteristics.
- Assign companies that fall in about the same strategy space to the same strategic group.
- Draw circles around each strategic group, making the circles proportional to the size of the group’s share of total industry sales revenues.

This produces a two-dimensional diagram like the one for the US retailing industry in Figure 3.9.

**FIGURE 3.9** Comparative market positions of selected retail chains: a strategic group map application

*Note: Circles are drawn roughly proportional to the sizes of the chains, based on revenues.*
Several guidelines need to be observed in mapping the positions of strategic groups in the industry’s overall strategy space. First, the two variables selected as axes for the map should not be highly correlated; if they are, the circles on the map will fall along a diagonal and strategy makers will learn nothing more about the relative positions of competitors than they would by considering just one of the variables. For instance, if companies with broad product lines use multiple distribution channels, while companies with narrow lines use a single distribution channel, then looking at broad versus narrow product lines reveals just as much about who is positioned where as looking at single versus multiple distribution channels: that is, one of the variables is redundant. Second, the variables chosen as axes for the map should expose big differences in how rivals position themselves to compete in the marketplace. This, of course, means analysts must identify the characteristics that differentiate rival companies and use these differences as variables for the axes and as the basis for deciding which firm belongs in which strategic group. Third, the variables used as axes do not have to be either quantitative or continuous; rather, they can be discrete variables or defined in terms of distinct classes and combinations. Fourth, drawing the sizes of the circles on the map proportional to the combined sales of the companies in each strategic group allows the map to reflect the relative sizes of each strategic group. Fifth, if more than two good competitive variables can be used as axes for the map, several maps can be drawn to give different exposures to the competitive positioning relationships present in the industry’s structure.

Because there is not necessarily one best map for portraying how competing companies are positioned in the market, it is advisable to experiment with different pairs of competitive variables. If we take number of aircraft and average number of flights daily for the airline industry in South Africa, it produces a two-dimensional diagram like the one in Figure 3.10.

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**FIGURE 3.10** Comparative market positions of selected airline rivals in South Africa: a strategic group map application

3.7 What Market Positions Do Rivals Occupy—Who is Strongly Positioned and Who is Not?

3.7.2 What Can Be Learned from Strategic Group Maps?

Strategic group maps are revealing in several respects. The most important has to do with which rivals are similarly positioned and are thus close rivals, and which are distant rivals. Generally speaking, the closer strategic groups are to each other on the map, the stronger the cross-group competitive rivalry tends to be. Although companies in the same strategic group are the closest rivals, the next closest rivals are in the immediately adjacent groups. Often, companies in strategic groups that are far apart on the map hardly compete at all. For instance, Wal-Mart’s clientele, merchandise selection, and pricing points are far too different to justify calling them close (global) competitors of Neiman Marcus or Saks Fifth Avenue in retailing. For the same reason, Timex is not a meaningful competitive rival of Rolex, and Kia is not a close competitor of BMW or Mercedes-Benz.

CORE CONCEPT: Strategic group maps reveal which companies are close competitors and which are distant competitors. Not all positions on a strategic group map are equally attractive.

The second thing to be gleaned from strategic group mapping is that not all positions on the map are equally attractive. Two factors account for why some positions can be more attractive than others:

1. Prevailing competitive pressures and industry driving forces favour some strategic groups and hurt others. Discerning which strategic groups are advantaged and disadvantaged requires scrutinizing the map in the light of what has also been learned from the prior analysis of competitive forces and driving forces. Quite often the strength of competition varies from group to group—there is little reason to believe that all companies in an industry feel the same degrees of competitive pressure, since their strategies and market positions may well differ in important respects. For instance, the competitive battle among Pick ‘n Pay, Woolworths, and even Spar is more intense (with consequently smaller profit margins) than the rivalry among Foschini, Stuttafords, Edgars and other fashion retailers. Similarly, industry driving forces may be acting to grow the demand for the products of companies in some strategic groups and shrink the demand for the products of companies in other strategic groups—as is the case in the radio broadcasting industry where satellite radio companies like XM and Sirius stand to gain market ground at the expense of commercial-based radio broadcasters: the consequence of the impact of such driving forces as technological advances in satellite broadcasting, growing buyer preferences for more diverse radio programming, and product innovation in satellite radio devices. Companies in strategic groups that are being adversely impacted by intense competitive pressures or driving forces may try to shift to a more favourably situated group; but shifting to a different position on the map can prove difficult when entry barriers for the target strategic group are high. Moreover, attempts to enter a new strategic group nearly always increase competitive pressures in the target strategic group. If certain companies are known to be trying to change their competitive positions on the map, attaching arrows to the circles showing the targeted direction helps clarify the picture of competitive manoeuvring among rivals.
The profit potential of different strategic groups varies relative to the strengths and weaknesses in each group’s market position. The profit prospects of companies in different strategic groups can vary from good to ho-hum to poor because of differing growth rates for the principal buyer segments served by each group, differing degrees of competitive rivalry within strategic groups, differing degrees of exposure to competition from substitute products outside the industry, and differing degrees of supplier or customer bargaining power from group to group.

Thus, part of strategic group map analysis always entails drawing conclusions about where on the map is the “best” place to be and why. Which companies/strategic groups are destined to prosper because of their positions? Which companies/strategic groups seem destined to struggle because of their positions? What accounts for why some parts of the map are better than others?

### 3.8 What Strategic Moves are Rivals Likely to Make Next?

Unless a company pays attention to what competitors are doing and knows their strengths and weaknesses, it ends up flying blind into competitive battle. As in sports, scouting the opposition is essential. Competitive intelligence about rivals’ strategies, their latest actions and announcements, their resource strengths and weaknesses, the efforts being made to improve their situation, and the thinking and leadership styles of their executives is valuable for predicting or anticipating the strategic moves competitors are likely to make next in the marketplace. Having good information to predict the strategic direction and likely moves of key competitors allows a company to prepare defensive counter-moves, to craft its own strategic moves with some confidence about what market manoeuvres to expect from rivals, and to exploit any openings that arise from competitors’ missteps or strategy flaws.

**CORE CONCEPT:** Good scouting reports on rivals provide a valuable assist in anticipating what moves rivals are likely to make next and outmanoeuvring them in the marketplace.

### 3.8.1 Identifying Competitors’ Strategies and Resource Strengths and Weaknesses

Keeping close tabs on a competitor’s strategy entails monitoring what the rival is doing in the marketplace, what its management is saying in company press releases, information posted on the company’s website (especially press releases and the presentations management has recently made to securities analysts). (“Defining Strategy” in Chapter 1 indicates what to look for in identifying a company’s strategy.) Company personnel may be able to pick up useful information from a rival’s exhibits at trade shows and from conversations with a rival’s customers, suppliers, and former employees.

Many companies have a competitive intelligence unit that sifts through the available information to construct up-to-date strategic profiles of rivals—their current strategies, resource strengths and competitive capabilities, competitive shortcomings, press releases, and
recent executive pronouncements. Such profiles are typically updated regularly and made available to managers and other key personnel.

Those who gather competitive intelligence on rivals, however, can sometimes cross the fine line between honest inquiry and unethical or even illegal behaviour. For example, calling rivals to get information about prices, the dates of new product introductions, or wage and salary levels is legal, but misrepresenting one’s company affiliation during such calls is unethical. Pumping rivals’ representatives at trade shows is ethical only if one wears a name tag with accurate company affiliation indicated.

In sizing up competitors, it makes sense for company strategists to make three assessments:

1. Which competitor has the best strategy? Which competitors appear to have flawed or weak strategies?
2. Which competitors are poised to gain market share, and which ones seem destined to lose ground?
3. Which competitors are likely to rank among the industry leaders five years from now? Do one or more up-and-coming competitors have powerful strategies and sufficient resource capabilities to overtake the current industry leader?

The industry’s current major players are generally easy to identify, but some of the leaders may be plagued with weaknesses that are causing them to lose ground; other notable rivals may lack the resources and capabilities to remain strong contenders given the superior strategies and capabilities of up-and-coming companies. In evaluating which competitors are favourably or unfavourably positioned to gain market ground, company strategists need to focus on why there is potential for some rivals to do better or worse than other rivals. Usually, a competitor’s prospects are a function of whether it is in a strategic group that is being favoured or hurt by competitive pressures and driving forces, whether its strategy has resulted in competitive advantage or disadvantage, and whether its resources and capabilities are well suited for competing on the road ahead.

**CORE CONCEPT:** Today’s market leaders don’t automatically become tomorrow’s.

### 3.8.2 Predicting Competitors’ Next Moves

Predicting the next strategic moves of competitors is the hardest yet most useful part of competitor analysis. Good clues about what actions a specific company is likely to undertake can often be gleaned from how well it is faring in the marketplace, the problems or weaknesses it needs to address, and how much pressure it is under to improve its financial performance. Content rivals are likely to continue their present strategy with only minor fine-tuning. Ailing rivals can be performing so poorly that fresh strategic moves are virtually certain. Ambitious rivals looking to move up in the industry ranks are strong candidates for launching new strategic offensives to pursue emerging market opportunities and exploit the vulnerabilities of weaker rivals.

Since the moves a competitor is likely to make are generally predicated on the views their executives have about the industry’s future and their beliefs about their firm’s
situations, it makes sense to scrutinize closely the public pronouncements of rival company executives about where the industry is headed and what it will take to be successful, what they are saying about their firm’s situation, information from the grapevine about what they are doing, and their past actions and leadership styles. Other considerations in trying to predict what strategic moves rivals are likely to make next include the following:

- 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 their dealer networks, entering additional geographic markets, boosting advertising to build better brand-name awareness, acquiring a weaker competitor, or placing more emphasis on direct sales via their website?
- Which rivals have a strong incentive, along with the resources, to make major strategic changes, perhaps moving to a different position on the strategic group map? Which rivals are probably locked in to pursuing the same basic strategy with only minor adjustments?
- Which rivals are good candidates to be acquired? Which rivals may be looking to make an acquisition and are financially able to do so?
- Which rivals are likely to enter new geographic markets?
- Which rivals are strong candidates to expand their product offerings and enter new product segments where they do not currently have a presence?

To succeed in predicting a competitor’s next moves, company strategists need to have a good feel for each rival’s situation, how its managers think, and what the rival’s best strategic options are. Doing the necessary detective work can be tedious and time-consuming, but scouting competitors well enough to anticipate their next moves allows managers to prepare effective counter-moves (perhaps even beat a rival to the punch) and to take rivals’ probable actions into account in crafting their own best course of action.

**CORE CONCEPT:** Managers who fail to study competitors closely risk being caught napping when rivals make fresh and perhaps bold strategic moves.

### 3.9 What are the Key Factors for Future Competitive Success?

An industry’s **key success factors (KSFs)** are those competitive factors that most affect industry members’ ability to prosper in the marketplace—the particular strategy elements, product attributes, resources, competencies, competitive capabilities, and market achievements that spell the difference between being a strong competitor and a weak competitor—and sometimes between profit and loss. KSFs by their very nature are so important to future competitive success that *all companies* in the industry must pay close attention to them or risk becoming an industry also-ran. To indicate the significance of KSFs another way: how well a company’s product offering, resources, and capabilities measure up against an industry’s KSFs determines just how financially and competitively successful that company will be. Identifying KSFs, in light of the prevailing and anticipated industry and competitive conditions, is therefore always a top-priority analytical and
strategy-making consideration. Company strategists need to understand the industry landscape well enough to separate the factors most important to competitive success from those that are less important.

**CORE CONCEPT:** **Key success factors** are the product attributes, competencies, competitive capabilities, and market achievements with the greatest impact on future competitive success in the marketplace.

