**Chapter2 Study Guide**

**Value Chains**

* The value chain is the set of interrelated activities that bring products or services to market.

**Components of the Value Chain**

* There primary components of the value chain are as follows:
  + Inbound logistics
  + Operations
  + Outbound logistics
  + Marketing and sales
  + Support
* The secondary components of the value chain are as follows:
  + Firm infrastructure
  + Human resource management
  + Technology / research and development
  + Procurement
* In a value chain, goods and information don’t necessarily flow in a line from one function to another.
* A firm’s value chain can be a key source for competitive advantage if:
* It can’t be copied by competitors without engaging in painful tradeoffs.
  + It helps to create and strengthen other strategic assets over time.
* Firms can buy software such as supply chain management, customer relationship management, and enterprise resource planning software to efficiently integrate activities within the firm, and with its suppliers and customers.
* A firm could build its own software for processes that account for competitive advantage and buy generic software for process that does not provide competitive advantage. But using packaged, third-party SCM, CRM, and ERP software typically requires adopting a very specific way of doing things.

**Dell’s Struggles: Nothing Lasts Forever**

* For years Dell’s super-efficient, vertically integrated manufacturing and direct-to-consumer model helped the firm earn more profit on its own systems when compared with rival PCs.
* While Dell sold direct to consumers, rivals had to share a cut of sales with the less efficient retail chains responsible for the majority of their sales.
* Later, contract manufacturers serving Dell’s rivals also improved manufacturing efficiency.
* The price advantage Dell enjoyed over rivals also shrank in absolute terms.
* The direct-to-consumer model also suffered when sales of notebook PCs outpaced the more commoditized desktop market.
* Customers often wanted to compare products in person and this lead to further decline.
* Dell’s struggles as computers, customers, and the product mix changed, all underscore the importance of continually assessing a firm’s strategic position among changing market conditions.

**Brand**

* + A firm’s brand is the symbolic embodiment of all the information connected with a product or service.
  + Consumers use brands to lower search costs, so having a strong brand is particularly vital for firms hoping to be the first online stop for consumers. A strong brand proxies quality and inspires trust.
  + Early customer accolades for a novel service often mean that positive press will also likely follow. But show up late and you may end up paying much more to counter an incumbent’s place in the consumer psyche.

**Scale**

* + Advantages related to a firm’s size are referred to as **scale advantages**.
  + Businesses benefit from **economies of scale** when the cost of an investment can be spread across increasing units of production or in serving a growing customer base.
  + Firms that benefit from scale economies as they grow are sometimes referred to as being **scalable**.

**Switching Costs and Data**

* **Switching costs** exist when consumers incur an expense to move from one product or service to another.
* Tech firms often benefit from strong switching costs that cement customers to their firms. Similarly, firms that seem dominant but that don’t have high switching costs can be rapidly trumped by strong rivals.
* Wells Fargo has found that customers who use online bill payment (where switching costs are high) are 70 percent less likely to leave the bank than those who don’t use it.
* Switching costs also strengthens the suppliers' hand, even when rivals offer more compelling rates or services. In order to win customers from an established incumbent, a late-entering rival must offer a product or service that not only exceeds the value offered by the incumbent but also exceeds the incumbent’s value and any customer switching costs.

**Sources of Switching Costs.**

* Learning costs
* Information and data
* Financial commitment
* Contractual commitments
* Search costs
* Loyalty programs:
* A new entrant must not only demonstrate to consumers that an offering provides more value than the incumbent, they have to ensure that their value added exceeds the incumbent’s value plus any perceived customer switching costs.

**Differentiation**

* **Commodities** are products or services that are nearly identically offered from multiple vendors. Consumers buying commodities are highly price-focused.
* In order to break the commodity trap, many firms leverage technology to differentiate their goods and services.
* Data also plays a critical role in differentiation. Each time a visitor returns to Amazon, the firm uses browsing records, purchase patterns, and product ratings to present a

**Network Effects**

* **Network effects** exist when a product or service becomes more valuable as more people use it.
* A firm with a big network of users might also see value added by third parties.
* Switching costs also play a role in determining the strength of network effects.
* Users may choose a technically inferior product simply because the product has a larger

**Distribution Channels**

* **Distribution channels**, the path through which products or services get to customers, can be critical to a firm’s success.
* Web sites such as Amazon use affiliate networks to obtain sales and they have over a million affiliates. Google similarly receives some 30 percent of its ad revenue from advertisements distributed within third-party sites.
* The ability to distribute products by bundling them with existing offerings is a key Microsoft advantage.

