


## Strategic Management Course

Oct. 2005 – June 2006

### Lessons 9 & 10 : Market Organisation and Competitive Advantage

*Prof. David Ward*

### Course Outline and Contents

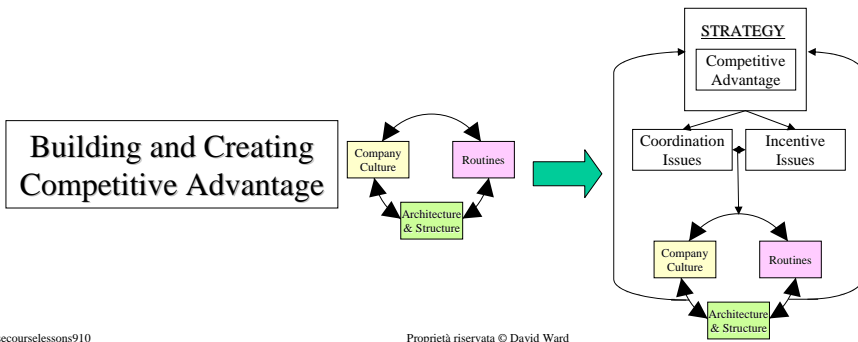
- Introduction to Strategy and Strategic Management
- Business Strategy
- Competitive Advantage
- Internal Context: Organisation Design
-  • Market Organisation and Competitive Advantage
- External Context: Industry Analysis
- The Spectrum of Competition and Niche Markets
- Competition in Concentrated Markets
- Entry and the Advantage of Incumbency
- Creating and Capturing Value in the Value Chain
- Globalisation and Strategy
- Current trends in Strategic Management
- Strategic Management in a Changing Environment

## Summary of Lessons 7 & 8

Types of Organisation: Divisional, Functional, Mixed (matrix)

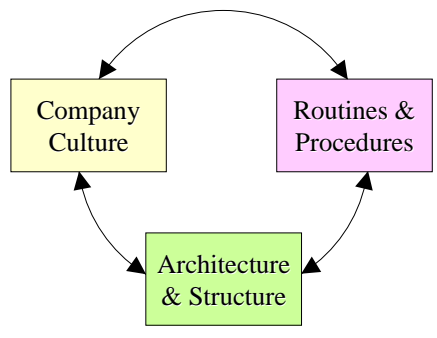
Linkages: Personal Networks, Liaison, Project Teams, Integrators

A strategy may be aligned by combining the ARC levers that encompass the internal context with the competitive advantage of the organisation.



## The ARC Model

Lessons 7 & 8



**Architecture:** is the 'relationship' structure of a company.

**Routine:** is the procedural (both formal and informal) part of a company.

**Culture:** is the creed or beliefs of a company.

## Applying ARC analysis to Assess Strategic Alignment

Lessons 7 & 8

First assess the key coordination and incentive issues of your strategy or the strategy under examination.

*Coordination is the acquisition and allocation of assets i.e. facilities, machinery, inventory etc. or non-physical e.g. knowledge, experience etc. Ensure that these are available at the right time, format and amount.*

*Incentives are objectives that may be tangible (e.g. financial) or non-tangible (e.g. winning awards) and may differ greatly across an organisation. Performance measurements may also differ greatly from profit maximisation (Sales) to recognition (R & D).*

Next use the ARC method to see just how key coordination and incentive issues are tackled

## Aligning Strategy and Organisation

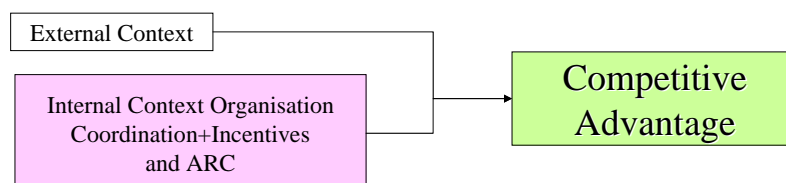
Lessons 7 & 8

A strategy may be aligned by combining the ARC levers that encompass the internal context with the competitive advantage of the organisation.

In more simple terms this means Combining ARC with C.A.:

Aligning Strategy = ARC + Competitive Advantage

Since (in general) very little can be done in terms of organising the external context what is important is that the internal context organisation is maximised.



## Summary of Lessons 7 & 8

Lessons 7 & 8

Industry analysis is essentially a framework for identifying, understanding and anticipating industrial change. It focuses on the *long-term performance*.

