



Business Economics II

Session III: Markets and strategy



Industries and their profit

Average Return on Invested Capital in U.S. Industries, 1992–2006

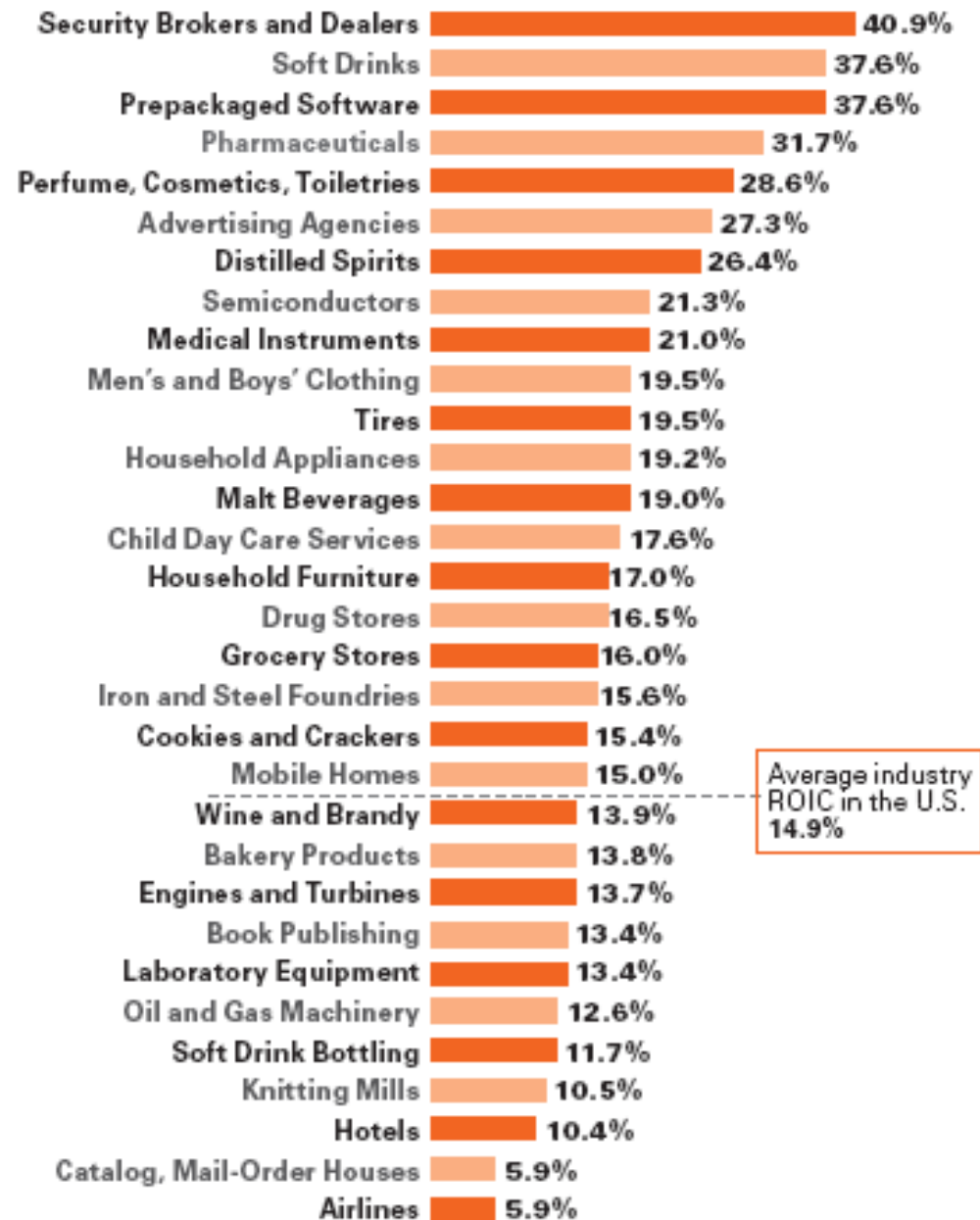




Industries

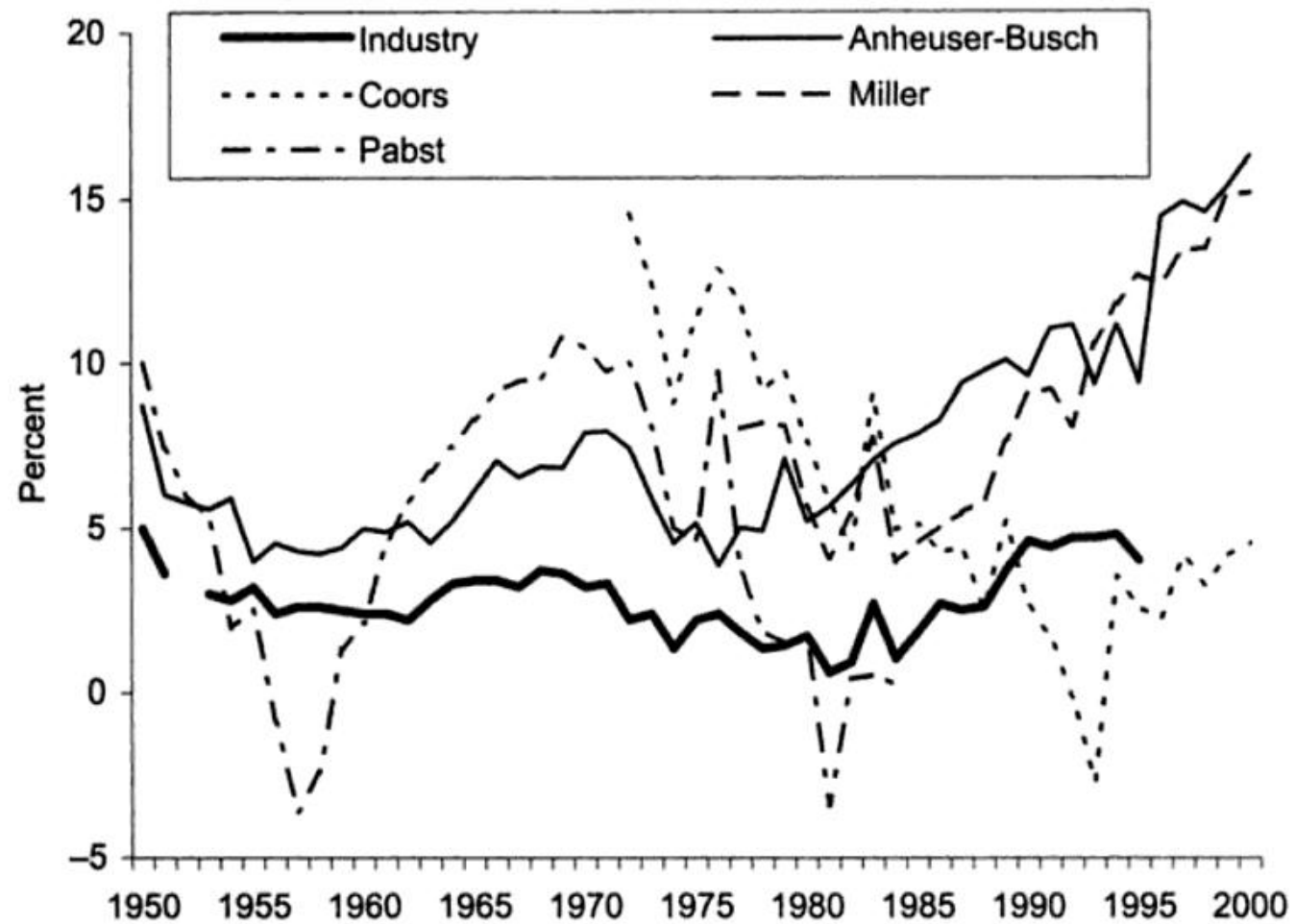
Profitability of Selected U.S. Industries

