CHAPTER 2

RELATED THEORY AND LITERATURE REVIEW

In this chapter, firstly, we will present the theory of SWOT analysis followed by the definition of Porter's Five Force analysis. Next, literature survey will be illustrated in final section.

2.1 The SWOT Analysis

SWOT is an acronym for a company's strengths, weaknesses, opportunities, and threats. SWOT refers to an analysis of the strategic environment involving internal and external factors. Environment factors internal to the organization usually can be classified as strengths (S) and weaknesses (W) whereas external factors are classified as opportunities (O) and threats (T).

This approach is an easy tool for getting a quick overview of a company's strategic situation. The point of the analysis is to enable the organization to position itself to take advantage of particular opportunities in the environment and to avoid environment threats. This analysis is useful for uncovering strengths that have not been fully utilized and in identifying weakness that can be corrected. Matching information about the environment with knowledge of the organization's capabilities enables management to formulate realistic strategies for attaining its goals.

An organization's strengths are its resources and capabilities that can be used as a basis for developing a competitive advantage while the absence of certain strengths may be viewed as a weakness. The external environmental analysis may reveal certain new opportunities for profit and growth. However, the changes in the external environment may present threats to the organization.

Strickland (1984) introduced some of the key considerations in compiling a SWOT analysis listing as follows;

2.1.1 Strengths (Internal Analysis)

- A distinctive competence?
- Adequate financial resources?
- Good competitive skills?
- Well though of by buyers?
- An acknowledge market leaders?
- Well-conceived functional area strategies?
- Access to economies of scale?
- Insulated (at least somewhat) from strong competitive pressures?
- Proprietary technology?
- Cost advantages?
- Competitive advantages?
- Product innovation abilities?
- Proven management?
- Other?

2.1.2 Weaknesses (Internal Analysis)

- No clear strategic direction?
- A deterioration competitive position?
- Obsolete facilities?
- Lack of managerial depth and talent?
- Missing any key skills or competences?
- Poor track record in implementing strategy?
- Plagued with internal operation problems?
- Vulnerable to competitive pressures?
- Falling behind in R&D?
- Too narrow a product line?

- Weak market image?
- Competitive disadvantages?
- Below-average marketing skills?
- Unable to finance needed changes in strategy?
- Other?

2.1.3 Opportunities (External Analysis)

- Serve additional customer groups?
- Enter new markets or segments?
- Expand product line to meet broader range of customer needs?
- Diversify into related products?
- Add complementary products?
- Vertical integration?
- Ability to move to better strategic group?
- Complacency among rival firms?
- Faster market growth?
- Others?

2.1.4 Threats (External Analysis)

- Likely entry of new competitors?
- Rising sales of substitute products?
- Slower market growth?
- Adverse government policies?
- Growing competitive pressures?
- Vulnerability to recession and business cycle?
- Growing bargaining power of customers or suppliers?
- Changing buyer needs and tastes?
- Adverse demographic changes?
- Other?

2.2 Porter's Five Force Analysis

The Porter model, five forces, is defined as a tool for business analysis. It is useful model used to understand the competitive force with operate in an industry and to evaluate industry attractiveness. This approach shows a summary of the main forces, which are exerted on and by the various factors in the market. The model focuses on five basic competitive forces that shape competition within an industry. They consist of the risk of new entry by potential competitors, the degree of rivalry among established companies with an industry, the bargaining power of buyers, the bargaining power of suppliers and the closeness of substitutes to an industry's products.