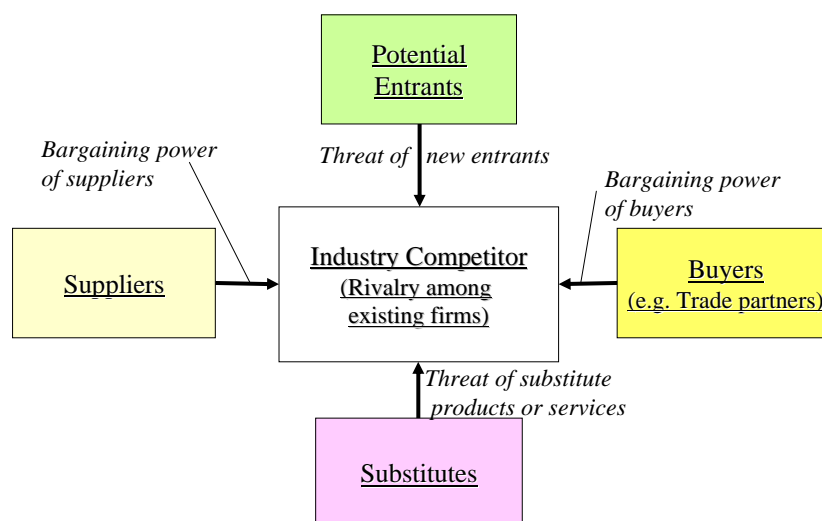
The SCP is essentially a framework which was developed by governments to highlight areas where intervention may lead to improved social welfare. In an industrial analysis it is therefore intended to analyse behaviour (e.g. product pricing and strategy) and not monetary performance such as profitability.

The value to the final buyers of the goods or services produced less the value of the resources that are used to produce them is the Potential Industry Earnings (PIE).

Potential Industry Earnings (PIE) = Value - Resources

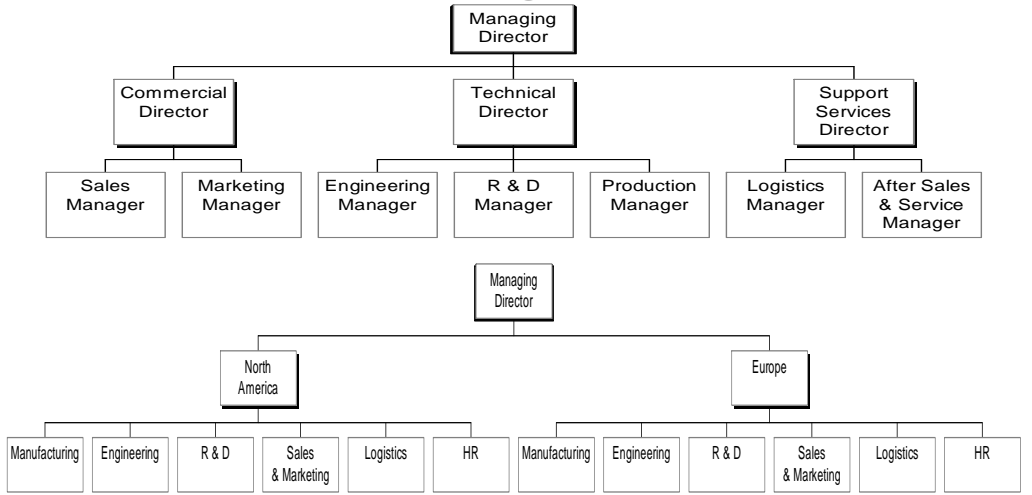
## Porter's 'Five Forces' Framework

Lessons 7 & 8



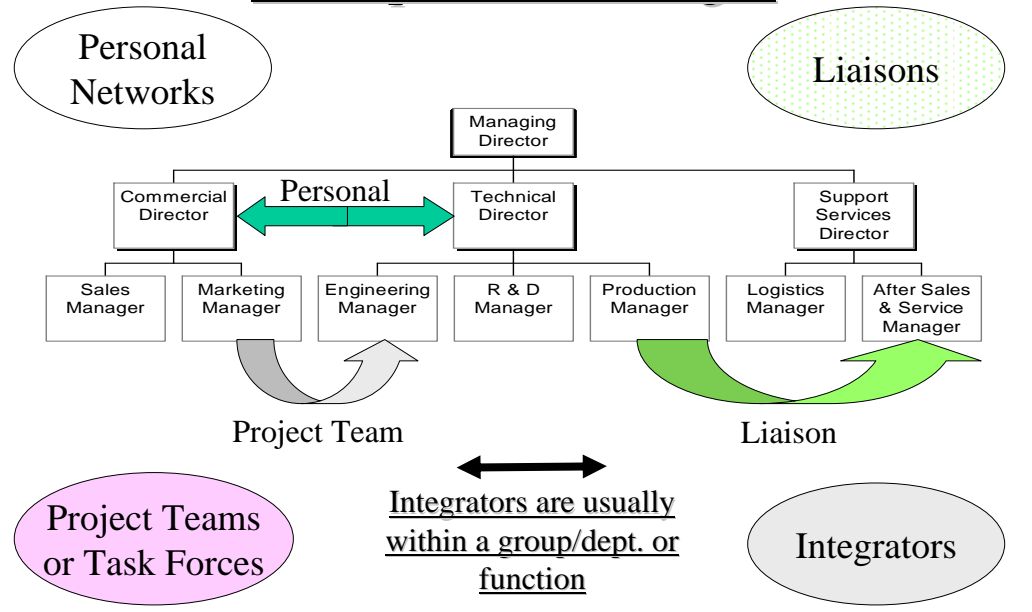
# Examples of Organisations

## Functional Organisation



## Divisional Organisation

# Examples of Linkages



## A Framework for Industry Analysis

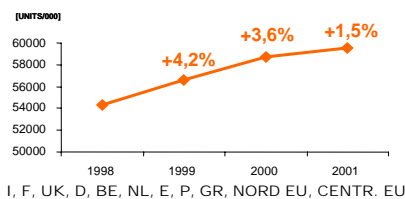
According to Porter there are five forces involved in the framework of Industry<sup>o</sup> Analysis:

- Suppliers (Strategic and Non)
- Buyers (Consumers and Trade Partners)
- Substitutes (Threat of substitute products)
- Potential Entrants (threat from new entrants)
- Industry Competitor (Rivalry among existing firms)

<sup>o</sup> (well-defined industry)

## Examples of Industry Analysis

### WESTERN EUROPE

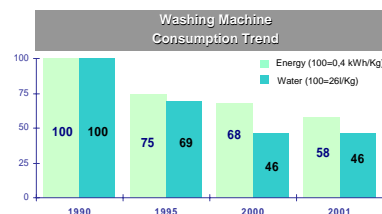


I, F, UK, D, BE, NL, E, P, GR, NORD EU, CENTR. EU

The market is 60,000,000 units on a population of 320 m

|   | 1998  | 1999  | 2000* |
|---|-------|-------|-------|
| Total fixed assets                      | 359   | 419   | 646   |
| Trade receivables                       | 379   | 376   | 389   |
| Stocks                                  | 152   | 145   | 183   |
| Trade accounts payable                  | (403) | (443) | (500) |
| Net Working capital                     | 128   | 78    | 72    |
| % on net sales                          | 9%    | 6%    | 4%    |
| Provisions, funds and other liabilities | (147) | (157) | (190) |
| NET INVESTED CAPITAL                    | 340   | 340   | 528   |
| Net financial position                  | 107   | 91    | 227   |
| Total net worth                         | 224   | 244   | 287   |
| Minority interest                       | 0     | 5     | 14    |
| TOTAL SOURCES                           | 340   | 340   | 528   |

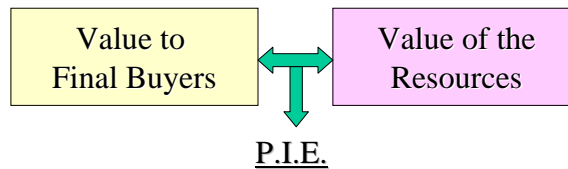
| Years | % market | Producers |
|-------|----------|-----------|
| 1970  | 70%      | 400       |
| 1980  | 75%      | 150       |
| 1990  | 80%      | 15        |
| 2000  | 84%      | 9         |



Energy consumption of a washing machine decreased by 40% in 10 years, water consumption decreased by 55%

## Value Creation - PIE

The value to the final buyers of the goods or services produced less the value of the resources that are used to produce them is the Potential Industry Earnings (PIE).



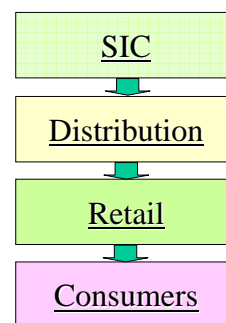
1. Factors that affect the value created
2. Factors that affect the sharing of the value

together these show the attractiveness of the industry

Can you give examples of factors that positively affect the PIE?

## Examples of forces that affect PIE

- ✍ Population growth
- ✍ Social-demographic trends
- ✍ Income growth or spread
- ✍ Technology advance or breakthrough
- ✍ Reduction in raw materials costs
- ✍ More suppliers coming on the market
- ✍ Currency fluctuations
- ✍ Work contracts
- ✍ Labour costs
- ✍ Legislation
- ✍ etc.




## Keywords of Lessons 7 & 8

- Creating and Building
- Functional and Divisional
- Organisation slack
- Organisation cost
- Industry analysis
- Framework
- Value creation
- Capturing Value
- Supplier
- Buyer
- Alignment
- Entry barriers
- Linkages
- Personal networks
- Liaisons
- Task forces
- Integrators
- PIE
- Value creation
- Exploiters
- Explorers
- Vertical Power
- Substitutes
- Potential Entrants
- Threats
- New entrants
- Industry Competitor
- Rivalry
- Organisation change
- Performance

## Lessons 9 & 10 – Market Organisation and Competitive Advantage

- Back flashes of Lessons 7 & 8 and open questions
- The Spectrum of Competition
  - Structure and Behaviour
- Niche Markets and Product Differentiation
- Consumer Preferences and Product Differentiation
- Differentiation and Competition
- Product Positioning
- Competition in Concentrated Markets
- Oligopoly: Strategic Interaction
- Elements of Strategic Interaction
- Information and Knowledge management

 This lesson was based on pages 93 to 118 of the textbook or pages 111 to 142 in the Italian version of the textbook.

