UNIT II Competitive Advantage - Strategic Management

COMPETITIVE ADVANTAGE

External Environment

Porter's Five Forces Model

Strategic Groups Competitive Changes during Industry Evolution

Globalization and Industry Structure

National Context and Competitive advantage

Resources

Capabilities

competencies

core competencies

Competencies & Low cost and differentiation strategies

Generic Building Blocks of Competitive Advantage

Distinctive Competencies

Resources and Capabilities durability of competitive Advantage

Environmental scanning and industry analysis

Environmental scanning

Environmental scanning is the monitoring, evaluating and disseminating of information from the external and internal environments to keep people within the corporation. It is a tool that a corporation uses to avoid strategic surprise and to ensure long-term health.

Scanning of external environmental variables

The social environment includes general forces that do not directly touch on the short-run activities of the organization but those can, and often do, influence its long-run decisions. These forces are

- Economic forces
- Technological forces
- Political-legal forces
- Socio-cultural forces

Scanning of social environment

The social environment contains many possible strategic factors. The number of factors becomes enormous when one realize that each country in the world can be represented by its own unique set of societal forces, some of which are very similar to neighboring countries and some of which are very different.

Monitoring of social trends

Large corporations categorized the social environment in any one geographic region into four areas and focus their scanning in each area on trends with corporate-wide relevance. Trends in any area may be very important to the firms in other industries.

Trends in economic part of societal environment can have an obvious impact on business activity. Changes in the technological part of the societal environment have a significant impact on business firms. Demographic trends are part of sociocultural aspects of the societal environment.

International society consideration

For each countries or group of countries in which a company operates, management must face a whole new societal environment having different economic, technological, political-legal, and Sociocultural variables. This is especially an issue for a multinational corporation, a company having significant manufacturing and marketing operations in multiple countries. International society environments vary so widely that a corporation‘s internal environment and strategic management process must be very flexible. Differences in social environments strongly affect the ways in which a multinational company.

Scanning of the task environment

A corporation‘s scanning of the environment should include analysis of all the relevant elements in the task environment. These analyses take the form of individual reports written by various people in different parts of the firms. These and other reports are then summarized and transmitted up the corporate hierarchy for top management to use in strategic decision making. If a new development reported regarding a particular product category, top management may then sent memos to people throughout the organization to watch for and reports on development in related product areas. The many reports resulting from these scanning efforts when boiled down to their essential, act as a detailed list of external strategic factors.

Identification of external strategic factors:

One way to identify and analyze developments in the external environment is to use the issues priority matrix as follows.

1. Identify a number of likely trends emerging in the societal and task environment. These are strategic environmental issues: Those important trends that, if they happen, will determine what various industries will look like.
2. Assess the probability of these trends actually occurring.
3. Attempt to ascertain the likely impact of each of these trends of these corporations.

Industry analysis: Analyzing the task environment

Michael Porter's approach to industry analysis

Michael Porter, an authority on competitive strategy, contends that a corporation is most concerned with the intensity of competition within its industry. Basic competitive forces determine the intensity level. The stronger each of these forces is, the more companies are limited in their ability to raise prices and earned greater profits.

Threat of new entrants

New entrants are newcomers to an existing industry. They typically bring new capacity, a desire to gain market share and substantial resources. Therefore they are threats to an established corporation. Some of the possible barriers to entry are the following.

1. Economies of scale

2. Product differentiation

3. Capital requirements

4. Switching costs

5. Access to distribution channels

6. Cost disadvantages independent of size

7. Government policy

Rivalry among existing firms

Rivalry is the amount of direct competition in an industry. In most industries corporations are mutually dependent. A competitive move by one firm can be expected to have a noticeable effect on its competitors and thus make us retaliation or counter efforts. According to Porter, intense rivalry is related to the presence of the following factors.

1. number of competitors

2. rate of industry growth

3. product or service characteristics

4. amount of fixed costs

5. capacity

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Treat of substitute product or services

Substitute products are those products that appear to be different but can satisfy the same need as another product. According to Porter, ―Substitute limit the potential returns of an industry by placing a ceiling on the prices firms in the industry can profitably charge.‖ To the extent that switching costs are low, substitutes may have a strong effect on the industry.

