INDUSTRY ANALYSIS AND COMPETITIVE ADVANTAGE

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DEFINITION OF COMPETITIVE ADVANTAGE

Delivering superior value to customers and in doing so earning an above average return for the company and its stakeholders

Competitive advantage requires a firm to be sustainably different from its competitors in a way that customers are prepared to purchase at a sufficiently high price

- **Supply Side**: how costs arise (cost advantage)
- **Demand Side**: how value is perceived and paid for by customers (differentiation advantage)
- **Market and Industry structure**: market rivarly which tells us how competition takes place in the industry (analysis of markets and competition)

Cost analysis

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Opportunity cost

- The sacrifice of alternatives foregone in producing goods or services

Cost structure

- **Fixed costs:** do not vary with output (buildings, machinery, advertising)
- **Variable costs:** vary with output (labour, raw materials)
- **Total cost:** Fixed cost + Variable cost
- **Average total cost:** Total cost / Total output
- **Average fixed cost:** Fixed cost / Total output

Marginal cost

- The cost of producing one extra unit of output

Economies of Scale

- An economy of scale refers to the extent to which unit costs fall (cost per unit of output) as the scale of operation (for example a factory) increases

- Firm-level economies of scale
  - Administrative economies
  - Financial economies
  - Marketing economies

Economies of scope

- Economies of scope arise when the average cost of a single product is lowered by its joint production with other products in a multi-product firm

- Economies of scope refer to increased variety of operations, not higher volume of output

- Shared distribution, adv, purchasing, etc.

