Strategic Management

Week 2

Competitive Positioning School

Agenda

Understanding of the key ideas underpinning the competitive positioning approach

Understanding of key models from the competitive positioning school that can be applied to organisations

The Positioning school is BUSINESS LEVEL STRATEGY and can be applied to a diversified corporation's activities in each one of the industries it as entered; or a single business that operates in only one industry

- A corporation is a diversified company that **owns or operates in several unrelated industries**. Companies may become diversified by entering into new industries on its own by merging with another company or by acquiring a company operating in another field or service sector. 5 Forces would need to be conducted for each of these industries. For example, 3M operates in communications, dental/orthodontics, films/sheeting/tools industries
- A single business that operates in only one industry would be for example Morning Star Tomato Processing, Starbucks Coffee, Bird E-Scooter hire

Theories of Firm Performance: The Positioning School

- Sometimes called the market-based view or Porterian view, **the positioning school (Michael Porter)**, focus is primarily on structural features of industrial markets and **relative performance** of firms linked to the market power of firms and market positions.

- Strategic choice is based on one of three **generic strategies** (cost, differentiation or focus)**.** Strategic challenges and implications are primarily framed with reference to matters of **competitive positioning** and strategic moves **vis-à-vis competitors**. (Mellahi, Jackson and Sparks, 2002)

THE PURPOSE OF THE FIVE FORCES ANALYSIS IS TO DETERMINE THE ATTACTIVENESS (PROFIT EARNING POTENTIAL) OF AN INDUSTRY!

Five Forces

"The state of competition in an industry depends on five basic competitive forces ... The ***collective*** *strength of these five forces* ***determines*** *the ultimate profit potential in the industry, where profit potential is measured in terms of long-run returns on invested capital..."*

(Michael Porter, 1980)

Michael Porter interview

Click here for link

http://www.youtube.com/watch?v=mYF2_FBCvXw&feature=youtu.be

Key Aspects of 5-Forces Analysis
What *is* the unit of analysis?

- Use at level of **strategic business units** (SBU), not corporate level
- First, define the industry/market/sector
- Do not just list the forces: rate them and derive implications for industry/organisation
- Note connections between competitive forces and key drivers in macroenvironment

JOHNSON, G., WHITTINGTON, R., SCHOLES, K., ANGWIN, D., & REGNER, P. 2016. Exploring Strategy: Text and cases. Pearson Education.

Competitive forces: The five forces framework

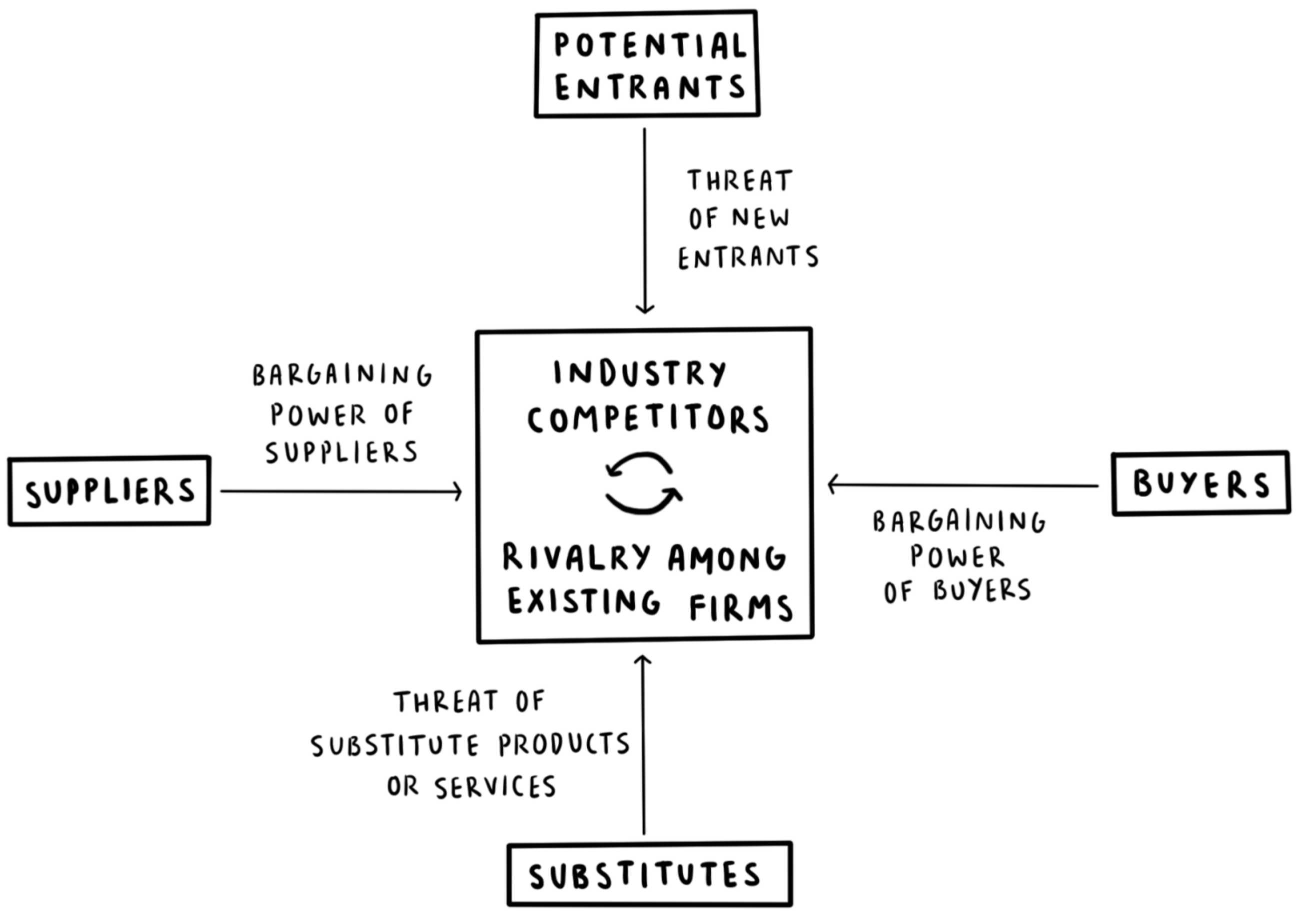
Porter's Five Forces Framework helps identify the attractiveness of an industry in terms of five competitive forces:

- ***The threat of entry***
- ***The threat of substitutes***
- ***The bargaining power of buyers***
- ***The bargaining power of suppliers and***
- ***The extent of rivalry between competitors***

The five forces constitute an industry's 'structure'.

Industry structure determines profitability.

The five forces framework



Source: Adapted from *Competitive Strategy: Techniques for Analyzing Industries and Competitors* by Michael E. Porter, copyright © 1980, 1998 by The Free Press.

Assessing the Five Forces

- General rule: The relative strength of forces determines an industry’s profit potential. Strong forces mean lower profitability.

THE FIVE FORCES FRAMEWORK

Rivalry between competitors

Competitive rivals are organisations with similar products and services aimed at the same customer group and are direct competitors in the same industry/market (they are distinct from substitutes).

The degree of rivalry is increased when e.g. :

- **Competitors are of roughly equal size**
- Competitors are aggressive in seeking leadership
- The market is mature or declining – low growth
- There are high fixed costs
- The exit barriers are high
- There is a low level of differentiation

This is the level of detail needed for the assessments – all 6 factors

THE FIVE FORCES FRAMEWORK

The threat of entry

Barriers to entry are the factors that need to be overcome by new entrants if they are to compete. The threat of entry is low when the barriers to entry are high and vice versa.

The main barriers to entry include:

- Economies of scale/Experience/Network effects
- High capital requirements
- Access to supply and distribution channels
- Differentiation and market penetration costs
- Legislation or government restrictions (e.g. licensing)
- Expected retaliation
- Incumbency advantages

THE FIVE FORCES FRAMEWORK

Threat of Substitutes

Substitutes are products or services that offer a similar benefit to an industry's products or services, but by a different industry. They are NOT rivals products.

Customers will switch to alternatives (and thus the threat is high) if:

- The **price/performance** ratio of the substitute is superior (e.g. aluminium maybe more expensive than steel but it is more cost efficient for some car parts)
- **Buyer Propensity** is high e.g. the substitute benefits from an innovation that improves customer satisfaction (e.g. high speed trains can be quicker than airlines from city centre to city centre)

THE FIVE FORCES FRAMEWORK

Threat of substitutes

Substitutes can take different forms:

product substitution e.g. coffee for tea

substitution of need e.g. need to travel (plane, rail, car)

The substitute serves the same need but is provided by a different industry!

THE FIVE FORCES FRAMEWORK

The BARGAINING power of buyers

If buyers are powerful enough to be able to BARGAIN FOR A GOOD/BETTER DEAL, then they can demand cheap prices or product/service improvements to reduce profits.