Bargaining power of buyers

Buyers affect the industry through their ability to force down prices, bargain for higher quality or more services, and play competitors against each other.

Bargaining power of supplier

Suppliers can affect the industry through their ability to raise prices or reduce the quality of purchased goods and services.

Corporate Governance and Social Responsibility

Corporate governance is a mechanism established to allow different parties to contribute capital, expertise and labour for their mutual benefit the investor or shareholder participates in the profits of the enterprise without taking responsibility for the operations. Management runs the company without being personally responsible for providing the funds. So as representatives of the shareholders, directors have both the authority and the responsibility to establish basic corporate policies and to ensure they arte followed.

The board of directors has, therefore, an obligation to approve all decisions that might affect the long run performance of the corporation. The term corporate governance refers to the relationship among these three groups (board of directors, management and shareholders) in determining the direction and performance of the corporation

Responsibilities of the board

Specific requirements of board members of board members vary, depending on the state in which the corporate charter is issued. The following five responsibilities of board of directors listed in order of importance

1. Setting corporate strategy ,overall direction, mission and vision

2. Succession: hiring and firing the CEO and top management

3. Controlling , monitoring or supervising top management

4. Reviewing and approving the use of resources

5. Caring for stockholders interests

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PEST Analysis

A scan of the external macro-environment in which the firm operates can be expressed in terms of the following factors:

- **P**olitical
- **E**conomic
- **S**ocial
- **T**echnological

The acronym **PEST** (or sometimes rearranged as "STEP") is used to describe a framework for the analysis of these macro environmental factors.

Political Factors

Political factors include government regulations and legal issues and define both formal and informal rules under which the firm must operate. Some examples include:

- tax policy
- employment laws
- environmental regulations
- trade restrictions and tariffs
- political stability

Economic Factors

Economic factors affect the purchasing power of potential customers and the firm's cost of capital. The following are examples of factors in the macro economy:

- economic growth
- interest rates
- exchange rates
- inflation rate

Social Factors

Social factors include the demographic and cultural aspects of the external microenvironment. These factors affect customer needs and the size of potential markets. Some social factors include:

- health consciousness
- population growth rate
- age distribution
- career attitudes

- emphasis on safety

Technological Factors

Technological factors can lower barriers to entry, reduce minimum efficient production levels, and influence outsourcing decisions. Some technological factors include:

- R&D activity
- automation
- technology incentives
- rate of technological change

External Opportunities and Threats

The PEST factors combined with external micro environmental factors can be classified as opportunities and threats in a SWOT analysis.

SWOT Analysis

A scan of the internal and external environment is an important part of the strategic planning process. Environmental factors internal to the firm usually can be classified as strengths (**S**) or weaknesses (**W**), and those external to the firm can be classified as opportunities (**O**) or threats (**T**). Such an analysis of the strategic environment is referred to as a SWOT analysis.

The SWOT analysis provides information that is helpful in matching the firm's resources and capabilities to the competitive environment in which it operates. As such, it is instrumental in strategy formulation and selection.

Strengths

A firm's strengths are its resources and capabilities that can be used as a basis for developing a competitive advantage.

Examples of such strengths include:

- patents
- strong brand names
- good reputation among customers
- cost advantages from proprietary know-how
- exclusive access to high grade natural resources
- favorable access to distribution networks

Weaknesses

The absence of certain strengths may be viewed as a weakness. For example, each of the following may be considered weaknesses:

- lack of patent protection
- a weak brand name

- poor reputation among customers
- high cost structure
- lack of access to the best natural resources
- lack of access to key distribution channels

In some cases, a weakness may be the flip side of a strength. Take the case in which a firm has a large amount of manufacturing capacity. While this capacity may be considered a strength that competitors do not share, it also may be a considered a weakness if the large investment in manufacturing capacity prevents the firm from reacting quickly to changes in the strategic environment.