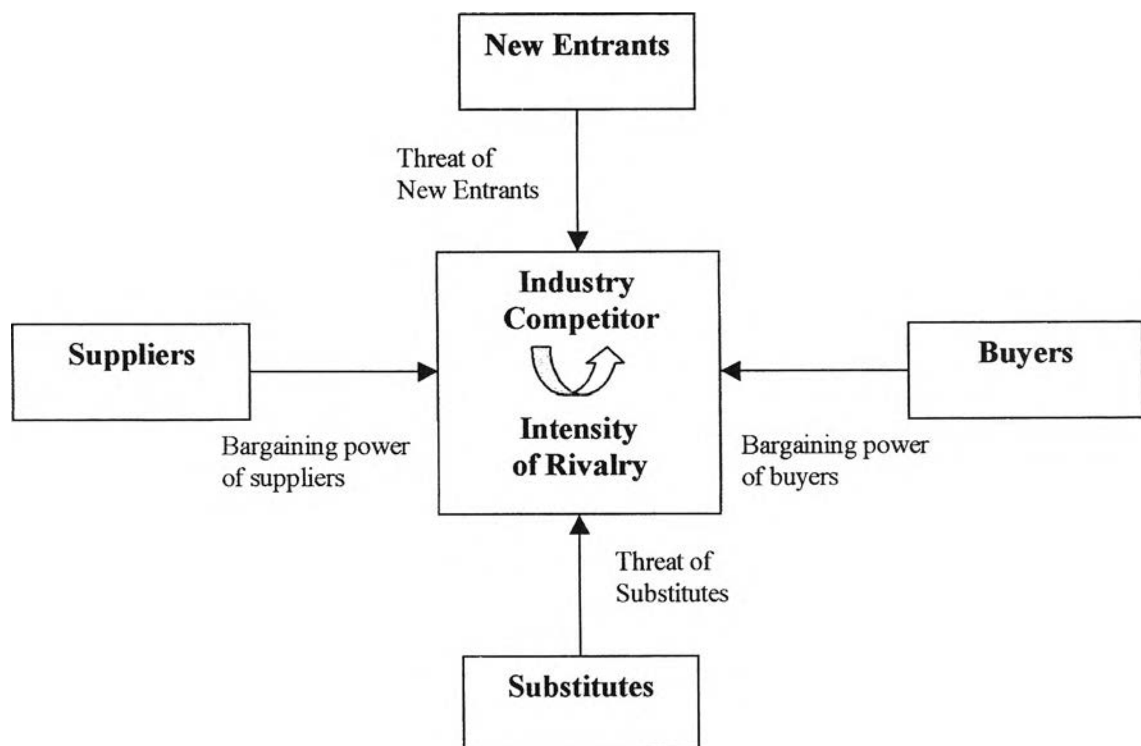

Figure 2.1: The five force model

2.2.1 Threat of new entrants

New entrants to an industry can threaten existing competitors. New entrants bring additional production capacity. Unless product demand is increasing, additional capacity holds consumers' costs, resulting in less sales revenue and lower returns for all companies in the industry. Usually, new entrants have substantial resources and a keen interest in gaining a large market share. As such, new competitors may force existing firms to be more effective and efficient and to learn how to complete on new dimensions. [Michael A. Hitt, 1999]

For barriers to entry, existing competitors try to develop barriers to market entry. However, potential entrants seek markets where the entry barriers are relatively insignificant. The absence of entry barriers increase the probability a new entrant can operate profitability in an industry. There are many factors that can be the threats of new entrants. They consist of economic of scale, proprietary product differences, brand identity, switching cost, capital requirement, access to distribution and government policy.

2.2.1.1 Economic of scale

Economic of scale refer to the quantity of a product during a given time period increases, the cost of manufacturing each unit declines.

Scale economic can be gained through most business functions such as, marketing, manufacturing, research and development and purchasing. New entrants face a dilemma when existing competitors have scale economics. Small-scale entry places them at a cost disadvantage. On the other hand, large-scale entry, where the new entrant manufactures large volumes of a product to gain economics, risks strong reactions from established competitors.

