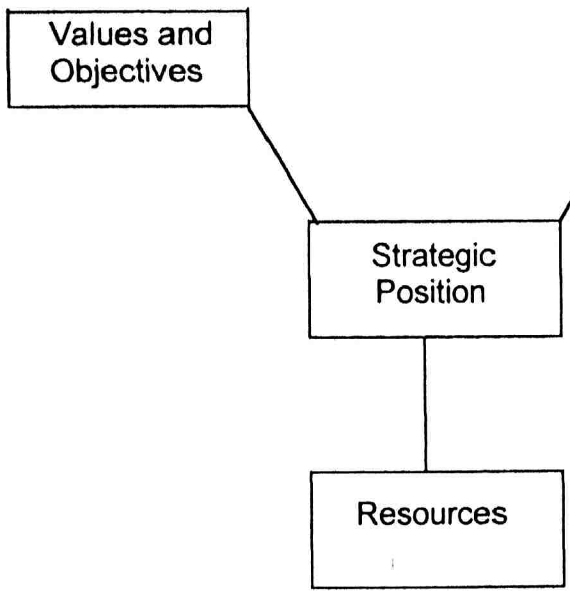
CHAPTER 2

LITERATURE REVIEW

This chapter will review some of the business strategy and marketing concepts that are applicable for analysing and understanding the palm oil industry as well as for formulating suitable strategies for adoption by the industry.

2.0 Definition of strategic analysis

According to Johnson and Scholes (1989), strategic analysis is concerned with understanding the strategic position of the organisation or industry, in relation to its environment, resources, expectation and objectives.



Adapted from Johnson and Scholes K. (1989), Exploring Corporate Strategy : Text And Cases : Prentice Hall Inc.

Strategic analysis is meant to help the industry to identify the key factors that are affecting the present and future well being of the industry so that actions can be taken accordingly.

The strategic analysis concept stress that understanding the environment is of central importance to the choice of a firm's strategy, as many of these variables could give rise to opportunities or threats to the industry.

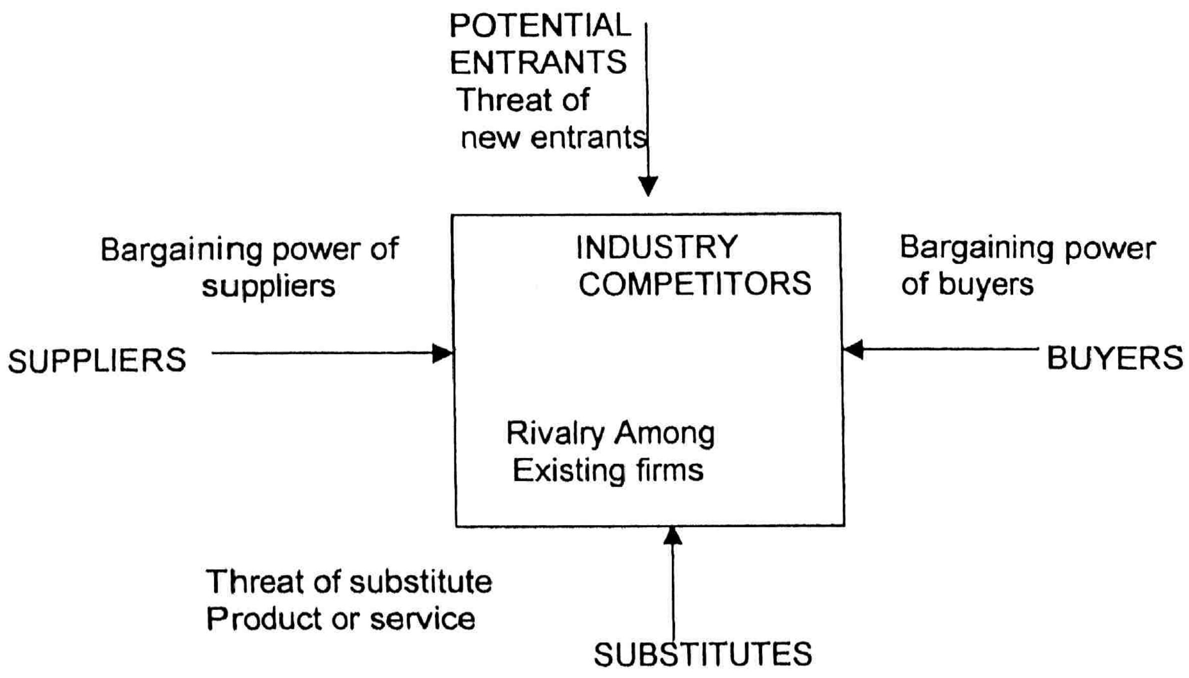
By knowing the industry strength and weakness, the industry can organise their resources to create competitive advantage and formulate suitable strategies to overcome their weaknesses.