Buyers in consumer markets do not have BARGAINING power, unless they are able to consolidate in some way and this rarely if ever happens.

Buyer power is likely to be high when:

- Buyers are concentrated, buyers in consumer markets are almost never consolidated.
- Buyers have low switching costs

THE FIVE FORCES FRAMEWORK

The bargaining power of suppliers

Suppliers are those who supply what organisations need to produce the product or service. Powerful suppliers can reduce an organisation's profits.

Supplier power is likely to be high when:

- The suppliers are concentrated (few of them)
- Suppliers provide a specialist or rare input
- Switching costs are high (it is disruptive or expensive to change suppliers)

STEPS IN AN INDUSTRY ANALYSIS

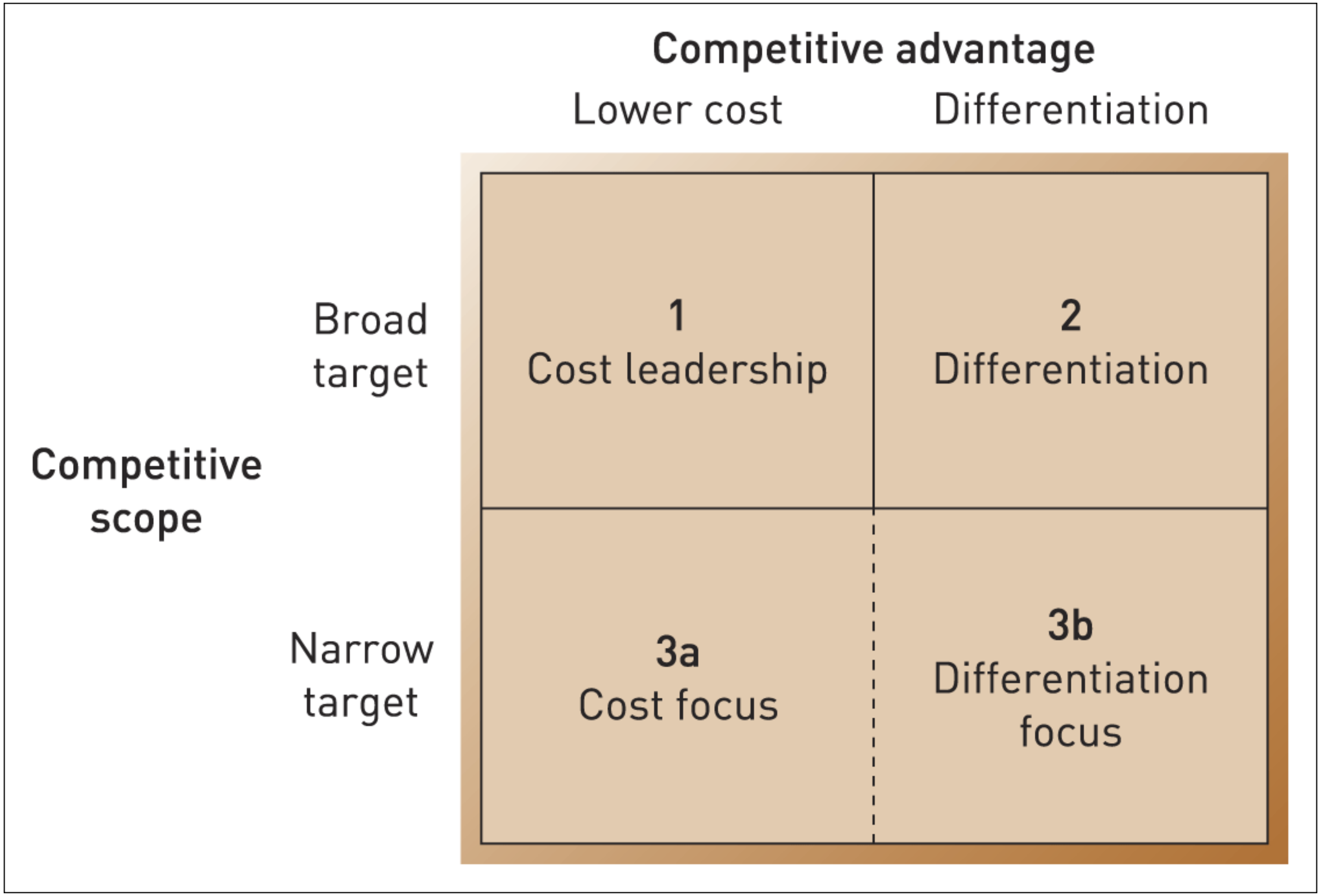
There are several important steps in an industry analysis before and after analysing the five forces:

