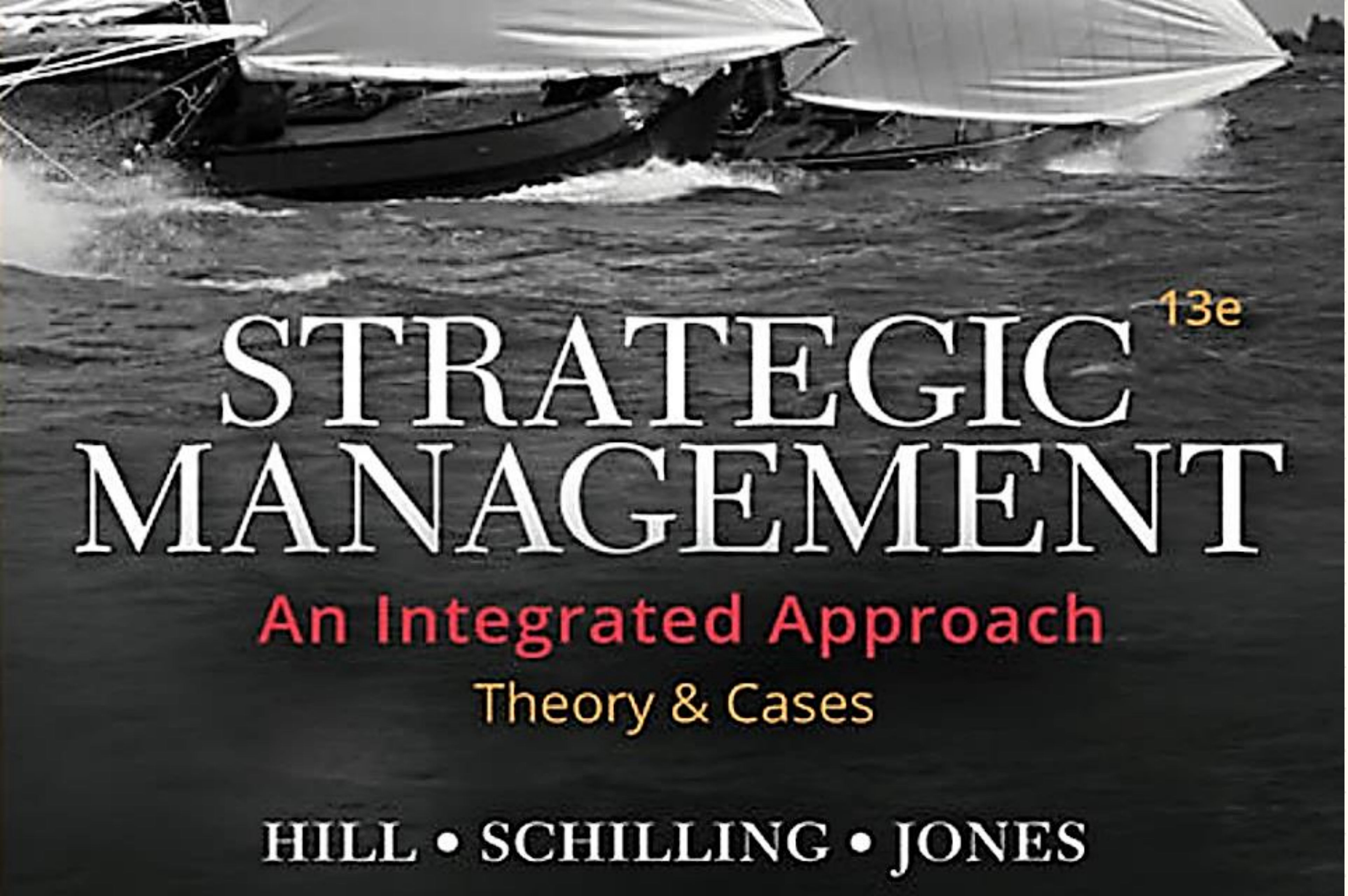
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# CHAPTER 6