In the beer industry, the KSFs are full utilization of brewing capacity (to keep manufacturing costs low), a strong network of wholesale distributors (to get the company’s brand stocked and favourably displayed in retail outlets where beer is sold), and clever advertising (to induce beer drinkers to buy the company’s brand and thereby pull beer sales through the established wholesale/retail channels). In apparel manufacturing the KSFs are appealing designs and colour combinations (to create buyer interest) and low-cost manufacturing efficiency (to permit attractive retail pricing and ample profit margins). In tin and aluminum cans, because the cost of shipping empty cans is substantial, one of the keys is having can-manufacturing facilities located close to end-use customers. Key success factors thus vary from industry to industry, and even from time to time within the same industry, as driving forces and competitive conditions change. Table 3.3 lists the most common types of industry key success factors.

An industry’s key success factors can usually be deduced from what was learned from the previously described analysis of the industry and competitive environment. Which

<table>
<thead>
<tr>
<th>Technology-related KSFs</th>
<th>Manufacturing-related KSFs</th>
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<tbody>
<tr>
<td>■ Expertise in a particular technology or in scientific research (important in pharmaceuticals, Internet applications, mobile communications, and most high-tech industries)</td>
<td>■ Ability to achieve scale economies and/or capture learning/experience curve effects (important to achieving low production costs)</td>
</tr>
<tr>
<td>■ Proven ability to improve production processes (important in industries where advancing technology opens the way for higher manufacturing efficiency and lower production costs)</td>
<td>■ Quality control know-how (important in industries where customers insist on product reliability)</td>
</tr>
<tr>
<td>■ High utilization of fixed assets (important in capital-intensive, high-fixed-cost industries)</td>
<td>■ Access to attractive supplies of skilled labour</td>
</tr>
<tr>
<td>■ Access to attractive supplies of skilled labour</td>
<td>■ High labour productivity (important for items with high labour content)</td>
</tr>
<tr>
<td>■ Low-cost product design and engineering (reduces manufacturing costs)</td>
<td>■ Ability to manufacture or assemble products that are customized to buyer specifications</td>
</tr>
</tbody>
</table>

**TABLE 3.3** Common types of industry key success factors
### Distribution-related KSFs
- A strong network of wholesale distributors/dealers
- Strong direct sales capabilities via the Internet and/or having company-owned retail outlets
- Ability to secure favourable display space on retailer shelves

### Marketing-related KSFs
- Breadth of product line and product selection
- A well-known and well-respected brand name
- Fast, accurate technical assistance
- Courteous, personalized customer service
- Accurate filling of buyer orders (few back orders or mistakes)
- Customer guarantees and warranties (important in mail-order and online retailing, big-ticket purchases, new product introductions)
- Clever advertising

### Skills and capability-related KSFs
- A talented workforce (important in professional services like accounting and investment banking)
- National or global distribution capabilities
- Product innovation capabilities (important in industries where rivals are racing to be first-to-market with new product attributes or performance features)
- Design expertise (important in fashion and apparel industries)
- Short delivery time capability
- Supply-chain management capabilities
- Strong e-commerce capabilities—a user-friendly website and/or skills in using Internet technology applications to streamline internal operations

### Other types of KSFs
- Overall low costs (not just in manufacturing) so as to be able to meet customer expectations of low price
- Convenient locations (important in many retailing businesses)
- Ability to provide fast, convenient after-the-sale repairs and service
- A strong balance sheet and access to financial capital (important in newly emerging industries with high degrees of business risk and in capital-intensive industries)
- Patent protection

Factors are most important to future competitive success flow directly from the industry’s dominant characteristics, what competition is like, the impacts of the driving forces, the comparative market positions of industry members, and the likely next moves of key rivals. In addition, the answers to three questions help identify an industry’s key success factors:

1. **On what basis do buyers of the industry’s product choose between the competing brands of sellers? That is, what product attributes are crucial?**
2. **Given the nature of competitive rivalry and the competitive forces prevailing in the marketplace, what resources and competitive capabilities does a company need to have to be competitively successful?**
3. **What shortcomings are almost certain to put a company at a significant competitive disadvantage?**
3.10 Does the Outlook for the Industry Present the Company with an Attractive Opportunity?