- Define the industry as clearly as possible
  - Is there an industry? What about technological convergence that blurs the distinction between industries?
- Identify the actors of each of the five forces and any different groups within them and the basis for this
  - Do NOT omit this stage, it is EXTREMELY important that you can name the rivals, identify the suppliers, markets, substitutes
- Determine the underlying factors of, and the total strength of, each force e.g. high, medium or low
- Assess the overall industry structure and attractiveness
- Determine how to position your business in relation to each of the five forces:
  - Cost, Differentiation or Focus

Porter’s 3 Generic Strategies

- Cost leadership
- Differentiation strategy
- Niche strategy (focus strategy)

Strategic Choice: Porter's generic strategies



Source: Adapted with the permission of The Free Press, a Division of Simon & Schuster, Inc., from *Competitive Advantage: Creating and Sustaining Superior Performance* by Michael E. Porter.

source: Johnson, Whittington and Scholes (2011) Exploring Strategy, 9th Edition, Pearson Education, Chapter 6

Cost-leadership

Cost-leadership strategy involves becoming ***the*** lowest-cost organisation in a domain of activity

Not simply lowest prices (that just reduces profit) but lowest underlying costs e.g. Walmart, CostCo

Three key cost drivers that can help deliver cost leadership:

- Lower input costs
- Economies of scale
- Experience

source: Johnson, Whittington and Scholes (2011) Exploring Strategy, 9th Edition, Pearson Education, Chapter 6

Differentiation strategy

Differentiation involves uniqueness along some dimension that is sufficiently valued by customers to allow a price premium.

- Within each market businesses may differentiate along ***different dimensions.***

Differentiation strategy

The key drivers of differentiation are:

- ***Product and service attributes –*** providing better or unique features (e.g. Apple or Dyson).
- ***Customer relationships –*** customer service and responsiveness (e.g. Zalando); customisation (e.g. SAP) or marketing and reputation (e.g. Coca Cola).
- ***Complements –*** building on linkages with other products/services (Apple and iTunes).

Focus strategy

A ***focus strategy*** targets a narrow segment or domain of activity and tailors its products or services to the needs of that specific segment to the exclusion of others.

Two types of focus strategy:

- ***Cost-focus strategy*** (e.g. Ryanair).
- ***Differentiation focus strategy*** (e.g. Ecover for ecological cleaning products).

Focus strategy

- ***Cost focusers*** identify areas where broader cost based strategies fail because of the added cost of trying to satisfy a wide range of needs (e.g. Iceland Foods)
- ***Differentiation focusers*** look for specific needs that broad differentiators do not satisfy so well (e.g. Savile Row tailoring)

‘Stuck in the middle’?

Porter argues:

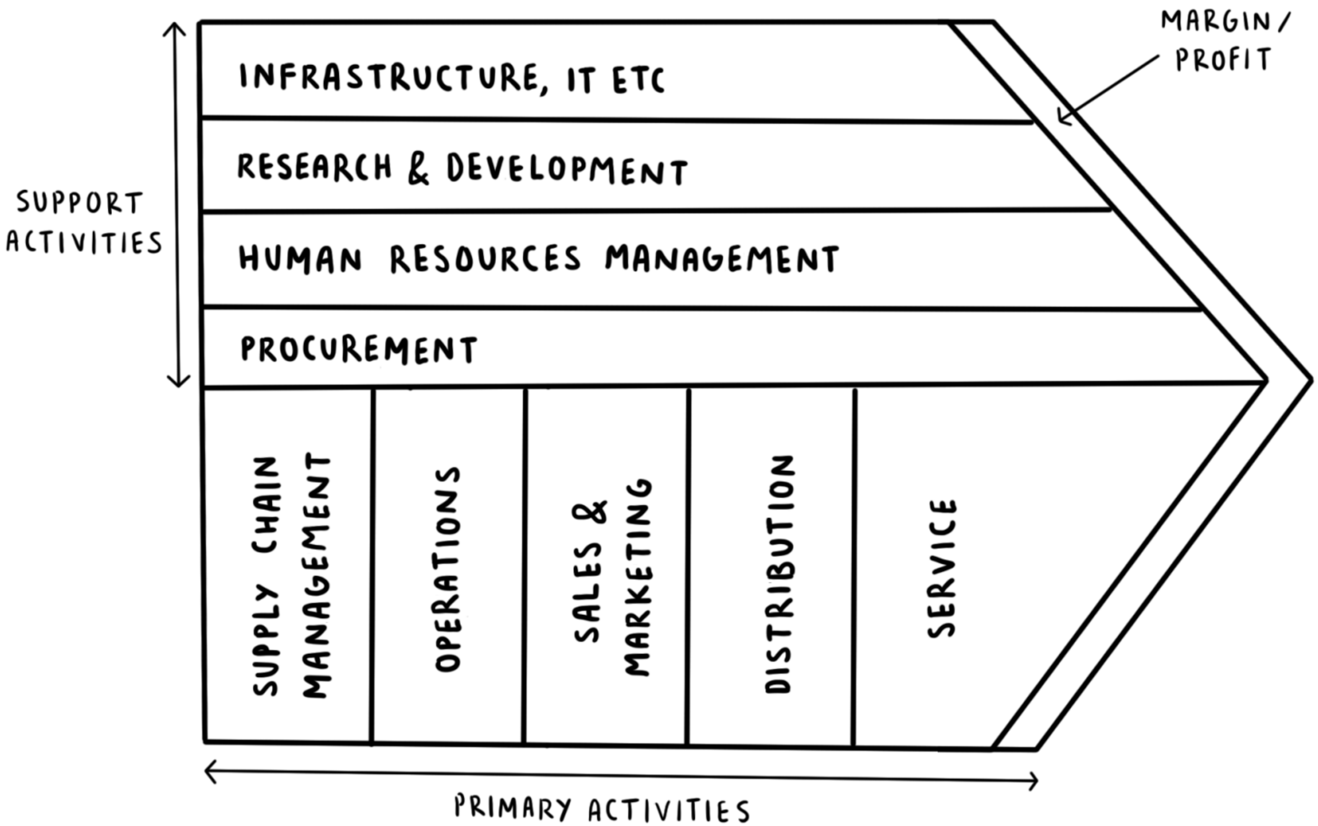
- It is best to choose which generic strategy to adopt and then stick rigorously to it.
- Failure to do this leads to a danger of being ***‘stuck in the middle’*** – doing no strategy well.
- The argument for pure generic strategies is controversial. Porter acknowledges that in special circumstances the strategies can be combined (e.g. if being unique costs nothing).

Porterian Competitive Positioning School and Strategic Planning

3 stage linear model steps:

1. Five Forces Analysis - analyse the industry
2. Generic Strategy - identify an appropriate strategic position
    - Cost
    - Differentiation
    - Focus
3. Value Chain - design the company value chain to **fit** the external environmental (industry forces) and the chosen generic strategy

Value Chain



MARGIN / PROFIT
SUPPORT ACTIVITIES
INFRASTRUCTURE, IT ETC
RESEARCH & DEVELOPMENT
HUMAN RESOURCES MANAGEMENT
PROCUREMENT
SUPPLY CHAIN MANAGEMENT
OPERATIONS
SALES & MARKETING
DISTRIBUTION
SERVICE
PRIMARY ACTIVITIES

Using the value chain (internal context)

- The **value chain** describes the categories of activities within an organisation which, together, create a product or service
- A generic description of activities – helps understand the discrete activities and how they both **contribute to consumer benefit** and **how they add to cost**
- **Sources of competitive advantage** can be analysed in any or all of these activities.
- Identifying activities where the organisation has particular strengths or weaknesses
- Looking for ways to enhance value or decrease cost in value activities (e.g. outsourcing)

source: Johnson, Whittington and Scholes (2011) Exploring Strategy, 9th Edition, Pearson Education, Chapter 3

A new application of value chain analysis

- The value chain can be appropriated to use to analyze the firm's capabilities from a resource-based view perspective!
- When appropriating value chain analysis to use to map firm resource-based view capabilities, we use the framework within a different framework with different theoretical assumptions

From the positioning school to the resource-based view

- In the late 1980s the positioning school began to be superceded by the resource-based view of the firm
- Static product/market positions were no longer a viable basis for long term strategy. Instead, firm level capabilities allow access to MULTIPLE market segments in DIFFERENT **<u>future</u>** scenarios (Amit and Schoemaker, 1993)
- Technological convergence blurred the distinction between industries
- There are greater profitability opportunities WITHIN an industry than BETWEEN industries
- The FIRM matters in achieving strategic success NOT the industry!

