Strategic Management for Competitive Advantage
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Lecture 05
Competition and Competitive Advantage - I

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Welcome to the course, 'Strategic Management for Competitive Advantage'. In the last class we have already covered, module one and module two, today, we will be covering module three, which is 'competitive analysis'. So, we will proceed with today's lecture on competitions and competitive advantage.

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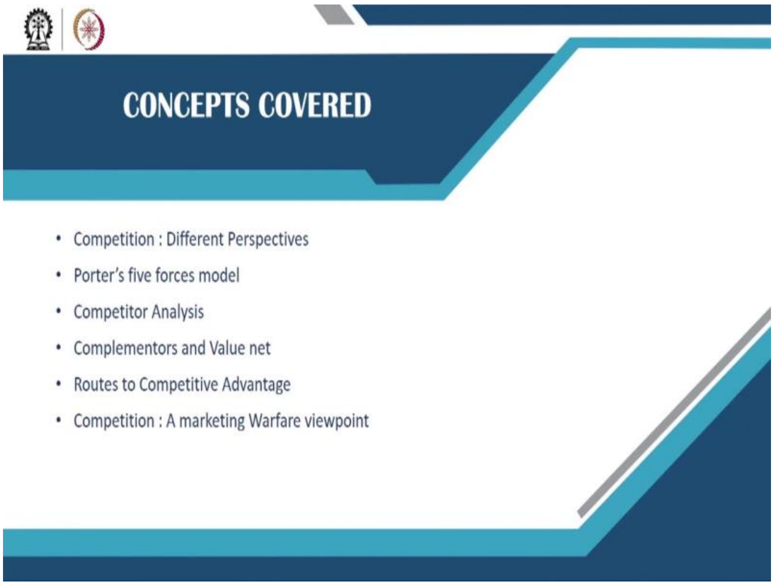

Now, the concepts that will be covered during this module are as follows: we will discuss competitions and different perspectives from an economist viewpoint, from a marketing viewpoint or perspective, and then we will be covering Porter's five forces model in detail. We will also be covering competitors' analysis, different frameworks, and also complementary and the total value net. You will also learn what are the different routes to competitive advantage and also competition - a marketing warfare viewpoint. All these we will be covering in today's lecture, let us proceed.

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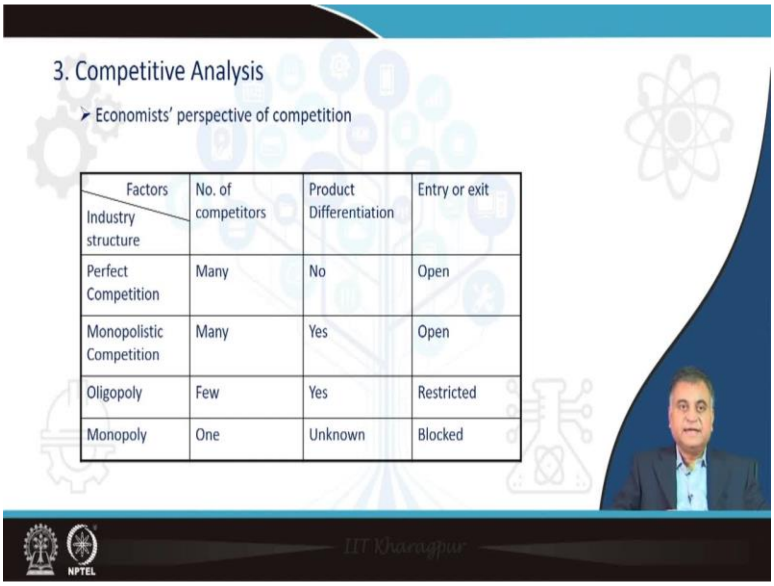

So, to start with, the competitive advantage is leveraged for the formulation of any corporate strategy. Basically, one of the main objectives is to get some competitive advantage, so that you can reign in market supremacy over the competitors. What are competitions? All of us know about competition. Competition basically is rivalry among the interested parties pursuing the same goal. So, the competition is ubiquitous, it is found in every sphere of life, even within the classes, toppers, they compete for the top position, there is a competition to it.

Now, there are various viewpoints for competitions like for say economist perspective of competition, which we will be discussing now. The Economist views competition at a mega scale or macro level. They consider factors that are influencing the competitions and different industries. Economists look at the competition for different industries at a macro level. So, the industry structure for competition for an economist may be - a perfect competition, monopolistic competition, oligopoly, or monopoly and the factors may be number of competitors, product differentiations, and entry or exit barriers for that industry.

