The purpose of the conceptual booklet is to serve as a “Lecture- and Student-Project- Improvement Tool”. It has been essentially influenced by ideas acquired during the participation in Professor Michael Porter’s MOC-Seminars at Harvard Business School, by numerous publications by Michael Porter, and by students’ comments during MBA, EMBA, MLUX- and MOC-class discussions (in Monaco, Shanghai, and Taiwan). The paper disseminates the findings of work in progress to encourage the exchange of ideas about competitiveness issues. The objective is to get the findings out quickly, even if the presentations are less than fully polished. The paper carries the name of the author and should be cited accordingly. The usual disclaimer applies.
“In a world of more open competition and relentless change, it is more important than ever to think structurally about competition”

Professor Michael E. Porter

A. Some basic insights on competitive advantage on the firm level

1. How to make strategic choices

We study some of the core problems for companies operating in a global competitive economy. We focus mainly on firm-level strategic entrepreneurial choices regarding where to engage in which activities to gain and sustain competitive advantage. We are faced with the challenges of integrating the multiple perspectives, functions, and interests that constitute the (multinational) firm. If we do not understand how firms compete, how they gain competitive advantage and to be internationally competitive it is very hard to talk about the impact of different stakeholders in determining the performance of a firm. What we need is a good grounding in firm-competition and strategy.

1.1. Core set of questions for companies (including MNCs) operating in industries that are located in a global competitive economy

- What is competition? How to cope with competition? And more specifically: How do firms compete? How to formulate an effective strategy for your business?
- How to create a “Sustainable Competitive Advantage” in an ever faster changing business environment? What are the steps that I should follow to become successful in the long run? How to link national and firm level advantages?

---


2 “Broadly speaking, investing to create and sustain competitive advantage is one of the best measures for dealing with a downturn, provided the advantage can be achieved cost effectively.” Ghemawat (2009)

1.1.1. **Competitive Advantage**

The driving force behind excellent performance is **competitive advantage**.

Competitive advantage has its source in either a

- Higher price or a
- Lower cost position.

**Determinants of Relative Performance**

![Determinants of Relative Performance Diagram]

When we think about competing in a global economy, i.e. competing across countries, we have to be very careful to break the costs into two parts:

1. One part of costs that has to do with the costs of inputs used (how high the wages are, the cost of raw material, electricity, buildings, etc.)
2. The other part of costs has to do with the efficiency with which the inputs are used, i.e. the productivity.

What we see is that developing countries have low cost because the inputs are cheap (labor, material, etc.), whereas advanced economies can often be “low cost” countries because they are much more efficient and more productive in the tasks that they perform.
Ideally, you want to be more productive in what you do!

When you are more productive then you can allow your wages to increase and you will enjoy a higher standard of living. Thus, the way how firms compete and what forms the basis of their competitive advantage becomes very important.

The process of economic development requires a process of transformation where a company that is located in a less developed country (LDC) shifts its advantage from lower input costs to ultimately higher productivity. Most frequently you see countries start out competing on cheap inputs (low-cost-labor, cheap resources, lots of abundant land on which you can plant foodstuff). The next stage in economic development usually is where you become much more efficient because you can use more efficient machinery or capital equipment. As you don’t have unique products you cannot command very high prices. But, nevertheless, you can be much more efficient and you start moving up the ladder of productivity. The very advanced countries are those that can achieve higher value products, i.e. unique products to be sold at very high prices which support even higher levels of productivity.

1.1.2. Value Chain

When thinking about cost and price, the fundamental tool for analyzing competitive advantage at the firm-level is the value chain. When you compete as a business you are conducting a whole series of activities of various types and it is those activities that give rise to that competitive advantage.

If you have a lower cost, it is because you are more efficient at some place in the value chain, or if you receive premium prices, this is because you can do things better than your rivals at some stage of the value chain. For example, you may have a better “After Sales Support” or you may have a higher performing “Product Design” than your competitors, or you may have fewer defects in manufacturing the product (as the Japanese had in the manufacturing of DRAMs).

Therefore, when we try to diagnose the differences in firms’ performance (within countries and also across countries) we are looking at differences in the value chain to answer the question: Why is the competitive advantage of company A larger than that of another company B in the same industry?

The value chain has to be tailored and adapted to each industry! Every industry will have a different value chain as the activities performed in the industries will be different. The general concept of the value chain is shown in the graph below.
How do (global) firms MNCs) decide where to do what?

Company decisions that are made in a global economy require good global overall strategic thinking. As many activities are performed by global MNCs in different parts of the world the global strategist has be aware of the possible steps a MNC can take to enhance the value of the location (outsourcing). One extreme is the local market - in a local industry you conduct all the activities in the local market while in a global industry (at the other end of the spectrum) you can say: I plan to do research in part A of the world, manufacturing in part B and will do something else in part C. So the global firm thinks about how to locate activities from an international perspective to maximize the superiority that it achieves. We try to understand what really drives the economic choices of the actors that we care about (which are the strategists in companies) and ask: What could cause a MNC to internationalize and to do more in different locations?

Again, the basic tool for understanding how to think about globalization and internationalization of the MNC is the value chain.

Many of the activities in the value chain can nowadays be done in any location (like operating your IT-center or call-center or manufacturing your engines, etc.) depending on the industry you are analyzing! As every industry is different, the strategic decisions have to be different and depend on what kind of business fits the country’s strengths and capabilities.

From the point of view of a country we can say that countries also want to capture the activities that are the most productive ones, i.e. these are the ones in the value chain that require a lot of skills, a lot of expertise and that will ultimately support the high wages. You want to capture those parts of the value chain in your country that support productivity! (this is true for all global
firms independent of whether they are located in developed economies or in less developed countries).

1.1.3. \textit{Operational Effectiveness vs. Strategy}

When capturing the competitive advantage, there are typically two ways to get an advantage in the value chain:

1. through assimilating and extending best practices (\textit{operational effectiveness}) and
2. through creating a unique and sustained competitive (strategic) position –

\textit{- and in order to be successful you have to do both!}

Ad (1): \textbf{Best practices} are universal things that are good for everybody. For example, a “best practice” would be having the most modern machinery in your plant, i.e. you find the best machinery in the world to do the machining, you buy that machine, thus you assimilate best practice in that part of the value chain. If your machine is newer and more effective then you have an advantage. \textit{This is one way how firms compete.}

Another example of “best practice” would be to have the latest generation of computer-aided design of software, one that is more powerful and efficient than the previous one. “Best practice” could also be thinking about outsourcing and managing your supply chain by using the latest thinking, application of ideas and research. So there are many best practices and one way to get a competitive advantage is to be the first to implement the best practice in your company. Theory tells us\textsuperscript{4} that \textit{“operational effectiveness”} is something that you have to do – however, it is not likely to give you a \textit{sustained} competitive advantage because if you implement the best practice it won’t be long before your competitor will imitate your best practice (and will also buy the new machine). You might have a temporary advantage but not a sustained one!

