

Reading the Competitive Environment

Summary of ch. 6 of the Colin White Text

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Reading the Competitive Environment

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What makes the Environment?

- ◆ Otherwise called the industry, the immediate or the transactional environment.
- ◆ 'Industry' stresses the nature of the product, 'immediate' the directness of the interaction and 'transactional' the nature of the transaction.
- ◆ The environment consists of the rules of the game and those who are playing. As the name implies it is usually a competitive environment.

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The Players (1)

- ◆ The rule makers directly relevant to the competitive environment may include:
 - various levels of government or government regulatory bodies
 - foreign governments within whose jurisdiction the relevant enterprise operates
 - multilateral agencies such as the WTO
- ◆ Industry associations
- ◆ Trade unions and other stakeholders organizations

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Players (2)

- ◆ Competitor enterprises
 - Foreign
 - Domestic
- ◆ Potential competitors
- ◆ Complementor enterprises
- ◆ Potential complementors
- ◆ Suppliers
- ◆ Customers

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The Industry

- ◆ The standard classification is usually out of date
- ◆ The degree of substitutability between products defines the industry
- ◆ The degree of complementarity also helps define the industry
- ◆ There are also industry or market segments and associated with them varying desired attributes of the product
- ◆ Switching costs, both real and psychological, deter any shift in demand

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The Transaction

- ◆ Ongoing - action, response and reaction
- ◆ Repeated or one-off?
- ◆ Transaction costs – search, negotiation and enforcement
- ◆ The universality of a direct competitive influence
- ◆ Cooperation v. competition

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The Forces of Competition

- ◆ Porter's five:
 - Barriers to entry
 - Bargaining power of suppliers
 - Bargaining power of customers
 - Existence of substitutes
 - Intensity of competition
- ◆ It is possible to add a sixth: the degree of cooperation and bargaining strength of complementors

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Porter's forces of competition

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Barriers to Entry

- ◆ How easy it is to acquire an existing enterprise
- ◆ Product differentiation
- ◆ Cost advantages – economies of scale or scope: movement down the experience curve
- ◆ Impact of entry, plus likelihood of retaliation
- ◆ Control over inputs
- ◆ Market imperfections in general, e.g. patents
- ◆ Influence over the rules of the game
- ◆ Ignorance and transport costs
- ◆ Specificity of assets

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The Bargaining Power of Suppliers

- ◆ What is being negotiated – price and quality
- ◆ Negotiating ability of players
- ◆ Number of suppliers
- ◆ Size of suppliers
- ◆ Diversity of interests of suppliers
- ◆ The problem of asymmetrical investment
- ◆ The problem of asymmetrical information
- ◆ Switching costs

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The Bargaining Power of Customers

- ◆ The same factors are relevant to customers
- ◆ Generally in the market for final consumer goods there are more players than for industrial goods = greater weakness of bargaining power
- ◆ Switching costs are as much psychological as pecuniary

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The Existence of Substitutes

- ◆ Does the product have the same attributes?
- ◆ Does it satisfy the same utilities?
- ◆ What is the degree of substitutability? And the responsiveness to price change?
- ◆ Technical change is always creating new ways of satisfying utilities
- ◆ Innovation is always stripping unneeded attributes

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The Intensity of Competition

- ◆ This is not simply a matter of the number of players or the barriers to the entry of new players.
- ◆ How many potential competitors are there?
- ◆ The pricing and promotional strategies of existing players are relevant
- ◆ How far has the industry consolidated?

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The Bargaining Power of Complementors

- ◆ Complementors assist in reducing costs or adding value to what is consumed
- ◆ However complementors also seek a reward
- ◆ They extract their reward in the price of what they provide
- ◆ How far can they use bargaining power to extract a larger reward?

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Dynamic Factors

- ◆ There are factors which influence the forces of competition now although they relate to future trends:
 - future growth of the market for the relevant product or service
 - innovation which reduces the costs of production and distribution
 - instability in the relevant markets, particularly if it is cyclical

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Network Economics

- ◆ There is cumulative growth for some products in that they benefit from the growth of networks
- ◆ Any PC or the wireless handsets using 3G are only useful to a user in so far as they can link with other users
- ◆ The attraction of such products grows with the growth of the relevant networks

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Risk and Market Structures

- ◆ There is little scope for strategy in a perfectly competitive market
- ◆ As the number of players is reduced their impact on each other becomes greater and more obvious
- ◆ Oligopoly creates a new kind of risk, which can be labelled strategic risk
- ◆ There is little risk in a monopoly, except perhaps from government or from abroad

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The Iron law of Oligopoly

- ◆ Perfect competition and monopoly are rare
- ◆ There is a tendency for a small number of players to dominate any market or any industry whatever the level which is considered – regional, national or global.
- ◆ The main inhibiting factor in the operation of this law is government action which promotes a larger number of players than would otherwise be the case

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Indeterminateness of Outcomes

- ◆ There are multiple possible equilibria
- ◆ Which one emerges is the result of particular historical paths taken in the past
- ◆ The interaction of the strategies of the main players and also of many smaller players determines the outcome

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Path Dependency

- ◆ The present is the result of history
- ◆ Each present is a unique result of each history
- ◆ Apparently small events in the past can have a powerful impact on the present
- ◆ In theory to arrive at the same point one enterprise has reached might mean repeating that historical experience

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Country Risk

- ◆ This is the risk which arises because of the existence of national boundaries and the sovereignties contained within those boundaries
- ◆ It has a number of different components
 - political, economic, financial and cultural

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Political Risk

- ◆ This has three different sub-components:
 - political instability
 - government policy change
 - social instability
- ◆ It often interacts with economic risk

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Transfer Risk

- ◆ This is part of the market context sub-component of economic risk
- ◆ It has two main elements:
 - the effect of exchange rate variation
 - the impact of a change in regulations which prevent transfer, although strictly speaking this is an element of political risk

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Strategic Risk

- ◆ This is the risk which arises from the existence of other players whose strategy is
 - unknown
 - concealed
 - subject to change
- ◆ It consists of:
 - the competitive risk which reflects the indeterminateness of oligopoly
 - + country risk

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Videogame Wars

- ◆ There are a small number of real players – Nintendo, Sony and Microsoft: this is very much an oligopoly
- ◆ The makers of games are complementary to the console makers and vice versa: it depends on your perspective

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Characteristics of this Sector

- ◆ The market which is already large is growing rapidly
- ◆ The market is expanding from that of boys and young men
- ◆ Technical change is rapidly changing the sector, improving the quality of what can be done
- ◆ Will games be delivered by broadband on PCs, will they be delivered by wireless sets or will the existing situation continue

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Strategies

- ◆ Different generic strategies: price or cost leadership, product differentiation
- ◆ The importance of the quality of the games – much room for creative talent in this area
- ◆ Impossible to ignore the strategies of other players
- ◆ Timing a key issue

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