A tool for strategic business decisions

It is hard to attend a board meeting, a symposium, or indeed any sort of business meeting without hearing the word 'globalisation'. Yet many companies still try and develop their strategy in a very internal way and certainly without putting a major emphasis on what is going on outside.

In developing a strategy for a business, the idea is to analyse a company's situation and formulate a business plan that is more sustainable and productive in the long run. It is an attempt to build a plan that positions the company in a space in the market where it has a chance to make reasonable returns through matching its skill within an area where the competition is not too fierce and potential margins too low. It sounds basic but large sections of the active sports industries are what can be described as mature – a stage usually marked by consolidation and small companies failing. Add to that the flight of industries to lower wage production countries and it is not surprising that the last quarter century has been an uncomfortable cocktail for many.

Curiously it was just a quarter century ago when Michael E. Porter, professor at Harvard Business School, and a leading authority on international competitiveness, started to present his concept of the competitive forces as a tool to look at the wider business environment. He looked at the five factors of customers, suppliers, new entrants, substitute products, and added this to the competitive situation to get an overview. His argument runs that the stronger the forces the lower the earnings potential in the sector, but that every company through its skills and its customer and supplier links can be positioned very differently within a sector. The one which is strongest with regard to the five forces wins the cream of the earnings.

Five key questions

Taken simply we need to ask some apparently simple questions:



Shoe soles make their mark on a popular trail in the US Zion National Park. In a crowded market every company needs a clear strategy.

WSA

- What does competition look like amongst the existing players in the sector?
- What threats are there of new competitors in the sector?
- Is there a danger from substitute products?
- What is the bargaining power of the customers?
- What is the bargaining power of the suppliers?

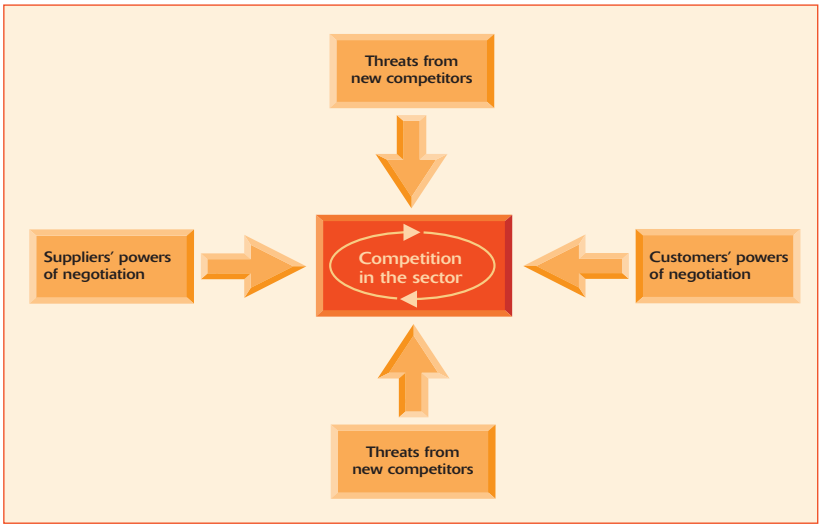
Porters five forces

Some basic information needs to be gathered in terms of market size and growth rate, the scope of competitive rivalry, the number of competitors and their relative sizes. In a world where companies can vary the way in which the value chain is located and broken up it is necessary to assess the prevalence of backward or forward integration, and to look at the barriers to both entry and exit of a business area. Linked to this is the speed and nature of technological change and the implications of economies of scale, capacity utilisation and necessary resources.

These questions are more profound than they appear at first viewing. One wonders how carefully IBM considered the power of suppliers when they started buying from Microsoft and Intel, and Dell looked hard at the power of retail buyers and then decided they would by-pass them by selling direct to business and the consumer. The advent of the computer and the Internet has increased the number of ways a business can be configured and Porter addressed this with another paper in 2001, showing the possible impact on each of the five parameters. Yet this was simply the application of a logical mind with some knowledge of how business was using new technologies. This is the delight of the model; that a broad mind doing logical thinking can come to very sensible conclusions.

Looking in detail at suppliers, they can be said to be a strong force when what they supply makes up a large portion of product costs or is in some way vital to the production process. Also if it is expensive to switch suppliers or the suppliers can produce a component at much lower cost than industry members can make it themselves. Scale is important as if the supplier is much larger than the buyer, or if the buyer is only buying a small proportion of the output, then the supplier's position is stronger. If the component can have a big impact on product quality, or if the supplier does not have to battle with substitutes, these all make the suppliers stronger.

Few shoemakers who have sat in the bar in the Evergreen Laurel Hotel in Taichung have failed to remark on the fact that the increasing use of mobile phones by the younger generation was absorbing the disposable income that would have previously bought one or two more pairs of shoes per year. In reality this is not a 'direct' substitute which should include products from other sectors



WSA

that may cover the same need and thus displace the company's product from the market. A better example would be the replacement of a need for energy by the use of insulation. The force of substitute products will be strong if substitutes are readily available, attractively priced, considered to have comparable or better features and especially if the customer's switching costs are low. At the same time the model is also useful as it demands that the company establish the process of looking at the final consumers for a company's products and how they choose to live and spend their money.

Much of the value of this core tool is the very process of getting to the detail behind the questions and rigorously attempting to analyse the rivalry in the market place and how others might react. Thirty-five years ago the leather and footwear industry got very worried about the potential of Corfam. It did not succeed in the end, but since then many fine synthetic materials have moved in to replace suede and even grain leather. Equally it is half-a-century since we saw the introduction of polyester and every year now the sports industry finds a new yarn or one with specific new properties. At the same time many of the start-up businesses that have been introduced at Outdoor Retailer, ispo or Techtextile have struggled because of the competitive market place they have entered. In a market place with a small number of dominant players it is hard even for some technologies to get growth if some of these bigger companies cannot be persuaded to use it. With these bigger companies goes distribution, access to the retailer and to the consumer. It is curious in a marketplace where innovation is such a driving force that each year two or three compelling new technologies arrive and in retrospect most have had quite a rocky ride in their first decade.

Buyers with choices have power

This also helps us to understand aspects of the question on the power of customers, as big

brands such as Wal-Mart and Nike have tremendous power. Essentially buyers are strong if they buy in volume quantities, can integrate backwards, the product is standardised, or their costs in switching to substitutes or other brands are low. Simply put, if the buyers have choices they have considerable power.

Certainly a business of any size cannot possibly work in a vacuum to decide what products or services to offer. Each business is grounded in an industry or a market and it is vital to fully understand, not just to assume you understand, how that industry works. The competitive forces is a tool to help outline how the different issues in a market come together. It is a core tool used at all levels in a business – the senior strategists as well as the lower level business team should be using it. It is rather static so it needs to be repeated regularly. During the intense period of the development of the Internet and the dot.coms the major international banks had a monthly update, as new entrants and substitutes to traditional banking seemed to be springing up every week.

Some also argue that the model misses the fact that business is becoming more complex, and often customers are also competitors. It is certainly harder to define the line from raw material to the final consumer as a straight one and the definitions of what a consumer is and what a supplier is not always so clear. Increasingly important are other stakeholders who will take into account the thoughts and actions of environmental groups.

Marketers reading this will be well aware of Segmentation, Targeting, and Positioning (STP). Segmentation is necessary to understand the complexities in the market regarding existing needs and wants. It prepares the ground for targeting sub-segments of the market with specific offerings that are tailored to serve their specific needs. When looking at a particular segment strategists should consider new entrants in terms of barriers to entry. These are matters which make it harder for others to enter a segment. Ingredient branding is one way, following the route pioneered by NutraSweet, Intel, Gore and Vibram. This is the route that most of the new technologies try to take but it does require a component that truly adds value. A brand cannot afford to weaken its own image by pushing out propaganda supporting weak technologies that the consumer cannot identify. It also requires a high level of investment year after year in the component brand, but the rewards in creating a barrier to entry and thus superior profits can be considerable.

Defining the market that you are serving is not trivial. If you get it wrong, your segmentation, targeting and positioning strategies and subsequently your offerings might be irrelevant to your customers. This often has to do with confusing the approach of low price against high level of innovations but, for example, to look at Nike is to look at a business which could be classed as:

- Sports footwear
- Sports apparel
- Leisure
- Fashion
- Lifestyle

Looking back at the histories of both Reebok and Nike some of the occasional roller coaster movements of these businesses has come from apparent uncertainty about the positioning. The successful rallying cry for Nike has always been to be true to the core. Not a bad basic rule for strategic thinking.

OPTIMER DRI-RELEASE????