Only rarely are there more than five or six key factors for future competitive success. And even among these, two or three usually outrank the others in importance. Managers should therefore bear in mind the purpose of identifying key success factors—to determine which factors are most important to future competitive success—and resist the temptation to label a factor that has only minor importance a KSF. To compile a list of every factor that matters even a little bit defeats the purpose of concentrating management attention on the factors truly critical to long-term competitive success.

Correctly diagnosing an industry’s KSFs raises a company’s chances of crafting a sound strategy. The goal of company strategists should be to design a strategy aimed at showing up well on all of the industry’s future KSFs and trying to be distinctively better than rivals on one (or possibly two) of the KSFs. Indeed, companies that stand out or excel on a particular KSF are likely to enjoy a stronger market position—being distinctively better than rivals on one or two key success factors tends to translate into competitive advantage. Hence, using the industry’s KSFs as cornerstones for the company’s strategy and trying to gain sustainable competitive advantage by excelling at one particular KSF is a fruitful competitive strategy approach.21

CORE CONCEPT: A sound strategy incorporates the intent to show up well on all of the industry’s key success factors and to excel on one or two KSFs.

3.10 Does the Outlook for the Industry Present the Company with an Attractive Opportunity?

The final step in evaluating the industry and competitive environment is to use the preceding analysis to decide whether the outlook for the industry presents the company with a sufficiently attractive business opportunity. The important factors on which to base such a conclusion include:

- The industry’s growth potential.
- Whether powerful competitive forces are squeezing industry profitability to sub-par levels and whether competition appears destined to grow stronger or weaker.
- Whether industry profitability will be favourably or unfavourably affected by the prevailing driving forces.
- The degrees of risk and uncertainty in the industry’s future.
- Whether the industry as a whole confronts severe problems—regulatory or environmental issues, stagnating buyer demand, industry overcapacity, mounting competition, and so on.
- The company’s competitive position in the industry vis-à-vis rivals. (Being a well-entrenched leader or strongly positioned contender in a lacklustre industry may present adequate opportunity for good profitability; however, having to fight a steep uphill battle against much stronger rivals may hold little promise of eventual market success or good return on shareholder investment, even though the industry environment is attractive.)
The company’s potential to capitalize on the vulnerabilities of weaker rivals, perhaps converting a relatively unattractive industry situation into a potentially rewarding company opportunity.

Whether the company has sufficient competitive strength to defend against or counteract the factors that make the industry unattractive.

Whether continued participation in this industry adds importantly to the firm’s ability to be successful in other industries in which it may have business interests.

As a general proposition, if an industry’s overall profit prospects are above average, the industry environment is basically attractive; if industry profit prospects are below average, conditions are unattractive. However, it is a mistake to think of a particular industry as being equally attractive or unattractive to all industry participants and all potential entrants. Attractiveness is relative, not absolute, and conclusions one way or the other have to be drawn from the perspective of a particular company. Industries attractive to insiders may be unattractive to outsiders. Companies on the outside may look at an industry’s environment and conclude that it is an unattractive business for them to get into, given the prevailing entry barriers, the difficulty of challenging current market leaders with their particular resources and competencies, and the opportunities they have elsewhere. Industry environments unattractive to weak competitors may be attractive to strong competitors. A favourably positioned company may survey a business environment and see a host of opportunities that weak competitors cannot capture.

CORE CONCEPT: The degree to which an industry is attractive or unattractive is not the same for all industry participants and all potential entrants; the attractiveness of the opportunities an industry presents depends heavily on whether a company has the resource strengths and competitive capabilities to capture them.

