The Competitive Environment:

International Business in Focus

2013-14
The Components of a Company's Macro-environment

- General economic conditions
- Immediate industry and competitive environment
  - Suppliers
  - Substitute products
  - Rival firms
  - Buyers
  - New entrants
- Macroenvironment
- Technology
- Legislation and regulations
- Societal values and lifestyles
- Population demographics
How Strong Are Competitive Forces?

- Objectives are to identify
  - Main **sources** of competitive forces
  - **Strength** of these forces

- Key analytical tool
  - **Five Forces Model of Competition**
The Five Forces Model of Competition

- Firms in Other Industries Offering Substitute Products
  - Competitive pressures coming from the market attempts of outsiders to win buyers over to their products

- Suppliers of Raw Materials, Parts, Components, or Other Resource Inputs
  - Competitive pressures stemming from supplier bargaining power and supplier-seller collaboration

- Rivalry among Competing Sellers
  - Competitive pressures created by jockeying for better market position, increased sales and market-share, and competitive advantage

- Potential New Entrants
  - Competitive pressures coming from the threat of entry of new rivals

- Buyers
  - Competitive pressures stemming from buyer bargaining power and seller-buyer collaboration
The key elements in Porter’s analysis are

(1) The threat of potential entrants
Depends on the barriers to entry: economies of scale, differentiation, capital requirements, costs advantages, access to distribution channels, laws

(2) The threats of substitute products.
To minimise this a firm could either differentiate or reduce costs
(3) Threat from the bargaining power of suppliers. They can squeeze profits by raising prices or reducing quality.

(4) Bargaining power of buyers. Relevant considerations include ‘switching costs’

(5) The degree of competitive rivalry. Is influenced by market concentration and structure - but is affected by the other four forces.
The Threat of Entry & Barriers to Entry

The threat of entry is low when the barriers to entry are high and vice versa.

The main barriers to entry are:
- Economies of scale/high fixed costs
- Experience and learning
- Access to supply and distribution channels
- Differentiation and market penetration costs
- Government restrictions (e.g. licensing)

Entrants must also consider the expected retaliation from organisations already in the market.
Competitive Pressures
Associated With Potential Entry

- Seriousness of threat depends on
  - Size of pool of entry candidates and available resources
  - Barriers to entry
  - Reaction of existing firms
Common Barriers to Entry

- Sizable economies of scale
- Brand preferences and customer loyalty
- Capital requirements and/or other specialized resource requirements
- Access to distribution channels
- Regulatory policies
- Tariffs and international trade restrictions
There’s a sizable pool of entry candidates

Entry barriers are low

Industry growth is rapid and profit potential is high

Incumbents are unwilling or unable to contest a newcomer’s entry efforts

When existing industry members have a strong incentive to expand into new geographic areas or new product segments where they currently do not have a market presence
When Is the Threat of Entry **Weaker**?

- There’s only a small pool of entry candidates
- Entry barriers are high
- Existing competitors are struggling to earn good profits
- Industry’s outlook is risky
- Industry growth is slow or stagnant
Threat of Substitutes

Substitutes are products or services that offer a similar benefit to an industry’s products.

Customers will switch to alternatives (and thus the threat increases) if:

- The price/performance ratio of the substitute is superior (e.g. aluminium maybe more expensive than steel but it is more cost efficient for some car parts)
- The substitute benefits from an innovation that improves customer satisfaction (e.g. high speed trains can be quicker than airlines from city centre to city centre)
Competitive Pressures from Substitute Products

Substitutes matter when customers are attracted to the products of firms in other industries.

Examples

- Sugar vs. artificial sweeteners
- Eyeglasses and contact lens vs. laser surgery
- Newspapers vs. TV vs. Internet
How to Tell Whether Substitute Products Are a Strong Force

- Whether substitutes are readily available and attractively priced
- Whether buyers view substitutes as being comparable or better
- How much it costs end users to switch to substitutes
When Is the Competition From Substitutes *Stronger*?

- There are many good substitutes readily available
- Substitutes are attractively priced
- The higher the quality and performance of substitutes
- The lower the end user’s switching costs
- End users grow more comfortable with using substitutes
When Is the Competition From Substitutes \textit{Weaker}?

