

## **CHAPTER II**

### **LITERATURE REVIEW**

#### **2. Literature Review**

Literatures are used as tools in order to find out telecommunications industry in Lao PDR current situation and the strategy of domestic companies that is competing with local and foreign firms. The aim of this chapter is to review the literature to get the theme of the research. This chapter is divided into five parts, which is the relationship of the firms, outside environment and industry, including the industry level of four companies' analysis, Porter's five competitive forces. This chapter is about the examination of the firm in the internal environment, including the review of the study of core competence and competitive advantage.

#### **2.1 Theoretical Approach**

Earlier chapter was a description of how we conducted our research and analysis. Next step is to sort out what theories we are using in order to reach a deeper understanding of the telecommunication industry. In this chapter we describe different theories that will help us approach our problem and draw some conclusions from our data. The interest in Porter comes from the widespread use of his theories. His theories have been used in many companies for over twenty years and are still the most read and studied of the different strategic theories.

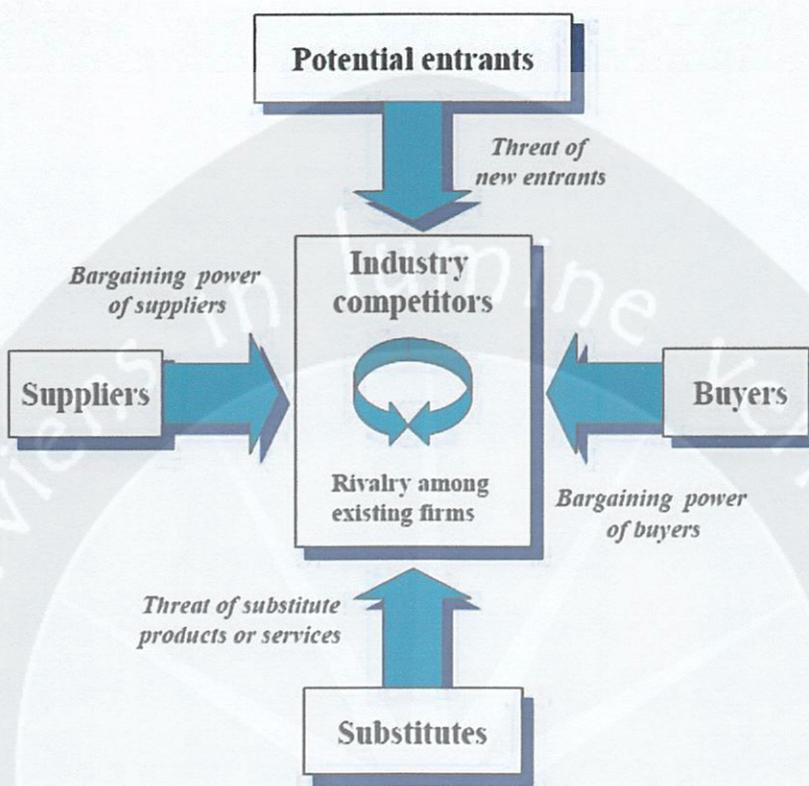
**We will take a critical stand towards these theories though in order to give a broader picture.**

## **2.2 Performing a Five Forces Analysis**

The Five Forces analysis developed by Porter (1980) is a framework designated to examine economic factors that influence industry profits. The aim of the framework is to explore how the firms or industries need to form the strategy to develop the opportunities in their own environment and protect themselves away from the competitive rivalry and some other threats. The general frameworks can be used for the public service and not be used for profit organizations where they compete for resources, such as charitable donations or government funding. The Five Forces Framework helps the manager to contrast a competitive environment. It has some similarities with other environment analysis tools, such as company framework, but tends to pay attention on the stand alone, business, single or strategic business unit rather than a single product.

