Strategic Management - The Competitive Edge

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Module No. # 03

Lecture No. # 15

Synthesis of Internal Factors – 2

Welcome to this class. In the last class, we looked at what is meant by key factors for success.

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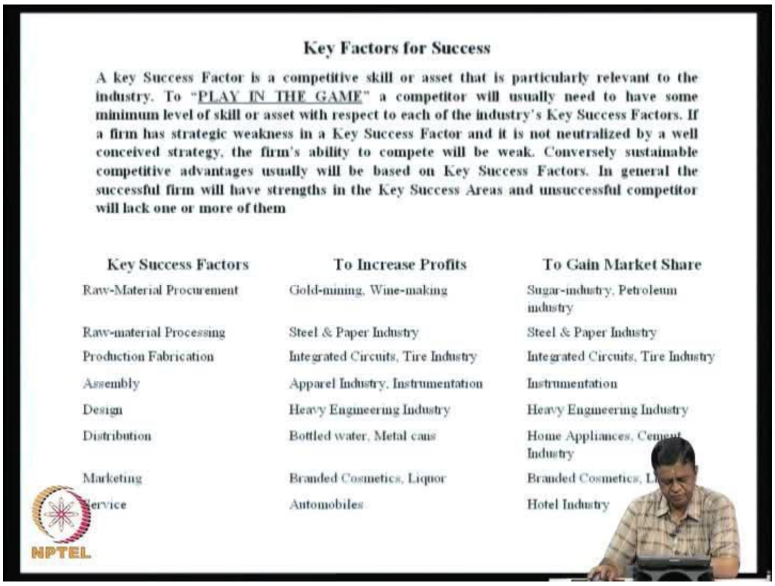

We looked at the key success factors, how it can help increase profits, how it can help to gain market share; we took different examples - whether it is raw material procurement, the industries where this can help increase profits, the industries where it can help in gaining market share. So, we went through different key success factors like: raw material procurement, raw material processing, production fabrication, assembly, design, distribution, marketing, and service. Now, let us continue further.

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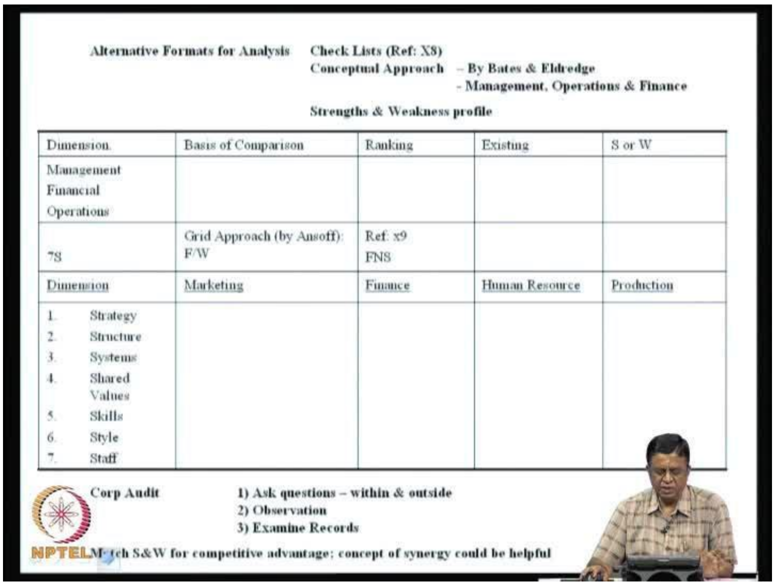

Now, in order to do analysis with respect to strengths or weakness, that is - the internal analysis, we make use of certain check lists. So, we will discuss one of the check lists. Now, this is a check list which is developed by two people: Bates and Eldredge; they give three dimensions: one is Management, second is Operations, and third is Finance.

Now, they ask us to give the basis of comparison on these three dimensions and give that ranking. What is the existing ranking with respect to the industry concerned and whether it can be used as a strength or weakness by the company?

The second approach which is given in the same table is a grid approach, which is by the gentleman Ansoff. So, what is suggested? The dimensions taken are the 7S matrix. He takes into account the four functional areas: Marketing, Finance, HR, and Production; using these four functional areas, he again suggests a ranking. All these are called the strengths and weakness profile for a company. So, you can use the Bates and Eldredge approach, or you can use the grid approach.

So, now, look at corporate audit. What are we trying to do essentially? We are asking questions about the company, both within the organization and outside the organization; then, we are making observations about the company; then examining the records of the company; then we are matching the strengths and weaknesses for competitive advantage. So, here, the concept of synergy could be useful; to put it simply - whether we can get more than an additive relationship. So, normally, your 1 plus 1 should result in 2; whether in the organization concerned, this 1 plus 1 can result in more than 2? This is what we are looking at.

