Seminar 3 — Competition, Strategy and Structure

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Companion to the Day 3 lecture — ANSWER KEY

Scope. Lecture material only: strategic orientations and the environmental scan; Porter's five forces and the three generic strategies; entry deterrence, switching costs and scale as barriers; global organizational structures (product, area, functional, matrix, transnational network); integration vs national responsiveness (Bartlett–Ghoshal) and Ghemawat's AAA; the diversification discount and the GVC "smile curve"; and measuring concentration (the HHI and defining the market with the SSNIP test).

Part 1. Multiple choice (10 questions)

Choose the single best answer.

1. Which is one of **Porter's five forces**?

(a) exchange-rate volatility
(b) threat of new entrants
(c) the firm's cost of capital
(d) corporate tax rate

Answer. (b). The five: rivalry, threat of entry, threat of substitutes, buyer power, supplier power.

2. Porter's three **generic strategies** are cost leadership, differentiation, and:

(a) diversification
(b) focus (niche)
(c) vertical integration
(d) globalization

Answer. (b). Focus applies cost or differentiation to a narrow competitive scope.

3. An industry's **HHI** is computed by:

(a) summing the market shares
(b) summing the *squared* market shares
(c) averaging firm sizes
(d) counting the firms

Answer. (b). HHI $= \sum s_i^2$ (shares in %: range 0–10,000); squaring rewards large shares.

4. The **SSNIP** (hypothetical-monopolist) test defines a market by asking whether a hypothetical monopolist could profitably impose a:

(a) large permanent price cut

(b) small but significant, non-transitory increase in price

(c) quality reduction only

(d) change in ownership

Answer. (b). If customers would switch away enough to make a 5–10% price rise unprofitable, the market is drawn too narrowly — widen it. Guards against the "cellophane fallacy".

5. A firm that organises its worldwide operations into divisions each responsible for a **product line** across all countries uses a:

(a) global area structure

(b) global product structure

(c) functional structure

(d) matrix structure

Answer. (b). Global product structure: product divisions carry worldwide responsibility — favours global integration and product focus.

6. Which condition most encourages an MNE to **decentralize** decisions to local units?

(a) uniform global product standards

(b) high competitive pressure demanding rapid local adaptation

(c) a strong desire for central control

(d) identical regulation everywhere

Answer. (b). High local-responsiveness pressure favours decentralised, area-based structures; uniformity/integration favours centralised product structures.

7. In the Bartlett–Ghoshal integration–responsiveness grid, the **transnational** solution seeks:

(a) high integration and low responsiveness

(b) low integration and high responsiveness

(c) high global integration *and* high local responsiveness simultaneously

(d) neither

Answer. (c). The transnational tries to be globally efficient *and* locally responsive *and* to share learning — demanding, hence the network structure.

8. The "**diversification discount**" is the empirical finding that, on average, diversified firms:

(a) trade at a premium to focused peers

(b) trade at a discount (lower q/value) than comparable focused firms

(c) never fail

(d) pay no tax

Answer. (b). Unrelated diversification tends to be associated with a valuation discount (Berger–Ofek; Lang–Stulz), though selection complicates the causal reading.

9. In the GVC "**smile curve**", the highest value-added activities sit at:

(a) the middle (assembly/manufacturing)

(b) the two ends (R&D/design and branding/marketing/after-sales)

(c) logistics only

(d) raw materials only

Answer. (b). Pre- and post-production intangibles capture most value; physical assembly in the middle earns least.

10. Which is a genuine **entry barrier** you can put a number on?

(a) consumer taste

(b) minimum efficient scale relative to market size

(c) the weather

(d) the firm's mission statement

Answer. (b). If minimum efficient scale is large relative to the market, few firms fit — a quantifiable barrier (alongside switching costs and learning economies).

Part 2. Discussion questions (10)

Short, open questions for the table; talking points follow each.

1. Five forces in a fabless world. In the semiconductor chain — IP/design (Arm), fabless designers (Nvidia), foundries (TSMC), equipment (ASML) — where does profit actually sit, and why?