For anyone (firm, state, nation) the first challenge of development is to become operational effective. LDCs are obviously disadvantaged in the process of upgrading their economies as most of them are stuck with an underdeveloped infrastructure - they are well behind “best practice”, the plants are deficient, they don’t have the latest machinery, nor good IT-systems or good logistics, many have a weak property rights structure, have lower investment, rely on foreign partners in everything they pursue, show a lack of up-to-date product performance, and compete almost solely on price. Such countries typically simulate the technology that has already been applied in the rest of the world. For them the problem is how to create an environment that is appreciated by foreign investors so that they actually build their presence in that particular country. The corporate sector in LDCs faces the challenge to transform itself and to create the conditions that enable them to move up the ladder of productivity, to implant more sophisticated activities in the value chain, to create more advanced skill requirements and build out more R&D-content.

\textsuperscript{4} See Porter, M. “What is Strategy”, HBS 1996
Ad (2): The basis for a sustained advantage stems not from just implementing the best practices but from creating a **unique value proposition**, i.e. a unique competitive position or **strategic uniqueness**.

*You have to compete to be unique!*

This requires that you deliver some *different products* and some *different value* to the customer. This requires that you relentlessly keep innovating by applying distinctive activities, come up with new products and unique practices, plus: you have to be fast (be first in the market) in all the activities performed.

### 1.1.4. Strategy Characteristics

A good strategy carries basically five characteristics:

- **A unique value proposition compared to competitors.** You try to do something different. If you are not trying to do something different you don’t have a strategy as you just compete on operational effectiveness. You must have a different value proposition. A value proposition is to answer:
  - *What customers?* (What end users? What channels?)
  - *Which needs?* (Which products? Which features? Which services?)
  - *What relative price?*

  If you have a strategy then a particular company has made different choices about these questions compared to its competitors. As there is no “best product” it all depends on what needs you try to meet.

  *This is at the heart of a good strategy: to have a really clear idea which needs you want to meet (and then let your competitors meet the other needs).*

  **The biggest mistake in strategy is to try to serve all the needs!** (which almost guarantees you will not serve them very well).

- **A different tailored value chain.** Besides the fact that a company has to make a choice to distinguish itself in terms of the value proposition that it offers to its customers, it also has to make a choice about how to distinguish itself in terms of the way it conducts its activities in the value chain.

- **Clear tradeoffs** – to choose what **NOT to do.** On the one hand you have to decide what you intend to do, but you also have to decide what you won’t do! Unless you choose not to offer certain needs or features you won’t be very good on those that you do offer. Tradeoffs occur when (a) strategic positions are incompatible (incompatible product or service features or attributes) so that there is a need for choice, (b) when there are inconsistencies in image or reputation across positions or (c) when there are
limits on internal coordination, measurement, motivation and control. Tradeoffs make a strategy sustainable against imitation by potential rivals.

d. Activities that fit together and reinforce each other. An important characteristic of a good strategy is to tie the various activities in the value chain together. If it is very hard for rivals to imitate the features of the product, the supply chain, the store location, the production system, the logistical system and the marketing chances are high that rivals don’t even try to enter (see Zara as an example).

e. Continuity of strategy with continual improvement in realization. To have a good strategy you have to do it for a while – do not shift direction frequently.

A summary is given in the following chart:

Five Test of a Sound Strategy

Overview

- A unique value proposition compared to competitors
- A different, tailored value chain
- Clear tradeoffs, and choosing what not to do
- Activities that fit together and reinforce each other
- Continuity of strategy with continual improvement in realization

Remember - There was this set of fundamental questions that we wanted to answer:

Why do companies succeed? How do companies succeed? Why do different firms – even when facing the same business environment – perform differently?

Applying Michael Porter’s theory of strategic behavior assures that in order to be successful you have to be operational effective and at the same time you must be able to create a unique and sustained competitive position.
B. Industry Analysis

1. Conceptualization of Firm Performance

There are a number of important conceptual tools to analyze differences in competitiveness among companies, industries, and nations.

The theoretical model on which an industry analysis is based refers to the classic, standard Industrial Organization (IO)-approach in the Bain-Scherer tradition. This approach embraces firms, industries and the nation as it applies the so called “Structure – Conduct - Performance Paradigm” (SCP Paradigm) as a theoretical tool. “This paradigm was originally developed to help governments identify industries within which social-welfare-maximizing perfect competition dynamics were not unfolding”.

1.1. Industrial Organization and the Structure-Conduct-Performance Paradigm

The standard Industrial Organization (IO)-approach in the Bain-Scherer tradition puts the structure, conduct and performance paradigm (SCP) in the center/focus of analysis. This concept requires a good understanding of basic Microeconomic Theory (especially (neo-classical) price theory). (see next page)

---

6 Barney, op.cit., p. 54
The Structure-Conduct-Performance Paradigm

**Basic Conditions**
- Technology
- Labor skills and organization
- Legal framework
- Raw material sources
- Transportation cost
- Purchase method
- Substitutability
- Price elasticity
- Rate of growth
- Cyclicality and seasonality

**Market Structure**
- Number of sellers and buyers
- Product differentiation
- Barriers to entry
- Vertical integration
- Diversification

**Conduct**
- Pricing strategies
- Product design strategies
- Research and innovation
- Promotional strategies
- Plant investment strategies
- Legal tactics

**Performance**
- Allocative and "X" efficiency
- Equity
- Progressiveness
- Macroeconomic stability

**Public Policy**
- Taxation and subsidies
- Regulation
- Price controls
- Antitrust
- International trade rules
- Basic research
- Information and education
- Public ownership

Source: Scherer (2003)
1.1.1. Characteristics of the SCP-Paradigm:

a. Basic external conditions of Demand and Supply

On the supply side they include: raw materials (and other inputs like the level of employee skills), product and production process technology, unionization (the degree to which workers are organized), product durability, value/weight (whether products are expensive or cheap to transport from factories to loci of consumption), business attitudes, and the legal framework in which corporations operate.