**Porters Five Forces**

* In the United States, technology and even business models can be patented.
* Firms that receive patents have some degree of protection from copycats that try to identically mimic their products and methods.
* The patent system is often considered to be unfairly stacked against startups.
* So-called patent trolls hold intellectual property not with the goal of bringing innovations to market, but instead in hopes that they can sue or extort large settlements from others.
* Even if an innovation is patentable, it could be nullified by the courts upon later review.
* Software patents are also widely granted, but notoriously difficult to defend.
* One of the most popular frameworks for examining a firm’s competitive environment is Porter’s five forces, also known as the Industry and Competitive Analysis. The five forces are:
  + The intensity of rivalry among existing competitors
  + The threat of new entrants
  + The threat of substitute goods or services
  + The bargaining power of buyers
  + The bargaining power of suppliers
* Consider how the rise of the Internet has impacted the five forces for music retailers.
  + Traditional music retailers scrambled to invest in selling music online out of what is perceived to be a necessity.
  + Their intensity of rivalry increases because they not only compete based on the geography of where brick-and-mortar stores are physically located, they now compete online as well.
  + Investments online are expensive and uncertain, prompting some firms to partner with new entrants such as Amazon.
  + The process of buying a plastic disc now faces substitutes as digital music files become available on commercial music sites.
  + Various choices that are available gives consumers (buyers) bargaining power. They demand cheaper prices and greater convenience.
  + The bargaining power of suppliers, the music labels and artists, also increases.
* The changes that impact one industry do not necessarily impact other industries in the same way.
* It is often suggested that the Internet increases bargaining power of buyers and lowers the bargaining power of suppliers. This suggestion is true only for some industries like auto sales and jewelry where the products are commodities and the price transparency of the Internet matters. But it’s not true across the board.
* In cases where network effects are strong or a seller’s goods are highly differentiated, the Internet can strengthen supplier bargaining power.
* Switching costs also weaken buyer bargaining power. Switching costs help cement customers to the company even when rivals offer more compelling rates or services.
* Tech plays a significant role in shaping and reshaping these five forces, but it’s not the only significant force that can create an industry shock.
* Government deregulation or intervention, political shock, and social and demographic changes can all play a role in altering the competitive landscape.

**Questions and Answers**

1. What is operational effectiveness?
   1. Answer: Operational effectiveness refers to performing the same tasks better than rivals perform them.
2. What is strategic positioning?
   1. Answer: Strategic positioning refers to performing different activities from those of rivals, or the same activities in a different way.
3. Is a firm that competes based on the features of technology engaged in operational effectiveness or strategic positioning? Give an example to back up your claim.
   1. Answer: Assuming that the features can be replicated, firms competing based on features alone are likely to be engaged in operational effectiveness. The automotive industry is an example of an industry that relies heavily on operational effectiveness because features such as power steering, antilock brakes, tire pressure sensors, and the like can be easily duplicated.
4. Consider the examples of Barnes and Noble competing with Amazon.com, and Apple’s offering iTunes. Are either (or both) of these efforts straddling? Why or why not?
   1. Answer: When a firm attempts to match the benefits of a successful position while maintaining its existing position, it is referred to as straddling. When competing with Barnes and Noble, Amazon is not straddling since it doesn’t include brick and mortar stores as part of its model. Barnes and Noble is straddling because it operates both virtual and brick and mortar stores. Apple’s offering of iTunes is not straddling because Apple doesn’t sell CDs.
5. What are switching costs? What role does technology play in strengthening a firm’s switching costs?
   1. Answer: Switching costs occur when consumers incur an expense to move from one product or service to another. There are several sources of switching costs including: learning costs, information and data, financial commitment, contractual commitment, search costs, and loyalty programs. Tech firms often benefit from switching costs because users invest time learning a product, entering data, creating files, etc. Data can be a particularly strong switching cost for firms that leverage technology. There is a cost associated with switching (data) from Facebook, Netflix, or FreshDirect to a competitor’s system.
6. Do you think it is possible to use information technology to achieve competitive advantage? If so, how? If not, why not?
   1. Answer: Used in isolation, information technology can’t build a sustainable competitive advantage. If used to build a value chain or brand, create scale economies and distribution channels, take advantage of switching costs, data and network effects, and achieve differentiation, information technology can be used to create a competitive advantage. IT is commonly used as an enabler of competitive advantage.
7. What are network effects? Name a product or service that has been able to leverage network effects to its advantage.
   1. Answer: Network effects exist when the value of a product or service increases as more people use it. eBay benefits from network effects as it increases its customer base, because future customers see it as way to maximize exposure. Each additional person that lists an item makes eBay more valuable.
8. Use the five forces model to illustrate competition in the newspaper industry. Are some competitors better positioned to withstand this environment than others? Why or why not? What role do technology and resources for competitive advantage play in shaping industry competition?
   1. Answer: The newspaper industry is threatened by substitute products such as cable television, satellite television, leisure activities that can be performed instead of reading a newspaper, and the Internet in the form of blogs and e-newspapers. As a result of this, competition is high. The threat of new entrants, with the exception of Internet rivals, is low. Individual buyer power is increasing with the increase in the number of substitutes. Supplier bargaining power, primarily for paper and inks, in the traditional newspaper model, is diminishing as print runs decline. Some competitors, like the Wall Street Journal, have a presence in both the traditional newspaper industry, and through their subscription website, the Internet news industry as well. Because of its subscription-based Internet newspaper, its specialized (financial) products and services, its reputation, and the synergy between its online and print products, the Wall Street Journal is in a relatively better position than its competitors. The WSJ has leveraged Internet technology by taking advantage of its existing print brand, thereby significantly reducing promotion costs for its Internet brand. On the other hand, the Internet version promotes the print version on its home page.
9. What is price transparency? What is information asymmetry? How does the Internet relate to these two concepts? How does the Internet shift bargaining power among the five forces?
   1. Answer: Price discrimination exists when sales of identical goods or services are transacted at different prices from the same provider. Information, or price transparency, is a condition where buyers know what products are being offered and at what prices throughout the entire market. The Internet fosters price transparency, and reduces price discrimination, by making information to counteract information asymmetry readily available. In certain cases this serves to enhance the power of buyers and reduce seller power.