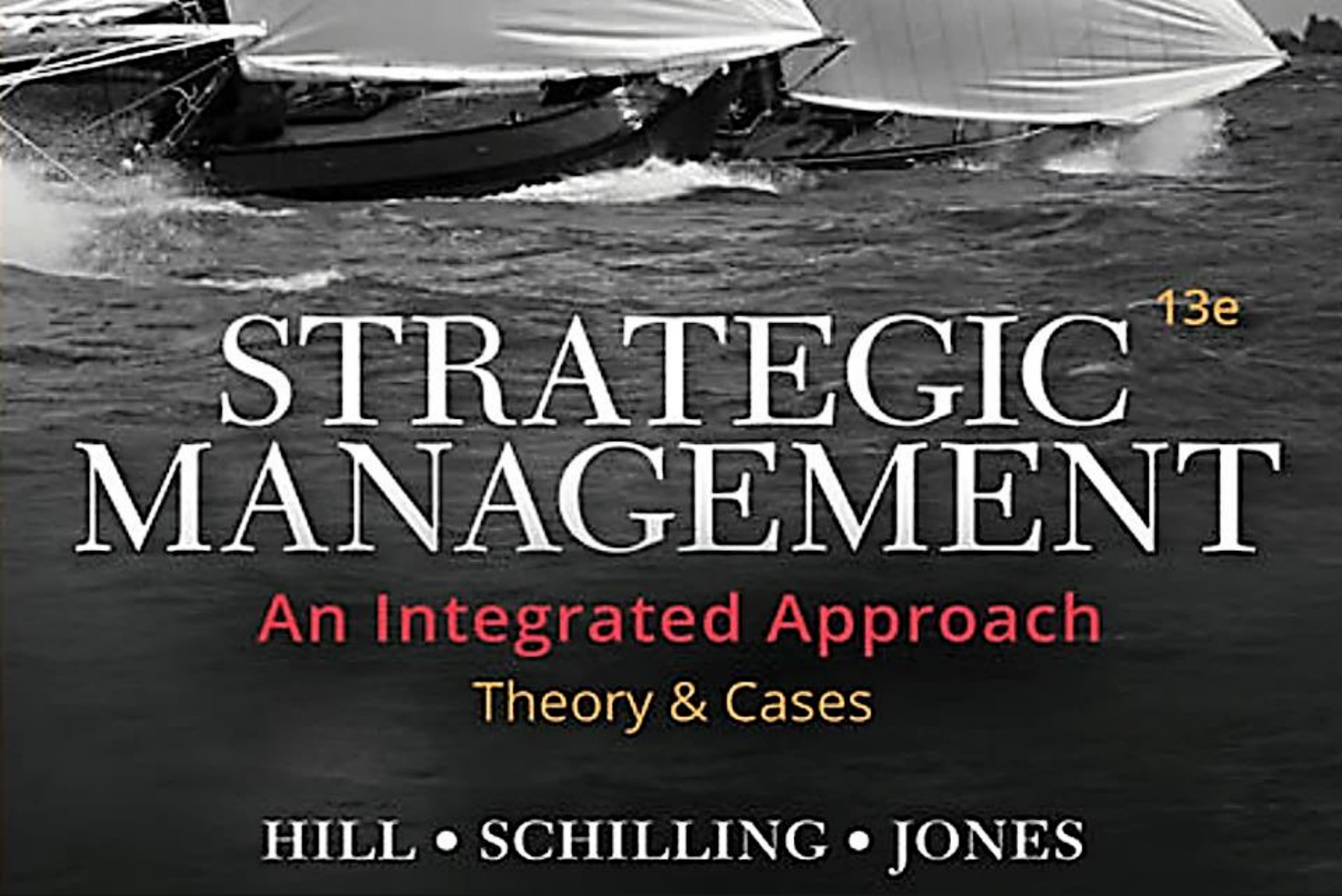
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STRATEGIC MANAGEMENT
An Integrated Approach
Theory & Cases
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CHAPTER 6
Business-Level Strategy and the Industry Environment

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LEARNING OBJECTIVES (1 of 2)

- Identify the strategies managers can develop to increase profitability in fragmented industries
- Discuss the special problems that exist in embryonic and growth industries, and how companies can develop strategies to effectively compete

LEARNING OBJECTIVES (2 of 2)

- Understand competitive dynamics in mature industries and discuss the strategies managers can develop to increase profitability even when competition is intense
- Outline the different strategies that companies in declining industries can use to support their business models and profitability

FRAGMENTED INDUSTRY

- **Fragmented industry** - Composed of a large number of small- and medium-sized companies.
- Reasons for fragmentation
  - Lack of scale economies
  - Brand loyalty in the industry is primarily local
  - Low entry barriers due to lack of scale economies and national brand loyalty
- Focus strategy works best for a fragmented industry.