2.2.1.2 Product differentiation

Customers may come to believe that an existing company's product is unique. This belief can result from service to the customer, effective advertising campaigns, or the company being the first to market a particular product. The belief that a company's is unique results in loyal customers who have strong brand identification. New entrants must allocate significant resources over a long period of time to overcome existing customer loyalties. To combat the perception of uniqueness, new entrants frequently offer their products at lower prices. However, this can result in lower profitability or oven a loss for the new entrant.

2.2.1.3 Capital Requirements

Competing in a new entry normally required resources to invest. Capital is needed for inventories, marketing activities, etc. Competing in a new entry may appear attractive but the capital required for successful market entry may not be available.

2.2.1.4 Switching costs

Switching costs are the one-time costs customers incur when buying from a different suppliers. The costs of buying new equipment and retraining employees may be incurred in switching to a supplier. If switching costs are high, a new entrant must offer a lower price or better product to attract buyers.

2.2.1.5 Access to distribution channels

Access to distribution channels can be a strong entry barrier for potential new entrants, especially in consumer nondurable goods industries. The new entrants must persuade distributors to carry their products.

2.2.1.6 Cost disadvantages independent of scale

The new entrants cannot duplicate if the existing competitors have cost advantage. Proprietary product technology, favorable access to raw materials, favorable location and government subsidies may provide cost reduction. Thus, the successful competition requires new entrants to find ways to reduce the strategic relevance of these factors.

2.2.1.7 Government policy

Generally, government can control entry into an industry through licensing and permit requirements.

An industry's entry will be easy to enter if:

- There is common technology
- There is little brand franchise
- There is access to distribution channels

But it is difficult to enter if:

- There is patented or proprietary know-how
- There is difficulty in brand switching
- Distribution channels are restricted

Checklists for the threat of entry be new competitors are presented as:

- Are the economics of scale of existing producers high?
- Are products in the industry, in general, differentiated?
- What are the capital requirements in the industry?
- Are the switching costs high?
- Is access to distribution channels open?
- Are there cost disadvantages independent of scale?
- Does government policy limit of foreclose entry?

2.2.2 Bargaining power of buyers

Normally, buyers (customers of the focal industry) prefer to purchase products at the lowest possible price while the companies seek to maximize the return on their invested capital. To reduce buyers' cost, they bargain for higher quality, greater level of service and lower price. These outcomes can be fulfilled by encouraging competitive battles among the company in an industry.

The important determinants of buyer power consist of buyer volume, buyer information, buyer switching costs relative to firm switching costs, ability to backward integrate, product differences, brand identity, impact on quality/performance and decision maker's incentives.

Under the following condition, buyers will be powerful,

- Buyers are concentrated – there are a few buyers with significant market share
- Buyers purchase a significant proportion of output – if the product is standardized
- Buyers possess a creditable backward integration threat
- The products are purchased large volume
- The product represents a significant proportion of the buyer's total cost

However, buyers are weak when:

- Manufacturers can take over own distribution/retailing
- The products are not standardized, which the buyer cannot switch to another product
- There are many/different buyers

Its checklists are shown as below:

- Who are the principal buyers of products?
- How powerful are they?
- Are their volumes large or small?
- Are their purchases standard or do they require customization?
- Do they face switching costs?
- Do they pose a threat of backward integration?

2.2.3 Bargaining power of suppliers

Increasing price and reducing the quality of products sold are potential means through which suppliers can have power over firms competing within an industry. If manufacturers cannot recover cost increase through pricing structure, a company's profitability can be reduced by the suppliers' action.

The factors that are the determinants of supplier power comprise differentiate of input, supplier concentration, importance of volume to supplier, impact of inputs on cost or differentiation and presence of substitute inputs.

Suppliers will be powerful if:

- They can threaten forward integration
- They are a concentrated group
- The customers are not considered important to the suppliers
- There are few suppliers
- Significant cost to switch suppliers
- They produce a product which is important to the buyer's business

On the other hand, suppliers are weak when:

- There are many competitive suppliers
- Product is standardized
- Credible backward integration threat by purchasers

Checklists of the power of suppliers are shown as follow:

- Who are the big suppliers?
- How powerful they are?
- Do they dominate their industry?
- Are they in a position to integrate forward?