# Business-Level Strategy and the Industry Environment

# 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

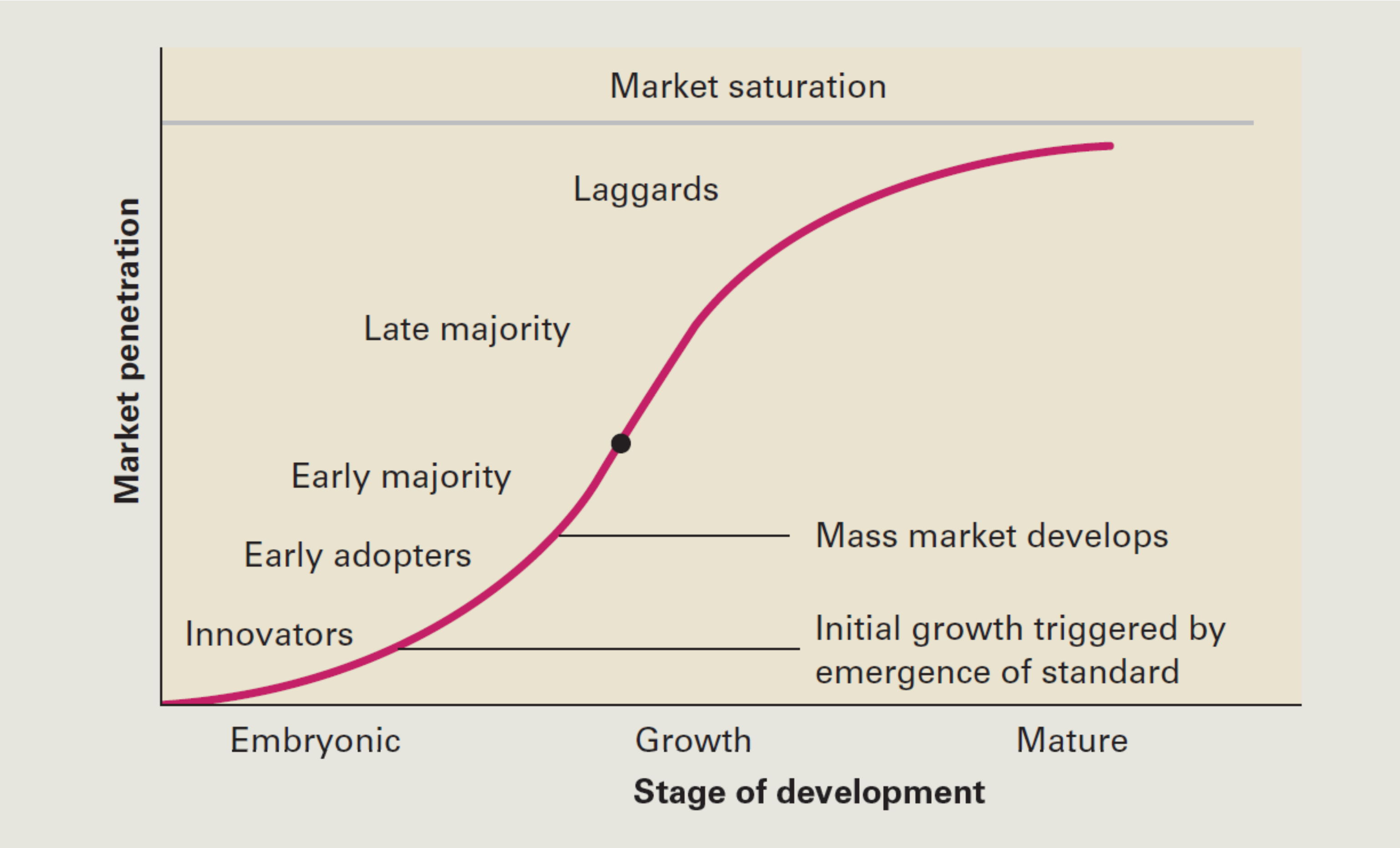
- Purchase a new technology only when it is obvious that it has great utility and is here to stay.

## Laggards

- Unappreciative of the uses of new technology.