## Possible Exam Questions

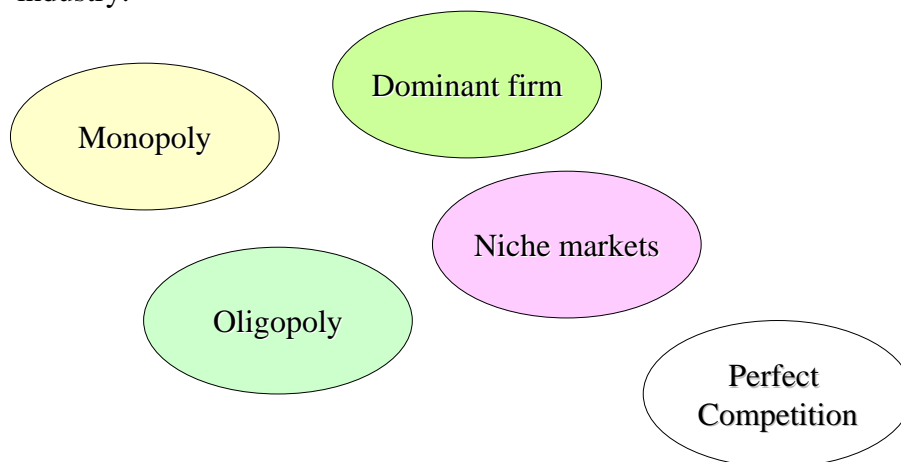
Define and depict each of the five categories or forms of competition in the spectrum of competition model for industry. Compare the monopoly and dominant company categories or forms of competition and make reference to two specific descriptive examples for each of these two categories.

Discuss the merits and demerits of monopoly, dominant, oligopoly, niche, perfect competition categories of industry. Provide examples for each category and the full name of this model.

Discuss the spectrum of competition providing examples of all five categories. Describe and then discuss the 'Perfect Competition' model within the spectrum of competition.

## The Spectrum of Competition

The spectrum of competition refers to the classification of the structure of an industry.



## Monopoly



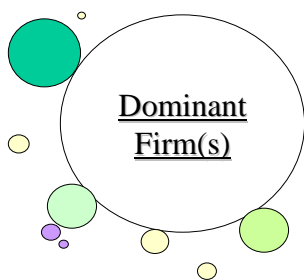
Monopolies are found in industries where a single company or one firm dominates and there is no competition.

*In general this implies that prices are 'high' (as is shown for Nutrasweet), margins are high but the market could be suffocated because of the 'high' price.*

Examples: Tobacco, ENEL Energy, Iraqi Oil, Mediaset, Grocery store in a remote village, Postage stamps

Can you think of companies or industries that started or still are monopolist in nature?

## Dominant Firm



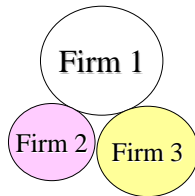
In this type of industry there is one dominant firm (or few firms) surrounded by a cluster of smaller firms.

*The dominant firm(s) tends to monopolise pricing (through price leadership) and protect their high profit margin markets. Also most of the competition will be kept on the fringe of the industry and thus concentrate on the 'small fish'.*

Examples: Computer operating systems software companies like Microsoft, Novell etc.

Can you think of dominant firm examples of competition?

## Oligopoly



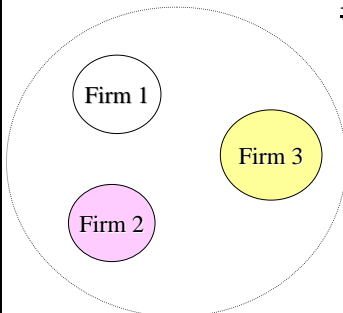
Oligopoly competition is typical of industries where the number of companies is limited and there is a strategic interdependence.

*Profitability is strongly dependent on the behaviour of the firms involved.  
Typical examples are the automobile and aircraft industries.*

Other examples: Oil companies, Supermarkets, Internet providers

Can you think of a monopoly industry that has become an oligopoly industry?

## Niche Markets

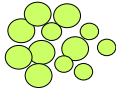


Niche markets imply localised competition and very strong product differentiation.

*Localisation does not imply exclusion of competing on a global basis or the market is small rather it implies that you are doing business with specific consumers in a specific area.*

Examples: Alessi, Valentino, Rolls Royce and Bentley

Can you think of a Niche market that has become an oligopoly industry or vice versa?



## Perfect Competition

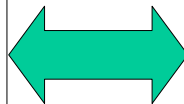
- Perfect competition can be viewed as the other extreme of the competition spectrum, the direct opposite to monopoly competition.
- It means that there are many (smallish) competitors, prices meet the consumers' expectations, however, there is no or very little product differentiation.
- The absence of product differentiation implies that consumers will tend to switch from one firm to another, especially if there are no other tangible benefits such as after-sales service, extended warranty, etc.
- In other words, brand loyalty will be low and competing companies are more vulnerable.
- Industries with this model will have cost as a value and the share of the PIE will be low.

## Market Structure and Behaviour

Market Structure: meaning the number, relative sizes and players in the industry and the underlying industry structure

Behaviour: meaning the way companies choose their competitive approach.

Competitive Intensity decreases as products become less undifferentiated and the number of the players reduces.



Competitive Intensity increases as products become more undifferentiated and the size of the players is relatively small.



