Unit 7: Strategies for Dynamic and Stable Industry Environments.

Objectives

After reading this unit you should be able to:

- understand the difference between dynamic and stable industry environments
- know how the concept of life cycle predicts the events and explains the dynamics in the environment
- identify the characteristics of a dynamic environment and know the different strategies applied in a dynamic environment
- finally, understand the various strategies adopted by firms in a stable environment

Structure

7.1 Introduction

The dynamics of an industry plays a critical role in the formulation of a firm's strategy. It can increase or decrease opportunities or a threat for a firm and it often force the firm to make strategic adjustments. A basic understanding of the process of evolution is essential since correct response to the change in the competitive environment can mean the difference between success and failure of a firm. The first part of the unit will present the concept of product life cycle to explain the process of industry evolution and its significance for the formulation of strategy. In the latter part of the unit, growth strategies in dynamic and stable environments will be dealt in detail.

7.2 Concept of Product Life Cycle

In today's business environment, it is not clear what changes are taking place currently, much less predict which changes will occur in the future. Given the importance of predicting the business environment accurately, it is desirable to have a robust technique which will help in anticipating the pattern of industry changes that one can expect to occur.

One of the most well-known and reliable tools for predicting the probable course of events in the future is the product life cycle (PLC) concept. The basic hypothesis of this concept is that an industry passes through a number of phases starting with introduction followed by growth, maturity and decline phases. Product life cycle theory predicts that industry growth follows an *S*-shaped curve because of the process of innovation and diffusion of a new product. The introduction phase is often characterized by a flat curve reflecting the difficulty of overcoming the buyers' inertia and their initial reluctance to try unknown and untested product. However, the product enters a rapid growth phase once the product proves successful. This rapid growth phase reaches a plateau once the product reaches all the potential buyers. This phase is called the maturity phase. In the final phase of the product life cycle the growth tapers off and the demand for the products starts declining as new substitutes start appearing in the market. The predictions of product life cycle theory about the strategies, competition and performance are explained in the table below.

Table: 7.1 **Strategy, Competition and Performance in Different Phases of Product life Cycle**

	Introduction	**Growth**	**Maturity**	**Decline**
Product	Poor quality, no standards, frequent design changes, basic product design	Good quality, product improvements, technical and performance differentiation	Superior quality, standardization, less product changes, less product differentiation	Very little product differentiation
Buyer behaviour	Buyer inertia, buyer need to be persuaded to try the product	Buyers will accept uneven quality, widening buyer groups	Repeat buying, saturation, mass market	Buyers are sophisticated
Marketing	High advertising expenditure and high marketing costs, skimming pricing	Higher advertising costs but as percentage of sales it will be lower than introduction	Broaden product line, market segmentation, service is important and deals are quite common	Low advertising and marketing costs
Strategy	Increase market share quickly, R&D and engineering capabilities are key factors	Change price and quality image. Marketing is a key area	Competitive cost is key. Bad time to increase market share. Also bad time to change price or quality image	Cost control key
Competition	Few competitors	Many competitors	Price competition, shakeout	Exits and fewer competitors
Risk	High risk	Growth covers risk	Cyclical trend sets in	
Margins and profits	High margins and low profits	Highest profits and fairly high prices	Lower profits, lower margins, falling prices. Increased stability of market shares	Falling prices, low prices and margins. Price may rise in later stages of decline phase

One major limitation of the PLC concept as predictor of industry evolution and dynamics is that it attempts to describe one pattern of evolution which will invariably occur. And except for the industry growth rate, there is little or no underlying explanation provided by this concept as to why the competitive changes associated with life cycle will happen. Moreover, the industry evolution can have so many different paths, the life cycle pattern may not always hold good. Nevertheless, the PLC is a robust model of industry evolution and it predicts the strategy, competition and the performance of a firm in different business environments. Generally, industries which have products in the introduction and growth phases operate in a dynamic environment, while those with products in the mature phase operate in a more stable environment. The stable and dynamic industry segments differ from one another due to the difference in speed and direction of the following industry dimensions:

- Long-term changes in growth
- Changes in buyers' segments
- Buyers' learning
- Diffusion of proprietary knowledge
- Product innovation
- Marketing innovation
- Process innovation
- Government policy change
- Entry and exit of competitors

A good understanding of all the above dimensions that can shape the industry dynamics will assist a firm to face and in some cases even influence the structural changes. A firm's ability to predict the future events will provide a valuable head start to direct environmental forces in ways appropriate to the firm's position. In fact, successful firms do not view environment change as *fait accompli*, to adjust to, but as an opportunity.