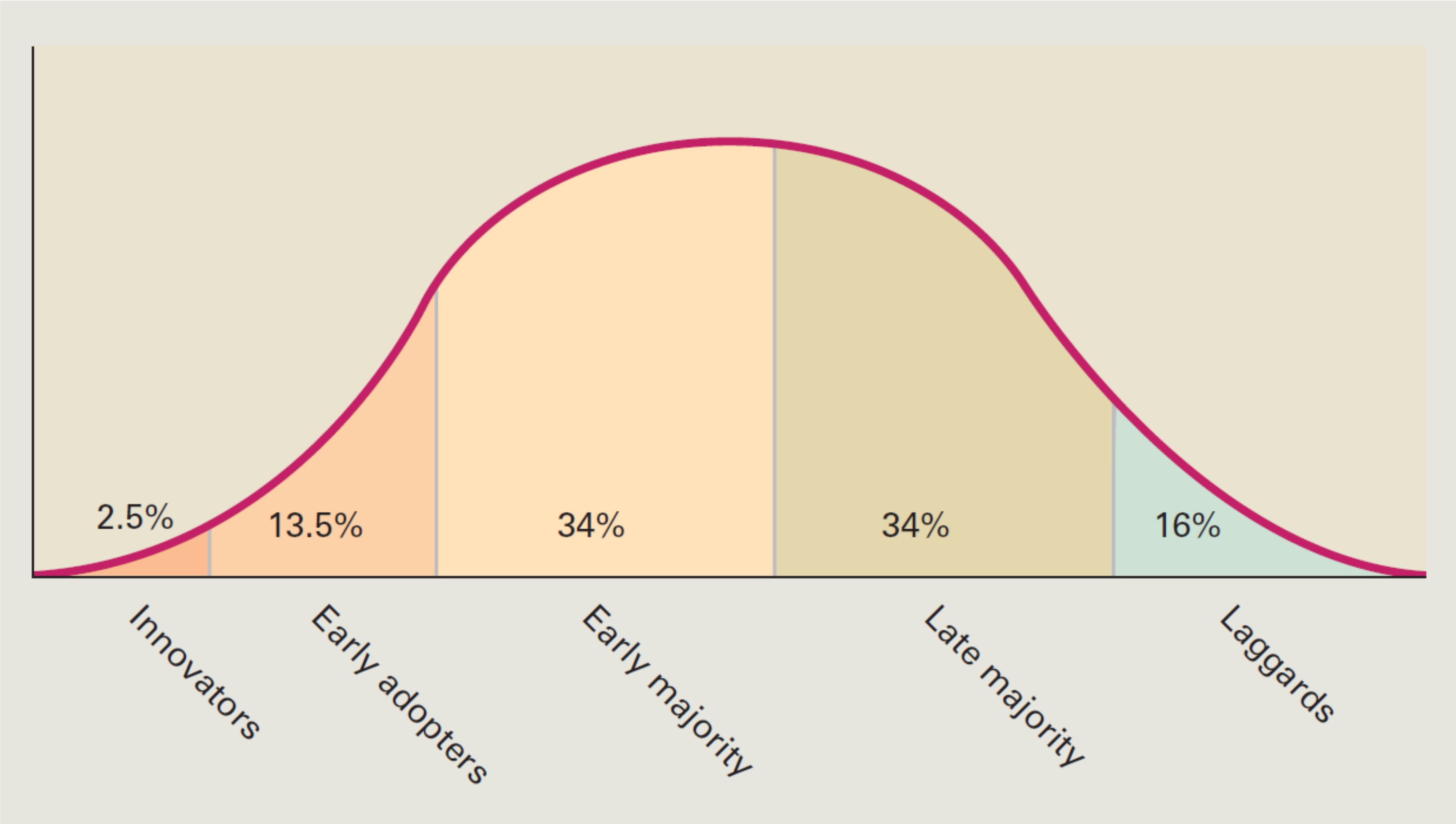
# CHANGING NATURE OF MARKET DEMAND (1 of 2)

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)