Values, expectations and objectives of different stakeholder groups within the industry also needs to be understood, as they are important in determining the suitability and acceptability of the strategies proposed.

In summary, strategic analysis determines the strategic position of the industry in terms of its opportunities and threats, strength and weaknesses, expectations and objectives. It is also to determine if current strategies are capable of dealing with the changes that are taking place in the industry environment. It is also an attempt to reduce the many influences that may be detrimental to a firm.

2.1 The structural analysis of industries

According to Michael E. Porter (1980), there are five competitive forces that drive the industry. Micheal Porter's idea can be diagrammatically depicted as follows :



Adapted from M.E. Porter : Competitive Strategy , The Free Press (1980)

In any industry, the rules of competition are embodied in the five competitive forces namely the entry of new competitors, the threat of substitutes, the bargaining power of buyers, the bargaining power of suppliers and the rivalry among existing competitors.

The collective strength of these five forces determines the ability of the firm in an industry to earn, on average, rates of return in excess of capital. Industry profitability is not a function of what the products looks like or whether it embodies high or low technology, but of industry structure.

The five forces determine industry profitability because they influence the prices, cost and required investment of firms in an industry.

The threat of entry places a limit on price and shapes the investment required for industry entry. Threat of new entrants are low if economies of scale, product differentiation, capital requirements and switching cost are high.

The threat of substitutes also limits the price that firms can charge. The more attractive the price alternative offered by substitutes, the thinner the profit enjoyed by firms in the industry. Substitutes not only limit profits in normal times, but they also reduce the profit that an industry can reap in boom times.

Buyers' power too has great influence on the prices that firms can charge. Buyers compete with the industry by forcing down prices and bargaining for higher quality or more services. All this is done at the expense of industrial profitability.

The bargaining power of suppliers determines the cost of raw materials and other inputs. Suppliers can exert bargaining power over the participants in the industry by threatening to raise prices or reduce the quality of goods and services purchased. Powerful suppliers can thereby squeeze profitability out of the industry .

The intensity of rivalry influences prices as well as the cost of competing in areas such as product development, advertising and sales force. The intensity of rivalry is high when there are numerous equally balanced competitors, slow industry growth, lack of differentiation and high exit barriers.

The five-forces framework allows a firm to see through the complexity and pinpoint those factors that are critical to competition in its industry, as well as to identify those strategic innovations that would improve the profitability of the industry. The five forces framework does not eliminate the need for creativity in finding new ways of competing in an industry. Indeed the Malaysian palm oil industry can direct its energies towards those aspects of industry structure that are most important to secure its long-run profitability.

2.3 Porter's Three Generic Strategies

In coping with the five competitive forces, Micheal E. Porter identifies three potential successful generic strategic approaches to outperform other firms in an industry:

i) overall cost leadership

ii) differentiation

iii) focus

		Strategic Advantage	
		Uniqueness	Low cost position
Strategic Target	Industrywide	Differentiation	Overall cost leadership
	Particular Segment	Focus	

2.3.1 Overall Cost Leadership

The first strategy is to achieve overall cost leadership in an industry through a set of functional policies. Cost leadership requires aggressive construction of efficient -scale facilities, vigorous pursuit of cost reduction from experience, tight cost and overhead control, avoidance of marginal customer accounts and cost minimisation in the areas like research & development, services, sales force, advertising and so on. Low cost relative to competitors becomes the theme running through the entire strategy, through quality, services and other areas cannot be ignored.