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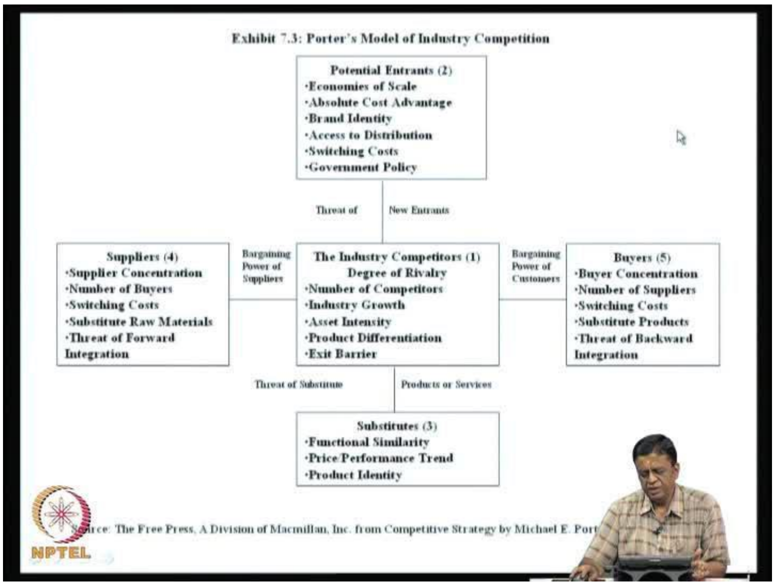

So, this can be the simplest way of looking at synergy. Here, I have given below (( )) diagram. This diagram gives you the Porter's model of industry competition. So, this is a very important model; it tells you, what are the forces which are driving industry competition, and how an industry should be coping with this type of industry competition.

If you look at it, broadly, this is represented by five blocks. Let us look at each of these blocks.

The first block looks at the degree of rivalry. What do we mean by the degree of rivalry? Degree of rivalry stands… You can look at this degree of rivalry under the broad headings of: Number of competitors, industry growth, asset, intensity, product differentiation and exit barrier.

What do we mean by this? We were trying to discuss this in the earlier classes. Number of competitors – suppose, you are the only player in the market, then you are a monopoly player. So, there is absolutely no competition for you. Suppose, there are number of players in the market, then you are really looking at a situation where, whether you are moving towards perfect competition. What is going to happen? Whether, the attributes of one cannot be distinguished from the attributes of the other player that is with respect to the product?

Suppose, there are few players; you are looking at an Oligopolistic market like the typical airline industry in India. Then, when we say industry growth, you are looking at the entire industry. What is the percentage by which it is growing per annum and how is the company growing? Suppose, you are growing at the same rate as the industry growth rate, no cost for a law. Suppose, you are growing at a lower rate compared to the industry growth rate, then you must be concerned. Suppose, you are going at a higher rate, then there is reason for the industry to feel happy.

The asset intensity: What do we mean by the asset intensity? A company will have number of assets: whether it can be with respect to the buildings, plant and machinery. Now, for software - the number of software developed, the types of protection which they have obtained for each of this software - all these going are to come in.

Then, the product differentiation: What is product differentiation? How you are differentiating your product from the competitor's product, gives you the edge. To the extent that you can sustain that edge, that is sustainable competitive edge. In the market place, to that extent, it is a sustainable competitive edge.

Then, what is exit barrier? Some of the markets which you can enter; say, it is a perfect competition - very close to a perfect competition. There is no particular bar on a player from entering or exiting that type of market; otherwise, this exit is open, contrast this with the monopoly market; you cannot exit that market. That is, the industry concerned cannot exit that market; that is actually blocked. So, you can have a blocked entry; you can have a blocked exit; you can have a restricted exit or you can have opening exit. This is the way, the market works.

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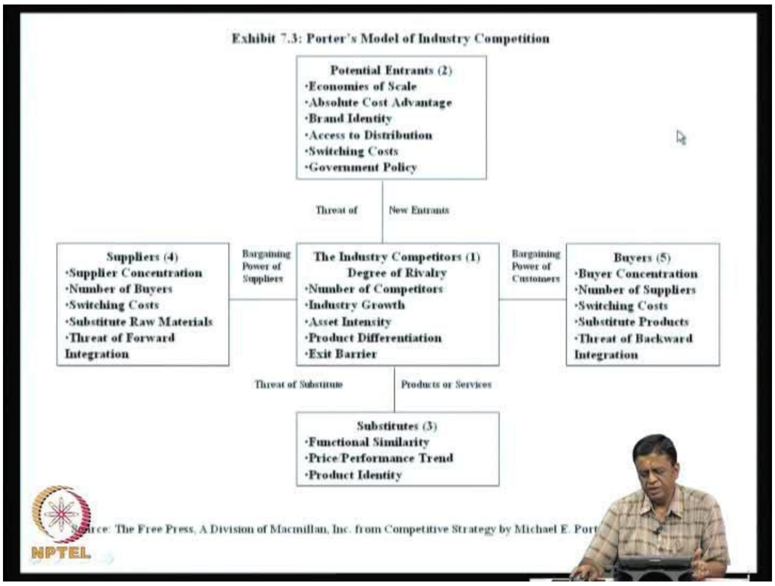

Now, look at the second block captioned - Potential Entrance. That potential entrance, again, has got certain dimensions mentioned. What are the dimensions? That dimensions are: economies of scale, the absolute cost advantage, then the brand identity, then access to distribution, then switching cost, then Government policy. What do you mean by all these?