Now, as we know in perfect competition, there are many competitors, product differentiation is, in fact, undifferentiated, and entry and exit barriers are open - anyone can come in anytime and anyone can exit the market at any point in time. Then, comes the monopolistic competition, in monopolistic competition there are many competitors and product differentiations are there, and entry and exit are also open. In an oligopoly, there are few competitors – the trend is consolidation of monopolistic market, consolidation through merger and acquisition. It leads to few big companies or competitors.

So, there are few numbers of competitors, there is high product differentiation and entry exits are restricted. In Monopoly, there is only one competitor, one company that is reigning in the market. They are the supreme and product differentiation is unknown. Again, entry and exit are blocked; they can neither leave the market nor enlarge it. They are governed by the govt. rules and restrictions. So, these are the economist's perspective on competition.

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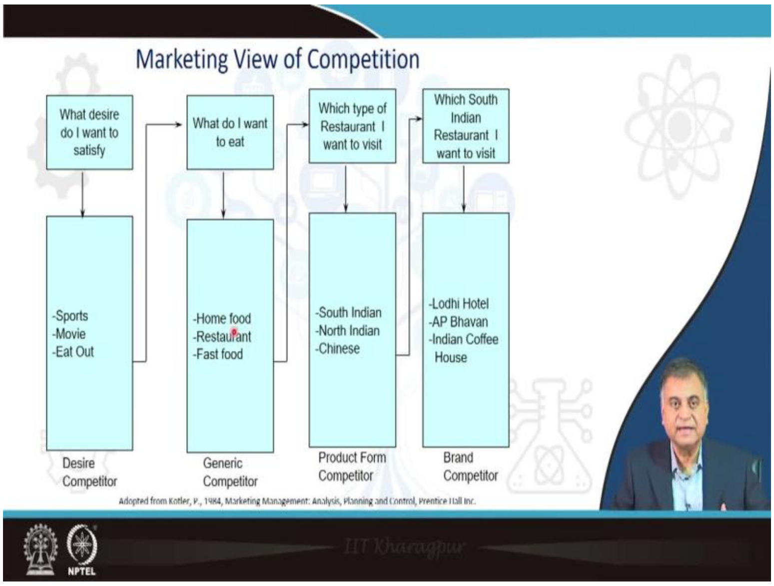

Now, there is a marketing view of competition, this is basically from the perspective of the buyers, what do buyers think about competition? Suppose, you have some leisure time during the weekend. Now you are planning, how to spend your leisure time at the weekend, how do you do it? So, you are contemplating many options that you are planning.

So, you may be having many desires at this stage. Like you may go to a Disney Park or any other resort or park or you may go to your friend's house for a social gathering, maybe you can go out and have some lunch or dinner at a restaurant, you may go for a movie, you may go for a game of tennis and observe the tennis games, or you wanted to go for playing cricket, or you wanted to go for having some recreation. So, here you see your desires are many and you are choosing what to do. So, your desires may belong to different industries or different services or different products that use different technology, but they are all competing with each other at this stage i.e., the desire stage.

So, your desire is, what do I want to satisfy? It may be sports, it may be a movie, it may be eating out, it may be going to Disney, it may be going to play tennis etc. So, they are competing with each other. So, Phillips Kotler says desire competitors are ubiquitous and any competition starts with the desire, then it goes to the generic competitors, then product form of competitors and it terminates in the brand competitors. These are the four forms of competitors - desire competitors, generic competitors, product form of competitors, and brand competitors.

Now, suppose you choose one of the options i.e., let's go out for eating. So, then next comes what do I want to eat? Whether it is home food, whether you want to go to a restaurant or you want to go for fast food. So, here these are generic competitors, these are competing with each other.

Suppose now you think that you wanted to go to a restaurant. So, then it becomes which type of restaurant I wanted to visit? So, there may be many choices, that is the product form of competitors like whether shall I go for North Indian food or South Indian food or Thai food or Chinese food or Japanese food. So, they are competing with each other which is the product form of competition. Now you choose, say, go for South Indian food. Next, you choose which South Indian restaurant you want to visit.