Industry environments vary in their basic strategic implications along a number of important dimensions, namely:

- Industry concentration
- State of industry maturity
- Exposure to international competition

The following sections will discuss the industry environment and the strategies based on these dimensions. In addition, in each of these environments, the structure of the industry, strategic issues and strategic alternatives are also discussed. Two important business environments are selected for discussion, namely dynamic environment characterized by very dynamic changes and stable environment typified by steadier and stable variations.

7.3 Dynamic Environment

Generally dynamic environment is characterized by newly formed or re-formed industries that has been created by technological innovations, emergence of new consumer needs/ segments, or other socio-economic changes that elevate a new product or a service to the level of potentially viable business opportunity. Dynamic environment is also created when old/traditional industries experience fundamental shifts in competitive rules coupled with growth in scale by orders of magnitude, caused by some of the factors mentioned earlier. The essential characteristic of a dynamic environment is the absence of any "rules of the game" which may pose a risk or provide an opportunity. In either case it must be managed from the strategic management point of view. The following section outlines the common characteristics of dynamic industry environment.

Characteristics of Dynamic Industry Environment

Embryonic and Spin-off Firms: Dynamic environment has a greater proportion of newly formed companies compared to more stable industry environment. Related to the presence of these companies is that of many spin-off firms or firms created by personnel leaving firms in the industry to create their own firms.

Technological and Strategic Uncertainty

Usually there is s great deal of technological uncertainty in a dynamic industry environment. Alternate production technologies may be at R&D stage or experimental stage, all of which not be tried on a large scale. Related to the technological uncertainty, but on a broader scale, are a wide variety of strategic approaches often tried by the industries in dynamic environment. There is great deal of uncertainty about the strategies of the competitors with different firms following different approaches to product/market positioning, marketing, etc.

High initial costs coupled with steep cost reduction

Small production volumes coupled with newness of technological/production process produce high costs in a dynamic environment relative to a more stable environment. But the steep learning curve is followed rapidly by a succession of ideas related to improved production procedures, plant layout, and employee productivity and so on. Additionally, increasing sales make major additions to the scale and accumulated volume of output produced by firms. If the gains due to learning are combined with increasing market opportunities, the initial high costs are eclipsed by the rapid decline in costs.

First-Time Buyers

Most of the buyers of the new product/services produced by embryonic industries in a dynamic market are first-time buyers. The task of a firm in a dynamic environment is thus of convincing the buyers and persuading them to try the new products or services instead of the existing ones.

Short-Time Horizons

The pressure to develop customers or produce products to meet the demand is so great that problems are dealt expeditiously rather than relying on comprehensive analysis of future conditions.

The other features of a dynamic industry environment include inability of firms to obtain raw material and components, absence of required infrastructure, absence of product or technological standardization, erratic product quality, customers' confusion, etc. In an environment described above, firms will have to craft a strategy to survive and thrive which radically differs from strategies adopted by firms in more stable conditions. The following are some of the generic strategic alternatives available to a firm.

7.4 Strategic Choices in a Dynamic Environment

Industries operating in a dynamic environment have to cope with the uncertainty and risk inherent in the industry environment. The industry structure is highly amorphous, unsettled and rapidly changing and the rules of the game are largely undefined. Despite these factors, the dynamic phase of an industry is perhaps the time when there is a tremendous amount of latitude and freedom to experiment with new strategies and when the leverage from good choice is the highest in determining performance.

One of the strategic choices in a dynamic environment available to a firm is shaping and influencing the industry structure. A firm can set the rules of the game in areas such as product policy and new product development, marketing approach, and pricing strategy. The firm can seek to define the rules within the constraints dictated by the economics of the industry and its own resources in a way that yields the strongest position in the long run.

Another strategic choice available to a firm to compete in a dynamic environment is changing the orientation of its suppliers and channel partners. A firm must be willing to shift the orientation of its suppliers and distributors as the industry grows and starts maturing. Suppliers should be encouraged (sometimes coerced) to respond to the firm's special needs in terms of varieties, service and delivery. Similarly the distribution channels should be made more receptive in terms of investing in distribution facilities and infrastructure, advertising, etc and cooperate with the firm in all its marketing endeavours. Exploiting the supply chain in the early stages of the industry can provide strategic leverage to the firm.