Economies of scale: Generally, what is meant by economies of scale? You expect the cost per unit to come down when the number of units produced is increased. That is, when your production level goes up, you expect the cost per unit to come down. That is the economies of scale operating. We looked in the earlier classes with respect to economies of scope also, where you can get economies of scale by combining certain production lines. So, without that type of combinations, you can still look at economies of scale with respect to production. What is that?

Suppose, the number of units is increased, you expect the cost to come down. What do we mean by that? We expect learning curves to become operational; that is where, the labor or the labor force will become more and more competitive with respect to cost when they are producing more and more number of units of the same product. Now, when you are able to reduce the cost of per unit of the product, where is the company heading towards? The company is heading towards absolute cost advantage. This is one of the generic strategies suggested by Porter.

So, for a company, whether it can have, that cost leadership? Then, the third with respect to a potential entrant is brand identity, suppose, you are a well-known player in the market and you want to enter a particular market. You are a well-known player in other markets and you want to enter this new market because of your identity in well-known identity in other brands, you still gain, or you still have an advantage in the new market, as well. Example could be that of Reliance or Tata's trying to explore different market spaces, cashing in on the brand identity.

What is this access to distribution? Some of these big companies, some of these big industries have a very good distribution network. In a competitive market, this access to distribution plays a vital role.

What is the switching cost? Suppose, there are number of potential entrants in the market place, that is, you have more than one entrant in the market place, now, suppose a company wants to switch between these entrants, for the company concerned, there is a switching cost that is involved.

Then, the last dimension that is considered is the Government policy. That is, everyone should be concerned about that, and with respect to any sector, what is the type of government policy which the sector wants to release, which the government wants to follow?

All these - this block itself, when you look at all these dimensions, when they feed to block number one, what is it, that you are looking at? You are looking at, suppose you are already a player in the market; when you are a player in the market, you should be worried about that threat of new entrants into your market arena. That is the life cycle of the company itself in that particular market. You should be really concerned, or you should be really looking at or watchful over all these aspects - suppose a new player comes, what is going to happen? Whether it causes our company? What is the type of dent it can cause in our company's markets?

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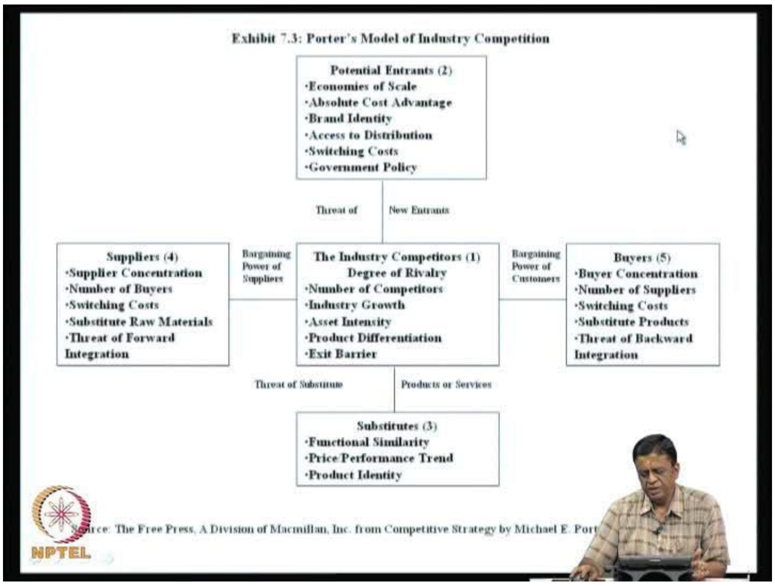

Similarly, look at this third block. Suppose you are in a market, and that market has products which can be substituted for your product, that is, the present product which you are putting into the market place, the products of that particular company can be used as a substitute; that is, a new that is a another player.

So, what are the dimensions? You are looking at the dimensions of functional similarity, what is the price or the performance trend, and what is the product identity? As long as it is coming from a reasonably good player with good brand identity, at a competitive price, able to perform the same functions as your product, then you have a real competition on hand which means that threat of substitute products or services is going to stare at you; that is at the company product line.

So, this is what competition is all about. So, you call it, what you call breakneck competition or cutthroat competition; whatever you want, call that. So, this is a many times...

Having lived in Bangalore for such a long time, when I drive my car, now, many times I wonder whether I am driving the car or walking on the road. Because there are so many cars on the road, almost all the roads, the cars are actually crawling. So, similarly, in a market place, suppose you have few players in the market place, then you have a certain distinct advantage.

Now, suppose, you have many players in the market place, then the threat of the substitute products always looms large. Now, add to that - the grey market. So, what is that grey market? That is cheap products from different countries or different players.

One of our neighboring countries is an expert in producing these cheap products; that can also be a great threat to the companies. So, then, we come into the realm of Government protection; all those types of things to protect the quality of quality products from being exploited by this cheap products, and all that.

