

**A STRATEGIC ANALYSIS OF A NORTH AMERICAN ONLINE PLUMBING  
RETAILER**

by

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## **Abstract**

This project assesses the current business environment faced by OPR Inc., a leading internet retailer of decorative plumbing products, based in suburban Boston, Massachusetts. An internal analysis of the company is conducted followed by an external analysis of the online plumbing retail strategic group. It is determined that no industry participant holds a sustainable competitive advantage over its rivals and that entry into the industry is likely due to the presence of economic profits. It is established that OPR should exit the online plumbing retail industry and several strategic alternatives are considered to that end. Finally, it is recommended that the owner of OPR Inc. sell the company to a possible industry entrant.

*~ To Dad, Mom and Karim ~*

*Thank you for the love and inspiration.*

## **Acknowledgements**

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# Table of Contents

Approval.....	ii
Abstract .....	iii
Dedication .....	iv
Acknowledgements .....	v
Table of Contents .....	vi
List of Figures .....	viii
<b>1: Introduction.....</b>	<b>1</b>
1.1 Project Scope.....	1
1.2 OPR Inc.....	1
1.2.1 Ownership and Control .....	1
1.2.2 Corporate Level Strategies .....	2
1.2.3 Decorative Plumbing Products Supply Chain .....	2
1.2.4 Products and Customers .....	4
<b>2: The Online Plumbing Retail Strategic Group.....</b>	<b>6</b>
2.1 Industry Definition .....	6
2.2 Industry Overview.....	8
2.2.1 Industry Growth and Life Cycle.....	8
2.2.2 Industry Structure.....	8
2.3 Five Forces Analysis .....	9
2.3.1 Threat of Substitution (Low and Stable).....	9
2.3.2 Bargaining Power of Buyers (Very Low and Stable).....	10
2.3.3 Bargaining Power of Suppliers (Low and Stable).....	11
2.3.4 Threat of New Entrants (High and Stable).....	11
2.3.5 Industry Rivalry (Moderate and Stable).....	14
2.3.6 Industry Attractiveness.....	15
<b>3: Competitive Advantage at OPR Inc. ....</b>	<b>16</b>
3.1 Value Chain Analysis.....	16
3.1.1 Primary Activities .....	16
3.1.2 Secondary Activities .....	21
3.1.3 Leadership as Source of Competitive Advantage .....	23
3.1.4 Sustainability of Competitive Advantage.....	24
<b>4: Situational Assessment and Prognosis .....</b>	<b>25</b>
4.1 Current External Environment .....	25
4.2 Most Likely Future External Environment .....	25
4.3 OPR’s Current Position.....	26
4.4 OPR’s Most Likely Future Position .....	26

4.5	Best Course of Action for OPR.....	28
<b>5:</b>	<b>OPR Exit Strategy Solution Analysis .....</b>	<b>29</b>
5.1	Evaluation Criteria .....	29
5.2	Strategic Alternatives .....	29
5.2.1	Maintain the Status Quo.....	29
5.2.2	Sell OPR to an Integrated Wholesaler/Retailer .....	29
5.2.3	Sell OPR to a Rival Online Plumbing Retailer .....	30
5.2.4	Liquidate OPR.....	30
5.3	Possible Scenarios .....	30
5.3.1	Integrated Wholesalers/Retailers Enter the Industry through Acquisition.....	30
5.3.2	Integrated Wholesalers/Retailers Enter the Industry through Greenfield Investment .....	31
5.3.3	Large-Scale Wholesalers do not Enter the Industry .....	31
5.4	Analysis of Strategic Alternatives and Scenarios.....	31
5.4.1	Evaluation Matrix.....	31
5.4.2	Integrated Wholesalers/Retailers Enter the Industry through Acquisition.....	32
5.4.3	Integrated Wholesalers/Retailers Enter the Industry through Greenfield Investment .....	34
5.4.4	Integrated Wholesalers/Retailers do not enter the Industry at All .....	36
5.5	Cross-Scenario Evaluation of Strategic Alternatives .....	37
<b>6:</b>	<b>Recommendations and Conclusion.....</b>	<b>39</b>
<b>7:</b>	<b>Works Cited.....</b>	<b>40</b>