Opportunities

The external environmental analysis may reveal certain new opportunities for profit and growth. Some examples of such opportunities include:

- an unfulfilled customer need
- arrival of new technologies
- loosening of regulations
- removal of international trade barriers

Threats

Changes in the external environmental also may present threats to the firm. Some examples of such threats include:

- shifts in consumer tastes away from the firm's products
- emergence of substitute products
- new regulations
- increased trade barriers

The SWOT Matrix

A firm should not necessarily pursue the more lucrative opportunities. Rather, it may have a better chance at developing a competitive advantage by identifying a fit between the firm's strengths and upcoming opportunities. In some cases, the firm can overcome a weakness in order to prepare itself to pursue a compelling opportunity.

To develop strategies that take into account the SWOT profile, a matrix of these factors can be constructed. The SWOT matrix (also known as a **TOWS Matrix**) is

shown below:

SWOT / TOWS Matrix

	Strengths	Weaknesses
Opportunities	S-O strategies	W-O strategies
Threats	S-T strategies	W-T strategies

Strengths - Weaknesses

Opportunities : S-O strategies - W-O strategies

Threats : S-T strategies - W-T strategies

S-O strategies pursue opportunities that are a good fit to the company's strengths.

- **W-O strategies** overcome weaknesses to pursue opportunities.
- **S-T strategies** identify ways that the firm can use its strengths to reduce its vulnerability to external threats.

W-T strategies establish a defensive plan to prevent the firm's weaknesses from making it highly susceptible to external threats.

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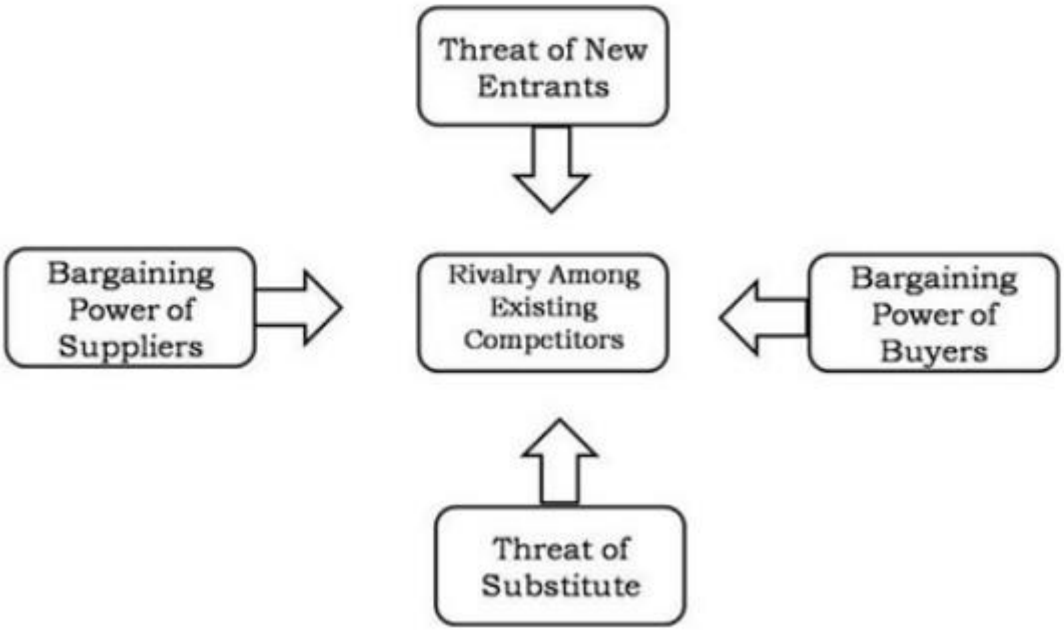

1. Economies of scale: Intel vs. AMD

2. Product differentiation: Apple Vs Dell

3. Capital requirements: To start Insurance Firms

4. Switching costs :example of windows to Linux; it is difficult to switch

5. Access to distribution channels: HLL Vs Arasan Soap

6. Cost disadvantages independent of size

7. Government policy: New banks policy of RBI.

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Strategy Formulation

Corporate Strategy:

Corporate strategy is primarily about the choice of direction for the firm as a whole. This is true whether the firm is a small, one-product Company or a large multinational corporation. In a large multi-business company, however, corporate strategy is also about managing various product lines and business units for maximum value. In this instance, corporate headquarters must play the role of organizational ―parent‖ in that it must deal with various product and business unit ―children‖. Even though each product line or business unit has its own competitive or cooperative strategy that it uses to obtain its own competitive advantage in the marketplace, the corporation must coordinate these different business strategies so that the corporation as a whole succeeds as a ―family‖.

Corporate strategy, therefore, includes decisions regarding the flow of financial and other resources to and from a company‘s product lines and business units. Though a series of coordinating devices, a company transfers skills and capabilities developed in a one unit to other units that need such resources. In this way, it attempts to obtain synergies among numerous product lines and business units so that the corporate whole is greater than the some of its individual business unit parts. All corporations, from the smallest company offering one product in only one industry to the largest conglomerate operating in many industries in many product must, at one time or another, consider one or more of these issues.

Directional Strategy:

Just as every product or business unit must follow a business strategy to improve its competitive position, every corporation must decide its orientation towards growth by asking the following three questions:

- Should we expand, cut back, or continue our operations unchanged?

- Should we concentrate our activities within our current industry or should we diversify into other industries?

- If we want to grow and expand, should we do so through internal development or through external acquisitions, mergers, or joint ventures?

A corporation‘s directional strategy is composed of three general orientations towards growth (sometimes called grant strategies):

Growth strategy expands the company‘s activities.

Stability strategies make no change to the company‘s current activities.

Retrenchment strategies reduce the company‘s level of activities.

Growth strategies

By far the most widely pursued corporate strategies of business firms are those designed to achieve growth in sales, assets, profit, or some combination of these. There are two basic corporate growth strategies: concentration within one product line or industry and diversification into other product and industries. These can be

achieved either internally by investing in new product development or externally through mergers acquisitions or strategic alliances.

Concentration strategies

Vertical integration

Growth can be achieved via vertical integration by taking over a function previously provided by supplier (backward integration) or by distributor (forward integration). This is a logical strategy for a corporation or business unit with a strong competitive position in a highly attractive industry. To keep and even improve its competitive position through backward integration, the company may act to minimize resource acquisition costs and inefficient operations, as well as to gain more control over quality and product distribution through forward integration.

The firm, in effect, builds on its distinctive competence to gain greater competitive advantage. The amount of vertical integration can range from full integration, in which a firm makes 100% of key supplies and distributors, to taper integration, in which the firm internally produces less than half of its key supplies, to no integration, in which the firm uses long term contracts with other firms to provide key supplies and distribution. Outsourcing, the use of long-term contracts to reduce internal administrative costs, has become more popular as large corporations have worked to reduce costs and become more competitive by becoming less vertically integrated.

Although backward integration is usually more profitable than forward integration, it can reduce a corporation's strategic flexibility; by creating an encumbrance of expensive assets that might be hard to sell, it can thus create for the corporation an exit barrier to leaving that particular industry.

Horizontal integration

It is the degree to which a firm operates in multiple geographic locations at the same point in an industries value changed growth can be achieved via horizontal integration by expanding firm's product into other geographic locations or by increasing the range of product and services offered to current customers.

Stability strategies: The corporation may choose stability over growth by continuing its current activities without any significant change in direction. The stability family

of corporate strategies can be appropriate for a successful corporation operating in a reasonably predictable environment. Stability strategies can be very useful in short run but can be dangerous if followed for too long.

Sum of the more popular of these strategies ar

1. Pause and proceed with caution strategy

2, no change strategy

3. Profit strategy

Corporate parenting:

Corporate parenting views corporation in terms of resources and capabilities that can be used to build business value as well as generates synergies across business units.

The corporate parenting strategies can be developed in following ways.

1. Examine each business unit in terms of its critical success factors.

2. Examine each business unit in terms of areas in which performance can be improved