On the demand side they include: price elasticity of consumer demand, the existence of substitutes for firm and industry products, rate of growth of demand, cyclical (whether products are bought repetitively or occasionally) and seasonal characteristics (are there time patterns in consumer purchases), purchase methods (like impulse purchasing, comparison shopping), and marketing type.

b. Determinants of Market Structure

Defining the market is important when we try to measure the concentration ratio and the extent to which a market is dominated by one or a few large producers. Determinants of market structure include therefore primarily the number of firms and the extent of foreign competition (e.g. from within the single market or in global markets), the market share of the largest businesses (measured by the concentration ratio), the nature of costs in the short and long run (for ex., entry costs into a market, capital costs which will vary from industry to industry, sunk costs (related to advertising and marketing), depreciation of capital equipment; are there natural cost advantages such as location advantages (when you are located close to ports or when you have access to cheaper labor or important raw materials), the degree to which an industry is vertically integrated upward and/or downward in the supply chain (e.g. forward and backward vertical integration), the extent of product differentiation or product branding (are these homogeneous goods that bear essentially the same physical characteristics – which is associated with perfect competition – or are the goods non-homogeneous goods, are the products differentiated from their competitors through branding, or packaging and marketing – if there is strong product differentiation and brand loyalty this allows firms to charge higher prices, demand becomes less price elastic, reduction in the cross-price elasticity of demand), price and cross price elasticity of demand, the number and size of buyers of the industry’s product, the turnover of customers from one seller to another (“market churn”) – this might be affected by brand loyalty and the effects of advertising and marketing.

c. Determinants of Market Conduct:

Market structure will affect the behavior of firms. How does market structure affect pricing, output and other decisions of businesses within the market (for ex., product strategy and advertising, research and innovation, plant investment, and legal tactics).
Are there dominant firms? Is there evidence of anti-competitive behavior (such as collusive pricing agreements or predatory pricing), are there vertical restraints? How important is non-price competition in the market? Is there *interdependence* between firms? Do businesses behave strategically to retain profits by deterring the entry of new competitors in the long run?

d. **Criteria to determine Market (Industry) Performance:**
The criteria to determine market or industry performance are related to welfare economics, that is, productive and allocative efficiency, progress (dynamic efficiency), full employment, equity and justice. The terms “market” and “industry” are often used inter-changeably. The criteria are aimed at **public policy** (not business policy!) as they include taxes and subsidies, international trade rules, regulation, price controls, antitrust and information provision, trends in real price levels over time and the size of business profits (do we find evidence of excess profits?). What is the level of spending on research and development – does it lead to a faster pace of technological advancement and innovation? How much is spent on human capital, does it lead to rising labor productivity in the industry? Does the conduct of firms give rise to efficient outcomes in relation to allocative efficiency, productive efficiency and dynamic efficiency?
1.1.2. Procedure

The structure of an industry determines the conduct of buyers and sellers and, by implication, its performance along such dimensions as profitability, efficiency and innovativeness. Market Structure (especially the number of competitors and the degree of rivalry between the competitors) is the principal influence on a company’s behavior (Market Conduct) whereby market structure itself depends on the external conditions of supply and demand and results in the attempt of firms to influence the Intensity of Competition. At the same time Public Policy might have a direct impact on both Market Conduct and Market Structure. An example might be public utilities competing with private sector firms. Incentive systems (like taxes and subsidies) are frequently tailored to the conditions of individual industries. A company’s conduct will be influenced by the way government regulates a market (for example, through price controls or other interventions).

The final outcome (Performance) centers around the “big trade off” between equity and efficiency. “Good performance is what a nation’s citizens ultimately seek from their industries.” There is an obvious feedback-effect (as shown by the dotted lines in the Figure on p.10) incorporated in this process as Market Conduct, for ex., will also impact the Basic Conditions while the Market Structure will, in turn, shape the Basic Conditions (of Supply and Demand). This implies that the chain of causation does not run in only one direction. Pricing and product strategies can have an impact on the structure of the market, legal tactics (like lobbying) can have an impact on public policies or on entry into the market.

Bain and Scherer advanced the research program of uncovering general relationships between industry structure and performance through an extensive set of empirical studies for the US. The same was done in Europe by Manfred Neumann, Ingo Bobel and Alfred Haid who published a number of empirical studies on the question why some industries were more profitable than others.

---

8 Scherer (1996), p. 3.
1.2. SWOT Analysis

Strategists often use a technique called **SWOT** — an acronym for *Strengths, Weaknesses, Opportunities, and Threats* - to determine the final choice of products and markets (economic strategy)\(^{10}\). Though some scholars downplay SWOT's effectiveness, it is not a bad starting point for analyzing your position relative to that of your rivals. The output of a SWOT analysis varies, but key data typically includes a comparison of four basic elements:

1. **Environmental Conditions and Trends** (economic, technical, physical, political, social – related to the local community, the nation, the world) which are related to
2. **Opportunities and Risks** (identification, inquiry, assessment of risk)
3. **Distinctive Competence** (these are financial, managerial, functional or organizational capabilities, reputation and history) is related to
4. **Corporate Resources** (as existing or constraining opportunity, identification of strengths and weaknesses, programs for increasing capability).

Arguments like financial power, strength or weakness of management teams, strength or weakness of marketing capabilities, presence or absence of patents or intellectual property protection, and an assessment of distribution channels should as well be used to determine the best match between “opportunity” and “resources”. The SWOT analysis also includes the external market conditions to assess potential opportunities and threats.\(^ {11}\)

How to perform a SWOT analysis?

Typically, the following three-step process is applied:

1. Perform an external analysis and LOOK OUTSIDE THE (GLOBAL) ORGANIZATION (= the market for goods and services)
2. Perform an internal analysis and LOOK INSIDE THE (GLOBAL) ORGANIZATION (= identify the internal capabilities/resources)
3. MATCH THE INTERNAL CAPABILITIES AND THE EXTERNAL ENVIRONMENT? (= strategic fit)

---


\(^{11}\) Find out more about SWOT in BNET's "Analyzing Your Business's Strengths, Weaknesses, Opportunities, and Threats."
1.2.1. The View from Outside (external analysis) to find out about Strengths, Weaknesses and Opportunities:

Identify the Threats and Opportunities from Outside (similar to what Porter describes as “how to relate a company to its environment”) that might affect your business in the future and force you to reformulate your strategy—such as:

- Potential entrants
- Existing customers
- Demographic changes
- Suppliers that try to cut you off
- Substitutes that undermine my business
- Macroeconomic trends that influence my customer’s ability to pay
- Competitors who can produce the same quality goods at a lower price or a better product at the same price
- Distribution issues
- Technology
- Regulation

Ask: Where can potential threats to my market position come from? Can they come from (1) the customers’ side or (2) can they come from incumbent firms? To give an answer you have to understand your customer. A good strategist must know his/her (current and potential) customers. Therefore, any analysis of the external environment starts with a deep demand analysis (“customer analysis”).

- Most importantly you must know: Who are the customers?
- Can we identify common features for the customers? Can we segment the market according to such features in a homogeneous way (according to age, gender, geographic location, type of users, income, behavior)?
- What is important to customers? How are they using a product/service?
- Are they price sensitive? (Price elasticity of demand)
- Which needs aren’t being served (or just poorly met)?
- What new strategies are my competitors starting to employ?

Or do potential entrants pose a threat? What are the potential substitutes for my product? And at the same time try to find positive arguments for potential opportunities that you see for your enterprise.