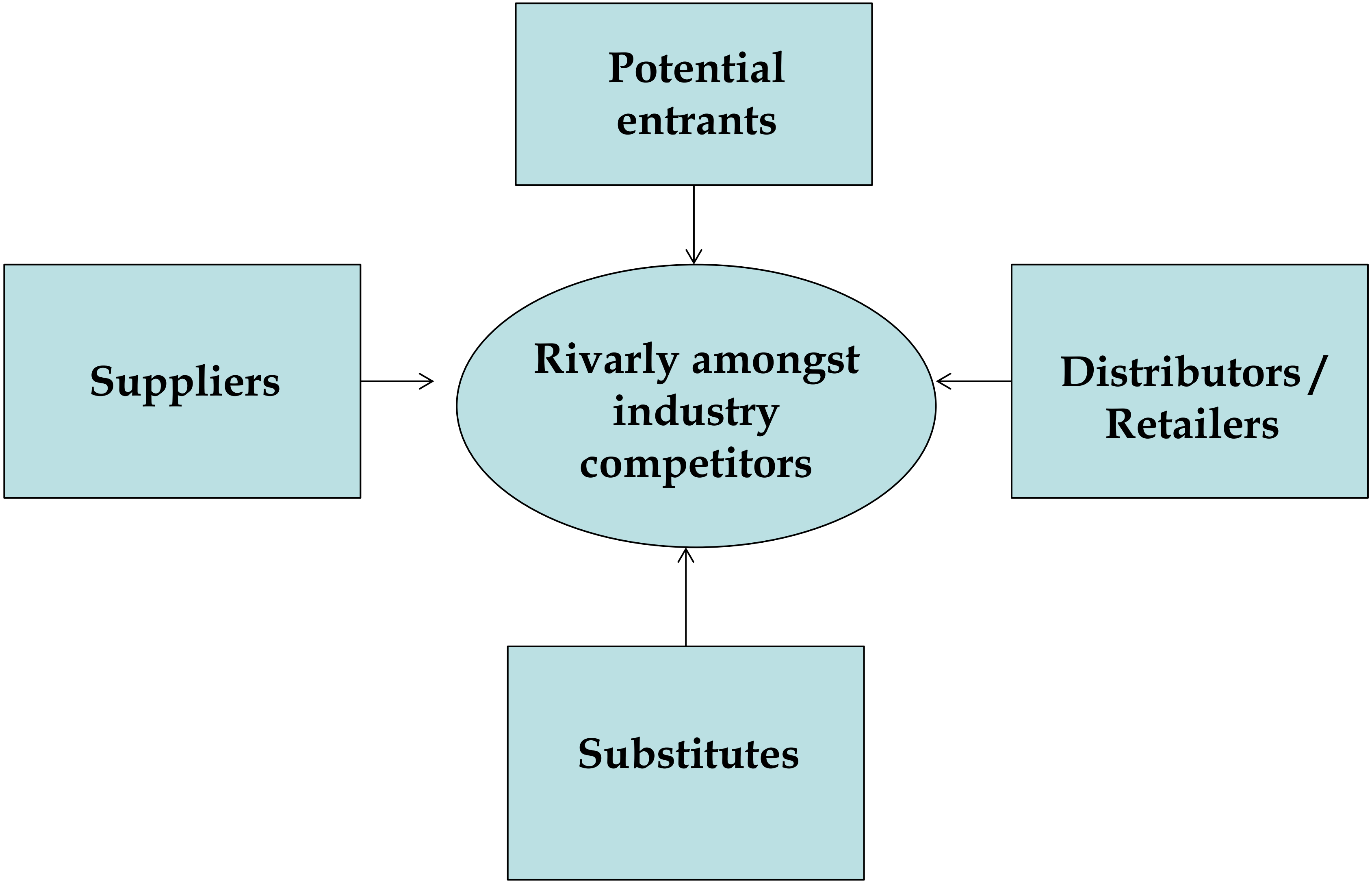
Demand analysis

- Elasticity of demand
  - Degree of responsiveness of demand to a change in price.
  - Low price elasticity (insensitive to change in price): food, petrol
  - High elasticity (sensitive to change in price): entertainment, fashion

- <u>Final demand</u> versus <u>derived demand</u>

- <u>Industrial / Producer</u> versus <u>consumer goods</u>

Analysis of competition: Porter's Five Forces Framework



Porter's Five Forces

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Potential entrants: threat of entry

- Above-average profits attract investors to enter an industry.
- Entry barriers - where a potential entrant has (fixed and variable) costs of production higher than the incumbents it faces (scale economics and experience)
- Product differentiation
- Capital requirements
- Access to distribution
- Level of expected retaliation

Threat of Substitutes

- Comparative price / performance
- Comparative features
- Comparative technology

Porter’s Five Forces

Power of Suppliers and Buyers

- Limited suppliers / buyers
- Switching costs – accustomed to using a particular supplier/buyer
- Substitution possibilities
- Relative importance of product to the provider and the user
- Credible threat of vertical integration

Intensity of Rivalry high if…

- Several equal strong players
- Low/no growth in market
- Supply in excess of demand
- Greater proportion of fixed assets
- Few possibility of differentiation
- Major exit barriers

Porter's Generic Strategies

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PRODUCT CHARACTERISTICS

MARKET SCOPE		*Commodity*	*Differentiated*
	Broad	**Cost leadership**	**Differentiation**
	Narrow	**Cost focus**	**Differentiation focus**

Danger Area – 'Stuck in the Middle'

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Danger Area – 'Stuck in the Middle'

FOCUS

Cost leadership

- True cost leadership is only achieved by the possession of undisputed cost advantage
- If the competitors catch up, the cost leadership is lost
- New forms of product differentiation, so that costs is not the major purchase criterion
- Changes in consumer buying behaviour towards new products and / or taste and style

Differentiation

- The differentiation is only achieved by satisfying buyer needs uniquely
- The objective is to realize a price premium that exceeds the cost of differentiation
- When the competitors catch up, the differentiation edge is lost
- Risk of creating differentiation that buyers do not values
- Excessive price premium (or too low)
- Failure to understand costs of differentiation
- Failure to “stay ahead”
- Inadequate or misleading buyer segmentation

Focus

- The ability to serve the needs of a specific buyer group better than any other competitor
- Risk that target segment becomes unattractive
- Broad scope competitors create offers that overwhelm the target segment
- The strategy is imitated by other competitors

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Criticisms of Porter's Generic Strategies

- Cost leadership and differentiation can be combined profitably
  - Cost leadership is not necessarily price leadership
  - Differentiation does not necessarily involve premium pricing

Common objectives, their performance criteria and main measures

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Profit and financial objectives	Profitability	•Profit •% Profit / sales •Contribution margin •ROI
	Contribution to owners	Earnings per share Price/earnings ratio
Growth objectives / marketing objectives	% yearly growth	Sales ($ and volume) Profits
	Competitive strenghts	Market share Brand awareness & preference
	Contribution to customers	Price/quality ratio Cust. satisfaction Cust. Loyalty
Social responsibilities objectives	Contribution to employees Contribution to society	

Market share and market concentration

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Definitions of market share:

- Volume market share
- Value market share
- Relative market share

Definition of market concentration:

The four firms concentration ratio is the percentage of market share held by the 4 Largest Firms (LF) in an industry:

$CR_{4LF} = \Sigma ms_{4LF}$ → $CR_{4LF} = ms_1 + ms_2 + ms_3 + ms_4$

ms=market share

Concentration levels (range from 0 to 100 percent)

- **No concentration** (high fragmentation): 0 - 5% means that the four largest firm in the industry would not have any significant market share.
- Low concentration: 5% to 50%.
- Medium concentration: 50% to 80%.
- High concentration: 80% to 100%. This category ranges from oligopoly to monopoly.

THE END ☺