

Impact of the Analysis of the Microenvironment: an example of distillery in the Czech Republic

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Abstract

This paper deals with an analysis of the industry and competitors and with their importance in determining a competitive position of a company. For the analysis of the industry, its basic characteristics, structure, and life cycle are important factors. The paper presents the basic characteristics of the industry which are important for the production of fruit spirits. This paper includes the Porter's five forces analysis of the industry. The conclusion provides formulation of key factors for achieving success.

Keywords: key success factors, industry analysis, micro-environment.

1. Introduction

1.1 Introduction to the Analysis of the Industry

An industry is represented by a set of companies that manufacture products with the same economic purpose. In their production, companies use same kinds of raw materials and similar technological processes (Dvořáček, 2003).

When analysing an industry, its basic characteristics, structure, and life cycle are primarily examined. The basic characteristics include the total market size, number and strength of competitors, industry development, entry and exit barriers, capital requirements, number and bargaining power of customers, etc. (Bowman, 1996; Sedláčková and Buchta, 2006).

When evaluating an industry structure, it is mainly the number and strength of individual businesses in that industry that are examined. If there is a large number of businesses with a relatively small strength in the industry, the industry is termed atomized. If there is small number of companies with great possibilities to influence events in the industry, we speak of a consolidated industry. In the case of a consolidated industry, a monopoly may occur, which means that there is only one business in the industry. Alternatively, we can speak of an oligopoly, i.e. there is one dominant business in the industry. The significance of the industry structure is elaborated, for instance, by McGahan (2003). Her research is focused on how the industry structure affects profitability of businesses and return on investment. The conclusion is that industries developed according to four characteristic trajectories – radical, progressive, creative, and intermedia. These trajectories of changes are given by two types of obsolescence risk. The first concerns key activities in the industry, i.e. those activities that have historically contributed most to its profitability. The second risk concerns key assets in the field, i.e. resources, know-how, trademarks, etc. that made a business unique. McGahan also offers recommendations on how to face these risks.

The industry life cycle includes the following stages: birth, growth, maturity, and decline. Each of these stages has its own specifics for strategy formulation. In the stage of birth, businesses usually compete with each other for market share and subsidize their products from other activities. In the growth stage, the essential positions on the market are usually already defined. Despite this, businesses continue competing for consolidation of their position. In the stage of maturity, the industry no longer grows and ceases to be attractive for potential competitors. Businesses no longer need to invest in strengthening their positions, and cash flows coming from their products are used for developing other activities. In the stage of decline, businesses usually leave their positions (Horáková, 2003; Kotler et al., 2013).

1.2 Key Success Factors

Key factors are the factors that most influence the well-being of businesses in the industry. These factors include, for instance, particular characteristics of products and services, unique resources and capabilities, and distribution channels. As for technology, these may be innovation and achieving peak performance. In production, key factors may be the ability to achieve low cost, flexibility to respond to orders, etc. In terms of sales, it may be important and effective advertising, building customers' awareness. It always depends on a particular business and industry. A company thus have to possess key success factors if it is to achieve financial success (Thompson and Strickland, 1998).

In the analysis of key success factors, we can formulate four basic phases. First, identification of the key factors for a given business. Second, identification of the resources and capabilities to build competitive advantages. Third, formulation of standards for each key success factor in order to surpass the competition. Fourth, estimation of the degree of imitation by competitors (Johnson et al., 2008). Another prerequisite for achieving success in an industry is the needs and desires of customers and a thorough study of competition (Grant, 2010).

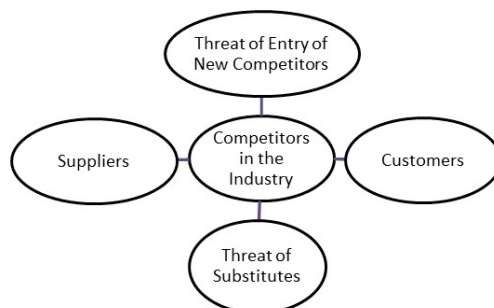
1.3 Analysis of Competition

For determination of a successful business strategy, an analysis of competition is of paramount importance. In the analysis, businesses should mostly focus on the following points:

- Analysis of current and potential competitors. Businesses have to analyse to what extent their objectives, vision, products, and other significant characteristics are similar.
- Costs and costs structure of competitors. Business at risk are mainly those with costs above the level of costs achieved by competition. At this point, it is necessary to see what caused the difference in costs. The cause may be different prices of raw materials and materials, technologies, advertising costs, etc.
- Predictions of reactions of competitors on particular business activities. For successful prediction of reactions of competitors, it is necessary to continuously gather information about competitors and evaluate their ongoing activities.
- Analysis of competitors' portfolio, culture, etc. (Porter, 2004, Johnson et al., 2008).

For analysis of the competitive environment, Porter (2004a, 2004b) formulated his well-known and much used tool called Porter's Five Forces model (see Fig. 1). This model evaluates the competitive environment in the industry using five individual forces: the bargaining power of suppliers, the bargaining power of customers, the threat of entry of new competitors, the threat of substitutes, and existing competitors in the industry.

Figure 1 Porter's Five Forces Model



Source: Porter, 2004a

Literature offers different views on competition. Sometimes, competition is not considered an enemy, but is rather looked upon as a rivalry among several players, competing for the distribution of economic effect

(Hammel, in Gibson, 2000). In contrast, there are also opinions which speak of formation of a fierce competition environment and creation of the so-called super competition (Souček, 2005).

2. Analysis of Microenvironment

2.1 Industry analysis

The product of micro distilleries is fruit spirit. Thus, the relevant industry is the market with alcoholic beverages. Table 1 shows the total alcohol consumption during the last 5 years in the Czech Republic per one person.

Table 1 Alcohol consumption in the Czech Republic (litres per one person)

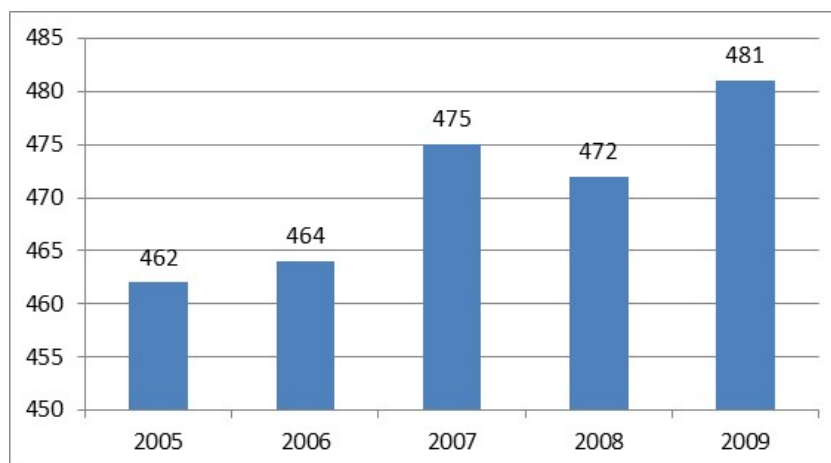
Beverage Type	Totally/ pure alcohol	2006	2007	2008	2009	2010
Alcoholic drinks	Totally	184,3	185,8	183,2	177,6	170,9
	Pure alcohol	10,2	10,4	10,4	10,4	9,8
Spirits with ABV 40%	Totally	8,0	8,2	8,1	8,2	7,0
	Pure alcohol	3,2	3,3	3,2	3,3	2,8
Wine	Totally	17,2	18,5	18,5	18,7	19,4
	Pure alcohol	2,0	2,1	2,1	2,1	2,2
Beer	Totally	159,1	159,1	156,6	150,7	144,4
	Pure alcohol	5,0	5,0	5,2	5,0	4,8

Source: Czech Statistical Office

Between 2006 and 2010, the overall alcohol consumption dropped by 13.4 litres of alcohol per person per year; converted to litres of pure alcohol, the consumption has dropped by 0.4 litres per person per year. In spirits with ABV 40%, the total decline was by 1 litre per person per year; converted to litres of pure alcohol, the consumption has dropped by 0.4 litres per person per year. Wine consumption in the years has increased slightly. Beer consumption – expressed in the total consumption – has decreased by approx. 15 litres per person, however, converted to pure alcohol, the consumption fell only by 0.2 litres. Thus, the greatest decline in consumption was recorded in 40% ABV spirits.

Figure 1 shows the development of the number of payers of alcohol tax among micro distilleries.

Figure 1 Number of payers of alcohol tax among micro distilleries



Source: Ministry of Finance of the Czech Republic, the Customs Administration

The data is obtained from the statistics of the Customs Administration of the Czech Republic. The number of these tax payers is different from the number of permits granted for micro distilleries. According to the Ministry of Agriculture of the Czech Republic, the number of the permits granted is about 650. The difference in these numbers is given by the fact that there can be multiple persons with permits in one micro distillery. This mostly concerns "family micro distilleries." The Customs Administration data, however, includes only years up to 2009. Figure 1 clearly show that the number of micro distilleries has in recent years stabilized at about 470 to 490 units.

Table 2 shows an estimation of the total production of alcohol in micro distilleries.

Table 2 Estimation of the total production of alcohol in micro distilleries

Year	2006	2007	2008	2009
Pure alcohol in litres	2 207 960	4 300 214	2 562 293	3 732 932
Pure alcohol in litres per one micro distillery	4 759	9 053	5 429	7 761

Source: Author

The data by the Customs Administration regarding the alcohol tax imposed on micro distilleries and relevant rates of alcohol tax were used for calculation of the estimated production of pure alcohol in each year. Further, calculation of the average production per one micro distillery was carried out.

From the data in the table, we can see a slightly rising trend in alcohol production in micro distilleries, both overall and per one micro distillery. The data also clearly reveals fluctuations in production in each year. This can be explained by unfavourable natural conditions for fruit crop. Also, the reason may be the fact that micro distilleries process fruit grown on private small gardens, which are usually typical with their extensive planting. These areas are characterized by the fact that fruit trees tend to have a good crop one year, while they "rest" during the second year, which accounts for the smaller crop.

2.2 Porter's Five Forces Model

Threat of Entry of New Competitors

The threat of entry of new competitors into the industry is relatively high, because the barriers to entry can be assessed as rather low. The total initial investment into establishing a microdistillery, using a smaller capacity and adjusting an existing building, can be below CZK 2 million. Compliance with legislative requirements may present a barrier, however, they are achievable. Technologies for distillation are commercially available from several manufacturers and their acquisition is not a problem.

Threat of Substitutes

A substitute for fruit spirits produced in micro distilleries is mostly alcoholic beverages, which can be bought through the ordinary consumer network. The consumption of spirits has slightly decreased in recent years. The biggest threat of potential substitutes for fruit spirits is probably wine, the consumption of which is very stable. It can be assumed that in connection with the trend of the increased emphasis on a healthy lifestyle, consumers may switch from spirits to wine or other drinks with a lower alcohol content. Also, as for volume, these beverages are much cheaper due to the excise tax and value added tax. The advantage of spirits produced in micro distilleries is its image of a very high quality product.

Soft drinks are not considered substitutes for fruit spirits.

Bargaining Power of Customers

A micro distillery is entirely dependent on the growers who have their fruit processed in it. The bargaining power of individual growers is very small. The prices for distillation by micro distilleries are fixed and their

amount cannot be negotiated. Revenues from a single grower – due to the legal limit of 30 litres of pure alcohol per household and year – represent a small proportion of the total sales of a micro distillery. Therefore, the bargaining power of individual growers / customers is negligible. However, negative references by a few customers on a specific micro distillery could have a very negative impact.

Bargaining Power of Suppliers

The bargaining power of suppliers is rather small. There are only a few suppliers of distillation technologies on the market. It can be said that technologies are mutually substitutable. Very often, businesses renovate and repair their distillation equipment supplied by competitors.

Rivalry among Competitors

Rivalry among competitors is significantly affected by the distance between individual businesses. If individual micro distilleries are located far enough from each other, there is no threat they would significantly compete with each other. Most growers would be willing to deliver fruit or ferment only within a certain distance. However, if more micro distilleries are located relatively close to each other, they will directly compete for potential customers. In that case, rivalry among them would be significant.

3. Conclusion - Key Success Factors

Based on the analyses and previous study of literature, it is possible to formulate the key success factors. The main success factor is provision of a high-quality service that will result in a soft and aromatic distillate. In order to secure this factor, it is necessary to possess high-quality technological equipment, adequate technical knowledge, and practical experience of the micro distillery staff, who also must be helpful in communication with customers and willing to show them the distillate production process and answer all questions. The second key success factor is the choice of a suitable location. Micro distilleries provide a relatively homogeneous service, therefore businesses located close to each other compete quite strongly.

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