## Niche Markets and Product Differentiation

When product differentiation is low and competition is high this effectively acts as a profit-destroyer. This is especially true if market growth is low or stagnant.

### Benetton

- Colourful knitwear (maximising manufacturing efficiency and effectiveness)
- Young age groups (e.g. 0-12)
- Branding strategies (United colours of Benetton, 0-12)
- Product positioning (focused)
- Promotional strategies (e.g. shops, F1, advertising)

What allows companies to differentiate their products?

## Consumer Preferences and Product Differentiation

Consumer preferences are about the main characteristics that existing (or potential) products possess. In other words what consumers care about (other than price of course).

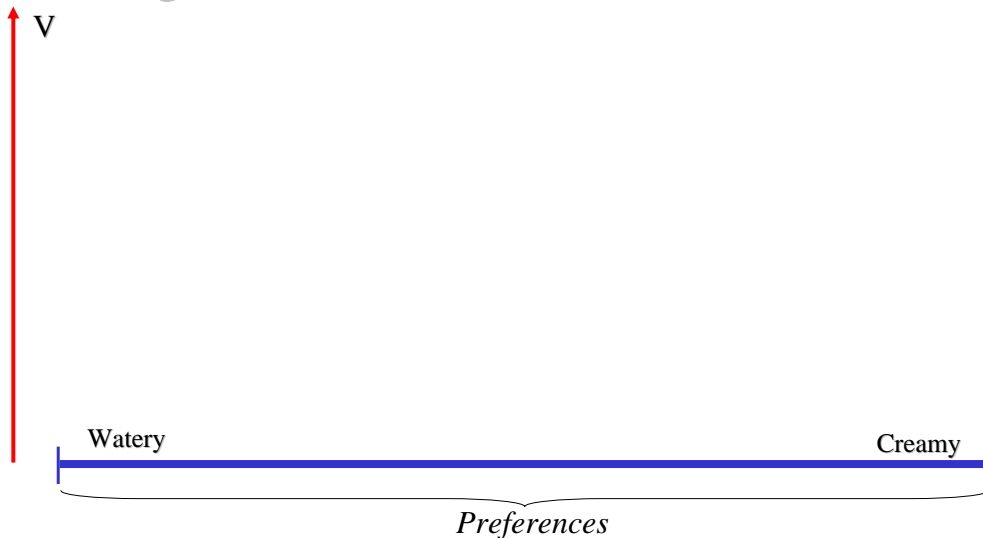
Take for example yoghurts.

Let us suppose we define two extremes for defining a series of yoghurts (e.g. CREAMY and WATERY).



# Yoghurts

Classroom session



Type of Question: Semantic Differential see Kotler p. 135

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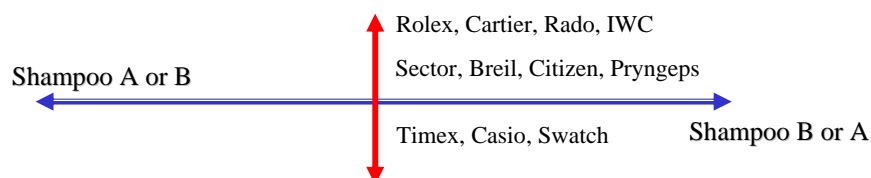
## Horizontal and Vertical Differentiation

**Horizontal differentiation:** concern those products where the consumers disagree about which product is better.

Examples: Soft drinks, food, beer, shampoos

**Vertical differentiation:** concern those products where the consumers perceive quality in a vertical manner and *agree* on how the products are ranked.

Examples: cars, hotels, holiday retreats,

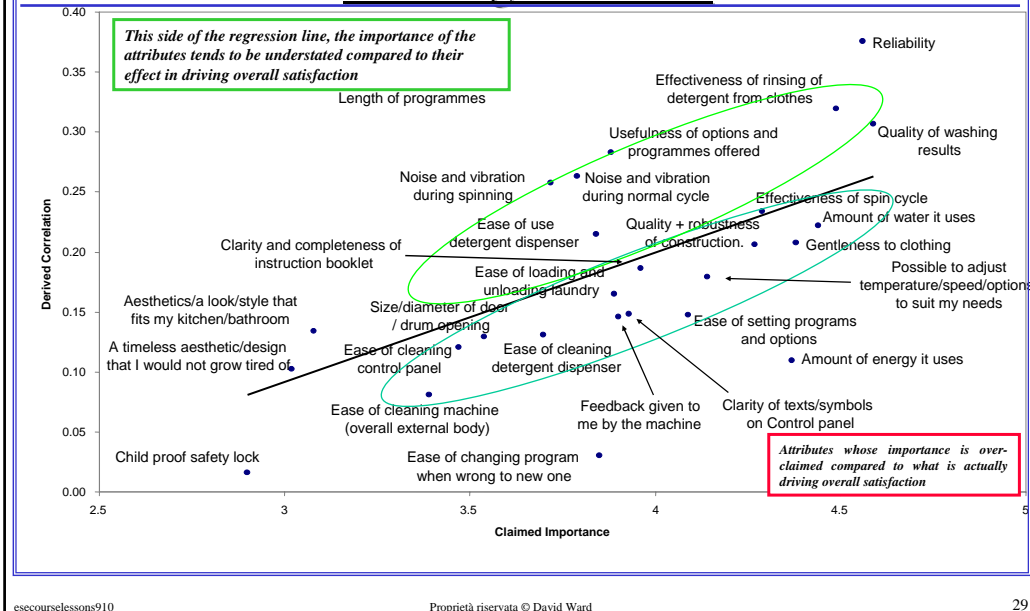


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## Correlation's vs. Claimed Importance Washing Machines



