Management 390 Industry Analysis

Date: Apr. 15, 15

Contemporary page 88 – 99, 104

# Extending the five forces framework

## Does industry matter?

* Five forces has subject to two main attacks
  + Theoretical foundations
    - Structure-conduct-performance approach to industrial organization that underlies it lacks rigor
    - Empirical weakness
      * It appears that industry environment is a relatively minor determinant of a firm’s profitability
* The industrial analysis is important because if there is no industry analysis it is hard to make strategic decision
* Architectural advantage
  + Reveals industry analysis is important for establishing competitive advantage within an industry

## Complements: a missing force in the porter model

* Complements increase the value of product
  + Opposite to the substitute
  + If products are close complements, they have little or no value in isolation
* Bargaining power is the key to the value shard between producers of the different complementary products

# Dynamic competition: hypercompeititon, game theory, and competitor analysis

## Hypercompetition

* Intense and rapid competitive moves, in which competitors must move quickly to build new advantages and erode the advantages of their rivals
* If industries are hypercompetitive, their structures are likely to be less stable than in the past
  + Superior profitability will tend to be transitory
  + Only route to sustained superior performance is through continually recreating and renewing competitive advantage 🡪 The age of temporary advantage

## The contribution of game theory

* Game theory allows us to model the competitive integrations of Porter’s Five Forces
  + Permits the framing of strategic decisions. Game theory provides a structure, a set of concepts, and a terminology that allows us to describe and understand a competitive situation in terms of
    - Identify of the players
    - Specification of each player’s options
    - Specification of the payoffs from every combination of options
    - The sequencing of decisions using game trees
  + Can predict the outcome of competitive situations and identify optimal strategic choices
    - Predict the equilibrium outcomes of competitive situations and consequence of strategic moves by any one players
    - Penetrate the insights into central issues of strategy that go well beyond pure intuition
  + Strategic behaviour through a firm can improve its competitive outcome
    - Cooperation
    - Deterrence
    - Commitment
    - Changing the structure of the game being played
    - Signaling

### Cooperation

* One of the key merits of game theory is its ability to encompass both competition and cooperation
* A key deficiency of the five forces framework is in viewing interfirm relations as exclusively competitive in nature
* Coopetition
  + Recognition of the competitive/cooperative duality of business relationships
  + There is no simple dichotomy between competition and cooperation
    - All business relationships combine elements of both

### Deterrence

* To impose costs on the other players for actions deemed to be undesirable
* The key to effectiveness is credible

### Commitment

* Involves the elimination of strategic options
  + Binding an organization to a future course of action
  + Under quantity adjustments, a hard commitment will tend to have a positive effect on the committing firm’s profitability because it will tend to be met by other firms reducing their output

### Changing the structure of the game

* Creative strategies can change the structure of the competitive game
* Establishing alliances and agreements with competitors can increase the value of the game by increasing the size of the market and building joint strength against possible entrants
* There are many opportunities for converting win-lose to win-win situations

### Signaling

* Competitive reactions depend on how the competitor perceives its rival’s initiative
* Signaling
  + Used to describe the selective communication of information to competitors designed to influence their perceptions and hence provoke or suppress certain types of reaction
* The credibility of threats is critically dependent on reputation
* The benefits of building a reputation for aggressiveness may be particularly great for diversified companies where reputation can be transferred from one market to another
* Signaling may also be used to communicate a desire to cooperate. Price announcements can facilitate collusive pricing among firms

## Is game theory useful?

* Game theory provides clear predictions in highly stylized situations involving few external variables and restrictive assumptions
  + Mathematically sophisticated body of theory that suffers from unrealistic assumptions
  + Lack of generality and analysis of dynamic situations through a sequence of static equilibriums
* Game theory has not developed to the point where it permits us to model real business situations in a level of detail that can generate precise predictions
* In the empirical application
  + It is good at explaining the past than predict the future
* Game theory is useful not because it gives us answers but because it can help us understand business situations
  + Provides a set of tools that allows us to structure our view of competitive interaction
* Our emphasis in strategy formulation will be less on achieving advantage through influencing the behaviour of competitors and much on transforming competitive games through buiding positions of unilateral competitive advantage

## Competitor analysis and competitive intelligence

### Competitive intelligence

* Competitive intelligence involves the systematic collection and analysis of information about rivals for informing decision making
* Three main purpose
  + Forecast competitors’ future strategies and decisions
  + Predict competitors likely reactions to a firm’s strategic initiatives
  + Determine how competitors’ behaviour can be influenced to make it more favorable
* The key requirement is to understand competitors in order to predict their responses to environmental changes and our own competitive moves

### A Framework for predicting competitor behaviour

* The key to the competitor intelligence is a systemic approach that makes it clear what information is required and for what purposes it will be used
* The objective is to understand one’s rival
* Four part framework
  + Competitor’s current strategy
  + Competitor’s objectives
  + Competitor’s assumptions about the industry
  + Competitor’s resources and capability