Given the dynamic nature of the industry environment and the fast pace of change, firms can adopt the strategy of exploiting their innovations and building an enduring long run competitive advantage based on low cost or differentiation. Three variants of innovative strategy are available for a firm: i) to develop and market the innovation itself, ii) to develop the market and innovation jointly with other companies through a strategic alliance, and iii) to license the innovation to others and let them develop the market. The optimal choice of the strategy depends on three factors, namely, the possession of complementary assets to exploit its innovation and create a competitive advantage, the height of barriers to imitation by the competitors and the presence of capable competitors that can rapidly imitate the innovation.

Complementary assets are those required to exploit an innovation such as competitive manufacturing facilities capable of maintaining high product quality while ramping up the volume to meet the rapidly growing customers' demand and state-of-the-art manufacturing facilities that enable the firm to move quickly down the experience curve without encountering any hitches and bottle-necks in the production process. Complementary assets also include marketing know-how, adequate and competent sales force, access to good distribution channels, and an after-sales service and support network. These assets, in particular, can develop brand loyalty and help the firm penetrate the market rapidly.

Barriers to innovation are factors that prevent the competitors from imitating a firm's distinctive and unique competencies. These barriers particularly are effective in preventing second and late entrants from imitating the innovation. Ultimately, all innovations are susceptible to imitation, but the higher the barrier the more difficult it is for the rivals to imitate.

Capable competitors are firms that can rapidly imitate the pioneering company. A rival's ability to imitate an innovation essentially depends on its R&D skills and access to complementary assets. In general, the greater the number of rivals with such capabilities, the more rapid is the imitation likely to be.

The strategy of going alone with the innovation makes sense when i) the innovator has the necessary complementary assets to develop the innovation, ii) the barriers to imitation are high, and iii) the number of capable competitors is limited. The second variant of the innovation strategy, namely, developing and marketing the innovation jointly through a strategic alliance makes sense when i) the innovator does not possess complementary assets, ii) barriers to imitation are high and iii) there are quite a few capable competitors. Such an alliance is expected to prove mutually beneficial and each partner can share in high profits which neither of them is capable of earning on their own. The final variant of the strategy which involves licensing makes most sense when the i) innovating company lacks the complementary assets, ii) barriers to imitation are low, and ii) there are several capable competitors.

A vital strategic decision for competing in a dynamic industry is the appropriate timing of entry. While entry barriers are low in an emerging or embryonic industry, the risk can be quite substantial. Entering early is generally recommended when:

- Image and reputation are important to buyer and the firm is confident of developing a good reputation by being a pioneer.
- Customer loyalty is valuable and being first to the market helps build customer loyalty
- Being early puts the firm ahead of others on the learning curve, experience is difficult to imitate and it will be neutralized by future technological generations.
- Absolute advantage can be gained by early commitment to suppliers, channel partners, etc.

However, early entry is risky when:

- Cost of opening up the market such as customer education/awareness, regulatory approvals, etc. is great

- Technological change will make early investments obsolete and the second and late comers can gain advantage by having access to more advanced and newer technologies.
- Early competition with small firms will be replaced bigger and more formidable competition at a later stage.

7.5 Decision to Enter Dynamic Markets

A dynamic and developing industry is attractive to enter if it has the potential to provide above average returns and if the firm is confident that it can create a defendable position in the long run. Quite often firms enter dynamic and risky industries whom the existing firms are going rapidly and making good profits or the ultimate size of the industry promises to be large. These are valid reasons to enter the market, but a firm has to ultimately carry out a structural analysis of the industry/environment (Porter's five forces model) before leaping into the fray.

Activity 1

You work for a company in the IT Industry (software) that has developed new software for banking industry. There are several other competitors who are also on the verge of introducing software products for the same industry. You need to do the following:

i) Give a report to the management about the external environment. and the strategies to compete in this environment.

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ii) On the basis of this report, recommend strategies to compete in this environment.

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7.6 Stable Environment

A the industry traverses the dynamic phase, the intense competition during this stage leads to a shake-out phase. As consolidation takes place, the industry enters a stable phase characterized by a small number of large companies. And though the stable industry may have some medium and small enterprises, the large companies dictate the competition because they can influence the Porter's competitive five forces. In fact, these are the companies that developed the most successful generic strategies in the industry. The transition to stable environment is nearly always a critical period for companies in an industry. It is a period during which fundamental changes often take place in companies' competitive environment, requiring difficult strategic responses. Many firms have trouble perceiving these environmental changes clearly; even when they do, responding to them may require changes in strategy that firms may shy away from. A shift to a more stable or mature industry environment can often bring about a number of important changes in an industry's competitive environment. These are discussed below.