CONSOLIDATING A FRAGMENTED INDUSTRY THROUGH VALUE INNOVATION (1 of 3)

- Value innovator - Defines value differently than established companies.
  - Offers the value at lowered cost through the creation of scale economies.
- **Chaining** - Obtaining the advantages of cost leadership by establishing a network of linked merchandising outlets.
  - Interconnected by information technology that functions as one large company.
  - Aids in building a national brand.

CONSOLIDATING A FRAGMENTED INDUSTRY THROUGH VALUE INNOVATION (2 of 3)

- **Franchising** - Strategy in which franchisor grants the franchisee the right to use the franchisor's name, reputation, and business model.
  - In return for a fee and a percentage of the profits.
  - Advantages
    - Finances the growth of the system, resulting in rapid expansion.
    - Franchisees have a strong incentive to ensure that the operations are run efficiently.
    - New offerings developed by a franchisee can be used to improve the performance of the entire system.

CONSOLIDATING A FRAGMENTED INDUSTRY THROUGH VALUE INNOVATION (3 of 3)

- Disadvantages
  - Tight control of operations is not possible.
  - Major portion of the profit go to the franchisee.
  - When franchisees face a higher cost of capital, it raises system costs and lowers profitability.
- Horizontal mergers - Merging with or acquiring competitors and combining them into a single large enterprise.

STRATEGIES IN EMBRYONIC AND GROWTH INDUSTRIES (1 of 2)

- Limited customer demand for products of an embryonic industry is due to:
  - limited performance and poor quality of the first products.
  - customer unfamiliarity with the product.
  - poorly developed distribution channels.
  - lack of complementary products.
  - high production costs because of small volumes of production.

STRATEGIES IN EMBRYONIC AND GROWTH INDUSTRIES (2 of 2)

- Industry enters the growth stage when a mass market starts to develop for its products.
  - **Mass market** - One in which large numbers of customers enter the market.
  - Occurs when:
    - product value increases, due to ongoing technological progress.
    - complementary products are developed.
    - production cost decreases, resulting in low prices and high demand.

MARKET DEVELOPMENT AND CUSTOMER GROUPS

Innovators

- First to purchase and experiment with a product based on new technology.

Early Adopters

- Understand that the technology may have important future applications.

Early majority

- Practical and understand the value of new technology.

Late majority

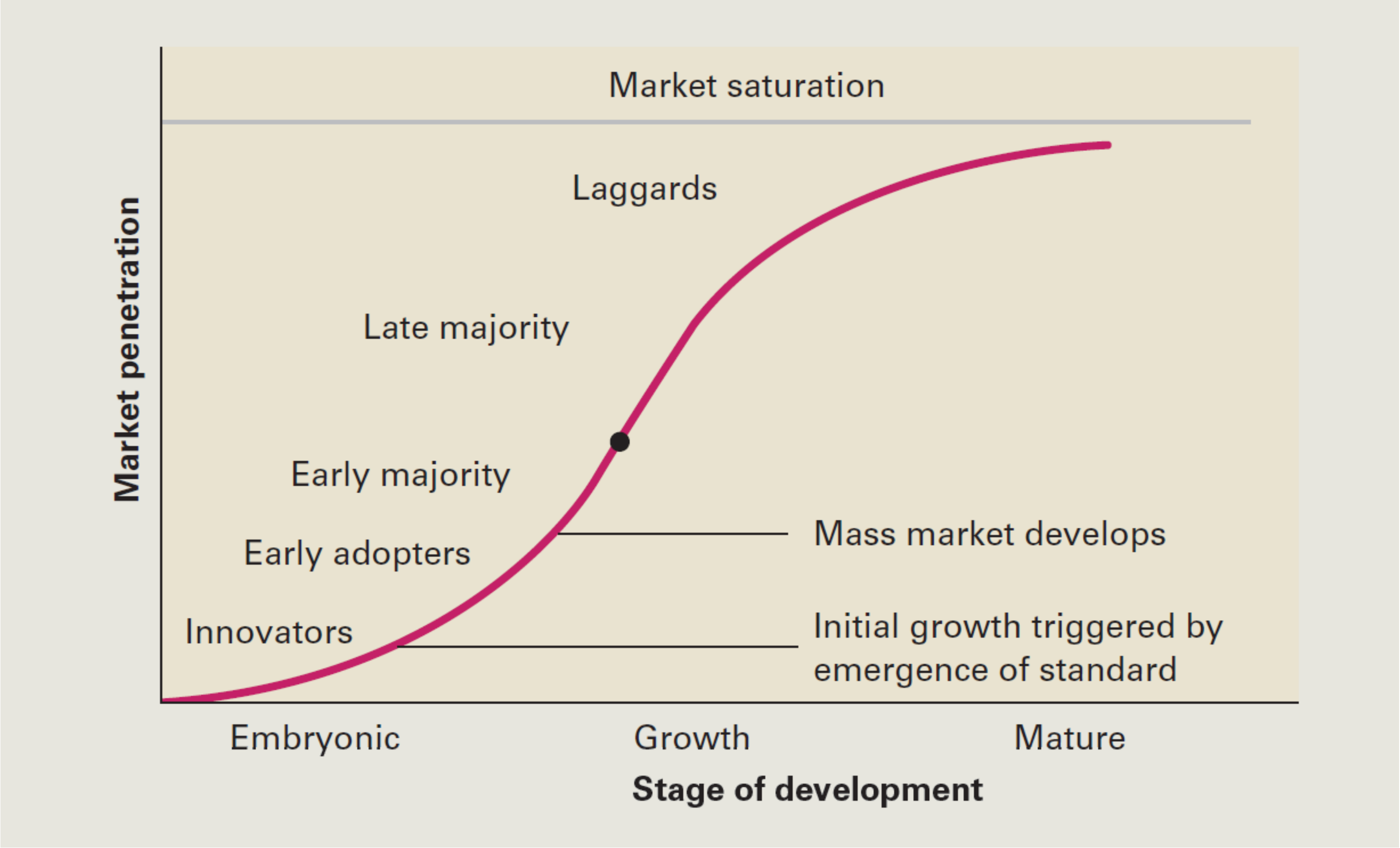
- Purchase a new technology only when it is obvious that it has great utility and is here to stay.