So, there may be many options, if you are in Delhi, it may be Lodhi hotel, it may be AP Bhavan, it may be an Indian coffee house, and it may be many other restaurants. So, they are competing with brand competitors. So, it starts with desired competitors and ends with brand competitors.

Now, suppose you decide you will go for say, Indian Coffee House. Now, if a South Indian hotel is confined to South Indian food only, what happens? You are restricting yourself to the brand competitor. Say after a few days, if some other South Indian hotel comes up across the road, so, they will be competing, and you will be losing market share from the new hotel.

So, it will be myopic on the part of earlier hotel to confine itself to only South Indian food or dishes. So, what other options they have? They may go backwards,, say from brand competitors if you look for the desired competitor, your opportunity increases. Suppose you want not only South Indian food but some Chinese food also, some enclosure you put for Chinese food or North Indian food that means, you are increasing your opportunities. As you go towards this product you are increasing your opportunities and if you go further back to generic competitor or desire competitor, you are increasing your opportunities further.

Although opportunities increase as one moves backwards, but decision for investing in new opportunities - Chinese food in addition to South Indian food require financial analysis based on economic criteria. This is the point we wanted to impress upon. So, this is in short, the marketing viewpoint of competition. So, you have got a glimpse of the economist perspective of competition, and the marketing view of competition.

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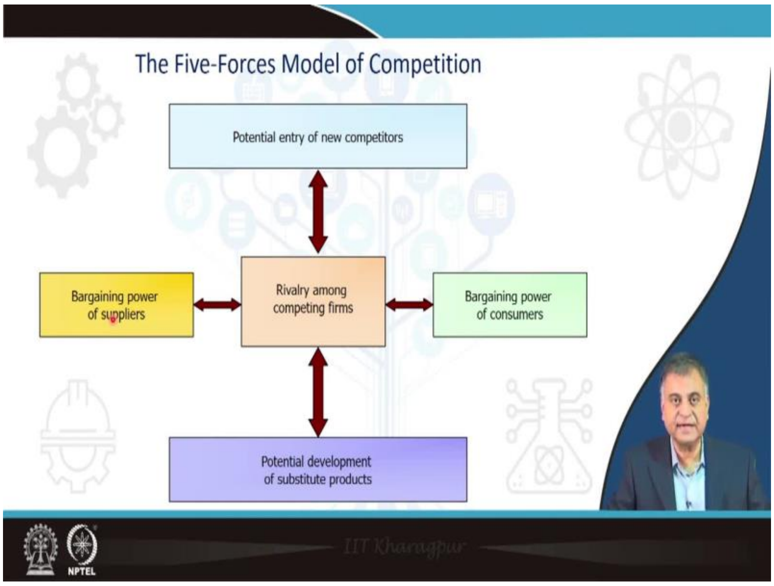

Now, we will be proceeding to Porter's five forces model of competition. You may be aware of it or must have heard about it, but we will discuss it in detail. So that you know the essence of it, this is a very important aspect and relates to five forces of competition. Basically, in any industry, how severe the competition is determined by these five forces. Basically, the intensity of competition and the state of competition in any industry is measured collectively with these five forces.

These five forces are the rivalry among competing firms, the potential entry of new competitors, the potential development of substitute products, the bargaining powers of consumers or buyers and the bargaining power of suppliers, these five forces collectively determine the intensity and the state of competition. The ultimate profit potential that can be obtained from a particular industry.

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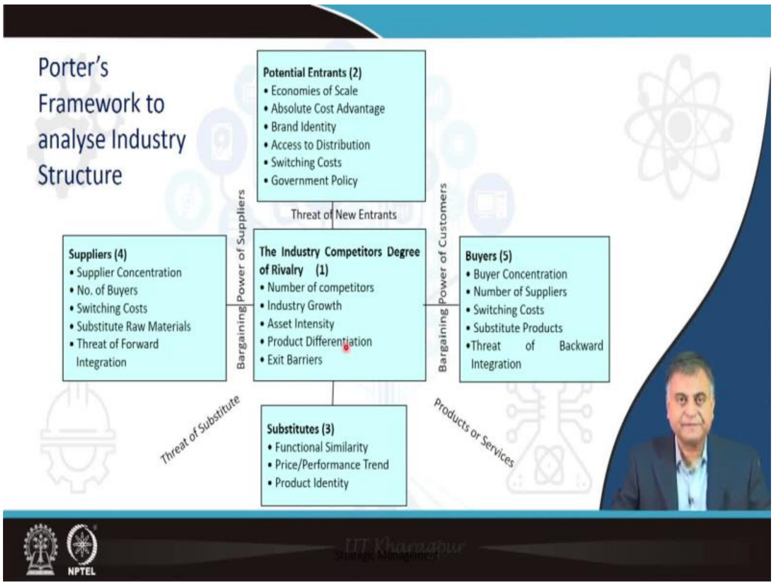