Average ROIC, 1992–2006





Example: beer



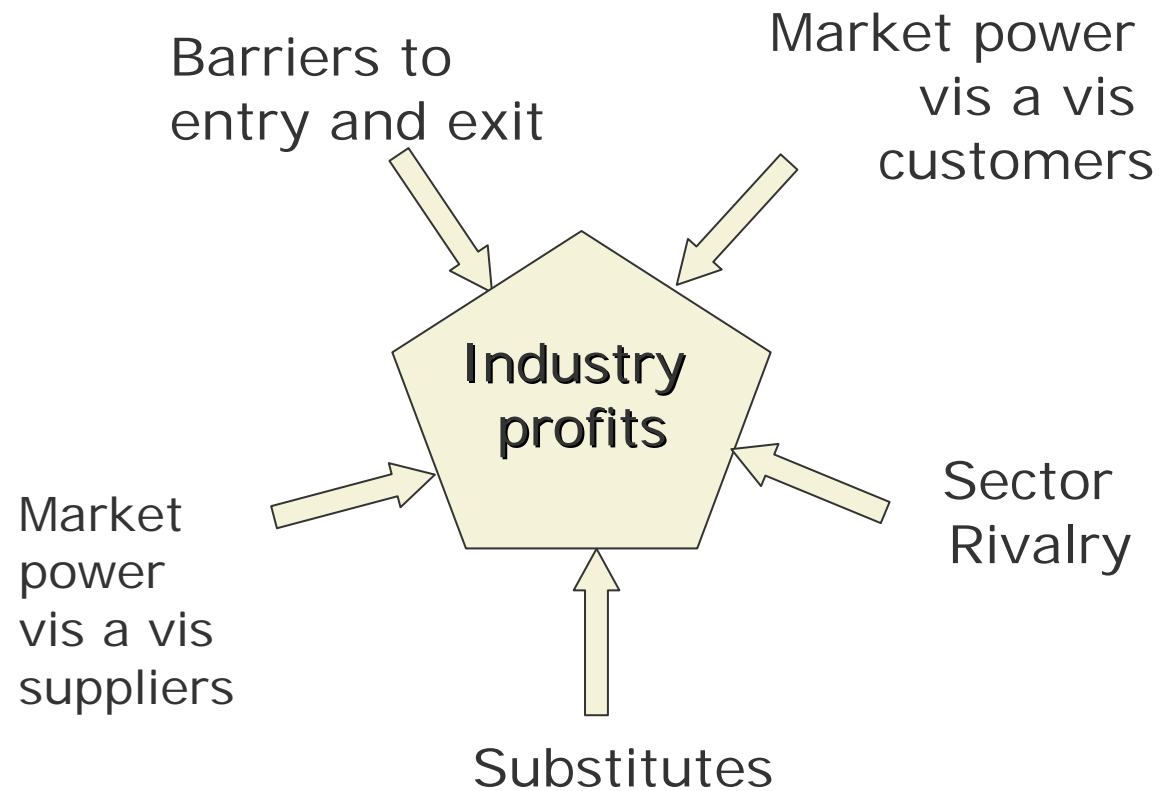


Two questions

- Why is historical average return in this industry 5%, while in others it is up to 10%?
- Why are returns systematically higher in some industries?



Competitive environment: Porter's five forces





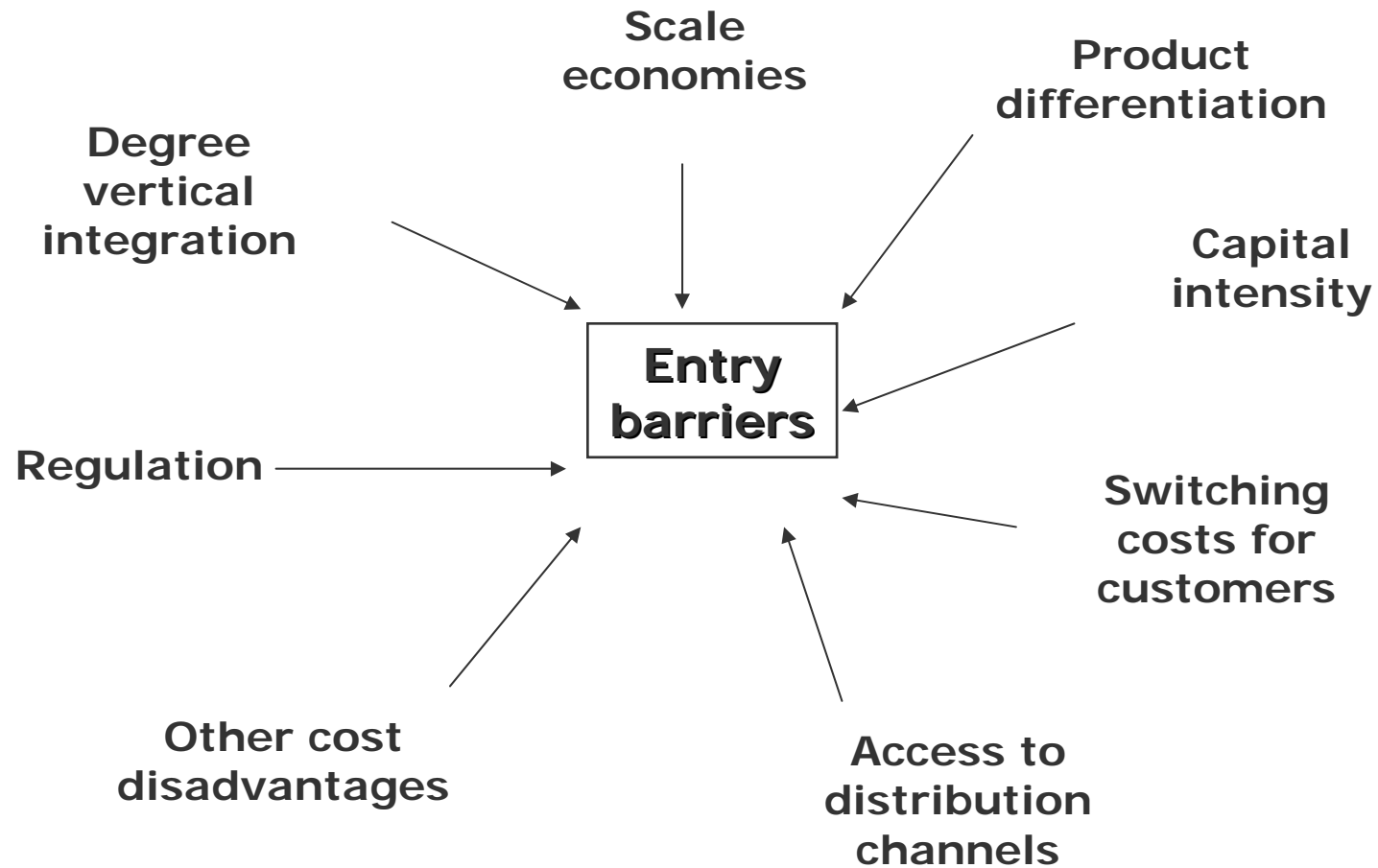
When would you expect higher profits?