A good external analysis also requires that you know who your competitors are. Such competitors can be firms that are already established in the market (incumbent firms) or they are potential newcomers, that is, firms who plan to enter the market in the near future. Developing a detailed picture of your competitors’ activities usually requires extensive analysis. Competitive intelligence is a field of strategic research that specializes in the collection and analysis of

---

12 This is not an exhaustive list—you might come up with more arguments when pondering the problem. See HBS Press, “Strategy: Create and Implement the Best Strategy for your Business”, Boston, 2006
information about rival firms, to gather information about their strengths and weaknesses. It is about adhering to a strict ethical code by collecting bits of information that are available either in the public domain or from other players in the marketplace.\(^{13}\) The goal is to amass enough data to make meaningful comparisons between your firm and your competitors — and to make better-informed strategic decisions as a result (to move strategically ahead”\(^{14}\)). You have to establish the strategic problem and to formulate a competitive strategy by DEFINING YOUR QUESTIONS BEFORE YOU BEGIN THE SEARCH FOR ANSWERS. Developing a competitive strategy begins with a rigorous evaluation of how your organization performs relative to one or more of your rivals. You must know your cost, value and price-framework (that is, apply the cost-value-price logic!\(^{15}\) - guesswork and gut feelings aren't rigorous; meaningful comparisons are possible only when you assess your own and other firms’ performance on the basis of quantitative data and thorough research. This enables you to clearly define the challenges your firm faces.\(^{16}\)

It is essential to define what G. Day and D. Reibstein called “defining the competitive arena”\(^{17}\) by being clear about what “competitive questions” you want to ask and what kind of research data you will need to formulate meaningful insights.

Generally speaking, most strategic problems boil down to one or more of the following questions:

- What products and services do you and your rivals offer, and what are their comparative benefits?
- What companies might produce similar products to yours?
- How significant are the resources (marketing budget, R&D budget, spin-off, or upgrade plans) your rival plans to deploy?
- How much does it cost you and your competitor to produce comparable products? Does one of you enjoy a cost advantage?
- Where do you and your rival sell products, and to which target audiences?
- How do your sales perform for different customer segments?
- What products does your rival have in the pipeline, and how will they be marketed?
- How is your rival's company organized? How well are operations performing?
- What are your rivals' sales channels (store, mail order, Internet)? What is their sales mix, and will it change?
- Is your rival considering a joint venture or strategic partnership?

Thus, more specifically, ask:

- Who are my top (three or four) competitors? (list them)

---

\(^{13}\) See HBS case no.......case on ethics written by Porter 1986 (check exact source)

\(^{14}\) Burgelman and Grove (2007)

\(^{15}\) See Shlomo Maital.....(2000)

\(^{16}\) Perhaps a rival is entering a foreign market first, or has found a way to lower prices through more efficient production. Perhaps your competitor's new management team has streamlined a sloppy organization, leaving the company with excess cash to spend on acquisitions. Having a handle on this kind of information makes it possible to redeploy your firm's money, time, manpower, or R&D efforts to maximum effect.

\(^{17}\) George Day and David Reibstein, Wharton on Dynamic Competitive Strategy, N.Y.: Wiley, 1997, p. 23
Market Structure, Conduct and Competitive Strategy

- How long have they been in business?
- Are they successful (profitable)?
- What is their size? Revenues?
- Are there other companies servicing the target market with a similar product?
- What is their market share?
- Are they expanding? Scaling down?
- How can I distinguish my company from my competitors?

Do improvements in technology, for ex., provide you with an advantage over the rival firms in your market? How does the Internet influence your business (is it a threat or an opportunity?) – does it undermine your business or does a new technology enhance your activities?

How do macroeconomic trends (for ex. the current financial crisis or shifts in the labor market) affect you and your rivals? Can I fill a niche in the market or does any of my products have substitute potential in another market? What is a threat for your company can be an opportunity for your rival, and vice versa.

1.2.2. The View from Inside (internal analysis): Resources, Capabilities, and Practices as Sources for Strengths, Weaknesses and Opportunities

The quest for competitive intelligence begins in your immediate environment\(^\text{18}\). To assess your competitor's strategic position, you must be aware of your own business situation. The critical information you need is your company's financial data: ask your CFO for data on cash flows and/or the ways to access outside capital (can you finance a new project from current sources or do you need outside creditors or investors), what is the financial performance of current operations (ROI), is the performance stable or is it deteriorating?

Be knowledgeable about the company’s marketing plans, R&D roadmaps, product plans (product ranges, price ranges, brand portfolios), distribution processes (retail and distribution network), supplier relationships, and especially, know the productivity figures. Why is this important? Because you should know yourself (know your cost-price-value framework) and – ideally - that of your rivals:

- Who am I and who are the players (competitors)? What specific companies are servicing this market?
- What types of goods are they offering (substitutes, complements)?
- How sensitive are these goods to price (therefore, you must know the meaning of the important concept of the (cross price) elasticity of demand!\(^\text{19}\))
- Which firms should I consider as competitors?

\(^{18}\text{C. Cohen (2009) (book on Strategic Intelligence)}\)

\(^{19}\text{Go back to a basic economic textbook and read in the microeconomic section about the concept of elasticities.}\)
What are resources? What are the capabilities? The capabilities or resources-based approach rests on Edith Penrose’s and Richardson’s idea to see the firm as a collection of capabilities. What makes them distinctive? Are there core competencies?

The concept of a corporation’s “distinctive competence” has already been discussed by K. Andrews and T. Levitt in the 1960s and was revived in 1990 by C. K. Prahalad and G. Hamel. A “core competence” is simply something a company does particularly well (where it shows a superior performance) and, at the same time, it is a capability that puts the company in a position to consciously deliver key benefit to the customer (based on the creation of some uniqueness that is highly valued by the customer). It describes “collective knowledge” rather than accomplishments of individual members in an organization. Each core competence results from the interaction of certain intangible assets, often from entirely different areas. A core competence can, for instance, be the ability to build up and cultivate longstanding customer relationships going beyond the strictly business sphere; the intangibles behind this can range from a command of social skills (human capital) through a strong brand (relational capital) to customer databases intelligently networked company-wide (structural capital). Often, it is precisely this combination of quite different intangibles that makes an especially strong contribution to the company’s (financial) value creation. Intangible assets can be both resources and processes. However, the “state” of an intangible asset cannot usually be measured directly. As a rule it must be described by a set of indicators, which provide a good approximation only in combination.

Such a competency is only meaningful when it is put into context, that is, when it is compared with that of your rivals. Therefore, one has to find a way how to assess the strength of your core processes. How can one compare one’s own activities against similar activities performed by other actors who are recognized for applying best practice. A common method to identify opportunities for (core) process improvement which is based on such a comparative analysis is benchmarking.