Laggards

- Unappreciative of the uses of new technology.

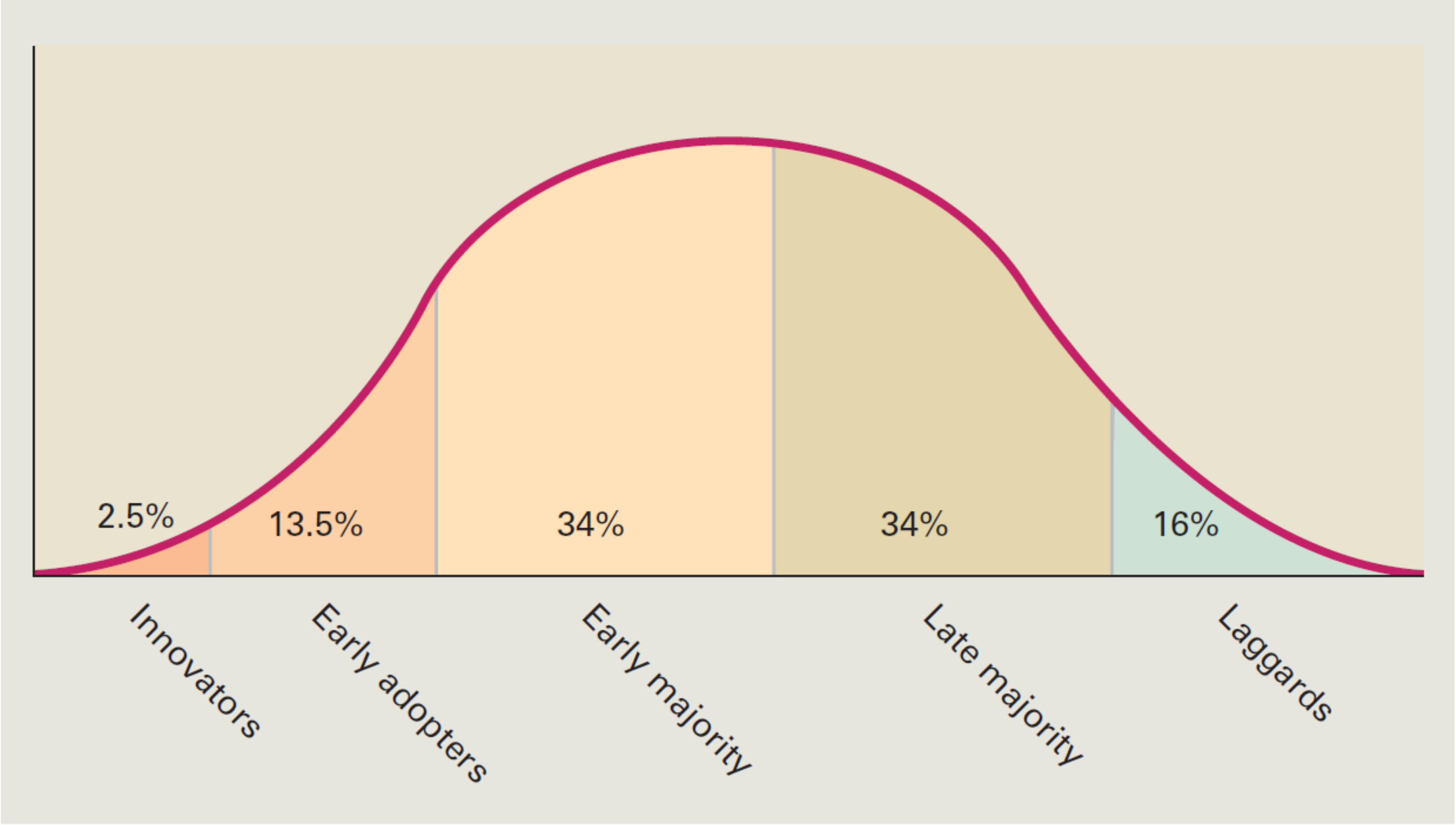
CHANGING NATURE OF MARKET DEMAND (1 of 2)

Figure 6.1 Market Development and Customer Groups



CHANGING NATURE OF MARKET DEMAND (2 of 2)

Figure 6.2 Market Share of Different Customer Segments



Source: Adapted from Rogers, EM. 2010. Diffusion of Innovations. New York: Simon and Schuster.