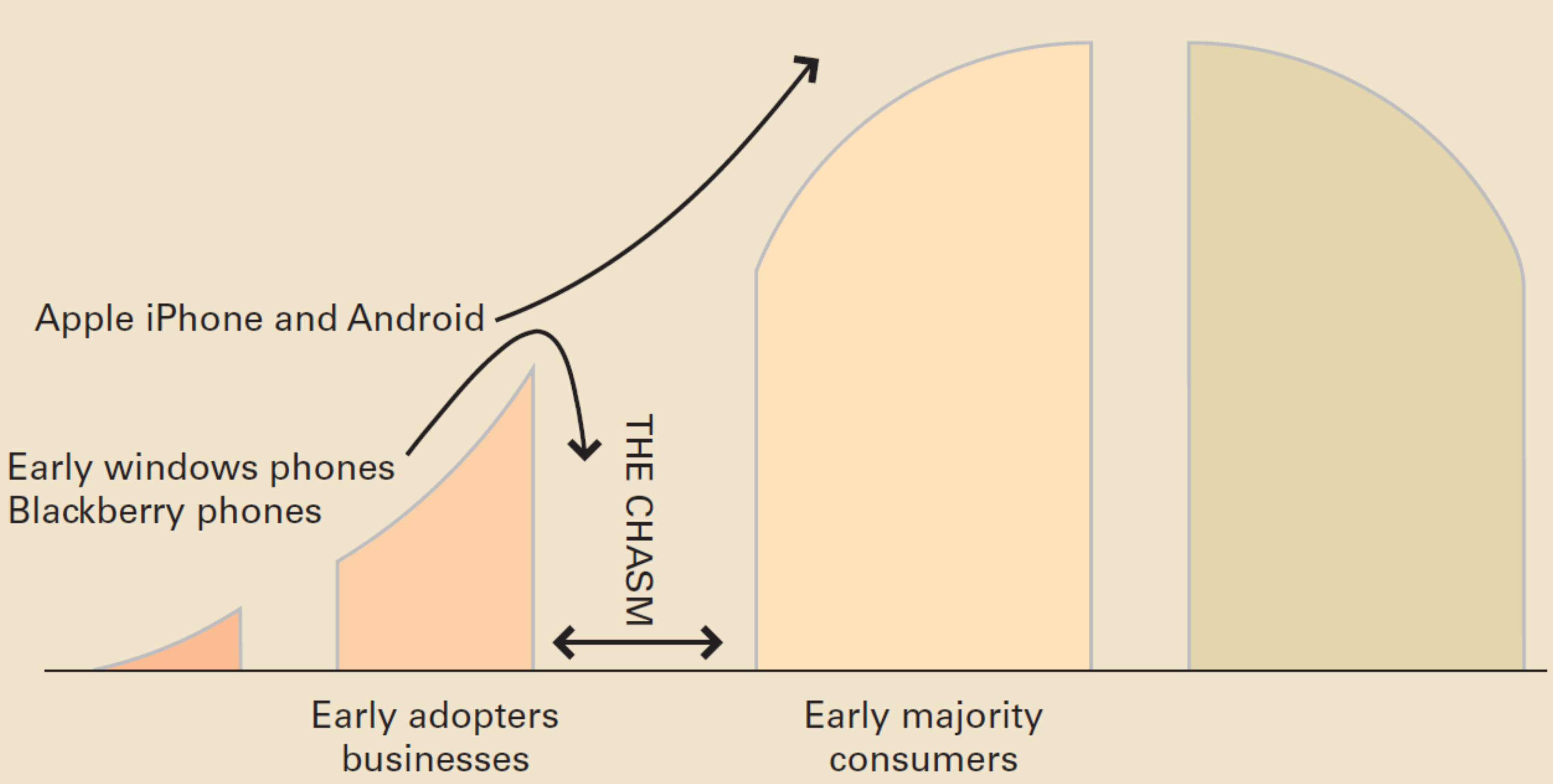
- New strategies are required to strengthen a company’s business model as a market develops.
  - Customers in each segment have very different needs.
- Competitive chasm - Transition between the embryonic market and mass market.
- Successful mangers must:
  - identify the needs of early adopters.
  - 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.<br>▪ Reached through specialized distribution channels.<br>▪ Companies produce small quantities of product that are priced high. | ▪ Value ease of use and reliability.<br>▪ Require mass-market distribution and mass-media advertising campaigns.<br>▪ 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.