2.3.2 Differentiation

The second generic strategy is one of differentiation the product or service offering of the firm, creating something that is perceived industry-wide as unique. Approaches to differentiation can take many forms : design or brand image, technology, features, customers service, dealer network or other dimension. It should be stressed that the differentiation strategy does not allow the firm to ignore cost, but rather they are not the primary strategic targets.

Differentiation provides insulation against competitive rivalry because of brand loyalty by customers and resulting lower sensitivity to price. It also increases margins, which avoids the need for a low-cost position. The firm that has differentiated itself to achieve customer loyalty should be better positioned vis-à-vis substitutes than its competitors.

Achieving differentiation may sometimes preclude gaining a high market share. It often requires a perception of exclusivity, which is incompatible with high market share. More commonly, however, achieving differentiation will imply a trade-off with cost position if the activities required in creating it are inherently costly, such as extensive research, product design, high quality materials or intensive customer support.

2.3.3 Focus

The final generic strategy -focus, that is focusing on a particular buyer group, segment of the product line, or geographic market; as with differentiation, focus may take many forms. Although the low cost and differentiation strategy are aimed at achieving their objectives nation-wide, the entire focus strategy is built around serving a particular target very well and each functional policy is developed with this in mind.

The strategy rests on the premise that the firm is thus able to serve its narrow strategic target more effectively or efficiently than competitors who are competing broadly. As a result, the firm achieves either differentiation from better meeting the needs of the particular target, or lower costs in serving this target, or both. Thus the focus strategy has two variants i.e. cost focus and differentiation focus. In cost focus a firm seeks a cost advantage in the target segment, while in differentiation focus, a firm seeks differentiation in a target segment.

2.4 Ansoff's Product - Market Expansion Matrix

In order to achieve growth H. Igor Ansoff (Corporate Strategy. UK: Penguin Book ,1968) has identified four possible strategies that firms can adopt :

i) Market penetration strategy
ii) Market development strategy
iii) Product development strategy
iv) Diversification strategy

Ansoff product-market expansion strategy

	Current Products	New Products
Current Markets	Market Penetration Strategy	Product Development Strategy
New Markets	Market Development Strategy	Diversification Strategy

2.4.1 Market penetration strategy

Here the industry could look for ways to increase the market share of its current products. There are three major ways to do this. In the case of palm oil the industry could encourage its current customers to buy more and use more palm oil per period. Alternatively, it could try to attract competitors' customers to use Malaysia palm oil. Finally it could try to convince current non-users to use palm oil.

2.4.2 Market Development Strategy

The Malaysian palm oil exporters could look for new markets who might need its current products. Instead of limiting itself in the traditional markets, palm oil exporters could develop new markets where growth potential is much higher. Alternatively, instead of selling only for food use, it could develop together the market for non-food use.

2.4.3 Product Development Strategy

The next strategy is to develop new products or improve the quality/features of existing products so that it could attract more customers and wider usage in existing market.

New product developments will increase the demand for basic raw materials i.e. crude palm oil.

2.4.4 Diversification strategy

Diversification strategy can be divided into two broad types i.e. related diversification and unrelated diversification. Related diversification or concentric diversification refers to development beyond the present product and market but still within the broad confines of the industry. In the case of palm oil, firms within the industry can diversify into further downstream products like oleochemicals, soap and detergents, palm kernel stearin and other specialty fats.

Unrelated diversification refers to developments beyond the present industry into products or markets which bear no clear relationship to present product or market. For growth within the palm oil industry, this strategy will not be applicable.