STRATEGIC IMPLICATIONS: CROSSING THE CHASM (1 of 2)

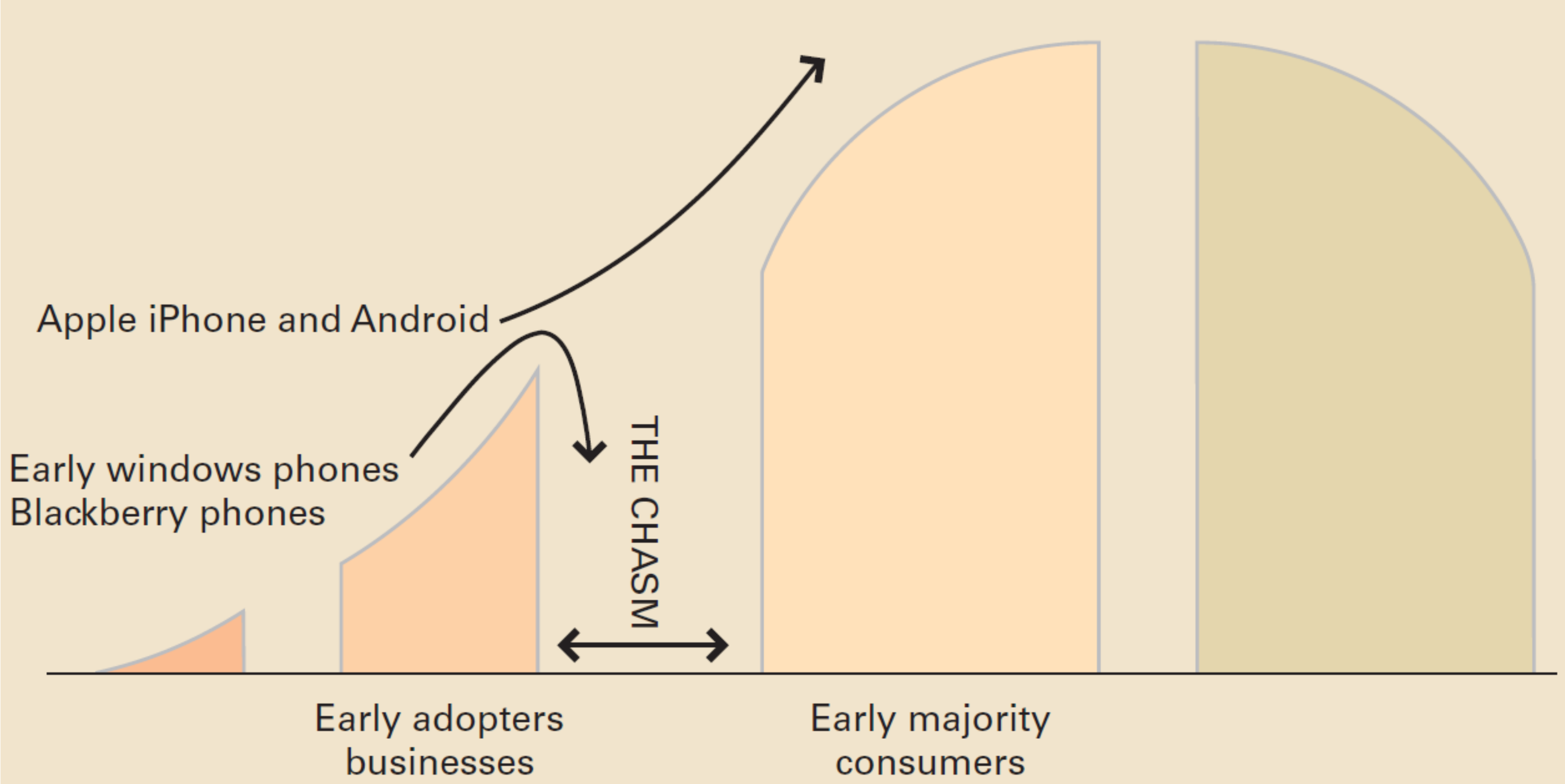
- New strategies are required to strengthen a company's business model as a market develops.
  - Customers in each segment have very different needs.
- Competitive chasm - Transition between the embryonic market and mass market.
- Successful mangers must:
  - identify the needs of early adopters.
  - adjust their business model by redesigning products, distribution channels, and marketing campaigns.
  - sell at a reasonable price.
  - abandon outdated business models.