- With companies unable to maintain past growth rates merely by holding market share, they turn their attention to attacking the shares of the others. This may lead to outbreaks of price, service, and promotional warfare.
- The product is no longer new and buyers are more knowledgeable and experienced, having already purchased the product, sometimes repeatedly. The buyers' focus shifts

from deciding whether to purchase the .product at all to making choices among brands. As a result of slower growth, more knowledgeable buyers, and usually greater technological maturity, competition tends to become more cost- and service oriented.

- As the industry adjusts to slower growth, the rate of capacity addition in the industry slows down. Firms need to monitor competitors' capacity additions, closely time its capacity additions with precision. This is rarely done and overshooting of industry capacity relative to demand is, therefore, common.
- As a result of technological maturity, often accompanied by product standardization and increasing emphasis on costs, transition to stable environment is often marked by the emergence of significant international competition. International rivals have different cost structures and different goals compared to domestic firms.
- Slowing growth, more sophisticated buyers, more emphasis on market share, and the uncertainties and difficulties of the required changes usually mean that industry profits fall in the short run from the previous levels. Some firms may be more affected than others, the smaller firms generally the most. Falling profits reduce cash flow during a period when they are needed the most.

Rapid growth in the dynamic stage tends to hide errors and allow most companies in the industry to survive and even to prosper financially. Experimentation is high, and a wide variety of strategies can coexist. Carelessness and negligence are, however, generally exposed by stable industry, however. Maturity may force companies to meet head-on the need to choose among the various strategies described in the next section.

7.7 Strategies in a Stable Industry Environment

In a stable industry environment, strategic group of industries follow similar generic strategies. Companies follow the same strategies as their rivals because any change during this phase is likely to stimulate a competitive response from their rivals. In fact, the main issue that firms need to contend in a stable industry environment is to adopt a strategy that simultaneously allows the firms to protect its competitive advantage while preserving industry profitability. In other words, in stable industry environment, competitive strategy hinges on how large companies collectively try to reduce the strength of the five forces of industry competition to preserve both individual and industry profitability. In the next section, the various price and non-price strategies adopted by firms in a stable environment to deter entry of rivals into an industry and to also reduce the level of rivalry within an industry are discussed.

Firms can generally use three strategies to prevent rivals from entering an industry. They are product proliferation, price cutting and excess capacity.

Product proliferation

Most companies produce a range of products instead just one product. This is done to target different segments with different products. Sometimes, companies expand their product range to fill a wide range to market niches, which creates an entry barrier for potential entrants sine they will now find it harder to break into an industry in which all the gaps or niches filled. This strategy of plugging market niches is called product proliferation.

Rationalizing the Product Mix

Although a broad product line and frequent introduction of new varieties and options may often be necessary and desirable, cost competition and fights for market share are too demanding sometimes to follow a product proliferation strategy. As a result, pruning of unprofitable items from the line and focusing attention on items that have some distinctive advantage (technology, cost, image, etc.) is more desirable.

Process Innovation

The importance of process innovations usually increases in stable and mature industry environment, as does the advantage of designing the product and its delivery system to facilitate lower-cost manufacturing. The success of the Japanese industry in industries such as electronics, automobiles, etc. is attributed to this strategy.

Price Cutting

In some situations, price cutting can be used as a strategy to deter entry of other companies, thereby protecting the profit margins of the incumbents in the industry. For instance, a firm can charge a high price for the product initially to seize short term profits and then cut prices aggressively to build market share and deter new entrants at the same time. The current players in the industry can thus send a signal to the potential entrants that if they enter the industry, the incumbent players will use their competitive advantage to drive down prices to a level which will make it unviable for new entrants to compete at that level.

Excess Capacity

A third strategy that firms use to discourage entry of potential rivals involves maintaining excess capacity that is, producing products much more in excess of the demand. The incumbent companies may intentionally develop excess capacity to warn potential new entrants that if they enter the industry, existing firms will strike back by increasing the output and putting a downward pressure on prices until the entry would become unprofitable.