# 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

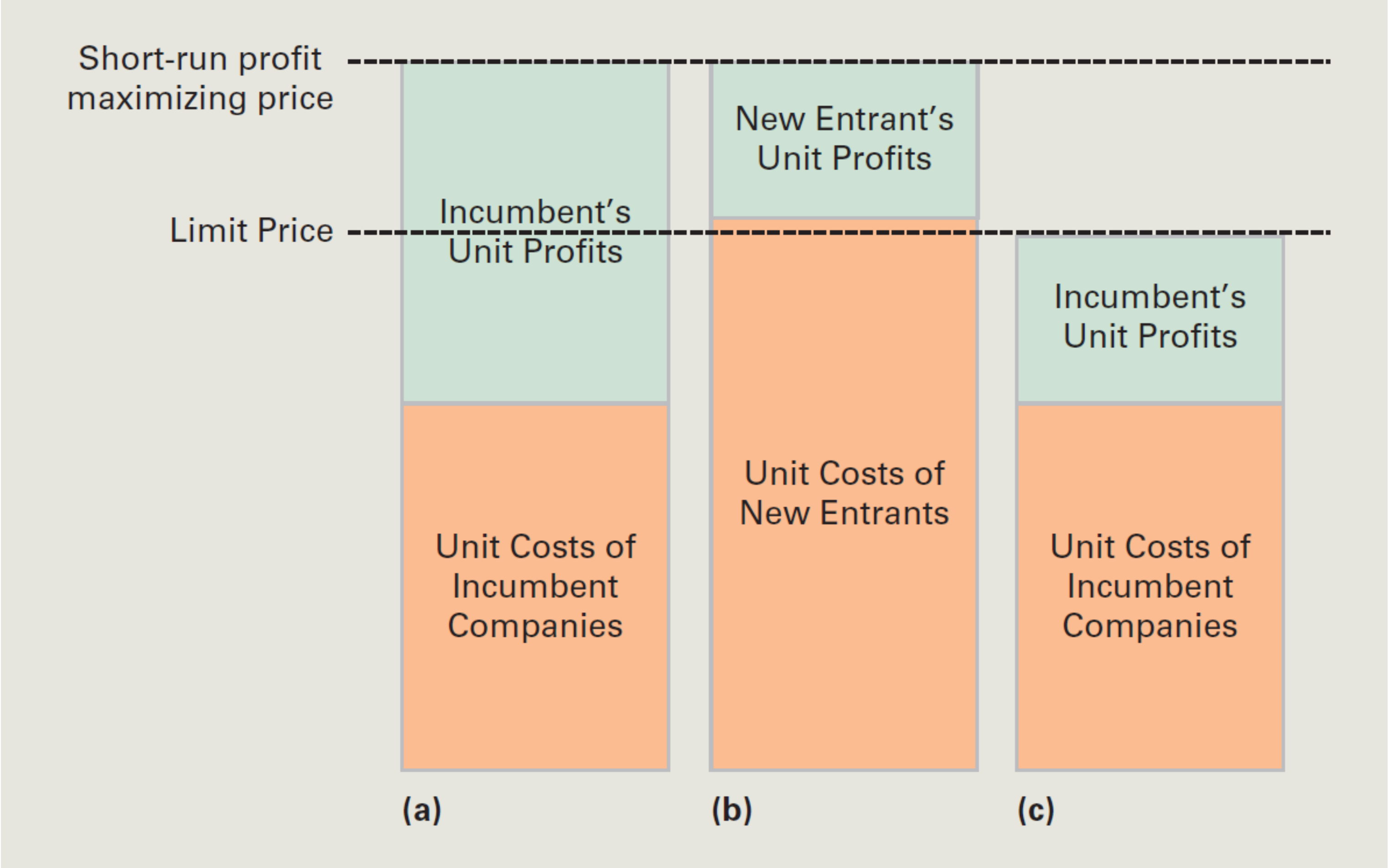
- Degree to which the results of using and enjoying a new product can be seen and appreciated by other people.