## Differentiation and Competition

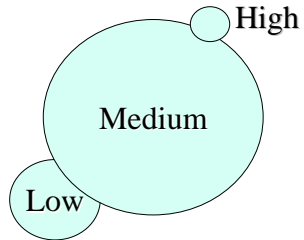
Where product appeal tends to overlap so competition tends to be more fierce.

Consequently where differentiation is strong, competition tends to be slack and soft.

In an extremely differentiated market or niche segment the predominance turns (can turn) into a monopoly.

The conclusion is that products compete more intensely the closer they are in terms of characterisation (less differentiation).

## Product Positioning



### Three dictums for success:

1. Locate close to the consumers
2. Locate far away from your competitors
3. Ensure that you can do this for as long as you want or need

A '*niche*' strategy would probably succeed more or achieve this e.g. having the only newsagents, groceries store etc. in all the small and remote villages of an area.

One way of obtaining point 3 is to be the first mover and build quickly, especially as once the consumer habits have been established it will take time, effort and resources to change.

## Coffee Break

you have 10 minutes!

## The Case of Pirelli Real Estate

In the coming years one of the biggest waves of public administration innovation will be the out-sourcing of non-core activities e.g. cleaning, road maintenance, maintenance etc.

This sector is now known as the Facility Management business which includes General Services activities.

This business in Italy alone is estimated to be worth 33Billion euros (2 Italian government budgets).

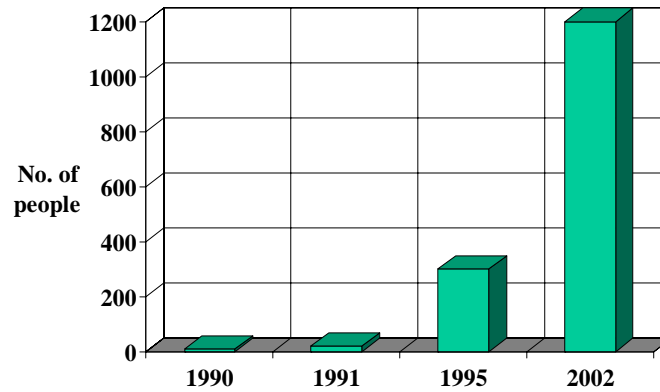
- The Pirelli real estate case is an example of a strategy that was developed perhaps by chance but nevertheless to meet specific company (running) objectives.
- The company has grown from 10 people to over 1200 people in 10 years! It has purchased the knowledge it needed!!!

## Some History

### (Trend and Discontinuities)

- Pirelli & C Real estate started in the early 90's when the IACI (Iniziativa Agricole Commercial Italiana) and Vitruvio (a real estate firm of the Pirelli group) managements decide to join forces. The new company was called Milano Centrale, a historical Pirelli brand.
- Shortly after this the Progetto Bicocca real estate activities were incorporated. This was effectively the start of the real estate and services activities for the company.
- In 1997 a joint-venture with Morgan-Stanley provided further emphasis on these two activities. Acquisitions included Unim. Edilnord, Cagisa, Altair, Comes, Compart-Montedison, Banca di Roma, RAS, Toro.
- In 2002 the real estate activities of Olivetti and Telecom were added.

## Macro Facts and Figures



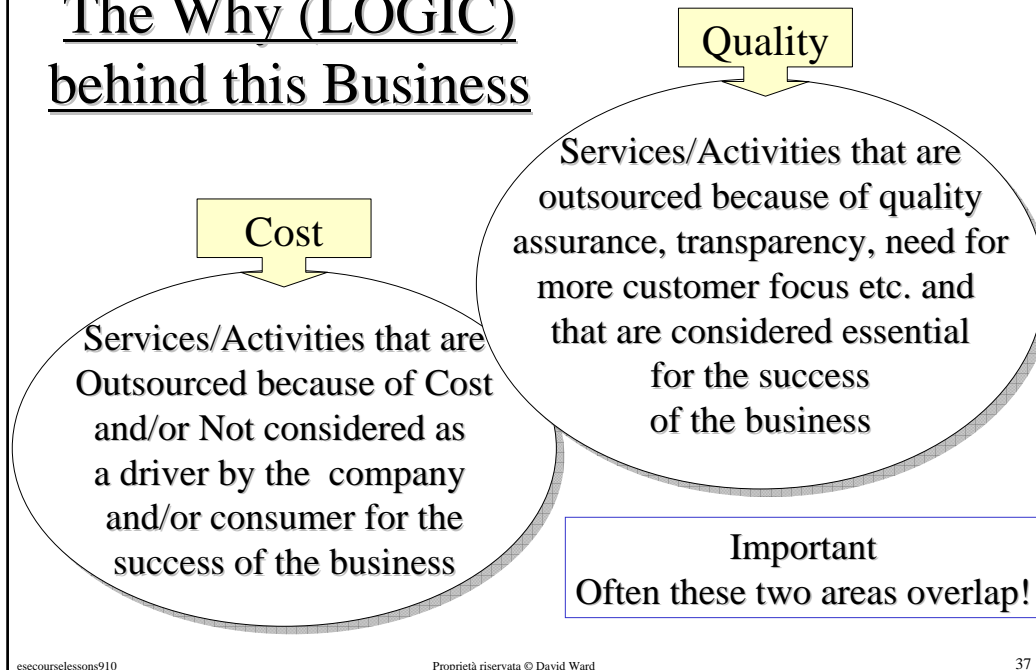
Today the average tender/contract is worth 405k euros (max. 46M euros). There are over 1200 running tenders. Contracts usually last 3-4 years. A UNI standard is now being prepared to certify/regulate this sector.