Five Forces Model introduced by Michael E. Porter (1980), which identifies five important forces in microenvironment, as: the bargaining power of suppliers, the bargaining power of buyers, the threat of potential new entrants; threat of substitutes; and the extent of competitive rivalry. (See figure 2.1)

**Figure 2.1 Porter's Five Forces**



Source: Porter 1980.

Definitely, these five major factors determine the intensity of competition in the industry. (Lynch, 2006) the Five Forces model exams how these five actors influence the competitiveness, and what opportunities and threats they will bring to the company. (Johnson et al., 2005) it contributes for the companies to understand their competitive environment, and create competitive advantages (Jobber, 2004).

It is essential to understand the relationships between the five competitive forces and the main drivers in the microenvironment. It originally identifies and classifies the sources of competition over the level of strategic business sectors Porter (1980). Instead of independent the five forces are connective with each other. Furthermore, Johnson et al. in 2005, point out before using the Five Forces model, it is necessary to notice that: (1) this model should not be used for the whole organization that because of the differentiation between each unit in an organization; (2) none of these competitive forces are exist independently. I.e. The change in one factor will trigger off change in another. (Johnson et al., 2005) Such as the government policy may change the intensity of rivalry. For example, if the Lao government allows fully owned company enter into Laos's mobile communication market; ETL will get more foreign rivals. On the other hand, because the organizations are running in the dynamic business environment, so all the forces of the organizations are dynamic and change depend on the business microenvironment.

#### **A. Rivalry Among Exciting Firms**

Internal rivalry refers to the jockeying for share by firms within a market. Besanko et al (2000). In order to gain more profit margins and customer loyalties, the firm will compete with its rivals. Rivalry among Exciting firms determines the intensity of competition in the industry. The Rivalry is high when;

1. **The capabilities of Competitors are nearly the same, and there is no market leader in the industry.**
2. **The competitors have similar strategies or the product differentiation is very low, thus the competition will tend to be a price war.**
3. **Exit Barrier is very High**
4. **Switching Cost is very Low for customer**  
(Barney, 2007)

#### **B. Threat of New Entrants**

It is not only the existing firms will influence the competitive rivalry of an industry, but also the new entrants will be the threat for the competition. Johnson and Scholes (2002) conclude that, new entrants will decrease the profits in two ways. Firstly, the market will be divided by more competitors. Secondly, entrants will decrease the concentration of market, so heating up the internal rivalry. Each industry maintained diverse characters that protect the profit of firms in the industry and limit the number of new entrants. These are Barriers to Entry:

1. **Economics of scale**
2. **Production Differentiation**
3. **Cost advantage independent of scale, such as proprietary**
4. **Government regulation Policy**  
(Barney, 2007)
5. **Capital requirements, includes initial investment and fixed cost**

6. **Switching Costs for customers**
7. **Access to Distribution Channels, whether it is controlled by existing players**  
(Jobber, 2004; Lynch, 2006)
8. **Brand loyalty of Customer or supplier to the existing players**
9. **Experience**  
(Johnson, 2005)

For different industries, they have their own particular barriers to entry. The profits of existing firms will be protected and maintained by those barriers, which can reduce the rate of new firms' entry. During to the aim of strategic, the barriers of entry always can enhance the competitive advantage of a firm.

### **C. Bargaining Power of Buyers**

Johnson, G. Scholes, K. and Whittington, R. (2005) refers that, "The buyer power refers to the ability of individual customers to negotiate purchases prices that extract profits from sellers." Generally speaking, when the power of buyer is strong, the relationship between buyer and sellers will be going to the monophony, which means there are many suppliers and one buyer in a market. Under this condition, the buyers will determine the price. However, in the reality it happens rarely, frequently there is asymmetry information between suppliers and buyers. Porter (1980) pointed that buyers have more powerful under the following conditions;