Besides all relational, structural, financial and economic factors, human capabilities (we call them “internal capabilities”) should not be overlooked and have to be taken into account! Are managers respected and effective? Is the individual employee personally motivated to change? Is the organization hierarchical or nonhierarchical? Are people accustomed to work together in a collaborative way? Does a culture for accountability for results exist? Are managers held responsible for carrying out a defined set of duties or tasks, and for conforming with rules and standards applicable to their posts? How is performance rewarded (is there an incentive system in place)? In other words, the “right set of people” must be aligned with the strategy (Porter calls it: ”fit” and/or ”alignment”). One possible solution: Address the Threats and Opportunities to find out “what are the “driving forces” of competition”? Always think of (and hopefully implement) alternative ways – there is always more than just one way!

20 See John Kay (2007)
22 See Collis and Montgomery (1995), pp. 118-125. They suggested that a resource or core competence has to pass a number of tests such as: the test of inimitability, durability, appropriability, sustainability and competitive superiority.
23 See Porter, Competitive Strategy, p.
1.2.3. How to evaluate Strengths and Weaknesses

As already said before: guesswork and gut feelings aren't rigorous; meaningful comparisons are possible only when you assess your own and other firms’ performance on the basis of *quantitative data and thorough research*. This enables you to clearly define the challenges your firm faces.

However, a practical problem is: *Who should perform this task?* You need to select and enlist specialists (industry specialist-executives, scientists, or engineers) to facilitate access to and cooperation from relevant information-gatekeepers who gather the fundamental data, as well as views from customers, suppliers etc. Create a SWOT-team with specialists from different functional areas of the firm. “It is the iron law of competition: leading an effective team or organization is above all a question of bringing different talented people together to perform at their best.”

In addition to collecting the needed data you also want context. If sales are up, is that because the new product finally gained momentum after marketing launched an advertising campaign, or is it because prices were cut and a rival discontinued a competing product? So brainstorm the results and the impact the results might have on the firm and then identify the top two, three or four strengths - and do the same for identifying the weaknesses.

---

24 James Allen, op.cit.
2.3. Industry Analysis and Porter’s Five-Forces

2.4.1. How to think about competition and strategy?

To formulate an effective corporate strategy, it is essential to have an answer to basic entrepreneurial questions. Not only is it important to know:

“What is your company doing”, and

“What are your competitors doing?” –

- more fundamentally, it is necessary to understand that implicit in the “Theory of Strategy” is a “Theory of Competition” that explains the nature of competition and what it takes to win. There seems to be a lot of confusion among managers about “how to think about competition” and what kind of competition you really want when setting out a strategy that will allow the company to be successful in the long run.

The most intuitive and common way of thinking about competition is that in any industry companies are competing to be the “best company” in the industry. This requires that you have the best product, the best manufacturing, the best supply chain, the best delivery service process, etc. When you are able to figure out “how to be the best” then you will win. This naïve way of thinking about the existence of one best way to compete would lure everyone to follow the same direction: if everybody wants to climb the same mountain, the peak of the mountain would get overcrowded and in the end it would get very hard for anybody to be successful at all. Typically, there really is no best way to compete as, for ex., there is no “best car” (as it all depends on what you will use the car to do for you) and there is no “best soap” (as it all depends on your specific needs).26

Therefore, a more rational way to think about competition and strategy is to find out “how to be unique?” “Uniqueness is the ability to succeed in meeting an important set of needs that an important set of customers have!”

From a strategy point-of-view the worst mistake is to compete with rivals on the same dimensions, that is, to engage in an arms-race where you fight on the same thing and ultimately nobody wins27. It is very difficult for a single firm or company to actually dominate an industry or market. You rather have to find a way to carve out a unique position in a market (niche) and to differentiate yourself from the rivals.

25 The following draws on material published by www.bnet.com; see also M. Porter (1980; 1998)

26 See knowledge@wharton, November 1, 2006: “Michael Porter asks, and answers: Why do good managers set bad strategies?” (http://knowledge.wharton.upenn.edu/article.cfm?articleid=1594)

27 Porter, M.E., What is Strategy, HBS 1996
2.4.2. Step by step procedure to formulating a competitive strategy

2.4.2.2. What does it need to become successful?

The essence of company strategy (and company success) is not just a single thing, it is rather a combination of different characteristics and different principles you should follow:

(1) Start with the right definition of your company goal! To maximize the company’s profit or ROIC (return on invested capital) is the primary goal to follow – rather than just “grow your business” or to maximizing shareholders’ value (because if you just measure a company’s success by the stock price you implicitly want to “please the shareholders” – which ultimately will not be the right path to follow - it may rather do harm to the company in the long run). “To think that stock price on any one day, or at any one minute, is an accurate reflection of true economic value is dangerous, he noted. Research shows companies can be undervalued for years. Conversely, during the Internet bubble, managers whose motivation and compensation were tied to stock price began to believe and act as if the share price determined the value of the company. Managers are now beginning to understand the goal of their companies is to create superior economic performance that will be reflected in financial results and eventually the stock price.”

We know there's a lag and it's ugly. But it's important that a good manager understands what the real goal is -- not spend time pleasing the shareholders."Just to grow your business is easy. You can grow your business by making some (stupid) acquisition, or by cutting the price in half, or even giving your product away for free (as some internet companies did) – which is rather absurd – as, for sure, everybody loves your product as it was for free, but it does not help you in the long run. In practice you see companies with lots of different objectives (they want to be big or want to have a large corporate group and there is little corporate governance pressure on the companies) and many of them have problems in improving their competitiveness. Why? Because if companies are not pushed to earn a profit, then it is very hard for any country to move ahead. A problem relates to the measurement of profitability, i.e. what measure one actually uses. Given the problems surrounding different accounting rules and accounting policies, you have to ensure that you measure profitability in a fair way. When companies are given the opportunity to simply write off investments (in order for your ROI to go up) then accounting policies are getting in the way of measuring profits fairly! Profits are getting distorted as managers are making bad and uneconomic choices. Another example is related to the "Bermuda Triangle of strategy" (which ) is the confusion over economic performance and shareholder value. "We have had this horrendous decade where people

---

28 Knowledge @wharton, Nov. 1, 2006(http://knowledge.wharton.upenn.edu/article.cfm?articleid=1594) For Shareholder Value as a Strategy. (source: http://blogs.hbr.org/hbr/hbreditors/2010/01/the_decade_in_management_ideas.html?cm_mmc=npv--DAILY_ALERT--AWEBER--DATE : "The notion of producing attractive returns for investors is as old as investing, but this was a decade when the pursuit of shareholder value eclipsed too much else. Increasingly sophisticated tools and metrics for value-based management pushed the consideration of stock price effects deep into operational decision-making, and made sure everything pointed toward bonus day. By 2009, even the man most stock most of value was saying it was a dumb idea. "Shareholder value is a result, not a strategy," Jack Welch proclaimed. "Your main constituencies are your employees, your customers and your products."

29 "Freebie marketing" is described : http://en.wikipedia.org/wiki/Razor_and_blades_business_model
thought the goal of a company is shareholder value. Shareholder value is a result. Shareholder value comes from creating superior economic performance."