## 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

| Marketing segments | Products: Existing | Products: New |
|---|---|---|
| Existing | Market penetration | Product development |
| New | Market development | Product proliferation |

# CAPACITY CONTROL (1 of 2)

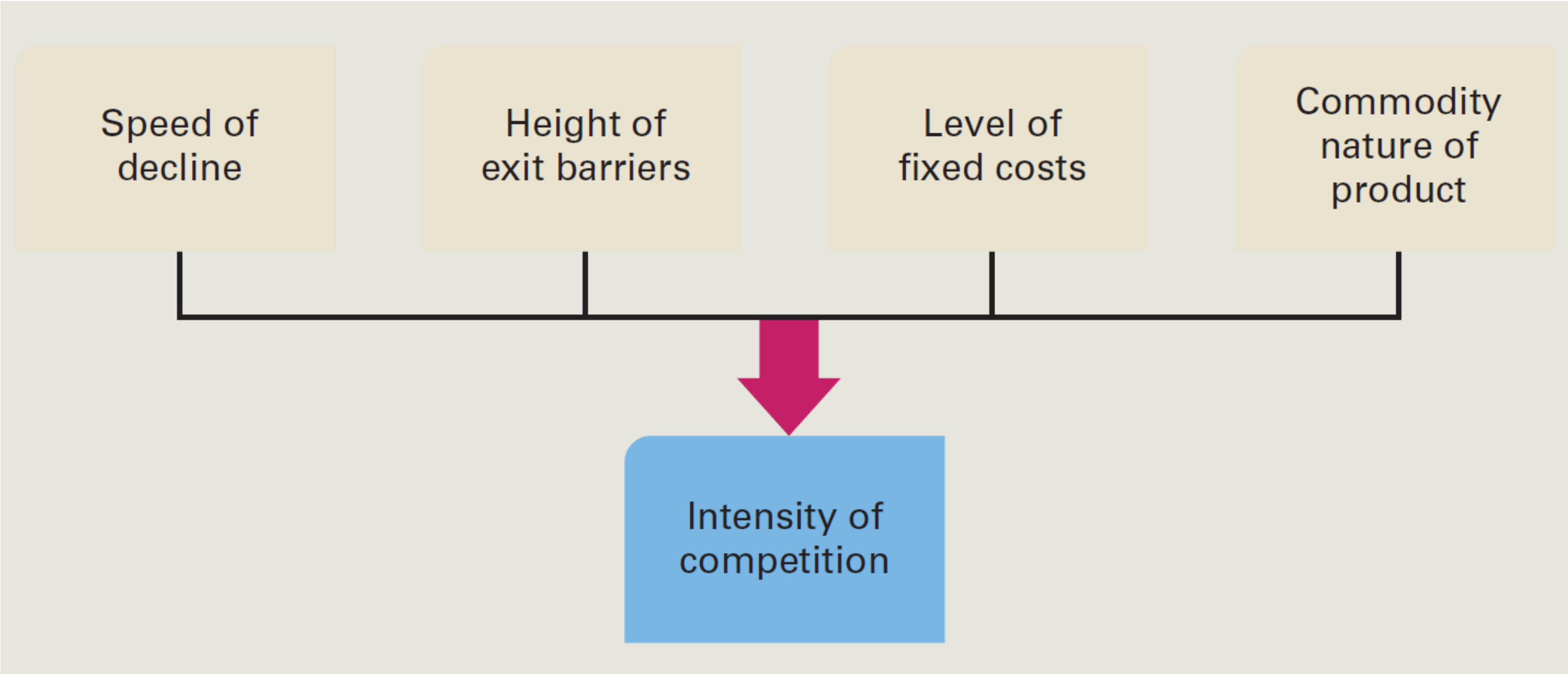
- Companies devise strategies to control or benefit from capacity expansion programs.
- Factors causing excess capacity.
  - New technologies that produce more than the old ones.
  - New entrants in an industry.
  - Economic recession that causes global overcapacity.
  - High growth of and demand in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