## What is the Product/Who are the Customers?

|                          | <u>Core (Business)</u> |
|--------------------------|------------------------|
| • Hospitals              | Care                   |
| • Universities           | Education              |
| • Town and City Councils | Services to the public |
| • Private companies      | Products/Services      |

|                          | <u>Non-Core examples</u> |
|--------------------------|--------------------------|
| • Hospitals              | Boiler maintenance       |
| • Universities           | Cleaning                 |
| • Town and City Councils | Catering, Call-centre    |
| • Private companies      | Products/Services        |

## The Why (LOGIC) behind this Business



## In terms of Organisation....

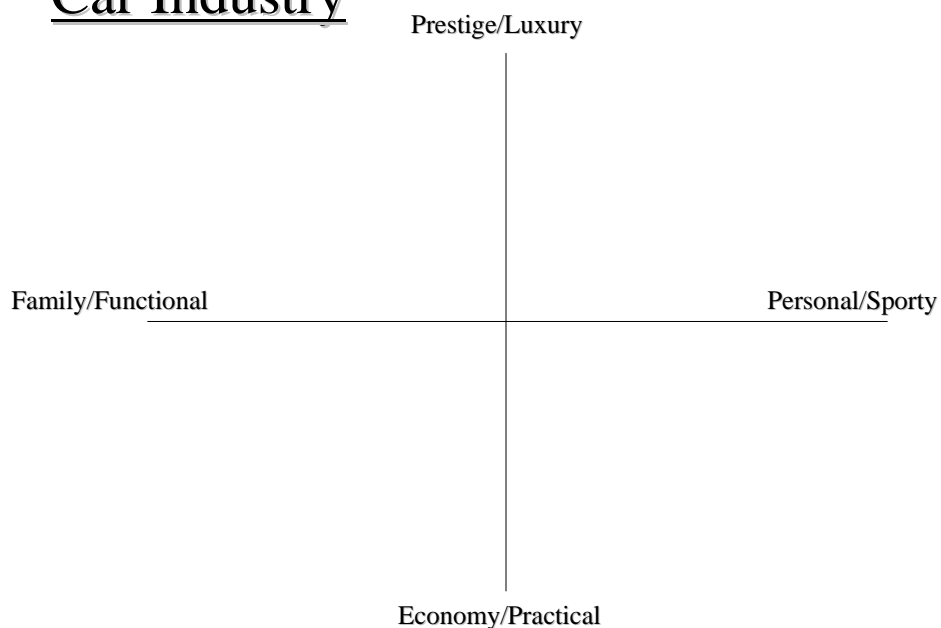
- The case of Pirelli Real Estate is an example of where the organisation substantially changed because of mergers and acquisitions.
- However, perhaps the biggest challenges will come from the growth of the market and the need to consolidate links with government institutions. These links are often both political and heirarchical.
- The organisation will need to adapt from Best Price to Best-In-Class or Best Practices depending on the tender.

## What could happen?

- New legislation (European or national)
- More (or less) bureaucracy.
- Market remains very fragmented.
- Big (bigger) companies (incl. The Mafia) move in and take over.
- Change of government or social-political perspective.
- Government focus becomes cost and not quality.
- Government cutbacks or irregular payments
- Irregular government tenders (timing and planning)
- Competition remains national or moves to a Dominant scenario.
- Etc.....

## Car Industry

Group session



## Competition in Concentrated Markets

Most well-known firms compete as major players in their industries, examples being:

|                   |                         |
|-------------------|-------------------------|
| Pharmaceutical    | : Glaxo, Bayer          |
| Automobile        | : PSA, Ford             |
| Semiconductor     | : Intel, AMD            |
| Airlines          | : BA, United            |
| Telecommunication | : Vodafone, Nokia, Bell |
| Petroleum         | : BP, Shell             |

These companies have a substantial market share and the markets where they compete are known as concentrated industries because competition is concentrated.