So, this is called Porter's framework to analyze industry structure. We will be discussing in-depth. How to describe all these five forces? How are they interrelated with each other? And how it affects a particular industry? Every industry, say, it may be a software industry, it may be steel industry, automobile industry, banking industry, or soft drinks industry, is applicable. So, the heart of the industry competition is the degree of rivalry among the competitors and what are the soft factors that determine the degree of rivalry? Soft factors that determine the degree of rivalry are the number of competitors in that industry.

So, if the number of competitors increases, what happens to the degree of rivalry? The degree of rivalry increases with the number of competitors in the market. Next is the industry growth, if the growth of the industry is high that time you will find the competition is also more because if the growth rate is high more and more competitors come into the market and competition intensify. Others are - the asset intensity, product differentiations and exit barrier.

Asset intensity is like if the capital investment is more, some industries, you will find, require huge capital investment such as steel plant, cement plant, chemical plants, refineries and huge automobiles plant; it requires huge capital investment. So, asset intensity is high and what happens if there is stagnation or if demand is not growing? Then it goes for a price war among the competitors to garner market share. It leads to a price war. Then product differentiation, if product differentiation increases, then the degree of rivalry increases or decreases? Product differentiation, in fact, dampens the rivalry, if you have a differentiated product people will come to you because of that differentiation.

So, it dampens the degree of rivalry. Exit barrier increases rivalry, because, if a competitor cannot go out, competitors have to be within the system. So, the number of competitors remains the same. So, it increases the degree of rivalry. Similarly, now, the potential entrants - new entrants, as we know new entrants always increase the rivalry, but a company that is in a mature stage will discourage or block the entry of new entrants because at that mature stage there is heavy competition. But at the introduction stage or the growth stage, the companies may encourage new entrants, because just to expand the market reach, if there are more players in the market, they will expand the market reach and afterwards, big companies can go for consolidating those. After some time, oligopolistic trend may set in and big firms can acquire those small companies through acquisitions and mergers.

So, in the introductory stage companies may encourage new entrants to come in for expanding the market reach, but at the mature stage, they discourage or they block others' entry. So, at this stage, in the mature state if a new company wants to come into the market (in mature business), then what is required? They have to come with a cost advantage or product differentiation, proprietary technology, then only they can capture the market. So, they have to get absolute cost advantage, how do they get absolute cost advantage? One of the ways may be through economies of scale. What is economies of scale? You get economies of scale by putting a big plant and big volumes of production, i.e., through high margin.

So, that unit cost of production comes down. When the unit cost of production comes down, you can earn more profit, the profit margin is more. So, in this stage, new entrants can come into the matured market through economies of scale in that they get the cost advantage and also, they may come with a brand identity. If the brand identity is strong, they also have to be dependent on access to distribution like you saw a mature market say ITC or Unilever, they are having very deep distribution network in India. So, now, if new entrants come to those areas, they also need to have such degree of distribution networks, otherwise, it will be very difficult to compete with them.

So, one should have the access to distribution, then the switching cost, why the buyers will go for buying that? If the switching cost is low, then it is easier for the new entrants to come in, but if the switching cost is high, it will be difficult for the new entrants to come in. I will talk about the switching costs just after a few minutes. Furthermore, threat of substitution, buyer's bargaining power, and supplier's bargaining power, we will talk about it more there.

The potential new entrants will also depend on the government policy. Government policy sometimes encourages or discourages. Encourage in the sense suppose, the government are now taking a policy to encourage the SMEs (small and medium enterprise) sectors. So, take the case of material handling that uses conveyor belts to transport coal, minerals, iron ores etc. If Government policy changes and manufacturing of rollers and idlers is opened up to SMEs (small and medium enterprises).

As the SMEs start production of rollers and idlers, the established players those who had monopoly are threatened as their profit margin was squeezed. So, this way government policy can encourage new entrants or also may discourage them. So, these are the threat of new entrants, and then we come to the threat of substitutes, what is a substitute? Substitutes are those products or services, which give similar functionalities. So, if the product is replaced by a substitute, that is a threat, just take the case of say, bottled water, there are different types of bottled water one can find in the market.