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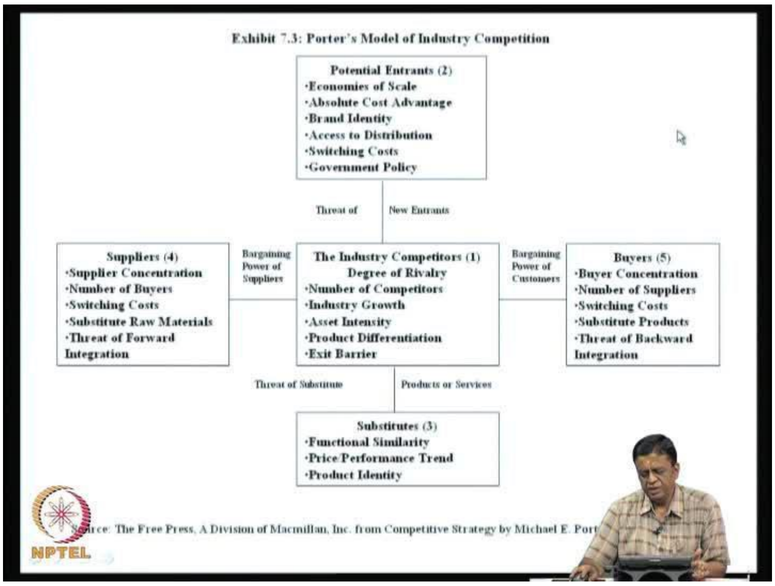

Now, look at block four that is Suppliers. What are the dimensions on which this block four is designed by Porter? One is Supplier Concentration, second is Number of Buyers, third is Switching Costs, Substitute Raw Materials, then, Threat of Forward Integrations.

What do you mean by supplier Concentration? Suppose you are highly dependent on one particular supplier, then what is going to happen? Then, suppose something were happen to that particular supplier, then your entire production line may suffer; that is, the company’s production line may suffer. Now, suppose, there are too many buyers from the same supplier, then what is going to happen? You are also one buyer for him and there are other buyers as well. So, he has a certain edge in supplying this. Then, what is going to happen? Suppose you do not have a substitute raw material, that is, you are dependent totally on him - all these will increase the bargaining power of the suppliers.

So, this is what is characterized by this small hiding which is coming there. That is, the increasing bargaining power of the suppliers depends on the number of suppliers in the market, and how much your company is dependent on those suppliers will tell whether the suppliers have bargaining power, or whether you have got alternatives.

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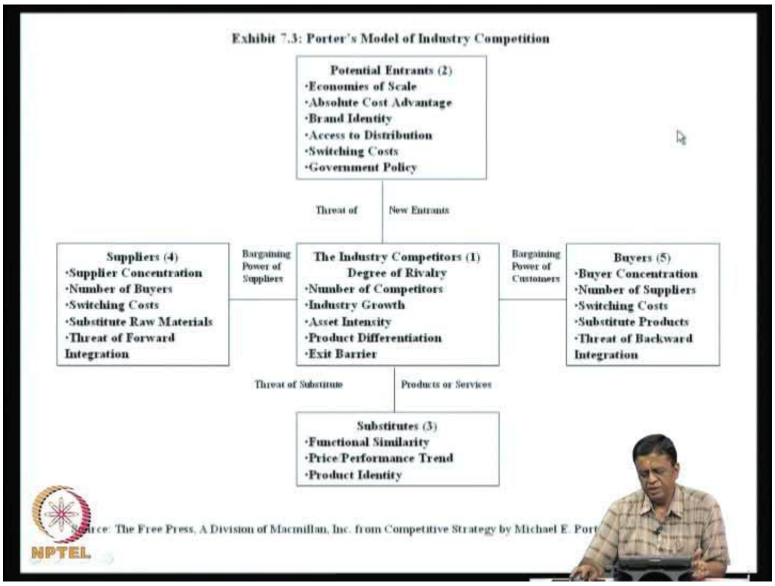

Then, next one that is the fifth block, is with respect to buyers. We are looking at similar dimensions as suppliers. The only distinct which we are seeing is - instead of threat of forward integration, we are looking at threat of backward integration. What is forward integration? You are looking at the distribution line - that is backward integration. You are looking at your raw material line - that is a supplier. So, what is the effect of this block? It gives bargaining power to customers suppose you are too much dependent on a particular customer.

When can that happen? This can happen in an industrial marketing situation where each order becomes vital for a company. So, each customer becomes an important customer for the company. When each customer becomes important for the company then, he as a certain bargaining power. So, that becomes quite crucial for the company’s success; that is your company success or growth or whatever.

So, you have these five blocks which is characterizing industry competition. It is called the Porter’s model of industry competition. So, the first block looks at the Degree of

Rivalry, the second block at the Potential Entrants, then the third block at the Substitutes, the fourth block at the Suppliers and the fifth block at the Buyers.

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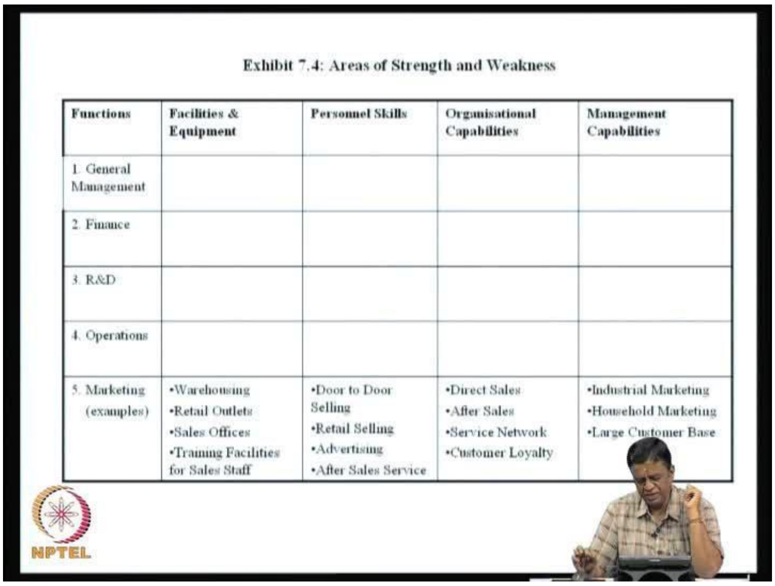