They also affect the competitive characteristics of the industry e.g. dictate pricing.

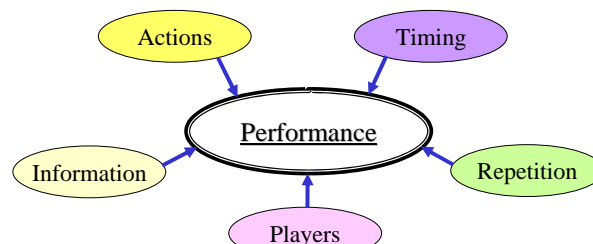
## Oligopoly: Strategic Interaction

There are two distinguishing features of oligopoly:

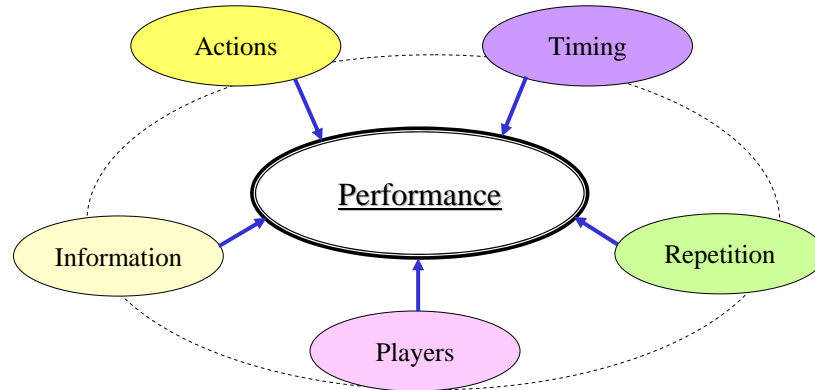
1. Few, large (i.e. large market share) companies,
2. The behaviour of these firms will determine how the incumbent firms will perform.

However, there is a set of 5 elements that help to understand and systematically think about strategy and the interaction it has with with oligopolistic companies.

In other words these elements affect their behaviour.



## Elements of Strategic Interaction



Notes: The dashed line implies that there is an interdependency between all 5 elements and performance

## Elements of Strategic Interaction

**Players:** These are the companies whose actions affect each other.

**Actions:** The choices available to incumbent companies can condition competition especially when it concerns investments, time-to-market, production output etc.

**Timing:** Timing may be critical not just for first movers but also for those who want to follow.

**Information:** There is also the exploitation of information within and between companies. This exploitation of information allows managers to make the right decisions.

**Repetition:** Often in oligopolistic firms there is a long competitive history and interaction leads to a more cooperative behaviour and the opportunity to leverage reputation repeatedly.

## Information

There are many types of information that can affect competitive intensity, for example:

- What firms know or believe to know about each other.
- What actions firms have taken (knowing who will be the first mover)
- Market knowledge such as conditions, pricing etc.

More recently large companies have begun to realise the competitive potential of archiving, accessing, assessing and communicating (internal or external) knowledge, this activity is known as Knowledge Management (KM).

Can you think of examples where information provides a competitive advantage? How does Knowledge management link to competitive advantage?

## Keywords of Lessons 9 & 10

- Monopoly
- Oligopoly
- Dominant
- Niche
- Perfect competition
- Customer Satisfaction
- Preferences
- Differentiation
- Positioning
- Players
- Actions
- Timing
- Information-knowledge
- Concentrated
- Customers
- Needs
- Repetition
- Knowledge management
- Services
- Quality
- Cost
- Facility Management
- General services
- Core
- Non-core
- Running objectives

## Summary of Questions

Can you think of companies or industries that started or still are monopolist in nature?

Can you think of dominant firm examples of competition?

Can you think of a monopoly industry that has become an oligopoly industry?

Can you think of a Niche market that has become an oligopoly industry or vice versa?

What allows companies to differentiate their products?

Can you think of examples where information provides a competitive advantage? How does Knowledge management link to competitive advantage?

## Example of Exam Question Marking

If a student chooses to answer 5 exam questions e.g. question 1 and the examiner gives him/her a 28/30, question 2 a 21/30, question 4 a 25/30, question 6 a 16/30 and question 7 a 26/30 - we add 28+21+ 25+16+26 then divide by 5 to get the average final exam score: in this example is 23 is the final exam grade.

This mark (23) then counts towards of the final grade depending on the exam percentage, e.g. for 60% we have  $23 * 0.6 = 13.8$ .

If the project is graded for this student as a 25/30 and the report % is, say 40% then this goes towards the final grade (e.g.  $25 * 0.4 = 10$ ). The final grade becomes:  $13.8 + 10 = 23.8$  which is rounded off to 24 for the final grade for the course.

$$\text{Report \%} + \text{Exam \%} = \text{Final \% or 30/30 grade}$$

## Suggested Readings/Hand outs

- Hand-out: Knowledge management as a competitive advantage.
- Briner B, (1997), *Gesù come manager: Gli insegnamenti di Gesù per il business di oggi*, Mondadori.
- Heller R. and Hindle T., (1998), *Essential Manager's Manual*, DK Publishing.
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