When...

- Higher barriers to entry
- Lower barriers to exit
- Higher market power against customers and suppliers
- Lower threat from substitutes
- Lower industry rivalry

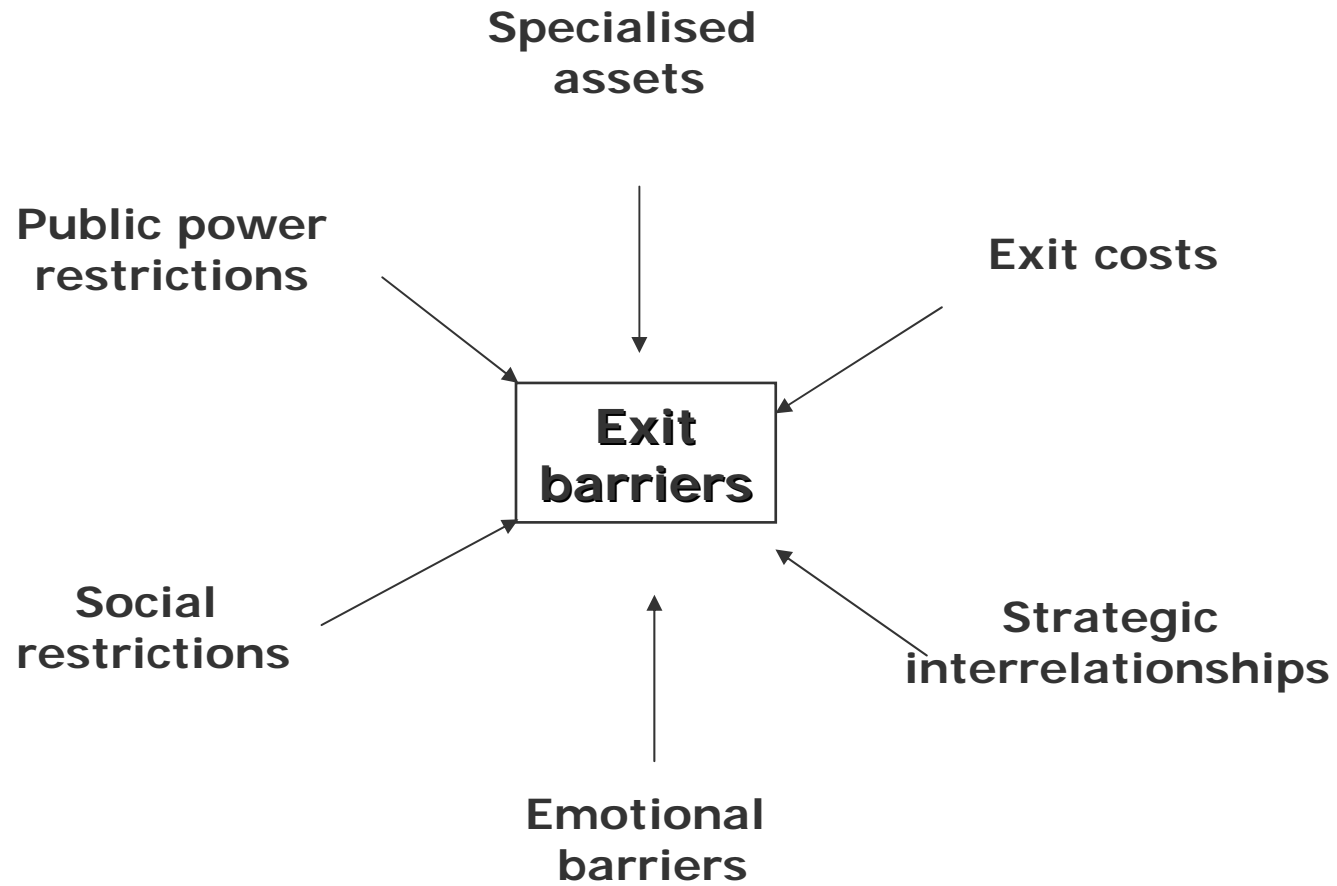


Barriers to entry





Exit barriers



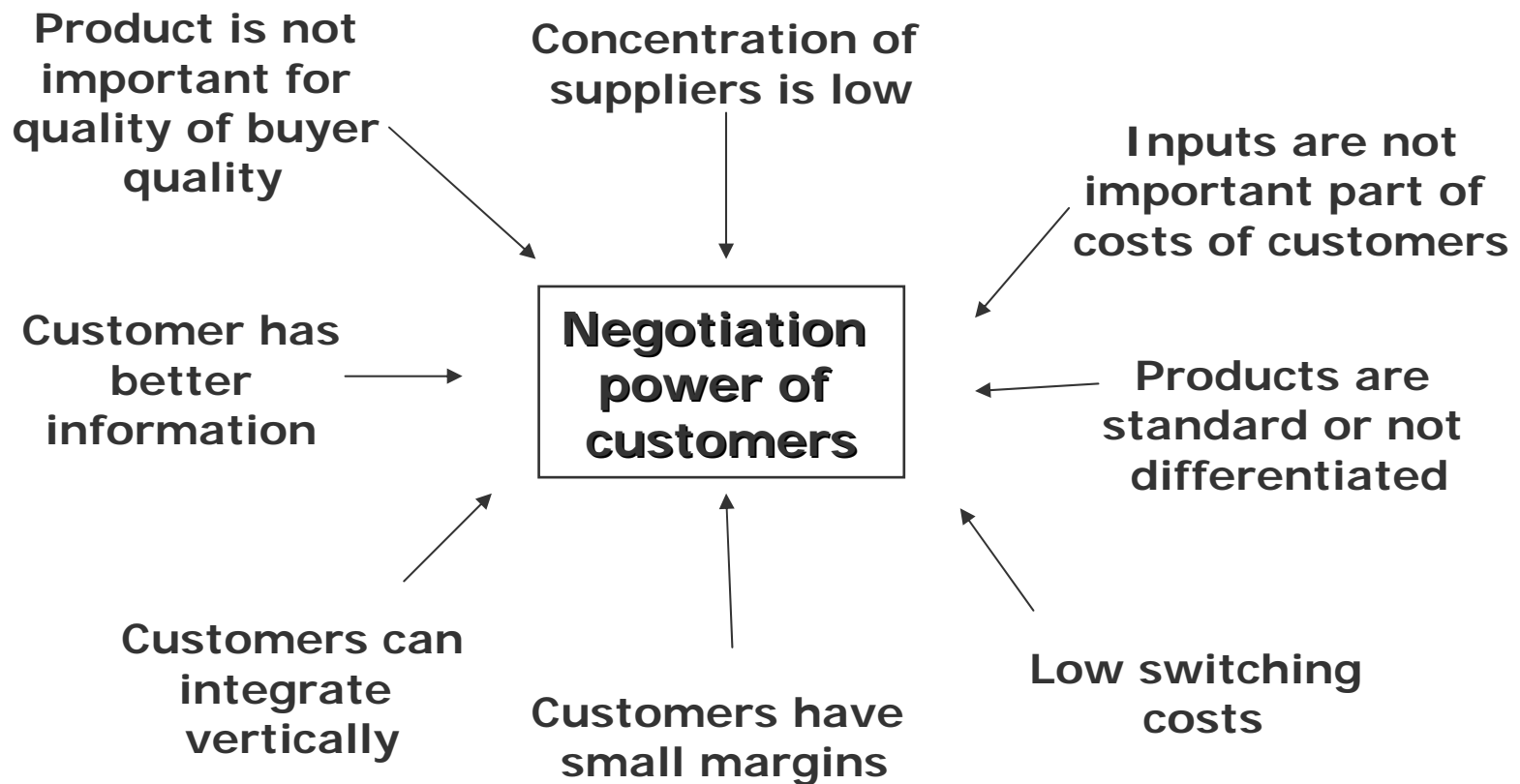


Market power vis a vis suppliers



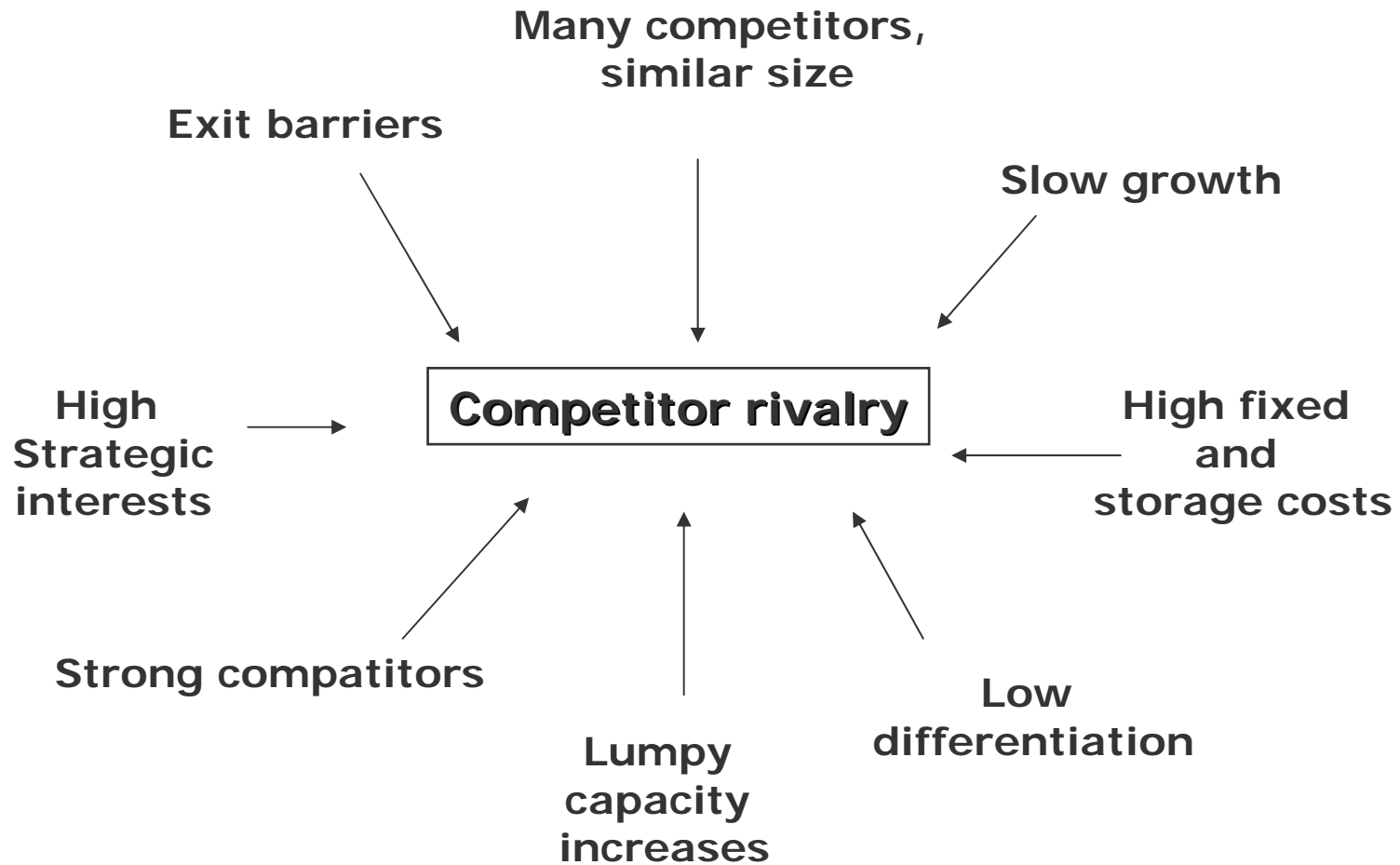