When a company decides an industry is fundamentally attractive and presents good opportunities, a strong case can be made that it should invest aggressively to capture the opportunities it sees and to improve its long-term performance and competitive position in the business. When a strong competitor concludes that an industry is relatively unattractive and lacking in opportunity, it may elect simply to protect its present position, investing cautiously if at all and looking for opportunities in other industries. A competitively weak company in an unattractive industry may see its best option as finding a buyer, perhaps a rival, to acquire its business.

Summary

Thinking strategically about a company’s external situation involves probing for answers to the following seven questions:

1. What are the industry’s dominant economic features? Industries differ significantly on such factors as market size and growth rate, the number and relative sizes of both
buyers and sellers, the geographic scope of competitive rivalry, the degree of product differentiation, the speed of product innovation, demand–supply conditions, the extent of vertical integration, and the extent of scale economies and learning-curve effects.

2 What kinds of competitive forces are industry members facing, and how strong is each force? The strength of competition is a composite of five forces: (1) competitive pressures stemming from the competitive jockeying and market manoeuvring among industry rivals, (2) competitive pressures associated with the market inroads being made by the sellers of substitutes, (3) competitive pressures associated with the threat of new entrants into the market, (4) competitive pressures stemming from supplier bargaining power and supplier–seller collaboration, and (5) competitive pressures stemming from buyer bargaining power and seller–buyer collaboration.

3 What factors are driving industry change and what impact will they have on competitive intensity and industry profitability? Industry and competitive conditions change because forces are in motion that create incentives or pressures for change. The first phase is to identify the forces that are driving change in the industry; the most common driving forces include the Internet and Internet technology applications, globalization of competition in the industry, changes in the long-term industry growth rate, changes in buyer composition, product innovation, entry or exit of major companies, changes in cost and efficiency, changing buyer preferences for standardized versus differentiated products or services, regulatory influences and government policy changes, changing societal and lifestyle factors, and reductions in uncertainty and business risk. The second phase of driving-forces analysis is to determine whether the driving forces, taken together, are acting to make the industry environment more or less attractive.

4 What market positions do industry rivals occupy—who is strongly positioned and who is not? Strategic group mapping is a valuable tool for understanding the similarities, differences, strengths, and weaknesses inherent in the market positions of rival companies. Rivals in the same or nearby strategic groups are close competitors, whereas companies in distant strategic groups usually pose little or no immediate threat.

5 What strategic moves are rivals likely to make next? This analytical step involves identifying competitors’ strategies, deciding which rivals are likely to be strong contenders and which are likely to be weak, evaluating rivals’ competitive options, and predicting their next moves. Scouting competitors well enough to anticipate their actions can help a company prepare effective counter-moves (perhaps even beating a rival to the punch) and allows managers to take rivals’ probable actions into account in designing their own company’s best course of action. Managers who fail to study competitors risk being caught unprepared by the strategic moves of rivals.

6 What are the key factors for future competitive success? An industry’s key success factors (KSFs) are the particular strategy elements, product attributes, competitive capabilities, and business outcomes that spell the difference between being a strong competitor and a weak competitor—and sometimes between profit and loss. KSFs by their very nature are so important to competitive success that all companies in the industry must pay close attention to them or risk becoming an industry also-ran.
Correctly diagnosing an industry’s KSFs raises a company’s chances of crafting a sound strategy.

7  Does the outlook for the industry present the company with sufficiently attractive prospects for profitability? If an industry’s overall profit prospects are above average, the industry environment is basically attractive; if industry profit prospects are below average, conditions are unattractive. Conclusions regarding industry attractiveness are a major driver of company strategy. When a company decides an industry is fundamentally attractive and presents good opportunities, a strong case can be made that it should invest aggressively to capture the opportunities it sees and to improve its long-term competitive position in the business.

This chapter has concentrated on suggesting which are the right questions to ask, explaining concepts and analytical approaches, and indicating the kinds of things to look for. There is no substitute for cutting-edge strategic thinking about a company’s external situation—anything less weakens managers’ ability to craft strategies that are well-matched to industry and competitive conditions.

The next chapter explores the methods of evaluating a company’s internal circumstances, resources and competitiveness.

References

See endnotes.