Each one is competing with the other, say, PVC pipe versus steel pipe. Steel pipes for those used for plumbing etc., steel pipes are costly, say Tata steel pipes are very costly, but PVC pipes are one-fourth of the cost of steel pipe, but the longevity of both these PVC and steel pipes are nearly the same. Similarly, if you see the copper wire, those are costly and copper wires are replaced with aluminum wires. Similarly, plastic is replacing steel. For manufacturing a car, previously most of the part was steel, but nowadays you will find that is replaced by plastics and fiber.

So, these are substitutes, similarly say, tea and coffee, if the coffee prices go high tea price can keep a check on it because the coffee drinkers will shift to tea if the price goes high. Therefore, tea keeps a check on the coffee price. These are the substitutes. What is switching cost here? Suppose, say, electric vehicle and IC engine vehicle. So, why electric vehicles being far superior in terms of being environmental friendliness than IC engine cannot penetrate the market. Why?

This is because of the switching cost; the switching cost to electric vehicle is much higher. Similarly, say, solar power - renewable energy, no pollution, then why it is not replacing the power plants and conventional non-renewable energy? Because of the switching costs to solar and other renewable energy is much higher.

So, after threat of substitute, the next will be discussed bargaining power of the customer. So, what is this bargaining power of customers? That depends on the buyer concentration, the number of suppliers, switching costs, substitute products, and the threat of backward integrations. Say, if the number of suppliers is more than buyers' then the bargaining power of buyer's increases, and if the switching cost is high, then buyers' power of bargaining decreases. If switching cost is low, then only buyers' bargaining power increases, if there are no substitute products, then buyers' bargaining power decreases and also buyer concentrations increase the buyer bargaining power. Like if few buyers buy a bulk of your material say one buyer may take 70% of your product.

So, naturally, they can exert more bargaining power on you. So, you can see Walmart and all those branded companies, they get their basic shirts, cotton shirts and all those things from Bangladesh, from China, from India and they take it in bulk. So, they can exert their bargaining power in terms of price, in terms of additional features, and in terms of quality. So, they can influence it. Similarly, if you see McDonald, McDonald has many franchises, so, they can bargain for the price of the chicken and the price of the meat. Similarly, Marriott hotel can bargain for the mattresses.

So, these are the buyers' concentrations. Another is the threat of backward integration, what is this threat of backward integration? Buyers sometimes may go for the backward, suppose say, steel plant - depend on coal, they depend on iron ore. These input materials are very strategic supplies to them, if they get these from somewhere else. They would like to get it from reliable suppliers or produce themselves. They can get it through backward integration that is why you will find Steel Authority of India or Tata steel (Tisco) has their own coalmines or iron ore mines to get the supply of raw materials. These are called threats of backward integration.

Then, there is bargaining power of suppliers, bargaining power of suppliers depends on supplier concentration, the number of buyers, switching cost, substitute of raw materials, and threat of forward integration. Suppliers' concentration means, that if there are very few suppliers, then suppliers' bargaining power increases. If there are more buyers, then suppliers' bargaining power increases. If switching cost is high, supplier bargaining power increases. If there is no substitute for raw materials then the bargaining power of suppliers increases and also the threat of forward integration. Suppliers may go for forward integration for controlling of price, take the case of Intel - it produces chips, which are basic inputs to all PC manufacturers.

Now, if Intel wants to make a venture into the PC market i.e., desktop or any other computer manufacturing segment. This is a threat of forward integrations. Similarly, suppliers bargaining power - you can see (one example) - OPEC countries, OPEC is all of you know, there are 13 countries that is Organization of Petroleum Exporting Countries. These 13 countries are controlling the price of international oil price since 1973. So, even in these conditions today, the war is going on you know between Russia & Ukraine and even the powerful countries now, going to the different OPEC countries for reducing oil price. So, these are the supplier's bargaining power.

So, all these five forces collectively determine the state of competition, the intensity of competition, and collectively they determine the ultimate or the potential profit that can be obtained from that particular industry. So, if you are going into a new industry, you have to look for these five forces. So, furthermore, we will be discussing this now, can you tell me, if these forces are very strong, it is an advantage or disadvantage?