Thus, unless you are making a sustained and reliable good profit you don’t have the right compass to guide your strategy!

(2) The number two-objective is to grow. Growth without earning a good profit would lead to failure in the long run, does not create economic value and does not give you a long run viable product. Porter et al. discuss some of the problems that Japanese companies encountered as they were managed not to earn a good profit – rather they were managed to grow their business and to earn a market share as high as possible. This led Japanese companies to make a lot of bad strategic mistakes: they imitated each other, copied and had too many products in the pipeline, were unfocused. Rather than to worry about their ROIC they wanted to be big, and when they were big they had to serve the whole market, offer all the product lines, had to provide all features. This fundamental difference in goals between Japanese companies and Western companies was ultimately the downfall of many Japanese companies in terms of strategy (and has led to the 12-year disaster period in Japan).

(3) What are the governance structures like? How do these affect the fundamental motivations of the company?

(4) You have to develop a unique value proposition. This means that you have to offer a different value than your rival in terms of the product, service, price-value-combination (again - think of the principle of the “cost-value-price”-logic).

(5) Finally, you have to find a way to configure your company, i.e., to configure your value chain in a distinctive way that allows you to deliver unique value. If you produce in the same way, if you market the same way, if you deliver in the same way – then you will never be “unique”. You must design your own value chain that is tailored to your specific needs. How to combine these various elements is a very complex process and needs a lot of attention in order to do it right.

There are a number of additional factors to consider:

Watch your Potential Competition (potential newcomers). Your competitive analysis should include any potential entrants and new players, even if they haven't yet captured a significant market share. New companies often bring new ideas and innovations to the marketplace and can quickly become major players. Don't underestimate anyone!

Future Competition. In your competitive analysis, you need to make a few predictions about what the competition is going to look like in the future. Competitors are constantly coming and going in the marketplace. Ask yourself: Who are my competitors likely to be in the future? If you are introducing a new product, how long might it take for the competitors to catch up? Forecasting future competition will give your potential investors the confidence in the long term viability of your business.

---

30 knowledge@wharton, Nov. 1, 2006
32 See Maital (2003)
Barriers to Entry. Companies whose competitive edge depends on new technology, new manufacturing techniques or access to new markets need to be aware of the common barriers new competition faces when trying to gain entry into the marketplace. They include:

- **Patents.** Patents provide protection for new products or services.
- **Market Saturation.** Saturation reduces the chance of competitors gaining a foothold in the market.
- **High startup costs.** This is a difficult obstacle for small competitors.
- **The need for significant expertise, or manufacturing and engineering difficulties.** This makes it difficult for competitors to have the knowledge to compete.

2.4.2.3. How to determine YOUR Competitive Strength in the Marketplace

By now it should be fairly clear to you whether you are a market leader, or one of several followers, or newcomer to the market. Once you have identified and analyzed your competition, and understand your competitive position, you are ready to do the following:

- Set up a **positioning map** and develop a specific **typology** (for which you have to justify the choices made). Possible (product specific) categories could be: Luxury (premium brands, luxury brands, affordable luxury); traditional vs. innovation based; global reach vs. national roots (development stages); distribution channels.
- Identify and discuss key areas of competitive advantage and disadvantage. Review the competitive environment for your product or service. Comment on both similar and substitute products or services.
- Summarize the major problems and opportunities facing your firm which may require action (SWOT). Issues which should be considered include types of market penetration, distribution coverage, product line needs, price revisions and/or cost reductions.
- Integrate your analysis of the competition with demographic analysis of your market to develop and implement a marketing strategy that will strengthen your market position.
- What determines the sustainability of a competitive advantage?

**HINT:** Distinguish distinctive capabilities from reproducible capabilities! What makes you unique? And what can be easily reproduced, imitated, bought or created? **Uniqueness means:** create irreproducible capabilities (and have in mind the history, the market structure, and the tacitness in existing relationships!)

The problem is: How to match the capabilities to markets?
2.4.2.4. Drivers of Profitability

What really drives profitability and how do we connect strategy to profitability?\(^{33}\)

Profitability is driven by two very distinct factors:

1. One is the industry in which you are competing (industry structure) (and we know that industries differ tremendously in their sustainable profitabilities)
2. The second (more classical) determinant of profitability is the “relative position” within the industry

When you analyze competition you have to look at both factors!

When we look across countries we actually see differences in both factors as the nature of the (same) industry is very different in different countries and companies can gain very different positions when based in different locations.

We clearly see how big the differences are across industries in terms of long-term sustained profitability.\(^{34}\) It is interesting to see that the industries that are the most profitable and attractive industries – repackaged software, pharmaceuticals, semiconductors, electro-medical apparatus, restaurants, and medical instruments – are those where the US is also internationally very

---

\(^{33}\) This is covered very well in Porter, Competitive Strategy: Techniques for…… (1998)

competitive. There is a relationship between the attractiveness of the industry and the international competitiveness that you can achieve from a given location.

2.4.3. Traditional Competitive Analysis on the Industry Level: Application of Porter’s Five Forces

Michael Porter lists a number of “competitive forces” that capture the industry structure and define the long-run profit potential for any industry: customer bargaining power, supplier bargaining power, product substitutes, barriers to entry, and potential new competitors. Detailing these factors provides a foundation for establishing your firm's strengths and weaknesses, as well as those of your rivals.

The 5-Forces Model focuses on industries (both in developed and developing industries/economies). The model was derived from the traditional Bain-Scherer Structure-Conduct-Performance-paradigm that an industry’s structure determines the “conduct” and that in turn ultimately determines the “performance” of the industry in the context of the general economic environment. However, strategic emphasis was now directed towards the competitive environment in which firms are operating.

In a broader context of competitiveness we should know: What is the industry performance within the national economy? Which industries are successful? Which are not? Why are industries inefficient? Which industries drive economic growth? Which industries have a world-export-position? Which ones might have a detrimental impact on productivity? Why? Are there trade barriers or other restraints to competition?

On a micro-level, we identify any gaps where prevailing industry trends conflict with a company's strategic objectives. As we have seen from the SWOT analysis this corresponds to answers given to the following questions:

- How does the firm compete within an industry?
- What are the company's sources of competitive advantage?
- Does the firm possess generic strategies?
- In order to be different, how do firms decide whether they want to be “low cost” or “differentiated” or “focused”?
- Does the firm consider “positioning”?
- Does the company fill a niche in the market?

---

35 A good source is: http://www.quickmba.com/strategy/porter.shtml; see also Porter (2007)

36 Michael Porter, Understanding Industry Structure, HBS Case (9-707-493) 2007. For an additional overview see BNET’s “five basic forces”. Learn more about this method in “Porter's Five Forces.” In Appendix B in his seminal book “Competitive Strategy” (pp. 368ff.) Porter describes how one should go about analyzing an industry.

Market Structure, Conduct and Competitive Strategy

- What is the nature of the competitive rivalry within the industry for generating competitive advantage?
- What are the entry and exit barriers in the industry?