Now, let us look at the area strengths and weaknesses for a company, which can again be listed down according to functions. We are still in our corporate audit - internal corporate audit, internal corporate analysis - kindly note that. So, we are looking at the different functional areas. The functions could be with respect to General Management, Finance, R and D, Operations, and then Marketing.

What could be the areas of strengths and weaknesses? It can be: facilities and equipment, personal skills, organizational capabilities, management capabilities. Then, what could be the examples for this? I have looked at one particular functional area; look at marketing - the facilities and equipment.

What are the types of examples that you can look with respect to marketing? That is the facility and equipment. You can look at warehousing; you can look at retail outlets; you can look at sales officers; you can look at training facilities for sales staff. All these are the facilities or the equipments, which you may require for this particular function.

What are the types of personal skills that you may require for Marketing? It can be door to door selling, it can be retail selling, or your advertising skills, or the after sales services. See, nothing can be more crucial than after sales service. This is highly It is a very important function; this is becoming highly relevant in the present day automotive industry, whether it is a two wheeler industry or a four wheeler industry.

The two wheeler market - if you look at any city in India, you have the two wheeler markets really getting saturated, many times. What do you mean by that? You have too many different options available for the buyer; that is you cannot particularly say that - this two wheeler especially if it is a motorbike, then this particular two wheeler only will be preferred because the consumer has got options. So, it need not always be that, he pick a TVS; he may be willing to look at other options.

Now, when a particular two wheeler of this nature is picked up in a city like in let us say Bangalore, this after sales service becomes so crucial. So, why do you why I am mentioning this? Many of these two wheelers, present day two wheelers, exert the customer to drive at a particular speed. They say - do not drive below this particular speed; maintain the speed of about 25 kilometers or 30 kilometers; do not go below that.

Normally, the tendency among the youth is to accelerate. Now, suppose for some reason, you are not able to accelerate on a particular stretch of the road, that is, you come down in speed, and you find that the traffic is getting cleared, the tendency is to accelerate. Now, when this tendency to accelerate comes, many of these two wheelers have suffered from what is called the air lock; that is, all of a sudden that two wheeler stops; it is not only happening to the bikes, it is also happening to the scooters manufactured by many of the reputed manufacturing companies. This problem of air locking, a brand new vehicle all of a sudden getting switched off, why is it happening?

This air locking is a very serious problem which has to be attended to not just by a sales person, but by the company service person only. So, this is type of skills you may require. That is, a marketing person may not be able to completely handle this; a company person’s assistance is also required, like the in the case of the particular example. Suppose you cost the marketing, the dealer who marketed the vehicle for you, he may not be able to handle it with his service staff; he may require the assistance of the company service staff only, to solve such type of problem. So, these are things which are happening.

So, this is an area of strength or weakness, could be an area of strength or weakness, depending on how the company is able to perform on this. Now, the organizational capabilities: it can be the direct sales, then the after sales, then the service network, then the customer loyalty.

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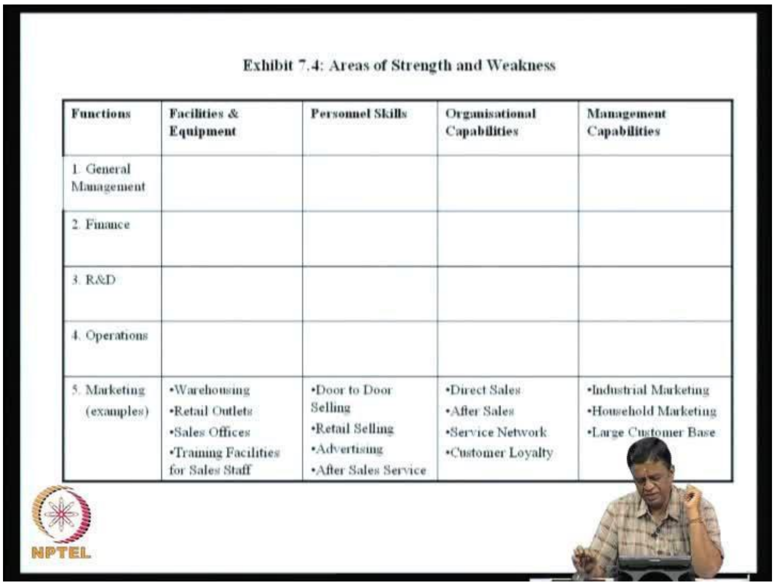
Exhibit 7.4: Areas of Strength and Weakness

Functions	Facilities & Equipment	Personnel Skills	Organisational Capabilities	Management Capabilities
1. General Management				
2. Finance				
3. R&D				
4. Operations				
5. Marketing (examples)	•Warehousing •Retail Outlets •Sales Offices •Training Facilities for Sales Staff	•Door to Door Selling •Retail Selling •Advertising •After Sales Service	•Direct Sales •After Sales •Service Network •Customer Loyalty	•Industrial Marketing •Household Marketing •Large Customer Base

What do we mean by the Management Capabilities? It can be industrial marketing, it can be household marketing, and it can be large customer base. So, customer loyalty need not be again explained.