COMPARISON OF MARKET SEGMENTATION APPROACHES

Innovators and early adopters	Early majority
▪ Technologically sophisticated and willing to tolerate the limitations of the product. ▪ Reached through specialized distribution channels. ▪ Companies produce small quantities of product that are priced high.	▪ Value ease of use and reliability. ▪ Require mass-market distribution and mass-media advertising campaigns. ▪ Require large-scale mass production to produce high-quality product at a low price.

CROSSING THE CHASM

Figure 6.3 The Chasm in the Smartphone Business



Source: Adapted from Moore, GA. 2009. Crossing the Chasm: Marketing and selling high tech products to mainstream customers. New York: Harper Collins.

FACTORS THAT ACCELERATE CUSTOMER DEMAND (1 of 2)

Relative advantage

- Degree to which a new product is perceived as better at satisfying customer needs than the product it supersedes.

Complexity

- Products perceived as complex and difficult to use will diffuse more slowly than those that are easy to use.

Compatibility

- Degree to which a new product is perceived as being consistent with the current needs or existing values of potential adopters.

FACTORS THAT ACCELERATE CUSTOMER DEMAND (2 of 2)

Trialability

- Degree to which potential customers can experiment with a new product during a hands-on trial basis.

Observability

- Degree to which the results of using and enjoying a new product can be seen and appreciated by other people.

Viral diffusion

- Identify and aggressively court opinion leaders in a market.
- Opinion leaders help develop the technology and recommend it.

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STRATEGIES TO DETER ENTRY IN MATURE INDUSTRIES

Product proliferation strategy

- Degree to which potential customers can experiment with a new product during a hands-on trial basis.

Observability

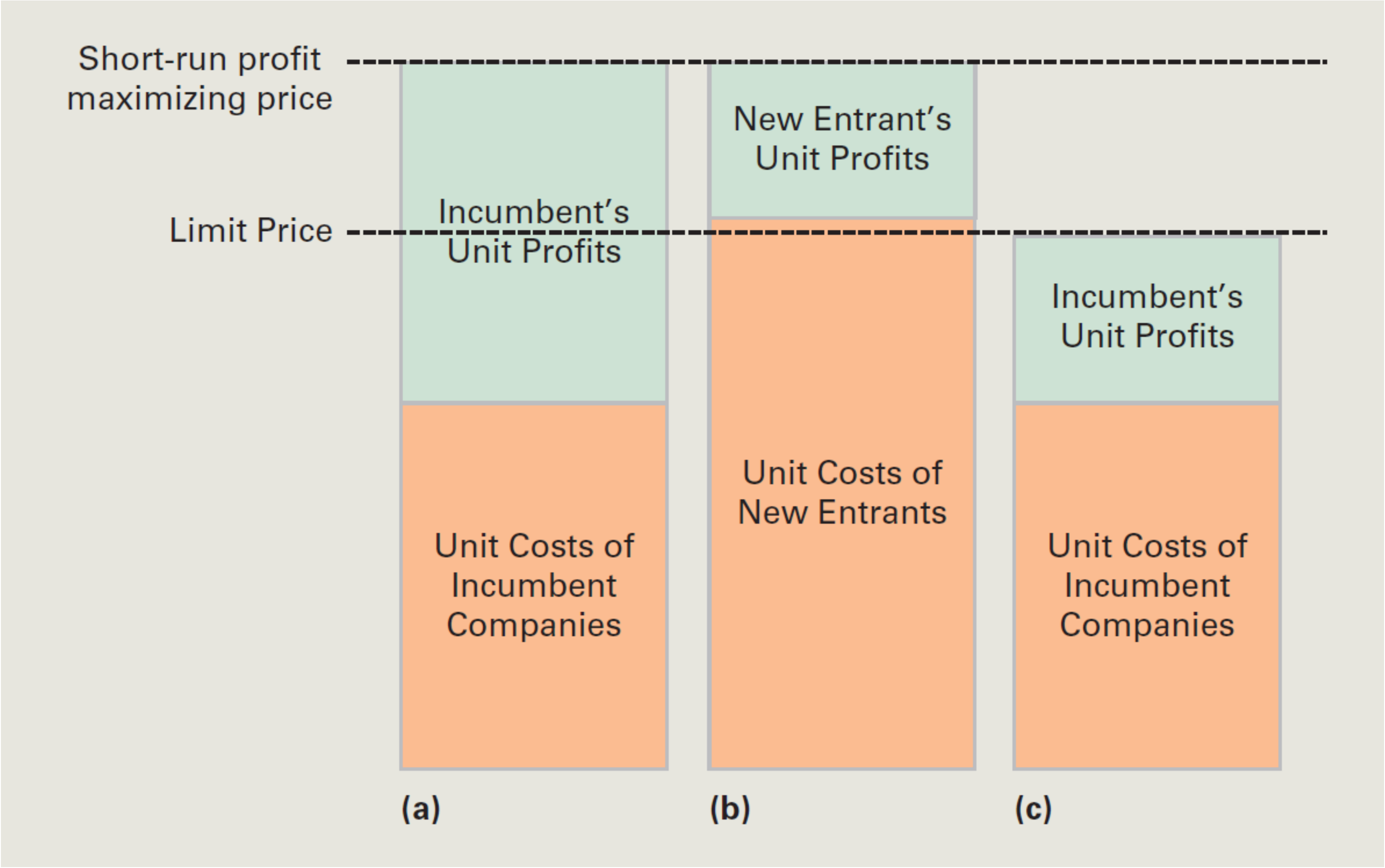
- Degree to which the results of using and enjoying a new product can be seen and appreciated by other people.