- Good substitutes are not readily available or do not exist
- Substitutes are higher priced relative to performance they deliver
- End users incur high costs in switching to substitutes
The bargaining power of buyers

Buyers are the organisation’s immediate customers, not necessarily the ultimate consumers. If buyers are powerful, then they can demand cheap prices or product/service improvements to reduce profits.

Buyer power is likely to be high when:

- Buyers are concentrated
- Buyers have low switching costs
- Buyers can supply their own inputs (backward vertical integration).
Competitive Pressures From Buyers and Seller-Buyer Collaboration

- Whether the relationships between industry members and buyers represent a *weak* or *strong* competitive force depends on

  - Whether buyers have sufficient bargaining leverage to influence terms of sale in their favor

  - Extent and competitive importance of strategic partnerships between certain industry members and the buyers
When Is the Bargaining Power of Buyers Stronger?

- Buyer switching costs to competing brands or substitutes are low
- Buyers are large and can demand concessions
- Large-volume purchases by buyers are important to sellers
- Buyer demand is weak or declining
- Only a few buyers exists
- Identity of buyer adds prestige to seller’s list of customers
- Buyers have ability to postpone purchases
When Is the Bargaining Power of Buyers Weaker?

- Buyers purchase item infrequently or in small quantities
- Buyer switching costs to competing brands are high
- Surge in buyer demand creates a “sellers’ market”
- Seller’s brand reputation is important to buyer
- A specific seller’s product delivers quality or performance that is very important to buyer
The bargaining power of suppliers

Suppliers are those who supply what organisations need to produce the product or service.

Powerful suppliers can eat into profits.

**Supplier power is likely to be high when:**

- The suppliers are concentrated (few of them).
- Suppliers provide a specialist or rare input?
- Switching costs are high (it is disruptive or expensive to change suppliers).
- Suppliers can integrate forwards (e.g. low cost airlines have cut out the use of travel agents).
Whether supplier-seller relationships represent a **weak** or **strong** competitive force depends on

- Whether suppliers can exercise sufficient bargaining leverage to influence terms of supply in their favor
- Nature and extent of supplier-seller collaboration in the industry
When Is the Bargaining Power of Suppliers *Stronger*?

- Industry members incur high costs in switching their purchases to alternative suppliers
- Needed inputs are in short supply
- There are only a few suppliers of a specific input
When Is the Bargaining Power of Suppliers *Weaker*?

- Item being supplied is a commodity
- Seller switching costs to alternative suppliers are low
- Good substitutes exist or new ones emerge
- Seller collaboration with selected suppliers provides attractive win-win opportunities
Competitive Pressures Among Rival Sellers

- Usually the **strongest** of the five forces

- Key **factor** in determining **strength of rivalry**
  - How aggressively are rivals using various **weapons of competition** to improve their market positions and performance?

- **Competitive rivalry** is a **combative contest** involving
  - **Offensive** actions
  - **Defensive** countermoves
What Are the Typical Weapons for Competing?

- Lower prices
- More or different performance features
- Better product performance
- Higher quality
- Stronger brand image and appeal
- Wider selection of models and styles

- Bigger/better dealer network
- Low interest rate financing
- Better or more ads
- Stronger product innovation capabilities
- Better customer service
- Stronger capabilities to provide buyers with custom-made products
What Causes Rivalry to be *Stronger*?

- Competitors are active in making fresh moves to improve market standing and business performance
- Slow market growth
- Number of rivals increases and rivals are of equal size and competitive capability
- Buyer costs to switch brands are low
- Diversity of rivals increases in terms of visions, objectives, strategies, resources, and countries of origin
- Outsiders acquire weak firms in the industry and use their resources to transform new firms into major market contenders
What Causes Rivalry to be Weaker?

- Industry rivals move only infrequently or in a non-aggressive manner to draw sales from rivals.
- Rapid market growth.
- Products of rivals are strongly differentiated and customer loyalty is high.
- Buyer costs to switch brands are high.
- There are fewer than 5 rivals or there are numerous rivals so any one firm’s actions has minimal impact on rivals’ business.