Understanding of criticisms and limitations of the competitive positioning school

ILLUSION OF RIGOUR BUT…

- Industries boundaries are arbitrary and how we assess each force is also arbitrary
- Incomplete information and imperfect cognitive abilities lead to questionable insights and inferences

We have '**bounded rationality**' (Simon, 1957). We cannot know everything, there will always be areas unknown to us

Confirmation bias is the tendency to search for and interpret information in a way that confirms our prior beliefs

Further reading

De Wit, B & Meyer, R (2010) Strategy: Process, Content, Context, 4^{th} Edition, Cengage Learning, p53-66

'Distortions and deceptions in strategic decision making' Lovallo & Sibony 2006, No1.

'Strategic decisions: when can you trust your gut?' Kahneman and Klein, McKinsey Quarterly, March 2010.

Is it possible to have perfect, real time, detailed information about every aspect of every competitor and every aspect of an industry?

Imperfect information is where in one or more respects information is imprecise, uncertain, incomplete, unreliable, vague or partially true.

Further reading

De Wit, B & Meyer, R (2010) Strategy: Process, Content, Context, 4th Edition, Cengage Learning, p53-66

'Distortions and deceptions in strategic decision making' Lovallo & Sibony 2006, No1.

'Strategic decisions: when can you trust your gut?' Kahneman and Klein, McKinsey Quarterly, March 2010.

BEWARE OF FOOLS WITH TOOLS MUST WE ALWAYS 'ANALYSE'?

The analytical tools examined in this lecture, (like all predetermined categories), might restrict and limit our view

However, tools such as five forces might also provide a common language that helps people to share ideas, engage in debate and surface underlying assumptions

LACK OF FOCUS ON CO-OPERATIVE STRATEGY

Five forces tends to encourage organisations to think of others as competitors rather than possible partners.

Porter views collaboration as an anti-competitive market distortion and a misallocation of resources.

In reality Collaboration with **some** competitors may give competitive advantage over **other** competitors (or potential entrants).

Further reading

Lynch. R, (2006), Corporate Strategy: page99 argues model tends to see others as threat but suppliers etc could co-operate

JOHNSON, G., WHITTINGTON, R., SCHOLES, K., ANGWIN, D., & REGNER, P. 2016. Exploring Strategy: Text and cases. Pearson Education. (CHAPTER 3 INDUSTRY & SECTOR ANALYSIS - available as e-book). Figure 7.8 illustrates various benefits from cooperation using the five forces framework.

TOO MUCH IN A MODERNIST TRADITION

Whilst Porter's (1980) contribution is recognised, it has been criticised as paradigmatically constrained to economics (machine, rational, objective, instrumental).

Porter has been criticized for the fact that he devotes little attention to the political and social aspects of organizational behavior in his analysis (Mintzberg et al., 1995).

Further reading

STONEHOUSE, G. & SNOWDON, B. 2007. Competitive advantage revisited: Michael Porter on strategy and competitiveness. Journal of Management Inquiry, 16, 256-273.

WHITTINGTON, R. 2004. Strategy after modernism: recovering practice. *European Management Review,* 1 (MARCH), 62-68.

TOO STATIC FOR A DYNAMIC WORLD

- “Five forces analysis can be regarded as rather static at a time when the business environment is increasingly dynamic” (Stonehouse & Snowdon, 2007)

- Some empirical research supports Porter i.e. industry structure changes slowly but less so in fast moving “Schumpeterian industries” e.g. computers, IT, internet, online games (Grant, 2005)

Further Reading
Grant (2005), Contemporary Strategy Analysis, Chapter 3
STONEHOUSE, G. & SNOWDON, B. 2007. Competitive advantage revisited: Michael Porter on strategy and competitiveness. Journal of Management Inquiry, 16, 256-273.

- Five forces treats firms as homogeneous (all the same).

- Industries are arbitrary constructs, different analysts will define the same activities/technologies in different ways. SIC are not widely agreed upon.

  Assumes greater differences **between** industries than within industry boundaries

- Rumelt (1991) argues **that firm-specific factors are more important** to the profitability of a business than industrywide factors – competing on resources is NOT merely economising (see Porter paper 'What is strategy?'

- If we take the central argument to its logical conclusion it is the INDUSTRY that determines firm performance, not the CEO, entrepreneur, organisation's innovative strategy.

SEE COMPARISON TABLES – POSITIONING SCHOOL VS RESOURCE-BASED VIEW IN YOUR MODULE HANDBOOK