Introduction and Industry Analysis

Professor R. Preston McAfee

Who Am I?

- Taught at UWO, CalTech, MIT, U Chicago
- Co-designer, U.S. PCS auction
- Co-Editor, *American Economic Review*
- FTC Expert, Exxon-Mobil, BP-Arco
- Author, 60+ articles on
  - Auctions, Pricing, Antitrust

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<th>Some Strategic Variables</th>
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<td>Inventory levels</td>
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Goals Of This Course

- Identify important factors for decisions
  - What information is useful?
- Identify how factors fit together
  - Necessarily partial, 2nd problem
- Identify candidate strategies
- Evaluate candidate strategies

Assessment

- Class Participation: 30%
- Presentation: 10%
- Case Write-ups: 25%
- Final Paper: 35%

Class Participation - 30%

- Will cold-call if no one volunteers
- Be prepared to answer case questions
- Do not be afraid to hazard a guess when you have done the reading
- Have some fun with it
**Case Write-ups - 25%**

- Individual
- 1-2 pages max
  - Either bulleted or paragraph style
  - Focused!
- Hand in six of eight
- Independent research required

**Final Paper 35%**

- 8-10 page (3200 word) analysis of a strategic situation
- Outline (2 pages)
- Choose something you find interesting
- Focus on analysis, not industry narrative and background
- Bullet or paragraph styles acceptable
- Maximum of four people per project

**Other Points**

- Responsible for website material
  - Check at least weekly for updates
- Responsible for material presented in class
- Not responsible for math beyond occasional graph
Industry Analysis

- Identify factors determining industry profitability
- Foundation for strategic analysis
- Competitive theory:
  - High profits attract entry
  - Entry erodes profitability
  - Sustained profits require entry barriers

Barriers to Entry

- Government (USPS, Taxis, Patents, Ag)
- Technology - Intel
- Economy of Scale - Boeing
- Reputation – Morton, IBM
- Switching Costs – TV programming codes
- Network Externality - Microsoft
- Scarce factor - Bauxite

When is Reputation an Entry Barrier?

- When an entrant pays more for a reputation
  - Free reputation for the first entrant
    - AOL
    - IBM mainframe computers
  - When an entrant can’t buy a reputation
    - Not worth trying the product
    - Mountaineering rope
    - Morton salt, Bayer aspirin
What Is a Market?
- Product or group of related products
  - Buyer substitution
  - Production substitution
  - Production synergies/complementarities
- Palm Pilot
- GE Aerospace
- Wireless web

Value Chain
- Industry produces
  total value = buyer value – supplier cost
- Firm shares total value with buyers, other firms, suppliers
- Model of industry identifies total value and participant shares

Porter’s Five Forces
- New Entrants
- Buyer bargaining power
- Supplier bargaining power
- Substitute products
- Rivalry
- Complements (synergies)
New Entrants
- Scale (efficient scale relative to industry)
- Lock-in/Switching
- Network
- Technology
- Product differentiation
- Government
- Reputation
- Scarce factor (essential factor)

Buyer Bargaining Power
- Concentration
- Elastic demand
- Substitutes
- Information
  - Poor information lowers buyer bargaining power
Supplier Bargaining Power
- Concentration
- Substitutes
- Differentiation
- Switching

Substitutes
- Differentiation
- New technology
- Risk of being blind-sided
  - IBM and Microsoft/Intel
  - Microsoft and the web
  - Wooden boats and fiberglass

Rivalry
- Concentration
- Exit barrier
- Differentiation
- Firm diversity
- Sales growth
- Scale economy
Amazon

Product: Internet book sales
Competitors: B&N, Borders, others
Rivalry: Intense
Substitutes: Brick & mortar, TV, ...
Potential Entrants: Yahoo, specialty
Buyers: individuals
  Buyer bargaining power: near zero
Suppliers: publishers, distributors, mail
  Supplier bargaining power: moderate
Complements: Broadband, advice, payment services, gift reminders

Examples of Complements

- Gasoline, cars, roads
- VCRs and rental tapes
- Operating systems, software, hardware
- Sony memory stick -- camcorders, MP3 players, PDAs, computers, digital camera
- Airlines, reservation systems
Strategy for Complements

- Provide the complements individually
- Subsidize the provision of complements by others
- Be subsidized to produce complements
- Form a jointly-funded complement provider
- Industry has a basis for cooperation

Generic Strategies

- **Value Strategy**
  - Locate at high quality end of spectrum
  - Offer superior product mix
  - Please upper end customers
- **Cost Strategy**
  - Locate at mass-market position
  - Create cost advantages with scale, design

Positioning

- **Accommodation**
  - Leave room for rivals
  - Specialize in group of customers
- **Dissuasion**
  - Fill product spectrum
  - Maximize threat of price war
  - Low marginal costs
Six Forces Form

Product:
Substitutes:
Competitors:
  Rivalry:
Potential Entrants:
Buyers:
  Buyer bargaining power:
Suppliers:
  Supplier bargaining power:
Complements: