CHAPTER II

THEORY

2.1 Porter Five Forces Analysis

As Porter’s 5 Forces analysis deals with factors outside an industry that influence the nature of competition within it, the forces inside the industry that influence the way in which firms compete, and so the industry’s likely profitability is conducted in Porter’s five forces model. A business has to understand the dynamics of its industries and markets in order to compete effectively in the marketplace. Porter (1980a) defined the forces which drive competition, contending that the competitive environment is created by the interaction of five different forces acting on a business. In addition to rivalry among existing firms and the threat of new entrants into the market, there are also the forces of supplier power, the power of the buyers, and the threat of substitute products or services. Porter suggested that the intensity of competition is determined by the relative strengths of these forces.

The five forces model of Porter is an outside-in business unit strategy tool that is used to make an analysis of the attractiveness (value) of an industry structure. The competitive Forces analysis is made by the identification of 5 fundamental competitiveness forces:
1. **Entry of competitor.** How easy or difficult is it for new entrants to start competing, which barriers do exist.

2. **Threats of substitutes.** How easy can a product or service be substituted, especially made cheaper.

3. **Bargaining power of buyers.** How strong is the position of buyers? Can they work together in ordering large volumes?

4. **Bargaining power of suppliers.** How strong is the position of sellers? Do many potential suppliers exist or only few potential suppliers, monopoly?

5. **Rivalry among the existing players.** Dose a strong competition between the existing players exist? Is one player very dominant or are all equal in strength and size.

![The Five Forces That Shape Industry Competition](image)

Figure 2.1 Porter’s Five Forces Analysis
2.1.1 Force 1: The Degree of Rivalry

The intensity of rivalry, which is the most obvious of the five forces in an industry, helps determine the extent to which the value created by an industry will be dissipated through head-to-head competition. The most valuable contribution of Porter's “five forces” framework in this issue may be its suggestion that rivalry, while important, is only one of several forces that determine industry attractiveness.

Intensity of rivalry depends on:

- The structure of competition. Rivalry will be more intense if there are lots of small or equally sized competitors; rivalry will be less if an industry has a clear market leader.
- The structure of industry costs. Industries with high fixed costs encourage competitors to manufacture.

2.1.2 Force 2: The Threat of Entry

Both potential and existing competitors influence average industry profitability. The threat of new entrants is usually based on the market entry barriers. They can take diverse forms and are used to prevent an influx of firms into an industry whenever profits, adjusted for the cost of capital, rise above zero. In contrast, entry barriers exist whenever it is difficult or not economically feasible for an outsider to replicate the incumbents’ position (Porter, 1980b; Sanderson, 1998). The most common forms of entry barriers, except intrinsic physical or legal obstacles, are depends on:
- Economies of scale.
- Capital / investment requirements.
- Customer switching costs.
- Access to industry distribution channels.
- Access to technology.
- Brand loyalty. Are customers loyal?
- The likelihood of retaliation from existing industry players.
- Government regulations. Can new entrants get subsidies?

### 2.1.3 Force 3: The Threat of Substitutes

The threat that substitute products pose to an industry's profitability depends on the relative price-to-performance ratios of the different types of products or services to which customers can turn to satisfy the same basic need. The threat of substitution is also affected by switching costs – that is, the costs in areas such as retraining, retooling and redesigning that are incurred when a customer switches to a different type of product or service. It also involves:

- Quality. Is a substitute better?
- Buyers' willingness to substitute.
- The relative price and performance of substitutes.
- The costs of switching to substitutes. Is it easy to change to another product?
2.1.4 Force 4: Buyer Power

Buyer power is one of the two horizontal forces that influence the appropriation of the value created by an industry (refer to the diagram). The most important determinants of buyer power are the size and the concentration of customers. Other factors are the extent to which the buyers are informed and the concentration or differentiation of the competitors. Kippenberger (1998) states that it is often useful to distinguish potential buyer power from the buyer's willingness or incentive to use that power, willingness that derives mainly from the “risk of failure” associated with a product's use.

- Concentration of buyers. Are there a few dominant buyers and many sellers in the industry?
- Differentiation. Are products standardized?
- Profitability of buyers. Are buyers forced to be tough?
- Role of quality and service.
- Threat of backward and forward integration into the industry.
- Switching costs. Is it easy for buyers to switch their supplier?

2.1.5 Force 5: Supplier Power

Supplier power is a mirror image of the buyer power. As a result, the analysis of supplier power typically focuses first on the relative size and concentration of suppliers relative to industry participants and second on the degree of differentiation in the inputs supplied. The ability to charge customers different prices in line with
differences in the value created for each of those buyers usually indicates that the market is characterized by high supplier power and at the same time by low buyer power (Porter, 1998). Bargaining power of suppliers exists in the following situations:

- Concentration of suppliers. Are there many buyers and few dominant suppliers? Compare: Kraljic Model.
- Branding. Is the brand of the supplier strong?
- Profitability of suppliers. Are suppliers forced to raise prices?
- Suppliers threaten to integrate forward into the industry (for example: brand manufacturers threatening to set up their own retail outlets).
- Buyers do not threaten to integrate backwards into supply.
- Role of quality and service.
- The industry is not a key customer group to the suppliers.
- Switching costs. Is it easy for suppliers to find new customers?

### 2.2 Targeting and Positioning Strategy

#### 2.2.1 Targeting

Targeting After the most attractive segments are selected, a company should not directly start targeting all these segments. The attractiveness of the segments is also depending on other important factors. In the main activity of defining a target
market, four sub activities are given which are the bases for deciding on which segments will actually be targeted.

The four sub activities within targeting are:

1. Defining the abilities of the company and resources needed to enter a market.
2. Analyzing competitors on their resources and skills.
3. Considering the company’s abilities compared to the competitors’.
4. Deciding on the actual target markets.

The first three sub activities are described at the topic competitor analysis. The last sub activity of deciding on the actual target market is an analysis of the information made available when comparing the companies abilities to the competitors’. This analysis leads to a list of segments which are most attractive to target and have a good chance of leading to a profitable market share.

Obviously, targeting can only be done when segments are predefined; there have to be segments to analyze the competitors which are in this market. When the process of targeting is ended, the markets to target are selected, but the way to use marketing in these markets is not yet defined. To decide on the actual marketing strategy, knowledge of the differential advantages of each segment is needed. When positioning a product, the segments are first analyzed, this process is described next.

Criteria for selecting target segments:

1. Market size – Substantiability
2. Expected growth – Future potential
3. Competitive position – Attractiveness
4. Cost of reaching the segment – Accessibility
5. Compatibility with the organization’s – objectives & resources

2.2.2 Positioning

Gunter and Furnham (1992) prescribe that after selecting target markets the strategist should develop positioning objectives to then develop them into a detailed marketing mix. However, Aaker (1996) recommends developing the positioning objective only after the brand identity and value proposition have been developed. In exploring the latter, it is useful to understand Aaker's definition of positioning is "the part of the brand identity and value proposition that is to be actively communicated to the target audience and that demonstrates an advantage over competing brands." Kotler (1994) refers to it as the unique selling proposition. Explained in other words, the positioning statement is the point where the bundle of attributes join to form one concept which aims at capturing the essence of that which the target audience seeks in the product category.

The benefit of following Aaker's recommendation lies in the expanded range of position alternatives. Three places are suggested in looking for brand position elements: the core identity (central, timeless essence of a brand), points of leverage within the identity structure (an attribute, sub-brand, special feature, or service), and the value proposition (benefits that drive relationships with target audiences).
According to Brooksbank (1994), the positioning strategy should include three components: customer targets, which are the product of the segmentation study; competitor targets, which are a product of the analysis of external environment; and competitive advantage, which is also a product of the environmental analysis.

In developing the positioning objective, Ries (1996) is concise and clear: "positioning is not what you do to the product, but what you do to the mind." Understanding how the mind receives, stores or rejects information will improve the chances of making the positioning objective coincide with actual positioning in the target audience. Although Ries & Trout have written several works relating to positioning, perhaps the key elements they require of a positioning strategy are: simplicity, a search for the obvious, placing the product at the heart of the category, and working to line up the strategy with the market's existing perceptions, attitudes, and beliefs.

Ries & Trout (1990) suggest the position is the mental angle used to enter the prospect's mind and the role of the entire strategy is to support that tactic. It appears that the process as outlined by Porter, Aaker, Kotler, Ries and Trout for STP is one in which the different elements interact: strategy points to the markets, research unveils position alternatives and the position tactic requires a full strategy to support it.
2.3 Competitive Advantage

According to the competitive advantage model of Michael Porter, a competitive strategy takes offensive or defensive action to create a defendable position in an industry, in order to cope successfully with competitive forces and generate a superior Return on Investment. The basic of above-average performance within an industry is sustainable competitive advantage. There are:

1. Cost Leadership (low cost)

   - Achieving cost of leadership means that a firm sets out to become the low cost producer in its industry.
   - A cost leadership must achieve parity or at least proximity in the bases of differentiation, even though it relies on cost leadership for its competitive advantage.
If more than one company try to achieve Cost Leadership, this is usually disastrous.

Often achieved by economies of scale.

2. Differentiation

- Achieving a differentiation means that a firm seeks to be unique in its industry along some dimension that is widely appreciated by buyers.
- A differentiator can’t ignore its position. In all area that don’t affect its differentiation it should try to decrease; in the differentiation area the cost should be at least be lower than the price premium it from buyers.
- Area of differentiation can be: product, distribution, sales, marketing, service, image, etc.

3. Focus

- Achieving focus means that a firm set out to be best segment or group of segments.
- 2 variant: cost focus and differentiation focus.

2.4 Global Marketing

The Oxford University Press defines global marketing as marketing on a worldwide scale reconciling or taking commercial advantage of global operational differences, similarities and opportunities in order to meet global objectives. Global marketing is not a revolutionary shift, it is an evolutionary process. While the
following does not apply to all companies, it does apply to most companies that begin as domestic-only companies.

Global marketing refers to marketing activities by companies that emphasize the following:

1. Standardization Efforts – Standardizing marketing program across different countries particularly with respect to product offering, promotional mix, price, and channel structure. Such efforts increase opportunities for the transfer of products, brands, and other ideas across subsidiaries and help address the emergence of global customers.

2. Coordination across Markets – Reducing cost inefficiencies and duplication of efforts among their national and regional subsidiaries.

3. Global Integration – Participating in many major world markets to gain competitive leverage and effective integration of the firm’s competitive campaigns across these markets by being able to subsidize operations in some markets with resources generated in others and responding to competitive attacks in one market by counterattacking in others.

Although Levitt’s view is somewhat extreme, many researchers agree that global marketing does not necessarily mean that products, promotion, pricing and distribution are standardized worldwide but that a company is proactively willing to adopt a global perspective instead of country-by-country or region-by-region perspective in developing a marketing strategy. Although not all companies adopt
global marketing, an increasing number of companies are proactively trying to find commonality in their marketing strategy among national subsidiaries.

2.4.1 Global Marketing Environment

The global marketing environment comprises the intermediate and the macro environment. The intermediate environment contains those factors which are semi-controllable through contracts and they will be categorized as suppliers, Distributors, facilitators and shareholders. For example in software industries the different vendors, application sellers, temporary specialist staffs and subcontractors etc are part of intermediate environment. The macro environment is made up of those factors and forces which are generally uncontrollable (Lee, 2005).

![Figure 2.3 Global Marketing Environments](image)
2.4.2 Market Behavior

Consumer behavior blending the elements of psychology, sociology, social anthropology and economics about when, why, how, and where people do or do not buy product. To understand the buyer decision making process, both individually and in groups, studies characteristics of individual consumers such as demographics and behavioral variables in an attempt to understand people's wants, also tries to assess influences on the consumer from groups such as family, friends, reference groups, and society in general.

Customer behavior study is based on consumer buying behavior, with the customer playing the three distinct roles of user, payer and buyer. Relationship marketing is an influential asset for customer behavior analysis as it has a keen interest in the re-discovery of the true meaning of marketing through the re-affirmation of the importance of the customer or buyer. A greater importance is also placed on consumer retention, customer relationship management, personalization, customization and one-to-one marketing. Social functions can be categorized into social choice and welfare functions.

Each method for vote counting is assumed as a social function but if Arrow’s possibility theorem is used for a social function, social welfare function is achieved. Some specifications of the social functions are decisiveness, neutrality, anonymity, unanimity, homogeneity and weak and strong Pareto optimality. No social choice function meets these requirements in an ordinal scale simultaneously. The most important characteristic of a social function is identification of the interactive effect
of alternatives and creating a logical relation with the ranks. Marketing provides services in order to satisfy customers. With that in mind, the productive system is considered from its beginning at the production level, to the end of the cycle, the consumer (Kioumarsi et al., 2009).

Belch and Belch define consumer behavior as 'the process and activities people engage in when searching for, selecting, purchasing, using, evaluating, and disposing of products and services so as to satisfy their needs and desires'.

### 2.4.3 Marketing Mix

Marketing mix is the set of controllable tactical marketing tools that the firm blends to produce the response it wants in the target market (Kotler, Philip and Armstrong, Gary, 2004, p56). These variables are known as the marketing mix or the 4 P's of marketing. They are the variables that marketing managers can control in order to best satisfy customers in the target market. The marketing mix is portrayed in the following diagram:
The marketing tools can be grouped onto four variables known’s as the “four P’s”:

3 **Product** - A tangible object or an intangible service that is mass produced or manufactured on a large scale with a specific volume of units. Some examples of the product decisions to be made: Brand name; Functionality; Styling; Quality; Safety; Packaging; Repairs and Support; Warranty; Accessories and services.

4 **Price** – The price is the amount a customer pays for the product. It is determined by a number of factors including market share, competition, material costs, product identity and the customer's perceived value of the product. The business may increase or decrease the price of product if other stores have the same product.

   Some examples of pricing decisions to be made include: Pricing strategy (skim, penetration, etc.); Suggested retail price; Volume discounts and wholesale pricing; Cash and early payment discounts; Seasonal pricing; Bundling; Price flexibility; Price discrimination.

5 **Place** – Place represents the location where a product can be purchased. It is often referred to as the distribution channel. It can include any physical store as well as virtual stores on the Internet.

   Distribution is about getting the products to the customer. Some examples of distribution decisions include: Distribution channels; Market coverage (inclusive, selective, or exclusive distribution); Specific channel members;
Inventory management; Warehousing; Distribution centers; Order processing; Transportation; Reverse logistics.

6 **Promotion** - In the context of the marketing mix, promotion represents the various aspects of marketing communication, that is, the communication of information about the product with the goal of generating a positive customer response. Marketing communication decisions include: Promotional strategy (push, pull, etc.); Advertising; Personal selling & sales force; Sales promotions; Public relations & publicity; Marketing communications budget.

### 2.4 Channel Conflict

Channel conflict occurs when one channel member’s actions prevent another channel from achieving its goal. Channel conflict can also occur when there has been over production. This results in a surplus of products in the market place. Newer versions of products, changes in trends, insolvency of wholesalers and retailers and the distribution of damages goods also affect channel conflict. In this connection, a company's stock clearance strategy is of importance. To avoid a channel conflict in a click-and-mortar, it is of great importance that both channels are fully integrated from all points of view. Herewith, possible confusion with customers is excluded and an extra channel can create business advantages.

Marketing channel conflict can take the following forms:
- Multi-channel conflict - occurs when two or more different marketing channels destructively compete against each other when selling to the same market;
- Horizontal channel conflict - occurs when two or more partners of the same marketing channel destructively compete against each other.
- Vertical channel – means conflict between different level within the same channels.

![Channel Conflict Diagram](image)

**Figure 2.5 Channel Conflict**

### 2.4.1 Cause of Channel Conflict

Channel conflict is an extremely difficult and potentially destructive marketing channel strategy and management issue. Causes of channel conflict include:
- Structural factors - badly designed channel structure and alignment to customer segments. The use of multiple channels (direct and indirect) and the inclusion of new or emerging channels without appropriate planning,
- Resource scarcity - too many channels (or channel partners) compete for too few customers,
- Goal incompatibility - the channel principal and channel partners have incompatible or misaligned goals,
- Poorly defined roles and responsibilities - the channel principal and channel partners' roles and responsibilities are unclear or not matched to their capabilities.
- Communications difficulties - goal incompatibility, perceptual differences and role incongruities may be caused by communications problems,
- Poor channel management - unstructured channel management processes, such as partner recruitment, pricing structures, incentive systems and promotional strategies can all lead to channel conflict,
- Weak channel performance assessment - channel principals fail to drive the desired channel-behaviour through clearly defined performance targets and roles. Enforcement of performance standards is weak.
- Intermediaries’ dependence on the manufacturer – affected by the manufacture’s product and pricing decisions.
2.4.2 Consequences of Channel Conflict

Destructive channel conflict can have serious consequences on channel efficiency, channel effectiveness and channel partners' and principals' profits. Such consequences lead to significant channel partner churn and low partner loyalty to principals. These consequences will lead to a negative impact on customers' purchasing behaviours. However, some channel conflict is desirable, provided it is well managed. A lack of horizontal channel conflict indicates weak market coverage. Well managed channel conflict is better defined as channel competition and is not destructive.

2.4.3 Manage Channel Conflict

Some channel conflict is the result of emerging new channels such as the Internet. While excessive channel conflict can cause destructive behaviour, the solution is not in simply eliminating all channel conflict, but includes optimizing market coverage and managing conflict constructively. It is also necessary to determine whether the decline in channel performance is a result of conflict with other channels and destructive to overall profitability.

In these circumstances, strategies to manage channel conflict, based on Kotler, are includes:

1. Designing the channel structure to reflect the products/services being sold, customers' needs, locations, customers' buying behaviours and the profitability of each transaction;
2. Establishing mutually agreeable and aligned business goals with the channel partners;

3. Effective communications - Take every opportunity to communicate with channel partners, eg include channel partners in business planning events;

4. Segment customers and align channels according to their ability to meet specific customer segment needs;

5. Encourage specialisation among channel partners, and create customer segment specific campaigns and align these with specific channels;

6. Clearly define channel roles and responsibilities, and use pricing solutions, rebates and incentives to encourage desired performance;

7. Develop specific channel products or offers which are not available to all channels;

8. Check behavioural performance through role audits, and regularly monitor channels for early warning signs of damaging behaviour;

9. Ensure that partner agreements are clear and exercise your rights when necessary

Channel conflict can have many causes and result in profit erosion. However, not all channel conflict is unhealthy and can be incorrectly confused with channel competition. Some channel conflict is a consequence of optimizing market reaches and market penetration.

To manage channel conflict, it is necessary to assess whether such conflict is leading to a fall in channel, channel partner or principal profitability. There are many
proven strategies to deal with channel conflict based on an evaluation of the root causes rather than the symptoms.

2.5 Product Mix

A product system is a group of diverse but related items that function in a compatible manner. A product mix is the set of all product and items a particular seller offers for sale. A product mix consists of various product lines. A company’s product mix has a certain width, length, depth, and consistency.

Product mix width refers to the number of different product lines the company carries. For example, a fairly wide product mix consisting of many product lines, including paper, food, household cleaning, medicinal, cosmetics, and personal care products.

Product mix length refers to the total number of items the company carries within its product lines. The company typically carries many brands within each line. For example, it sells eight laundry detergents, six hand soaps, six shampoos, and four dishwashing detergents.

Product line depth refers to the number of versions offered of each product in the line. It can be calculate the average depth of the product mix by averaging the number of variants within the brand groups. Finally, the consistency of the product mix refers to how closely relate the various product lines are in end use, production requirements, distribution channels, or some other way. The lines are less consistent insofar as they perform different functions for buyers.
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