Answer. Profit sits where a force is *weak for the incumbent*: at choke-points protected by huge scale, IP and switching costs. ASML (sole EUV supplier) and TSMC (leading-edge foundry) face little rivalry and weak buyer power because no one else can do what they do; Arm's architecture is entrenched by an ecosystem. Commoditised assembly and mature-node fabs, by contrast, face intense rivalry and strong buyers, so margins are thin. The lesson: "the industry" has no single attractiveness — five forces must be assessed *stage by stage* along the value chain.

2. Three generic strategies. Explain cost leadership, differentiation and focus, and what "stuck in the middle" means. Can a firm ever be both low-cost and differentiated?

Answer. Cost leadership wins on the lowest delivered cost; differentiation wins a price premium for distinctive value; focus applies either within a narrow segment. "Stuck in the middle" is achieving neither — higher cost than the cost leader and less distinctive than the differentiator — and typically earning below-average returns. The purist view says the two are inconsistent (differentiation costs money); the modern qualification is that operational excellence, scale, or technology can shift the whole cost–value frontier so a firm is temporarily both (IKEA, Toyota), but rivals eventually imitate, so a clear primary basis of advantage still matters.

3. Entry deterrence via platforms and switching costs. How do network effects, switching costs and scale act as entry barriers, and why can they make even a large, well-funded entrant fail?

Answer. Network effects make a product more valuable as more people use it, so an incumbent's installed base is itself a barrier; switching costs (data, learning, integrations, contracts) lock users in; scale economies mean an entrant must win huge volume just to match unit costs. Together they create a chicken-and-egg problem: users won't join a small network and the network can't grow without users. A rich entrant can subsidise adoption but must overcome the *coordination* of the whole ecosystem at once — which is why deep pockets alone often fail against an entrenched platform.

4. Integration vs responsiveness. Explain the integration–responsiveness trade-off (Bartlett & Ghoshal) and give a product that sits at each corner.

Answer. Global integration pushes toward one standardised, scale-efficient offer worldwide; local responsiveness pushes toward adapting to national tastes and rules. High integration/low responsiveness → *global* strategy (semiconductors, commercial aircraft). Low/high → *multidomestic* (retail food, media content). Low/low → *international* (simple exporting of a home product). High/high → *transnational*, seeking scale *and* local fit simultaneously (consumer electronics, cars). The grid's value is that it links the external pressures a business faces to the organisational structure it should adopt.

5. **Diversification discount.** Unrelated diversification tends to destroy value in developed markets but adds it in emerging ones. Reconcile this.

   Answer. In efficient developed markets, investors can diversify themselves cheaply, so a conglomerate adds no portfolio value while inviting agency costs, cross-subsidy of weak units, and opaque capital allocation — hence the discount. In emerging markets with institutional voids (weak capital, labour and contract markets), a group's internal capital market, shared brand and internal talent pool *substitute* for missing institutions, adding real value. The same strategy is a drag or a strength depending on how well external markets work — context, not the strategy label, decides.

6. **The smile curve.** Why is value concentrated at the ends of the value chain (R&D/design and brand/marketing) and thin in the middle (manufacturing)? What does this imply for development strategy?

   Answer. Value accrues to activities that are hard to imitate and protected by intangibles — patents and design at the front, brand and customer relationships at the back — while physical assembly is contestable, scalable and easily relocated, so it earns commodity margins (the "smile"). Implication: capturing more value means *moving along the curve* — upgrading from assembly into design or branding (as some Asian firms have) — rather than competing harder in the low-margin middle. It also explains why lead firms outsource manufacturing but keep design and brand in-house.

7. **What the HHI misses.** The HHI is the standard concentration measure. What can it fail to capture about real competition?

   Answer. As a snapshot of current shares it can miss: potential competition and the *threat* of entry (a contestable market disciplines prices even at high HHI); the definition of the market itself (too narrow or wide a market flips the number); multi-market contact and tacit coordination among a few firms; buyer power on the other side; and dynamic/innovation competition where today's leader is tomorrow's laggard. A given HHI can therefore be consistent with fierce or feeble competition — which is why regulators pair it with market definition (the SSNIP test) and evidence on entry and conduct.

8. **Choosing an organizational structure.** What are the main organizational structures an MNE can adopt, and which variables push a firm toward one rather than another?

   Answer. Main structures: international division; global *product* division (diversified product lines, high integration); global *area*/geographic division (locally responsive businesses); *functional*; *matrix* (product × geography); and network/*transnational* forms. The choice is driven by variables such as: product *diversity* (favours product divisions), degree of required *local responsiveness* vs *global integration* (area vs product), *size* and geographic spread, the importance of *knowledge sharing* across units, and the firm's *strategy and history*. Structure should follow strategy: the more a firm needs both global efficiency and local fit, the more it drifts toward matrix/transnational forms — at the cost of complexity and dual reporting.

9. **Ghemawat's AAA.** Explain Adaptation, Aggregation and Arbitrage. Why can a firm rarely maximise all three at once?

Answer. Adaptation = adjust to local differences to boost revenue (localise the offer); Aggregation = group countries to gain scale/scope (standardise across regions); Arbitrage = exploit differences (produce where cheap, sell where dear). They pull in opposite directions: adaptation multiplies variety and cost; aggregation demands standardisation; arbitrage locates activities by cost, not by market. Pursuing all three simultaneously overwhelms the organisation, so most firms *prioritise* one or two and design structure around them (e.g. aggregation via regional hubs plus targeted adaptation). The framework forces an explicit choice about *how* a firm creates cross-border value.

10. **Product differentiation and monopolistic competition.** How does differentiation let firms escape price competition, and when can differentiation actually destroy value?

    Answer. Under monopolistic competition many firms sell differentiated substitutes, so each has some pricing power (a downward-sloping demand curve) and earns a margin over marginal cost — differentiation softens rivalry and supports profit. But differentiation destroys value when it is *unwanted* (features customers won't pay for), when it fragments scale and raises unit cost above the premium earned, or when it is easily imitated so the premium evaporates while the cost remains. Useful differentiation must be valued by customers, hard to copy, and worth more than it costs — otherwise it is just complexity.

Part 3. Analytical questions (5)

Structured, exam-style problems; some have several parts. Full model answers follow.

1. **HHI computation and a merger.** An industry has four firms with shares 40, 30, 20, 10. (i) Compute the HHI. (ii) The two largest merge; compute the new HHI and the change. (iii) State the shortcut for the change and what a competition authority would infer.

   Answer. (i) HHI $= 40^2 + 30^2 + 20^2 + 10^2 = 1600 + 900 + 400 + 100 =$ **3000**. (ii) After the merger the top firm has 70: HHI $= 70^2 + 20^2 + 10^2 = 4900 + 400 + 100 =$ **5400**; the change is $5400 - 3000 = +$**2400**. (iii) Shortcut: a merger of two firms with shares s_1, s_2 raises the HHI by exactly $2s_1s_2 = 2 \times 40 \times 30 = 2400$ — the identity used in real merger review. Inference: an index above 2500 with a change over 200 is presumptively concentrated and would trigger close scrutiny; but the authority would first check the *market definition* (see Q4) and the threat of entry before concluding.

2. **Five forces on a fabless designer.** Assess the five forces facing a leading-edge fabless chip *designer* (e.g. a GPU firm), rating each and giving the overall verdict.

   Answer. *Rivalry*: few credible leading-edge designers, differentiated by architecture and software — *low-to-moderate*. *Buyer power*: large cloud buyers concentrate purchases and can design in-house — *moderate-to-high*, the main threat. *Supplier power*: acute — one cutting-edge foundry (TSMC) and one EUV toolmaker (ASML) sit upstream, so the designer depends on scarce capacity — *high*. *Threat of entry*: enormous capital, IP and software-ecosystem barriers — *low*. *Substitutes*: general-purpose CPUs or rival accelerators for some workloads — *moderate*. Overall: attractive today because entry is nearly blocked and rivalry is thin, but profit is squeezed between powerful *suppliers* upstream and increasingly powerful *buyers* downstream — the classic vulnerability of a strong firm in the middle of a chain.

3. **Five variables and choosing a structure.** An MNE with several distinct product lines, selling worldwide, needs to reorganise. (i) Identify five variables it should examine when choosing an organizational structure and describe three of them. (ii) Recommend a structure and justify it.

Answer. (i) Five variables: (a) *product diversity/relatedness*; (b) required *local responsiveness vs global integration*; (c) firm *size and geographic scope*; (d) importance of *cross-unit knowledge transfer*; (e) *strategy, control needs and administrative heritage*. Describing three: *product diversity* — many unrelated lines make a single global structure unwieldy and favour product divisions each running its own worldwide business; *integration vs responsiveness* — if scale and a standard offer dominate, organise by product; if national adaptation dominates, organise by geography; *knowledge transfer* — if success depends on sharing technology and best practice across units, a pure divisional silo underperforms a matrix or network. (ii) With *several distinct product lines* sold globally where scale matters, a **global product-division** structure is the natural fit (each division owns its worldwide product strategy and reaps scale); if strong local adaptation is *also* required, move toward a **matrix** (product × region) — accepting dual reporting and complexity as the price of getting both efficiency and responsiveness.

4. **Market definition and the SSNIP test (with a calculation).** A competition authority must decide whether "premium coffee pods" is a relevant market. (i) State the hypothetical-monopolist (SSNIP) test. (ii) With a 5% price rise and a gross margin of 40%, compute the *critical loss*. (iii) If the firm predicts it would actually lose 8% of sales, is the candidate a market?

   Answer. (i) SSNIP: ask whether a hypothetical monopolist over the candidate products could profitably impose a Small but Significant Non-transitory Increase in Price (typically 5–10%). If yes, the set is a relevant market; if too many buyers switch out, the market is wider. (ii) The *critical loss* — the sales loss at which the price rise just breaks even — is $L^* = \dfrac{t}{t+m} = \dfrac{5}{5+40} = \dfrac{5}{45} = \mathbf{11.1\%}$. (iii) The predicted *actual* loss (8%) is *less* than the critical loss (11.1%), so the 5% rise is profitable — the hypothetical monopolist would raise price, so "premium coffee pods" **is** a relevant antitrust market. Intuition: high margins make a firm reluctant to lose sales, so the critical loss is small and markets tend to be defined narrowly; this feeds directly into the HHI/merger analysis in Q1.

5. **Integration–responsiveness placement.** Place these four businesses on the I–R grid and name the appropriate strategy/structure for each: (a) commercial aircraft; (b) packaged breakfast foods; (c) mobile handsets; (d) cement. Justify each.

   Answer.

Business	Grid position	Strategy / structure
Commercial aircraft	high integration, low responsiveness	Global (product division)
Packaged breakfast foods	low integration, high responsiveness	Multidomestic (area division)
Mobile handsets	high integration, high responsiveness	Transnational (matrix/network)
Cement	low integration, low responsiveness	International/local (weight limits trade)

   Justification: *aircraft* demand global scale and a standard product, so integrate and organise by product; *breakfast foods* turn on national taste and regulation, so adapt and organise by geography; *handsets* need global scale in components/platform *and* local adaptation (language, carriers, regulation), the defining transnational tension; *cement* is too heavy to ship far and needs little adaptation, so it is run as many local businesses. The grid converts external pressures into an organisational recommendation.

Part 4. Case studies

Case A — LVMH: organising luxury for the world

LVMH (Moët Hennessy Louis Vuitton) is the world's largest luxury group, a portfolio of **75+ "Maisons"** spanning wines & spirits, fashion & leather goods, perfumes & cosmetics, watches & jewellery, and selective retailing (Sephora, DFS). Each Maison keeps a strong, protected **creative identity** and autonomy over product and brand, while the group **centralises** finance, real estate, media buying, talent and, crucially, capital allocation — funding new Maisons, acquiring brands, and cross-subsidising young houses with the cash of mature ones. The luxury strategy is **differentiation and controlled scarcity**: premium pricing, selective distribution, heritage and heavy brand investment. The group is global but manages strong local demand differences (Asia has been the growth engine) and defends brand equity market by market.

Questions.

1. Describe LVMH's structure in the lecture's language. Global product, global area, matrix, or transnational network? Justify.

   Answer. Closest to a **matrix/transnational network**: autonomous product houses (Maisons ≈ product divisions) crossed with strong central functions and regional market management. It combines global integration (shared finance, real estate, capital allocation, media scale) with high local responsiveness (brand identity, market defence) — the transnational aspiration, achieved by keeping creative units autonomous while centralising the functions where scale pays.

2. Which **generic strategy** does LVMH pursue, and how does controlled scarcity relate to pricing power and the five forces?

   Answer. Differentiation with a focus tilt (premium segment). Controlled scarcity and heritage raise willingness to pay and blunt rivalry and substitutes, giving pricing power; selective distribution limits buyer power and protects brand equity; high brand/craftsmanship barriers deter entry. The strategy manufactures the differentiation that softens four of the five forces.

3. Apply the **diversification-discount** debate to LVMH. One reason the conglomerate *adds* value; one reason it might *destroy* value.

   Answer. Adds value: a working internal capital market — mature houses fund young Maisons and acquisitions, plus shared scale in real estate, media and talent a standalone brand could not achieve. Destroys value: agency and cross-subsidy risk — weak houses propped up, empire-building deals, and investor difficulty valuing a complex portfolio (the classic discount channel). Net effect is empirical, hinging on whether central capital allocation beats the market.

Case B — The global beer industry: decline and consolidation at once

Global beer volumes have been flat-to-declining since around 2010, yet the industry produced one of the largest deals in consumer history: **AB InBev's $100bn+ acquisition of SABMiller**. Growth is regional — Latin America (roughly a sixth of the world market) expanded while North America stalled — and prices vary enormously (well under $2 a beer in some markets, $11+ in others), with the cheapest markets often growing fastest. Regulators forced divestitures as a condition of the merger (for example, SABMiller's US MillerCoors stake and some overseas holdings). A 2018 twist: US aluminium tariffs raised can costs even though about 98% of cans were produced domestically — because the *aluminium input* to those cans was imported.

Questions.

1. The AB InBev–SABMiller merger sharply raised concentration. Explain why regulators forced divestitures using the **change** in the HHI, not just its level — and why the relevant market is often national.

   Answer. A merger of two shares a, b raises the HHI by about $2ab$; even if the *global* level looks moderate, the increase within specific national markets can be large, breaching thresholds and triggering divestitures (e.g. the US MillerCoors stake sold). Competition happens in the market consumers actually substitute within — usually national/local (the SSNIP point) — so it is the ΔHHI in that relevant market that matters.

2. Growth is regional and cheap markets grow fastest. Where does the merged firm's value lie, and which of Ghemawat's **AAA** strategies dominates the deal logic?

Answer. Value lies in emerging, low-price, high-growth regions where volume expands. The deal rationale is mainly **aggregation** (global scale in brands, procurement, distribution) plus **arbitrage** (shifting brands and production toward growth markets); adaptation matters for local brands and tastes but is secondary. Buy scale, then reposition toward growth geographies.

3. The 2018 aluminium-tariff twist raised can costs despite domestic can production. Use the GVC/input logic to explain, and say what it shows about supplier power and trade policy in the five forces.

Answer. Cans were domestic, but their aluminium input was imported, so a tariff two steps upstream raised packaging costs down the chain. It shows the "supplier power" force is shaped by trade policy on *upstream inputs*, not only by direct suppliers: a policy aimed at metal imports raised brewers' costs. GVCs transmit policy shocks across borders even when final assembly is local.

Note. Case adapted from Collinson, Narula, Qamar & Rugman, *International Business*, 9th ed. (Pearson, 2024) and the instructor's seminar handouts; items follow the Warwick Summer School written-exam format. Answer key — set `\answersfalse` for the student sheet.