So, suppose some of the products we take from reputed companies, we not only try to see whether a repeat purchase, if it is required, you would like to make it from the same company. Suppose a particular electronic company, we are very happy with the product of that electronic company; it is coming out with a new product which is again useful to you, then you are very likely to go in for that product only.

So, mention might be made of this prestige - a very simple consumer product, which is being used by most of the houses; so, you have these prestige cookers. Now, what is the prestige company trying to do? Now, it has come up with different product lines. So, one of the product lines which has caught in a market space is the mixie. So, you have the prestige cookers; on the performance of the cookers of this particular company, you tend to think that this company's mixies or the mixers also will be good, and generally it has proven to be so. What is that? This is the customer loyalty that you can expect when your product is found to be good, which your marketing department that is the company's marketing department should be able to exploit.

Now, suppose in particular area, your management capability is reflected by your ability to build a large customer base, suppose it is a consumer product. Suppose, you are able to build a large customer base, then what is going to happen? Then, even if other players were to come into the market and this customer loyalty is also there, then to that extent, creating a dent into your market share or market space becomes that much more difficult. So, this is the way, you look at strengths and weaknesses in one more manner. You start looking at the functions; so, you start looking at the types of strengths and weaknesses associated with respect each functions.

What are given to you in this particular chart is with respect to one function that is marketing. What could be this facilities and equipment? What could be the personal skills? What is this organizational capability? What is this management capability? So, depending on where the company stands, you can say – yes, this is strength for me, and this is weakness. That is, you can yourself say - this is an s; this is a w, for my company

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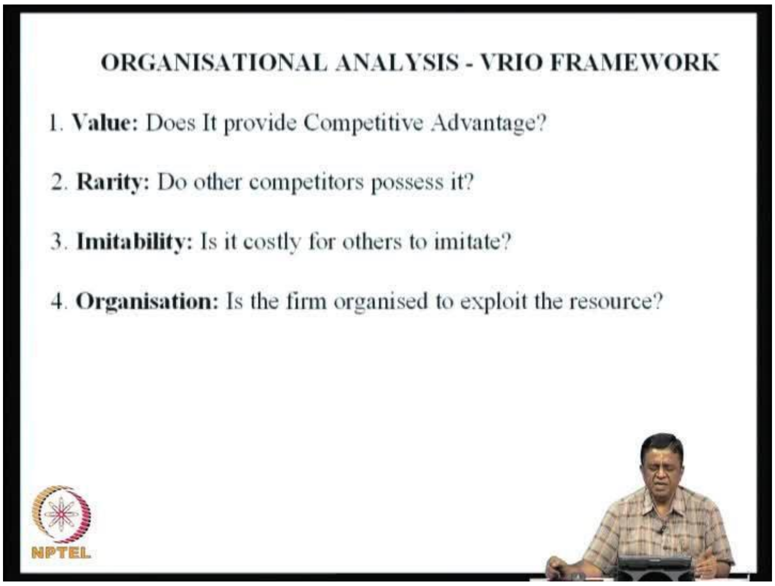

After all doing all that, what do you do? You do what is called an organizational analysis. What is meant by this organizational analysis? Many frameworks are suggested for doing this type of analysis: one of the framework which I am giving you is called a VRIO Framework. That is VRIO Framework.

It has got 4 dimensions: one is Value, second is Rarity, third is Imitability, and fourth is Organization. What is value? Your company is there and it is putting out products into the market place, or it as got different product lines in the market place. Now, what is that you should evaluate? The value in the market place; that is, how do you evaluate the value in the market place? You evaluate the value in the market place by finding out, by putting this particular product, do I get a competitive advantage.

So, if I am able to get competitive advantage by putting this new product into the market place, then it is creating value. Similarly, this competitive advantage - is it rare? What do you mean by, this is rare? That is whether the other competitors that is, the other players are also able to really get this type of value from the market place; then you really do not have a competitive advantage.

Suppose, it is rare, then it is giving value to the company. Now, you introduce a product into the market place, then suppose it is possible for other players to imitate your product very fast, but they find imitating is costly; not really worth the effort taken. So, what is the cost for others to imitate - that is the imitability. Why are we looking at that? We are looking at this because how long you can sustain the competitive advantage in a market place?

Once, your product comes into the market place, it is out there in the open, it is there for everyone to see, then many of your competitors or many of the prospective entrants into the market will be willing to do a, what you call - a reengineering, or whatever you want to call that - a cycle engineering, or whatever term you want; they will do all that to find out whether your product can be substituted with their product in the market place. So, as long as they are not able to do that, then you have a sustainable competitive advantage.

Now, the next questions is - Is your organization that is the company organized to exploit this resource?