Viral diffusion

- Identify and aggressively court opinion leaders in a market.
- Opinion leaders help develop the technology and recommend it.

LIMIT PRICING STRATEGY

Figure 6.4 Limit Pricing



STRATEGIES TO MANAGE RIVALRY (1 of 2)

Price signaling

- Companies increase or decrease product prices to:
  - convey their intentions to other companies.
  - influence the price of an industry's products.

Price leadership

- When one company assumes the responsibility for determining the pricing strategy that maximizes industry profitability.

Non-price competition

- Use of product differentiation strategies to deter potential entrants and manage rivalry within an industry.

STRATEGIES TO MANAGE RIVALRY (2 of 2)

Market penetration

- Occurs when a company concentrates on expanding market share in its existing product markets.

Product development

- Creation of new or improved products to replace existing products.

Market development

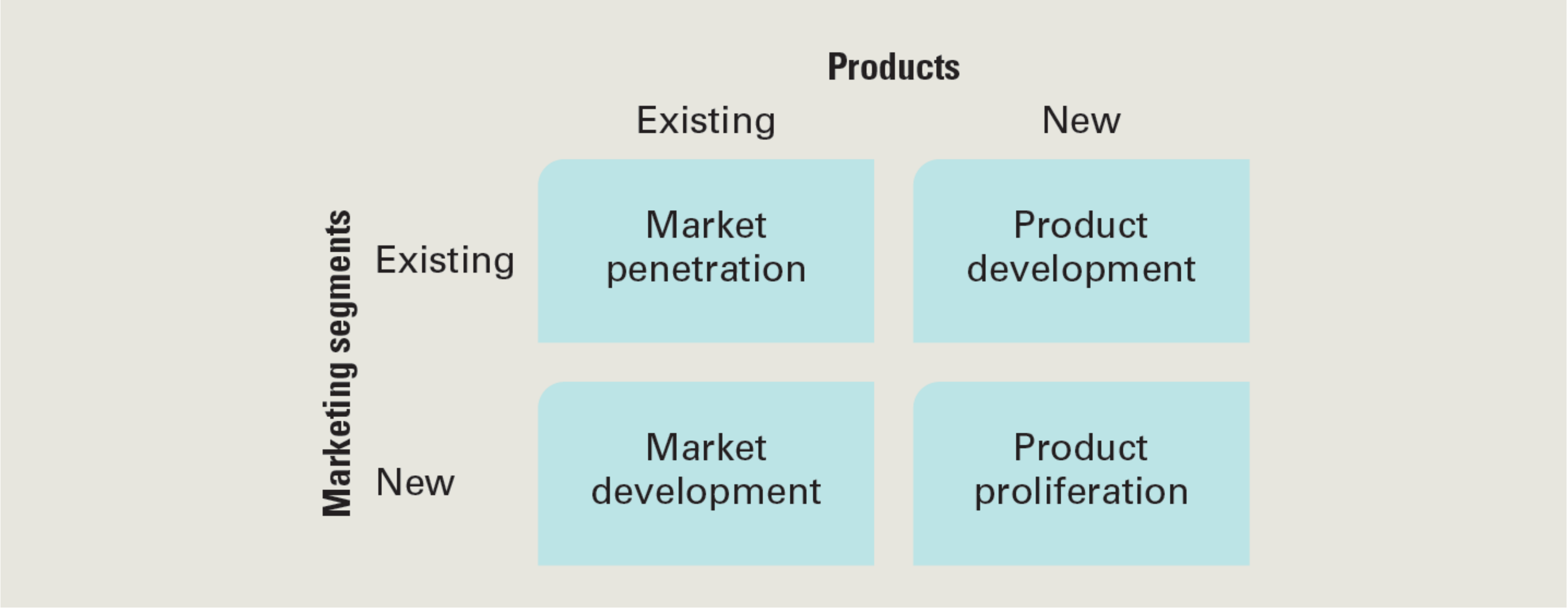
- When a company searches for new market segments for its existing products to increase the sales.