Buying Cheap Assets

Sometimes assets can be acquired very cheaply as a result of the distress sale of assets by companies unable to make successful transition to stable environment. A strategy of acquiring distressed companies or buying liquidated assets can improve margins and create a low-cost position if the rate of technological change is not too great.

Competing Internationally

A firm may break out of the stifling stable environment by competing internationally where the industry is more favourably structured. Sometimes equipment that is obsolete in the home market can be used quite effectively in international markets, significantly lowering the costs of entry there. Or industry structure may be a great deal more favourable internationally, with less sophisticated and powerful buyers, fewer competitors, etc. The shortcomings of this strategy are the usual risks involved in international competition.

Apart from discouraging new entrants, firms also use strategies to manage their competitive interdependence and decrease rivalry. Several options are available to companies to manage rivalry within the industry. Product differentiation is one such option. It allows a firm to compete for market share by offering different products or by using different marketing techniques. The four competitive strategies based on product differentiation are based on different combinations of product and market segments (not markets as in Ansoff's matrix) are as follows:

Market Penetration

When a company expands market share in its existing product markets, it is said to follow market penetration strategy. This strategy involves heavy advertising to promote and create product differentiation. In a stable and mature industry the major objective of promotion is to influence consumers' choice for the company's brands and products. A company can thus increase its market share by attracting customers.

Product Development

This strategy involves creation of new or improved products to replace existing ones. Product development strategy is vital for maintaining product differentiation and building market share.

Market Development

Market development strategy involves finding new market segments for a company's products. A firm following this strategy will try to capitalize on its brand reputation in one market segment by looking for new market segments in which to compete.

Product Proliferation

This strategy is used to manage rivalry within an industry and to deter entry. Product proliferation strategy essentially involves having a product in each market segment or niche and compete face-to-face with rivals for the customers.

Activity 2

Search the Web for a company which is in a stable environment. Based on the information available about the company and the industry it is operating in, try to explain and comment on the current strategy it is pursuing.

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7.8 Summary

In this unit we have discussed the various strategies that firms can use in different industry environments. Developing an appropriate strategy to suit the needs of different industry environments is crucial for a firm's survival. Companies must always be prepared for changes in the conditions in their environment if they are to respond to these changes in a timely manner.

In dynamic markets, developing a strategy to exploit technical innovations is a crucial aspect of competitive strategy. The three strategic choices for a firm in a dynamic industry are i) to develop and market the technology by itself, ii) to do so jointly with another company, or iii) to license the technology to existing companies.

Stable environment is characterized by a few large companies whose actions are so highly interdependent that the success of one company's strategy depends upon the responses of its competitors. The principal actions initiated by companies to deter entry of competitors are i) product proliferation, ii) price cutting, and iii) maintaining excess capacity. The principal actions initiated by companies to manage rivalry in a stable and mature industry include market penetration, product development, market development and product proliferation.

7.9 Self Assessment Questions

1) What are the characteristics of a dynamic environment? List some industries which are facing this situation and describe the features of the environment in which they operate.

2) For a firm which is operating in an industry listed in the answer to the previous question, suggest some strategies to survive and thrive.

3) How is stable industry environment different from a dynamic environment? Mention a few industries which in your opinion are operating in a stable environment. Explain briefly the characteristics of a stable industry environment.

4) Suggest suitable strategies for industries which you believe are operating in a stable environment.

7.10 Keywords

Dynamic Environment: Dynamic environment is characterized by newly formed or re-formed industries that has been created by technological innovations, emergence of new consumer needs/segments or other socio-economic changes that elevate a new product or a service to the level of potentially viable business opportunity.

Excess Capacity: A strategy that firms use to discourage entry of potential rivals by maintaining excess capacity that is, producing products much more in excess of the demand.

Market Development: Market development strategy involves finding new market segments for a company's products.

Market Penetration: When a company expands market share in its existing product markets, it is said to follow market penetration strategy.

Product Life Cycle: An industry passes through a number of phases starting with introduction followed by growth, maturity and decline phases. This concept is called product life cycle.

Product Proliferation: Most companies produce a range of products instead just one product. This is done to target different segments with different products. This strategy of plugging market niches is called product proliferation.

Price Cutting: In some situations, price cutting can be used as a strategy to deter entry of other companies, thereby protecting the profit margins of the incumbents in the industry.

Stable Environment: As the industry traverses the dynamic phase, the intense competition during this stage leads to a shake-out phase. As a result, the industry enters a stable phase characterized by a small number of large companies.

7.11 Further Readings

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