1. **The buyers group is very small, and the seller group is very large.**  
(Jobber, 2004)
2. **The firm has lots of rivals, and the differentiation of products or service is very low. It means buyers could purchase from alternative companies.**  
(Lynch, 2006)
3. **The switch cost from one supplier to another is very low.**  
(Johnson et al., 2005)
4. **The buyers could not get high economic profits from the product. Thus, the buyers will be more sensitive to the price and cost of the products or service, that they would like lowest price with highest quality.**  
(Barney, 2007)

**D. Bargaining Power of suppliers**

Richard Lynch (2006) argues suppliers are absolutely necessary for every organization that supports the organization's final production by raw materials or services. The suppliers will be more powerful when:

1. **The supplier group is very small or there is no substitute for the firms to buy raw materials, thus there are limited options for the firm to switch from one supplier to another.** (Lynch, 2006)
2. **The supplier has a wide range customers, thus they are more powerful in the bargaining** (Jobber, 2004)
3. **The payment for supplier takes a large part of total cost.** (Lynch, 2006)

4. **The switching cost from one supplier to another is very high, especially when the production requires some specialist materials of a supplier. (Johnson et al., 2005)**
5. **The entry barrier is very low, hence the suppliers are easily to enter their buyers' market to gain more margins, and compete directly with the buyers. (Johnson et al., 2005)**

#### **E. The threat of Substitutes**

The products or service provided by the substitutes are different from the firms', but still meet the needs of customers. (Barney, 2007) the threat of substitutes is reducing the potential sales volume and profit of the industry, which will take some customers out of this market. The treat of substitutes will be high when:

1. **Brand loyalty of customers is very high**
2. **The switch cost is very high for the customer when turn to purchase from the substitutes**
3. **The substitutes couldn't provide a lower price than the firm**

Furthermore, as it stated at the beginning of this sector, these five forces will influence each other in the industry. Thus, the threat of rivals will also high when it has a high threat of entrant or high threat of substitutes in an industry.

In summary, the five forces model is used to help the firm analyze whether the industry is profitable, what opportunity and threat it will face in the future. After doing the internal analysis, the firms could integrate their strength and

weakness with the opportunities and threats, and then deciding which generic strategies should be taken in this industry.

### 2.3 Strategy Definition

*“The essence of strategy is choosing to perform activities differently than rivals do”. (Porter, 1996)*

According to Porter (1996) a company must choose its activities in different ways than its competitors in order to deliver a unique set of value to its customers. Strategy is essential because there is not only one ideal position in the market. If there were, operational effectiveness would be enough for the company to succeed. Even if company was producing at its lowest cost, serving all types of customers, reducing the number of employees, offering the same products as its competitors and having the same equipment etc, the company would in the end find itself fighting evenly with its competitors. This means that operational effectiveness is not enough for the company to survive when it reaches a certain point. The company therefore needs a strategy in order to differentiate itself. But it is not only enough with a unique position; it needs to guarantee itself a sustainable advantage, otherwise there will be a risk of being copied. Trade-offs is important in order to stay competitive. If a company wants more of something it has to choose less of something else. Strategy is therefore also choosing what no to do. Strategy includes combining activities. The company needs to fit its activities together in a chain, where its position is as strong as its weakest link. It is more difficult for a competitor to copy a company with strongly fitted activities than to

imitate one particular activity. In 1996 Porter, The Company needs to perform many things well and succeed in integrating them, not only managing a few of them. The success of a strategy therefore depends on several things.

The Company's success depends on its ability to manage the often conflicting demands of its various stakeholder groups. However, based on classification systems such as Michell, Agle and Wood's (1997) tri-dimensional approach, or Johnson, Scholes and Whittington's (2006) Power/Interest Matrix, activist groups have traditionally been placed in the less powerful stakeholder categories. However, new communication technologies, such as the Internet, have arguably helped level the power imbalance between activists and large companies (Coombs, 1998; Health, 1998; Jaques, 2006) and have thereby enabled activist groups to become more effective and powerful than ever before (Blood, 2001). Activists have long been recognized for being highly effective at employing traditional public relations strategies and tactics (Reber & Berger, 2005). According Bunting & Lipski (2001), however, the reduction in constraints on geography, access, time and resources have effectively reduced the significance of corporate assets and made it easier for all stakeholders to communicate independently.