So, if these five forces are strong, what happens? Is it an advantage or disadvantage? It is a disadvantage because if the forces are very strong, markets are in a mature stage and the company will have difficulty in obtaining competitive advantage or getting profitability. So, weak forces mean you can take the competitive advantage from this, but here one company cannot get the competitive advantage in all these areas, it is not possible. Only you can aim for a few areas and take competitive advantage in those areas. You will develop your distinctive capabilities, your distinctive competencies in those few areas in order to take a competitive advantage and you can gain market profitability.

So, it may happen so, in the short term, it may be difficult for you to get a competitive advantage, but in the long term, you become comfortable with the system, and can get some competitive advantage in some of these areas. And you will leverage those competitive advantages for gaining a foothold in the market and getting profitability. So, in the long run, it will be beneficial to you. So now, furthermore, we will be continuing these in the next lecture.

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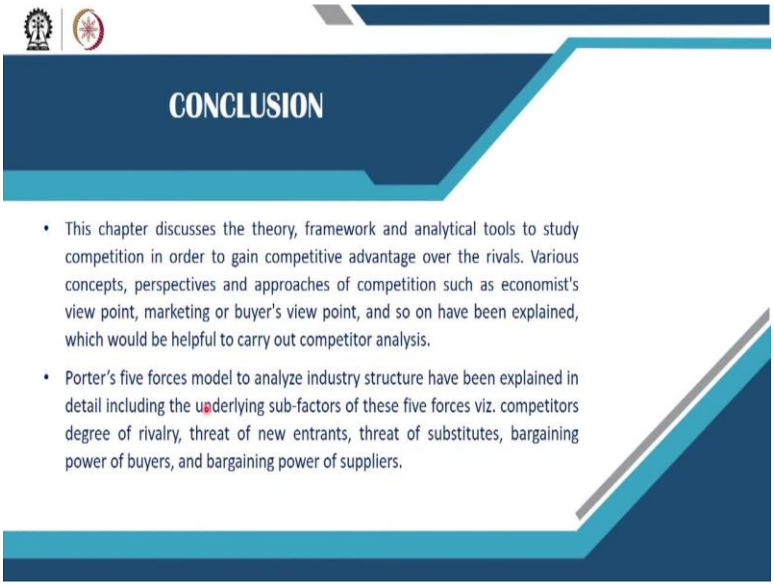

So, what we have done today, I will just summarize this chapter, we have discussed the theory, framework and analytical tools to study competition. So that we can get a competitive advantage over our rivals, then various concept perspective approaches of competition such as economist viewpoint, marketers or buyers' viewpoint have been explained during this lecture. Then we discussed Porter's five forces model to analyze industry structure and the detailed sub-factors. All these five forces - degree of rivalry, the threat of new entrants, and the threat of substitutes, bargaining power of buyer's and that of supplier's have been explained.

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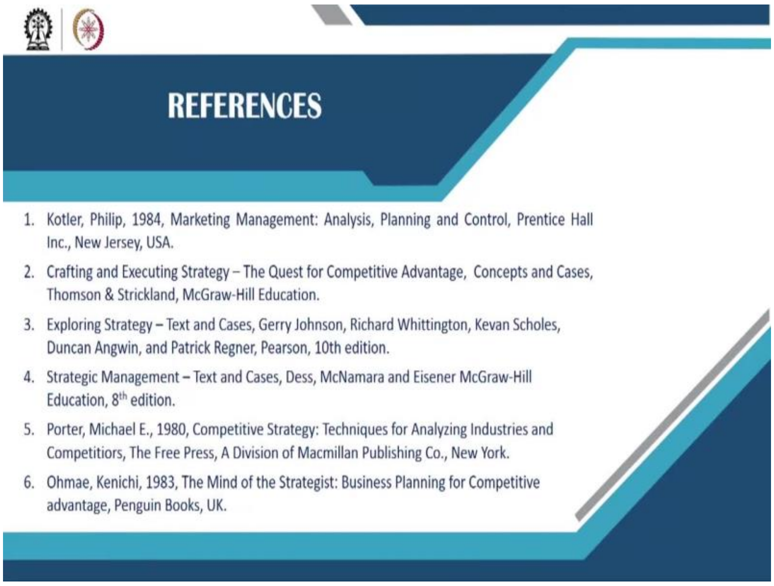

So, I will show you some references, these references will be helping you to know further on this topic. You can refer these books. Thank you very much.