Suppose you are having good innovators and your company is not exploiting that innovation, then it is no good. Having innovators itself is not a very big strength; that you must be able to cash in on the strength of these innovators in the market place, that is being innovative in a market place. So, this is all, the VRIO Framework tries to tell you

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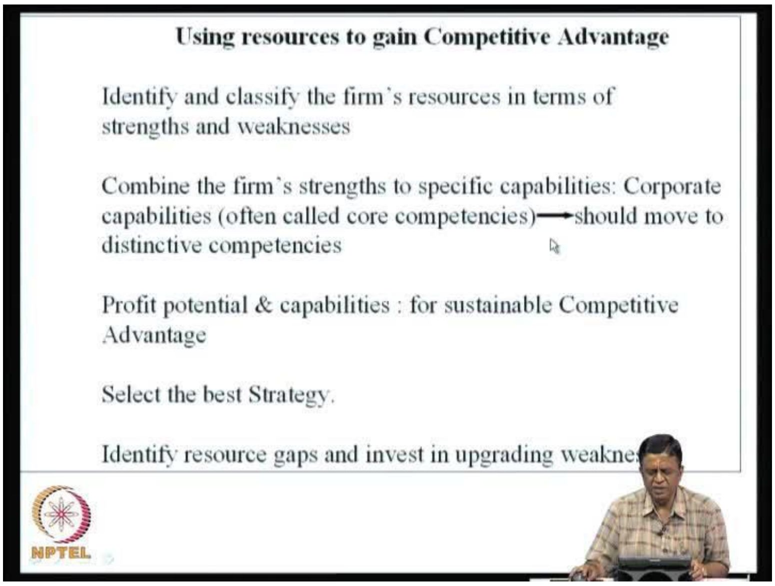

Here, I give a diagram, which tells you how to use your resources to gain competitive advantage; that is, using resources to gain competitive advantage.

So, what is the method of going about?

Take a firm, identify the firm's resources, and classify it in terms of strengths and weaknesses. Then, what is the next step? Combine the firm's strength to specific capabilities - corporate capabilities; these are often called core competencies.

Suppose, you are very good in a machine tool industry, let us say, HMT, very good in machine tool manufacturing - that is its core competency. Using this core competency, the company should move to distinctive competencies in the market place; that is the sustaining edge for the company in the market place. Now, when you are able to get that sustaining edge in the market place, the company gets what is called this sustainable competitive advantage. When is gets that sustainable competitive advantage, its profit potential and the capabilities will increase; that is look at the profit potential and capabilities for sustainable competitive advantage; that is the third step.

So, identify and classify the firm's resources in terms of strengths and weaknesses; then combine the firm's strength to specific capabilities - corporate capabilities, that is core competencies; should move to distinctive competencies; then look at what could be the routes for obtaining profits, achieving capabilities in the selected markets - that is what could be the different strategic routes that you can adopt; then select the best strategy.

So, using the top three, the above three, you have to develop options. When you develop these options, you select; that is you should have alternatives; not just stick to one. Select the best strategy, and one more thing which you have to do is - find out where is the gap with respect to resources in executing the risk strategy. That will be in fact considered a weakness.

Suppose, you do not have the resources, but the strategy is there, you are not able to execute the strategy for want of resources. So, that will be considered a weakness, and you should be able to invest in upgrading this weakness and over coming this weakness. So, this is the way a company can look at using resources to gain competitive advantage in the market place.

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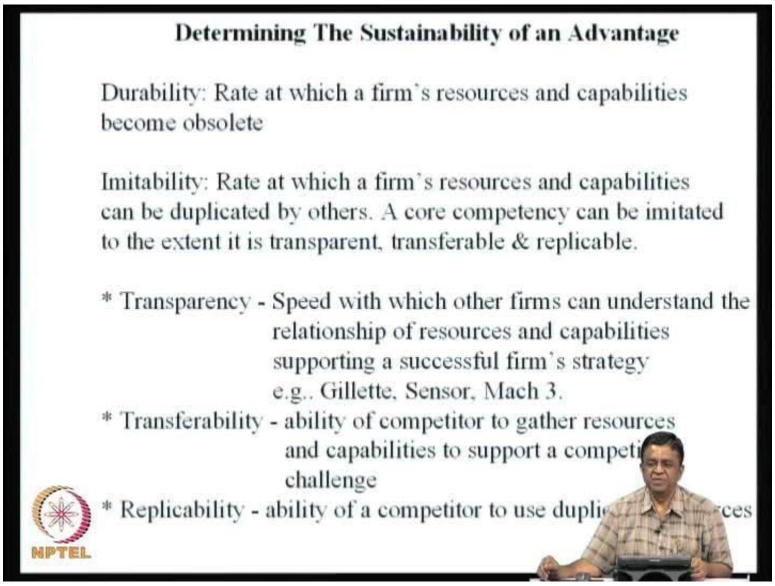

Now, I give you one more slide which tells you, how to determine the sustainability of an advantage, that is what are the dimensions - which tell you whether an advantage is going to be sustainable.

One of the dimensions is Durability. What is Durability?

It is the rate at which a firm's resources and capabilities become obsolete. What do you mean by this? Suppose you are a highly technology intensive firm, let us say.