However, extending the view beyond the traditional models of market structures such as perfect competition (where in an idealized situation a large number of equally able competitors drive an industry’s aggregate economic profits down to zero), and pure monopoly (where there exists an inverse relationship between the profitability of a monopolized industry and the price-elasticity of demand (Lerner’s measure of monopoly power))\(^{38}\) supports the development of new insights into a more realistic world of competitive behavior of individual actors.

A study of the industry's structure – represented by the strength of the five competitive forces - will reveal just how attractive the industry is for a long-term investment.

From a practical point of view we follow an approach developed by Purdue University which recommends to set up a worksheet for each of the five forces. Then ask: is the threat from each of the forces high or low by answering a number of “forces specific” questions. We will go through such questions in the following paragraphs. Answer each question with “yes” or “no” and justify your answer\(^ {39}\).

---

38 See I. Bobel, Industrial Organization, Tuebingen (Demokrit Verlag) 1978
39 See Purdue University, EC-722, AICC: Industry Analysis: The Five Forces (C. Ehmke et al.) 2004
2.4.3.1. Force 1: Competition among current firms (= Degree of Rivalry)

List all major players in the industry (select, for ex., the “luxury players” you will study in your industry analysis). You will be primarily interested in finding out about the intensity of competition by uncovering data detailing the number of competitors in the industry, their comparative size, product lines, strategies, costs, etc. Much of this information should already appear in your information gathering and research on your competition. Characteristics are: price discounting, new product introductions, advertising campaigns, service escalation, etc. Have a good look at the development of prices! Prices are often easy to match by rivals. More concretely find out the following:

a. Is the industry growing rapidly?
b. Does industry demand fluctuate with the economy? Is it cyclical?
c. Are fixed costs of the business a relatively low or a relatively high portion of total costs?
d. Are there significant product differences and brand identities among the competitors?
e. Are the competitors diversified rather than specialized?
f. Would it be hard to exit? (Getting out of the business because there are no specialized skills or facilities or long-term contract commitments, etc.)
g. Would my customers incur significant costs in switching to a competitor?
h. Is my product complex and requires a detailed understanding on the part of my customer?
i. Are my competitors’ businesses all approximately the same size as mine?

2.4.3.2. Force 2: Threat of competition from potential entrants.

Barriers to entry are factors which prevent or deter the entry of new firms into an industry even when incumbent firms are earning excess profits. There are two broad classes of barriers: structural (or innocent) and strategic. These two classes are also often referred to as economic and behavioral barriers to entry. Structural barriers to entry arise from basic industry characteristics such as technology, costs and demand. There is some debate over what factors constitute relevant structural barriers. The widest definition, that of Joe Bain, suggests that barriers to entry arise from product differentiation, absolute cost advantages of incumbents⁴⁰, and economies of scale. Product differentiation creates advantages for incumbents because entrants must overcome the accumulated brand loyalty of existing products. Absolute cost advantages imply that the entrant will enter with higher unit costs at every rate of output, perhaps because of inferior technology. Scale economies restrict the number of firms which can operate at minimum costs in a market of given size. A narrower definition of structural barriers is given by George Stigler (1964), who suggests that barriers to entry arise only when an entrant must incur costs which incumbents do not bear. This definition excludes scale economies as a barrier. There is some debate as to whether Stigler’s

---

⁴⁰ An “incumbent firm” is a firm that is already in position and working in the market.
Market Structure, Conduct and Competitive Strategy

Ingo Bobel

definition includes costs not currently being incurred by incumbents or costs which have never been incurred by incumbents.

Other economists would emphasize the importance of **sunk costs** as a barrier to entry. Since such costs must be incurred by entrants, but have already been borne by incumbents, a barrier to entry is created. In addition, sunk costs reduce the ability to exit and thus impose extra risks on potential entrants.

Strategic barriers to entry arise from the behavior of incumbents. In particular, incumbents may act so as to heighten structural barriers or threaten to retaliate against entrants if they do enter. Such threats must, however, be credible in the sense that incumbents must have an incentive to carry them out if entry does occur. Strategic entry deterrence often involves some kind of pre-emptive behavior by incumbents. One example is the **pre-emption of facilities** by which an incumbent over-invests in capacity in order to threaten a price war if entry occurs. Another would be the artificial creation of new brands and products in order to limit the possibility of imitation. This possibility remains subject to considerable debate.\(^4^1\) It should also be noted that governments are sometimes a source of entry barriers through licensing or granting exclusive rights (copyrights or patents) and other regulations.

New firms are attracted when they see profit opportunities. Newcomers bring new capacity and the desire to gain market share. How easy or difficult it is to enter depends on (1) the existing barriers to entry and (2) the reaction from incumbent firms that newcomers can expect. **Major sources of barriers to entry** are: supply-side economies of scale, demand-side economies of scale, customer switching costs and capital requirements, incumbency advantages independent of size, unequal access to distribution channels, restrictive government policy. More concretely find out the following\(^4^2\):

- a. Do large firms have cost or performance advantages in your segment of the market?
- b. Are there any proprietary product differences in your industry?
- c. Are there any established brand identities in your industry?
- d. Do your customers incur any significant costs when switching suppliers?
- e. Is a lot of capital needed to enter your industry?
- f. Is serviceable, used equipment expensive?
- g. Have newcomers to your industry difficulties in accessing distribution channels?
- h. Does experience help you to continuously lower costs?
- i. Does the newcomer have problems in obtaining the necessary skilled people, materials or suppliers?
- j. Does your product or service have any proprietary features that give you lower costs?


\(^{4^2}\)The Ivey case "A Note on the Cuban Cigar Industry" (9B03M001) and TN (8B03M01) were of great help.
k. Are there any licences, insurance or qualifications that are difficult to obtain?
l. Can the newcomer expect strong retaliation upon entering the market?

2.4.3.3. Force 3: Threat of competition from substitutes

These are products or services that perform the same or a similar function and are not in direct competition with you, but whose presence affects the sales growth of the industry.

There are always substitutes around!

You can gather this data by analyzing secondary competitor groups and contacting associations pertinent to them. More concretely find out the following:

- Do substitutes have performance limitations that do not completely offset their lowest price, or their performance advantage is not justified by their higher price?
- Do buyers incur costs in switching to a substitute?
- Do buyers find easily real substitutes?
- Are your customers likely/not likely to substitute?