#### **2.4 Competitive Advantage**

Porter (1985) said that enterprises sustainable competitive advantage has become the main areas of research in the field of strategic management. Firstly, we must understand the definition of competitive advantage in order to get

a wholly understanding of it and know how a firm can create and sustain superior performance. Grant (2002) gave the definition of competitive advantage as follows: When two or more firms compete within the same market, one firm possesses a competitive advantage over its rivals when it earns (or has the potential to earn) a persistently higher rate of profit.

This definition shows that competitive advantage is the ability of companies exceeded main rival's performance targets, namely profits. But competitive advantage doesn't mean higher profitability because a company may get profit for investment in technology or market share, or it may expense interest in order to meet of customers or employees benefits (Grant, 2002).

Porter (1985) related "Competitive advantage grows fundamentally out of value a firm is able to create for its buyers that exceeds the firm's cost of creating it. Value is what buyers are willing to pay, and superior value stems from offering lower prices than competitors for equivalent benefits or providing unique benefits that more than offset a higher price". He further related that sustainable competitive advantage is the foundation of average performance above. A firm can reach two basic types of competitive advantage that is cost advantage and differentiation, which the stem from the type firms organize and the separate activities a firm carries out the product of designing, producing, marketing, delivering and supporting, which can build a foundation for differentiation and offer a firm's relative cost position. (Porter, 1985) A firm must have a wide field to serve various industry segments, and access to different kinds of sources, to get the benefits of economies of scale, access to raw materials on preferential terms,

proprietary technology and so on, in order to get the cost advantage in the industry. By selecting one or more properties, many buyers in the industry are as an important and unique position to meet these needs, the firm finds the unique for enterprises, and in some respects it is widespread attention by the buyers, to achieve differentiation advantages, which can achieve premium received from the differentiation achieved. (Porter, 1985)

## **2.5 Strategic Competitiveness**

Acting against the competitor can be tough for the existing player that as a big share in the branch according to Porter (1983). The company is forced to do some consideration because of the newcomers. The existing company often spends an essential amount of money to protect the market share it already possesses. Even if it sometimes is a good idea to take action towards newcomers, it is often better to use the resources of the company to make it stronger and develop the business. The existing business can draw advantages from the newcomers when they spend a great amount of marketing money on introducing the industry's services or products. For example; when the Swedish operator 3 launched the 3G network, the company spent a lot of money to market the services which could be used in the net. Vodafone, Telia and Comviq got a free ride on the introduction and made the customers aware of their 3G services.

In this book of 1983 Porter further argues that high initial costs and precipitous reducing of costs is common in a new market. In the telecom industry there are large costs for buying the license and building the network. The same

goes for new technologies in the industry; in the beginning it takes time to learn but the more the user uses the technology, the more revenues the company gets. Environment analysis further explores the business position of the company on an economical perspective which focuses more on external factors. The results are then measured and compared by considering the situation with Porter's Five-Forces which helps to understand the structure of the industry and stake out a position that is more profitable and less vulnerable to attacks from competitors. Where does the company stand versus buyer, suppliers, entrants, rivals, and substitutes? Most importantly, an understanding of industry structure guides managers toward fruitful possibilities for strategic action, which may include any or all of the following: positioning the company to better cope with the current competitive forces, anticipating and exploiting shifts in the forces, and shaping the balance of forces to create a new industry structure that is more favorable to company. The best strategies exploit more than one of these possibilities (Thompson, Strickland, and Gamble, 2010; Porter, 1979).

In this chapter, it has made a review of theoretical frameworks, which are relevant to this research. Porter's five forces analysis on micro-environment and industry level are used to analysis the environmental system of the firms. These theories offered the guidance for the industry analysis of an external and internal environment of Lao PDR's telecommunication industry in reality.