That is your firm is a highly technology intensive firm, and this technology keeps on changing. When this technology keeps on changing, you should be able to upgrade to this technological changes. If you are not capable of doing so, then your durability with respect to the product lines becomes a question mark in a market place.

Then, the second dimension is imitability. What is the imitability?

It is the rate at which a firm's resources and capabilities can be duplicated by others - this is what I mentioned. Once you are out in a market place, it is open for other players to look at what you are offering in the market, and that market always lends itself to imitation by other players. So, a core competency can be imitated to the extent; it is transparent, transferable and replicable. This is a very important statement.

Suppose, you looked at your firm and said - this is my core competency, and you said - this is the strength on which I would like to sustain my competitive advantage. That can be done, provided, it is not easily possible for the competitors to duplicate your core competency. So, this is characterized; this imitation is characterized by these three dimensions: Transparency, Transferability and Replicability.

What is transparency?

It is the speed with which other firms can understand the relationship of resources and capabilities, supporting a successful firm's strategy. This example I have given you already, but again, repeating – Gillette, the sensor, or the Mach 3. There are so many players in this market, but they have found that it is not so easily transparent to imitate this Mach 3 technology and come out with a duplicate product or another product which can be having the same capabilities, as Mach 3.

What is transferability? Transferability is the ability of the competitor to gather resources and capabilities, to support a competitive challenge.

How strong is a competitor? Suppose, you are a very strong player in a market place, then suppose a new player comes into the market place, then you find that the market place is he is going to be a threat to you in a market place, then what can you do or what you might do?

You might find out, to what extent he can be a threat in a market place, and you can see, if you are a big market player, whether that threat can be obviated, or whether the entry itself can be nipped in the bud. So, this happens very commonly in a market place; not that this was not happening earlier.

So, I can give you a story from the Mahabharata itself. If you really see, after all, the Mahabharata war - the war was over. The Pandavas got control of their kingdom; after ruling the kingdom for several years, they gave the kingdom to one of their next generation people - that is, Parikshit. Parikshit was ruling the kingdom. When he was ruling the kingdom, he got a curse from one of the sages.

What was the curse? This Parikshit, on a hunting expedition, put a dead snake on a sage, who was in deep meditation, around his neck because he did not answer his query. So, the sage's son came later on to find that, his father's this dead snake his put around is father's neck. So, what did he do? He cursed the person who put the snake, saying that - let this person die of the same snake bite within seven days. Sage's had lot of powers; they do have lot of powers because of their different capabilities. So, what?

Then the father opened the eyes, and then they saw what is the extent of damage the son has done; then send the son to the kings court, told him that you asking him to tell him that he has given him this curse. Then, if it is capable, let him guard himself against the curse. So, the son obeyed the father's command; went to the court of the king and told Parikshit that - I have cursed you because you have done this. So, on my father's command, I am coming back to your court to tell you; if you can protect yourself, do protect.

So, what happens? The snake which was given the task of eliminating the king is the one by name, Takshaka; it is a highly poisonous snake; it can kill the person almost instantaneously, the bite. So, what happens? The king makes a broadcast throughout his kingdom that, anyone who is able to protect the king, in case he is bitten by a serpent, he is welcome to come to the court and he will be suitably (( )).

So, what really happens is, one Brahmin boy starts walking towards the court of the king. This Takshaka looks at this whole events unfolding and when he looks at this Brahmin boy walking towards the court of the king, asks him, why he is doing so? The boy replies. Takshaka asks - will you be able to really cure the king if he is bitten? He says, yes; then he says - I am Takshaka and I am entrusted with the task of killing the king.

Now, I want to find out about your powers; I will bite this tree opposite; this tree will be reduced to ashes immediately. This boy replied very calmly - yes you can do so; I will bring it back to life. True to what he said, he brought it back to life; then it was cause of worry for Takshaka. So, what did he do? He asked this boy - why are you going towards the court of the king - to get the reward? What is the reward that you are going to get?

So many gold coins; I will give you double the number of gold coins; the king is destined to die; do not stop this death. Now, in the present day context, market - it also operates in the same manner.

Suppose, you find a new player entering into the market can be a threat to a bigger player; it is very possible that the bigger player will approach this new player and ask him, why does he want to enter the market? He says - to make this type of profits in the market. He can always strike a deal saying that - do not enter this market; we will pay this much. These are the common things which keep on happening.

What is Replicability? Ability of a competitor to use duplicated resources, and capabilities to imitate the firm’s success. So, this also happens very commonly in the market place; very very common with respect to some of the competitors. They use substandard goods, substandard materials, but imitate your product in such a manner that, when the two products are kept side by side, it is hard to distinguish which is your product and which is the other’s product. So, look like type of thing - that is replicability.

So, this is where companies have suffered; sometimes using almost the similar names also, expect for some spelling changes; things like that. So, all these are some of the characteristics of the gray market, as well. So, a core competency can be imitated to the extent; it is transparent, transferable and replicable. Suppose it is not possible, that is, it is not transparent.

Suppose, it is not transferable, and suppose, it is not replicable, then it is not easily possible to imitate your core competency; that is a company core competency. To that extent, the advantage is sustained in the market place; this is what it comes to.

So, we will stop here. We will continue in the next class. Thank you.