2.4.3.4. Force 4: The buying power of customers (buyers’ power).

To what extent are your customers “locked in” to you? Determine the buying power of customers by looking at the amount of competition and by charting prices. If too many businesses are cutting prices because of customer pressure and do not produce a sufficient profit, investment in the industry may be unwise. Besides forcing down prices, buyers can demand higher quality or service and so drive up costs, and thus play off the competitors against each other. Keep an eye on the price-sensitivity (price elasticity) of the customers! More concretely find out the following:

a. Who are the buyers? Is there a large number of buyers relative to the number of firms in the business?
b. Do you have a large number of customers, each with relatively small purchases?
c. Does the customer face any significant costs in switching suppliers?
d. Does the buyer need a lot of important information?
e. Is there anything that prevents your customer from taking your function in-house?
f. Are the customers highly sensitive to price?
g. Is your product unique to some degree? Does it have accepted branding?
h. Are your customers’ businesses profitable?
i. Do you provide incentives to the decision-makers?
2.4.3.5. Force 5: The negotiating or bargaining power of suppliers (suppliers’ power).

To determine supplier power within the industry, find out who the major suppliers are and the extent of their product lines. You can do this by looking through trade periodicals and contacting associations. Suppliers’ power can show up through raising prices, shifting costs downstream to industry participants, limiting the quality of goods and services. More concretely find out the following:

a. Are my inputs (labor, material, services, etc.) standard rather than unique or differentiated?
b. Can I switch between suppliers quickly and at low cost?
c. Would my suppliers find it difficult to enter my business, or would my customers find it difficult to perform my function in-house?
d. Can I substitute inputs readily?
e. Do I have many potential suppliers?
f. Is my business important to my suppliers?
g. Has my costs of purchases a significant impact on my overall costs?

Summary: In order to develop effective competitive strategies, you need (1) to make a realistic assessment of your competitors’ strengths and weaknesses, as viewed by the market. But you also need (2) to ask yourself what each of your competitors does very well, better than your own company. Then, (3) ask yourself in what areas is each of your competitors weak. Set up a simple overall industry rating chart in which you list the five forces and group them as being “favorable”, “moderate” or “unfavorable”.

The following questions will assist you further:

• Are we trying to market our entire product or service line? Or, are we trying to focus on a new product or a new service?
• What specific marketing strategies have we utilized in the past?
  o How has each strategy affected sales?
  o What strategies are we currently using?
  o How do our competitors market their product?
• How much money is allocated to marketing?
• When making a sale, do we survey our customers?
• Why would someone choose our product?
  o What differentiates our product from our competitors' products?
  o Why do people choose our competitors' products or services?
  o Do we need to enhance our current product or service?
• Where are our customers located?
  o Are they from a specific region?
  o How do we attract new customers?
  o How do we increase sales from current customers?
2.4.4. Industry cost structure and distribution

When researching the cost structure of an industry, the first thing you'll have to do is identify the stages at which you add value to your product or service (that is, *how to configure the value chain*).

A product-oriented business, for ex., will have the following stages:\(^{43}\):

- Procurement
- Processing
- Fabrication
- Assembly
- Distribution
- Marketing.

Each stage adds additional value to the final product. Most trade associations have information regarding production and marketing costs for their respective industries.

2.4.4.1. Distribution systems

This section applies mainly to manufacturing (MFG). If yours is a business that most likely relies on additional distribution systems aside from your own sales force, you should conduct research into the best distribution system available.

When researching distribution systems within an industry, ask yourself three strategic questions:

- What are the current distribution channels and who controls them?
- Are any alternative distribution channels available?
- Have any new distribution channels emerged? Are any likely to emerge?

Many large industrial companies use their own sales force to sell directly to their customers. Other, smaller firms might sell directly to retailers or through wholesale distributors, brokers or agents.

In general, companies that sell more directly to the end user have more control over their marketing efforts, but also face greater risks.

\(^{43}\) A service business, of course, would not have “fabrication” and “assembly”.
2.4.4.2. Key success factors of your competitors

Perhaps the most important result of your industry analysis will be the identification of the key success factors of your competitors. Key success factors are assets and skills (capabilities) that a company within a particular industry must have to succeed.

Key success factors might be:

- Name recognition (brand, reputation)
- Access to distribution channels.
- Financial resources.
- Loyal consumers.
- Access to factor inputs (such as raw material).

Whatever the key success factors happen to be in your industry, the completed analysis of the industry should define them and provide you with enough information to make an educated guess about success factors needed in the future.

Porter emphasizes that it would be a mistake to assume that fast-growing industries, for ex., are attractive industries per se. It rather depends how growth influences the overall industry structure, who benefits and whose profits suffer from a high industry growth rate (think of the PC industry as an example for low industry profitability).
References


Allen, James (2008), Planning Success, Financial Times, Sept. 2


Berger, Suzanne (2005), How we compete: What companies around the world are doing to make it in today’s global economy, Doubleday: New York.


Bobel, Ingo and Amrita Martis (2010), Value Creation in Health Care: The Case of the CHPG Monaco, Journal of Strategic Management Education, 6 (2)


Collis, David J. and Cynthia A. Montgomery (1995), "Competing on Resources", HBR (July-August)


George Day and David Reibstein (1997), Wharton on Dynamic Competitive Strategy, N.Y.: Wiley


Fan Gang, China’s nonperforming loans and national comprehensive liability, *Asian Economic Papers (2)* 1, 2003 (pp. 145-152)

Froeb, Luke M. and Brian T. McCann (2008), Managerial Economics, Mason: Thomson


Ghemawat, Pankaj (2009) Beyond the Downturn, IESE Notes on Globalisation and Strategy, Year 5, No. 12, 2009


HBS Publishing Corp. (2006), Strategy: Create and Implement the Best Strategy for your Business – SWOT Analysis I, Boston

HBS Publishing Corp. (2006a), Strategy: Create and Implement the Best Strategy for your Business – SWOT Analysis II, Boston

Heger, Diana and Kornelius Kraft (2008), A Test of the Quality of Concentration Indexes, ZEW Discussion Paper 08-072


Ketels, Christian, G. Lindqvist and G. Solvell (2008), Clusters and Cluster Initiatives, Center for Strategy and Competitiveness, Stockholm School of Economics, June


Marsh, Peter (2008), How to play the home advantage, Financial Times, 27. November 2008


OECD (2008), Glossary of Statistical Terms (www.oecd.org/std/glossary)

OECD (2009), Clusters, Innovation and Entrepreneurship (edited by Jonathan Potter and Gabriela Miranda)

OECD (2009a), Factbook eXplorer (http://stats.oecd.org/oecdfactbook/)

Potter, J. and G. Miranda (2009), see OECD (2009)


Scherer, F. M. (2003), Industry Structure, Strategy, and Public Policy, Boston


van Stel, André, Roy Thurik, Andrew Burke (2008) Firms and Profits in the Retail Industry: Blue Ocean versus Competitive Strategy, EIM bv Publication, Zoetermeer (June 2008) (This report is published under the SCALES-initiative (Scientific AnaLysis of Entrepreneurship and SMEs), as part of the 'SMEs and Entrepreneurship programme' financed by the Netherlands Ministry of Economic Affairs)

P. Videla, Reviving the Global Economy, IESE Notes on Globalisation and Strategy, Year 5, No. 12, 2009