Product proliferation

- Large companies in an industry have a product in each market segment.

PRODUCT AND MARKET SEGMENTATION DIMENSIONS

Figure 6.5 Four Non-price Competitive Strategies



CAPACITY CONTROL (1 of 2)

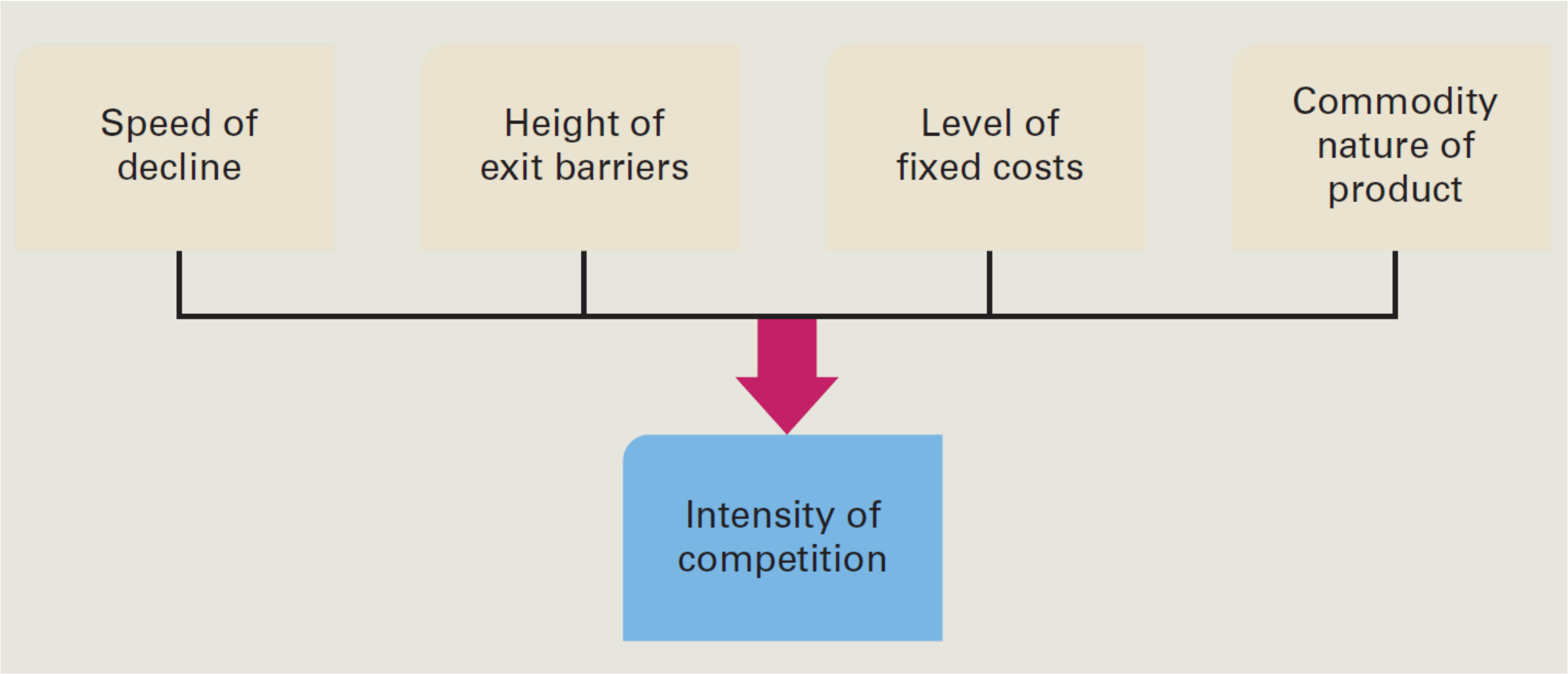
- Companies devise strategies to control or benefit from capacity expansion programs.
- Factors causing excess capacity.
  - New technologies that produce more than the old ones.
  - New entrants in an industry.
  - Economic recession that causes global overcapacity.
  - High growth of and demand in an industry that triggers rapid expansion.

CAPACITY CONTROL (2 of 2)

- Choosing a strategy
  - Each company individually must try to preempt its rivals.
    - Must forecast demand increase and establish operations to satisfy predicted demand.
    - Extremely risky.
  - Companies must collectively coordinate with each other to be aware of the mutual effects of their actions.
    - Must try to forecast competitors moves and share information to balance supply and demand.
    - Collusion on the timing is illegal (antitrust law).
    - Reduces risk.