2.2.4 Threat of substitute

Substitute products are different goods or service that can perform similar on the same functions as the focal product. In Poster's model, the threat of substitute comes from products outside the industry. Several sources to be determinants of substitution threat consist of relative price performance as substitutes, switching costs and buyer propensity to substitute.

Generally, the threat of substitute product is strong when switching costs and the substitute product's price is lower or its quality and performance capabilities are equal to or greater than the industry's products. Therefore, in order to reduce the attractiveness of substitute products, the company may differentiate their offering along dimensions that are highly relevant to customers such as, price, product quality and service.

In order to evaluate the threat of substitute, some important checklists that should be consider are:

- Are there many threats from substitute products?
- What form do substitute take?

The degree the substitute products are a threat depends on how well they can serve the same function as the industry product. The existence of substitute products can constrain prices and profits.

2.2.5 Rivalries among existing competitors

Competition among rivals is stimulated when one or more companies feel competitive pressure or when they identify an opportunity to improve their market position. Competition among rivals is based on price, product innovation and other action to achieve product differentiate including extensive customer service, unique advertising campaigns and extended product warranties.

The intensity of competitive rivalry among the competitors concern with several important factors such as, industry growth, fixed costs/value added, intermittent over capacity, product difference, information complexity and diversity of competitors.

Porter considers that the intensity of rivalry among existing companies depends upon the following:

- *The size of competitor* – where they are more of less equal, competition is likely to be strong; industries with dominant organizations in them tend to be stable.
- *The rate of market growth* – slow market growth leads to the increasing of competition to retain market share or to outlast competition.
- *The level of fixed costs* – high fixed costs can lead to the companies cutting prices to maintain turnover.
- *The degree of differentiation* – low product differentiation allows customers to move between competitors.
- *High exit barriers* – the higher the exit barrier, the greater the profitability that a company will engage in destabilizing competitive action.
- *Extra capacity only available in large increments* – it can lead to overcapacity even if only in the short term.

The important checklists for intensity of rivalry include:

- How many in number and how equally balanced are the competition?
- How fast or slow is the industry growing?
- Are fixed costs high?
- How diverse is the competition?
- How high are the exit barriers?

All these factors will help to identify both the strategic situation of the industry and also how the systems to be developed at an operational level in the company can support the overall strategy and take into account the forces acting in the market.

2.3 Literature review

There are some related literature, which involved textile industry for example, in 1973, Rudchada Buddhikarant studied the foreign investment for textile industry in Thailand. The author tried to analyzed and determined economic affects from foreign investment in Thailand during the period of time. In this thesis, the author used rate of return of assets, return on stockholder's equity and debt/equity ratio to measure the economic performance from foreign investment.

Next, in 1980, Vorabul Buranavet (1980) wrote thesis about the problems of Thai garment exports. The thesis started with studying Thai garment market in other countries and the way to expand distribution channel in the future including the government policy to support clothing products for export. Then, he found that there were three main problems to garment exports; production problem, market problem and government problem. And the author also recommended the method to solve these problems. In the same year, he also studied the problem of export of clothing industry in Thailand during 1974-1978. The author studied the market for Thai clothing industry in oversea and channel for market expansion in the future. Moreover, the studying also included supporting from the government and its policy in the aspect of export for clothing industry.

In addition, there is some literature that related critical success factor by Nattawut Tovikkai in 2000. The author studied the critical success factors of Thai jewelry industry to entrepreneurs, Thai government and related private organizations. He indicated eight critical success factors to survive in medium-end market of Thai jewelry industry, which consist of raw material, human resource, capital, technology, marketing, tax and government regulation, image and brand name and internet. He also suggests the strategies to develop jewelry industry in order to maintain and to strengthen its potential in the global market.