Market power vis a vis customers



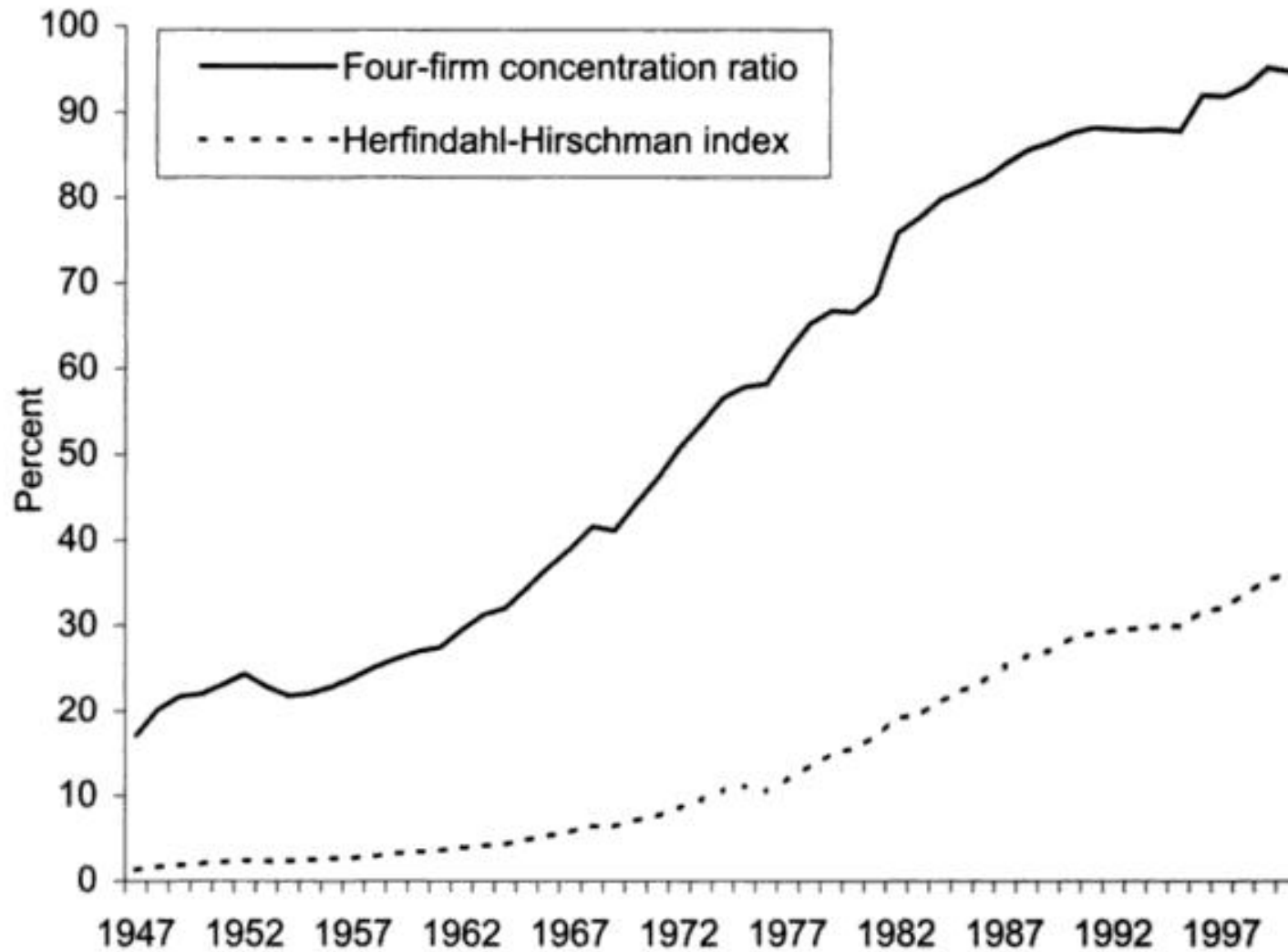


Rivalry





Market concentration



Evolución del grado de concentración del sector de la cerveza en los EE.UU. Tremblay and Tremblay, *The US*



Rivalry types

More services

Price competition

**Rivalry instruments
between competitors**

New
product
introduction

Advertising
battles





Industry analysis

- What products? Which ones are in another industry?
- Geographic scope of competition? Identify participants and segment them into groups, if appropriate:
 - Who are: buyers? suppliers? competitors? substitutes? potential entrants?
- Assess underlying drivers of each force to determine which are strong and weak
- Test for consistency:
 - Why is the level of profitability what it is?
 - Which are the controlling forces for profitability?
 - Is analysis consistent with actual profitability?
 - Are more profitable players better positioned?
- Analyze recent and likely future changes in each force
- Identify aspects of industry structure that might be influenced by competitors, or by new entrants