THE SEVERITY OF DECLINE

Figure 6.6 Factors that Determine the Intensity of Competition in Declining Industries



CHOOSING A STRATEGY (1 of 2)

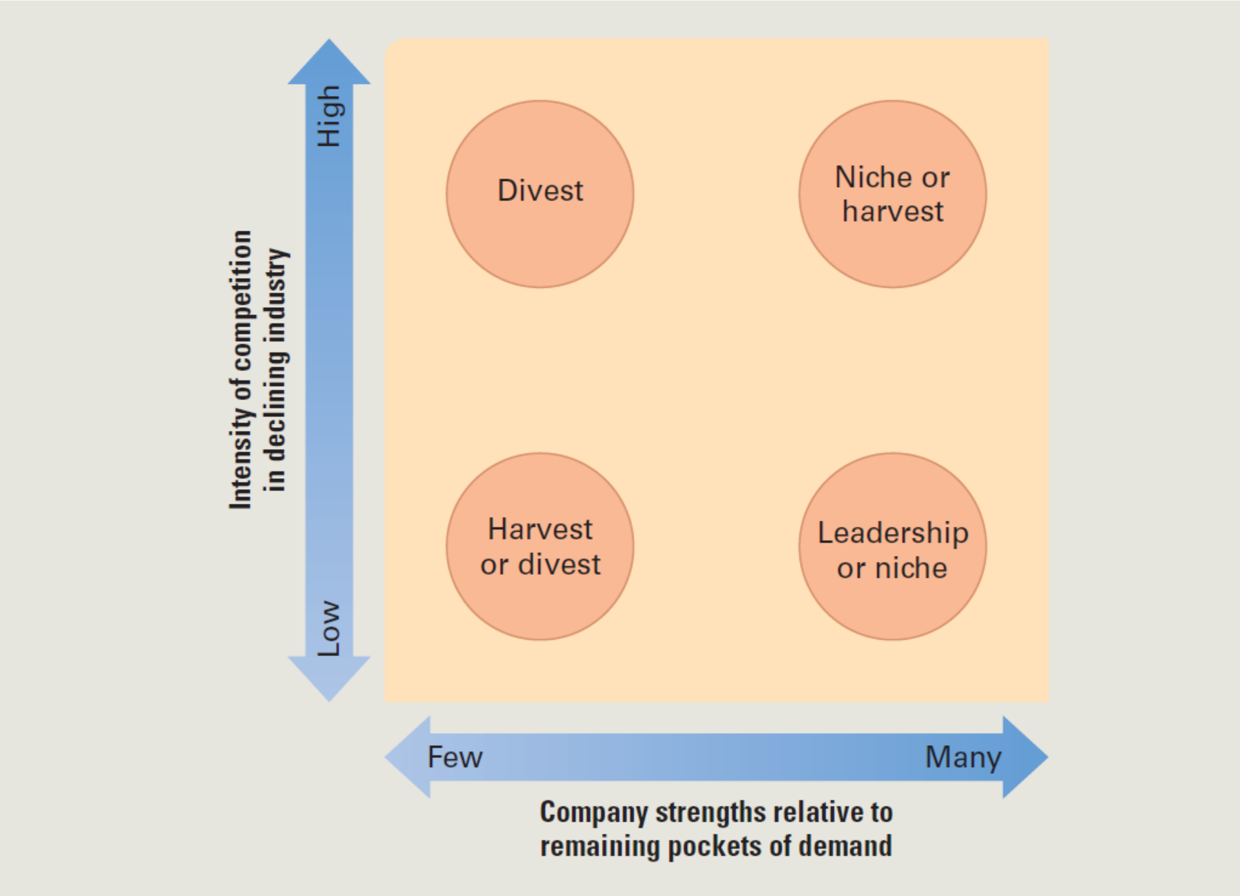
- **Leadership strategy** - When a company develops strategies to become the dominant player in a declining industry.
- **Niche strategy** - When a company focuses on pockets of demand that are declining more slowly than the industry as a whole to maintain profitability.

CHOOSING A STRATEGY (2 of 2)

- **Harvest strategy** - When a company reduces to a minimum the assets it employs in a business to reduce its cost structure and extract maximum profits from its investment.
- **Divestment strategy** - When a company exits an industry by selling off its business assets to another company.

FRAMEWORK FOR GUIDING STRATEGIC CHOICE

Figure 6.7 Strategy Selection in a Declining Industry



APPENDIX

NOTE TO INSTRUCTOR: Choose from the following questions (also found in the text at the end of the chapter) to conduct in-class discussions around key chapter concepts.

DISCUSSION:

- Why are industries fragmented? What are the primary ways in which companies can turn a fragmented industry into a consolidated industry?

DISCUSSION:

- What are the key problems in maintaining a competitive advantage in embryonic and growth industry environments? What are the dangers associated with being the leader in an industry?

DISCUSSION:

- What investment strategies should be made by: (a) differentiators in a strong competitive position, and (b) differentiators in a weak competitive position, while managing a company's growth through the life cycle?

DISCUSSION:

- Discuss how companies can use: (a) product differentiation, and (b) capacity control to manage rivalry and increase an industry’s profitability.

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DISCUSSION:

- What strategies might these enterprises use to strengthen their business models (a) a small pizzeria operating in a crowded college market, and (b) a detergent manufacturer seeking to unveil new products in an established market?