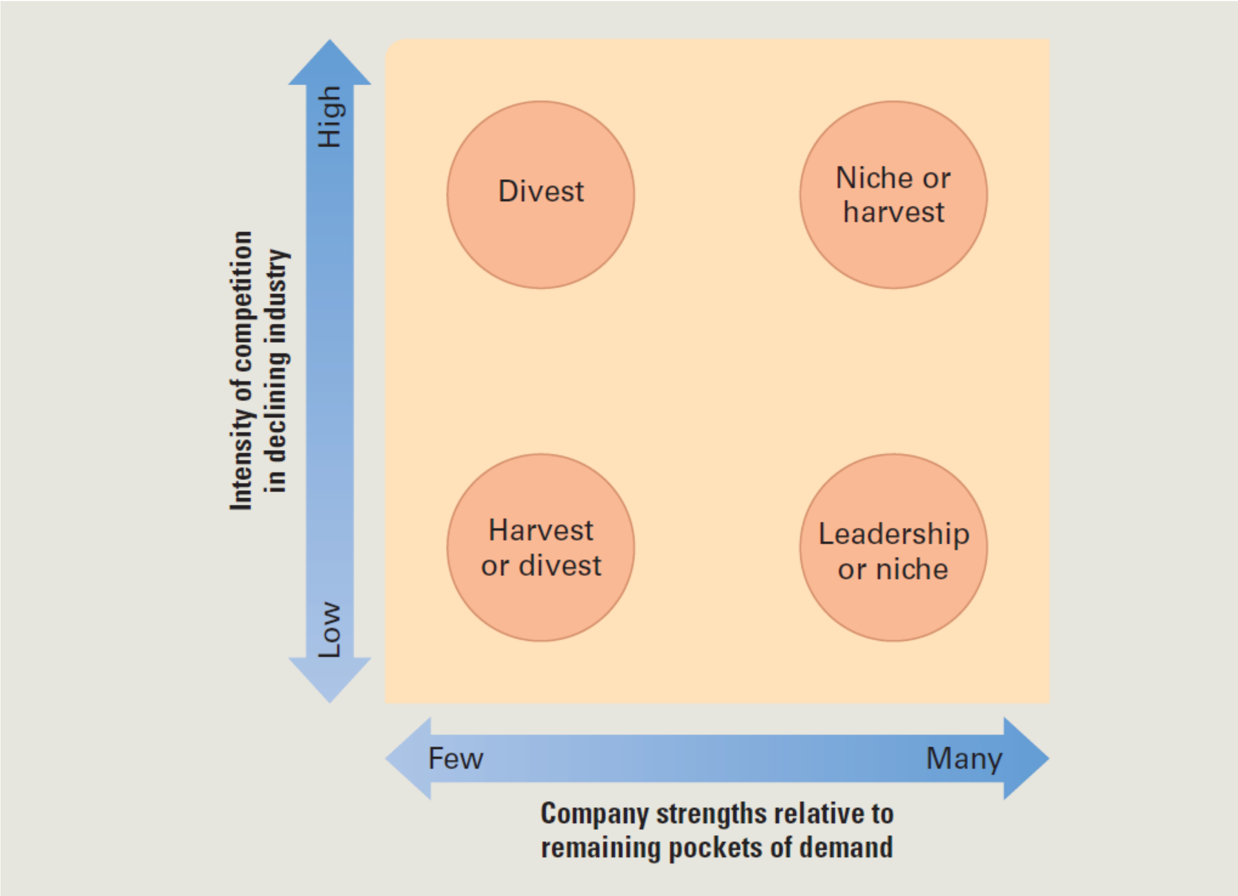
- **Leadership strategy** - When a company develops strategies to become the dominant player in a declining industry.
- **Niche strategy** - When a company focuses on pockets of demand that are declining more slowly than the industry as a whole to maintain profitability.

# 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.

# 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?