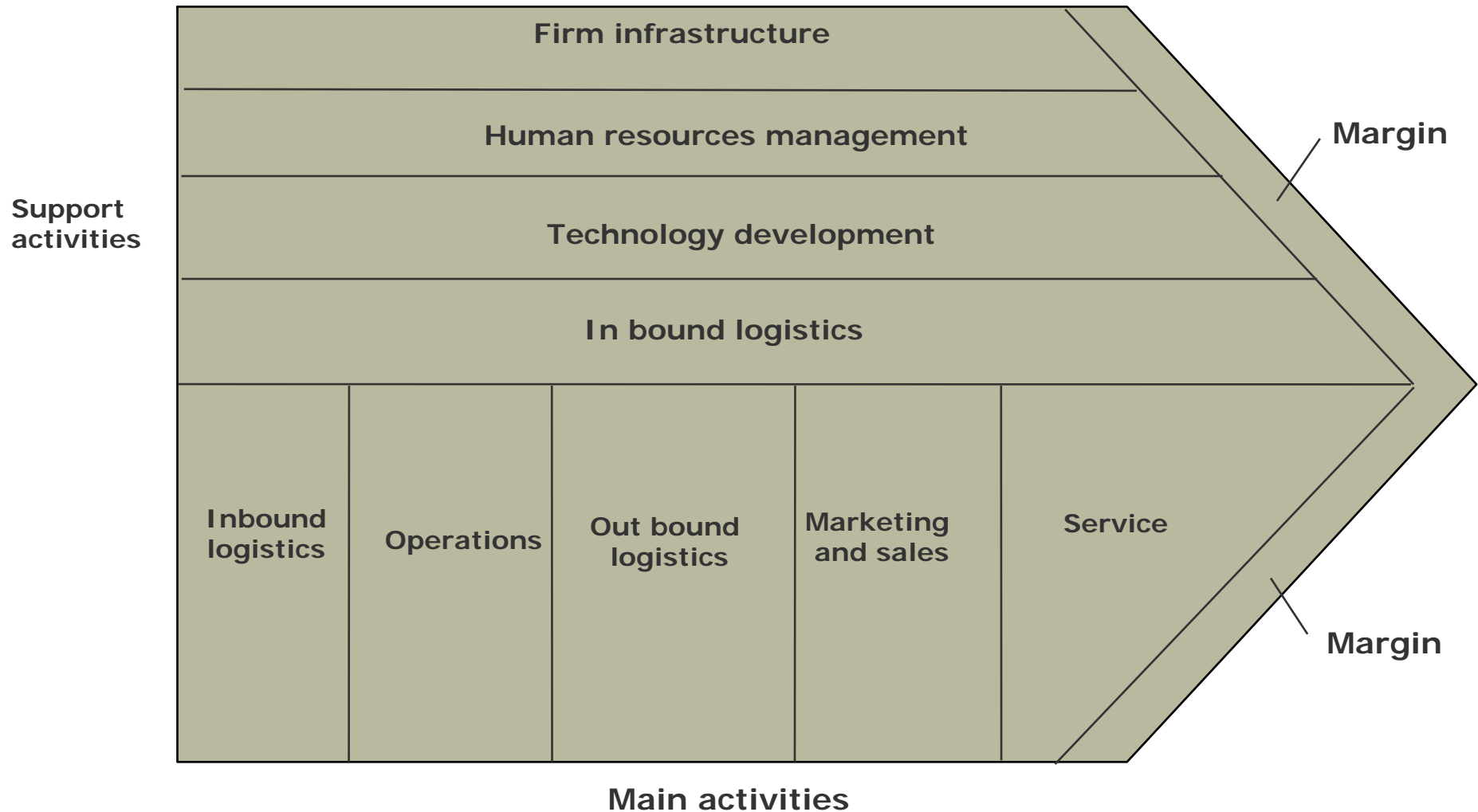


Common pitfalls

- Defining the industry too broadly or too narrowly
- Making lists instead of engaging in rigorous analysis
- Paying equal attention to all of the forces rather than digging deeply into the most important ones
- Confusing effect (price sensitivity) with cause (buyer economics)
- Using static analysis that ignores industry trends
- Confusing cyclical or transient changes with true structural changes
- Using the framework to declare an industry attractive or unattractive rather than using it to guide strategic choices



How do firms generate value? The value chain





Value chain weaknesses

- Useful for “traditional” industrial firms
- Less useful to analyse service firms
 - New economy
- Alternative models
 - Shops: each product is a project...
 - Networks: communication
- Use
 - http://www.value-networks.com/Articles/configuring_value.pdf



Strategies to achieve competitive advantage

- Cost reduction
 - Ryanair: <http://www.ryanair.com/site/EN/>
 - Formule 1: <http://www.hotelformule1.com/formule1/index.html>
 - It is not about lower prices but lower costs!
- Differentiation
 - Singapore Airlines: http://www.singaporeair.com/saa/en_UK/content/exp/index.jsp
 - Four Seasons: <http://www.fourseasons.com/>
 - Use perceptions!
- Choose one or the other and focus on it