## List of Figures

Figure 1: Supply Chain for Mainstream Products .....	3
Figure 2: Supply Chain for Specialty Products .....	4
Figure 3: Product-Customer Matrix for OPR .....	5
Figure 4: Product-Customer Matrix with Strategic Positioning for Decorative Plumbing Retail .....	7
Figure 5: Michael Porter's Five Forces Model .....	9
Figure 6: Fixed Cost Barrier to Entry .....	13
Figure 7: Pressure from Online Retailers on Suppliers to Bear Costs of Returns .....	20
Figure 8: Value Chain for OPR .....	23
Figure 9: Performance Matrix for OPR .....	27
Figure 10: Evaluation Matrix for OPR Industry Exit .....	32
Figure 11: OPR's Evaluation Matrix with I-W/R Entry through Acquisition .....	32
Figure 12: OPR's Evaluation Matrix with I-W/R Entry through Greenfield Investment .....	35
Figure 13: OPR's Evaluation Matrix with no I-W/R Entry at All .....	36
Figure 14: OPR's Cross-Scenario Evaluation Matrix .....	38



# **1: Introduction**

## **1.1 Project Scope**

OPR Inc.<sup>1</sup> is an online retailer of plumbing products based in suburban Boston, Massachusetts. The company was founded in 1993 and demonstrated rapid growth as the internet gained widespread acceptance and consumers became comfortable with the idea of shopping online. In 2011, online retail is commonplace and OPR is established as a member of the small group of companies which dominate online plumbing retail in the United States and Canada. The company has grown organically since inception and ownership now desires a more formal understanding of OPR's ability to generate economic profits today and in the future.

This paper shall serve as a tool for ownership of OPR to understand the strategic environment in which they operate and to assist them in the process of strategic decision-making for the future. The analysis in this paper begins with an examination of the online plumbing retail industry as a whole. This analysis is followed by an internal review of OPR as a company and a report on its existing strategies. The company's expected future performance will be examined and evaluated after which several strategic alternatives will be presented. Finally, these alternatives will be analysed in order to arrive at a specific set of recommendations for OPR's owner.

## **1.2 OPR Inc.**

### **1.2.1 Ownership and Control**

OPR is a privately held company with one hundred percent ownership belonging to Robert Smith<sup>2</sup>. On a day-to-day basis, however, Robert's brother, Allan Smith, operates the company. OPR is Robert's primary personal investment and source of income. As such, he has

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<sup>1</sup> The name OPR Inc. is used in place of the subject firm's actual name at the request of that company's management.

<sup>2</sup> Because the subject firm is privately held, it is not always possible to provide hard data or references for information which the company considers confidential. In such cases, assertions are based on the author's years of experience working closely with the subject firm as general manager of the plumbing distributor, Cheviot Products Inc.

two often-competing goals for the company, profit maximization and risk minimization. Allan considers OPR a family concern, and shares these goals. No principal-agent problem exists between ownership and control at OPR.

### **1.2.2 Corporate Level Strategies**

OPR operates a single line of business: decorative plumbing products. Decorative plumbing products are finished plumbing goods with some level of aesthetic design consideration. Examples include bathtubs, sinks, and toilets. These products are distinct from rough plumbing products such as pipes and fittings, which OPR does not retail.

Geographically, OPR began business targeting the entire USA as a market. The company subsequently expanded into Canada where the presence of a key supplier and an appreciating currency made business attractive. Traditionally, plumbing retail has been executed through physical showrooms located in close proximity to consumers. Even large showroom chains rarely span more than three or four states and only one chain can claim truly national status. Compared to these brick-and-mortar stores, OPR's geographic scope is very large.

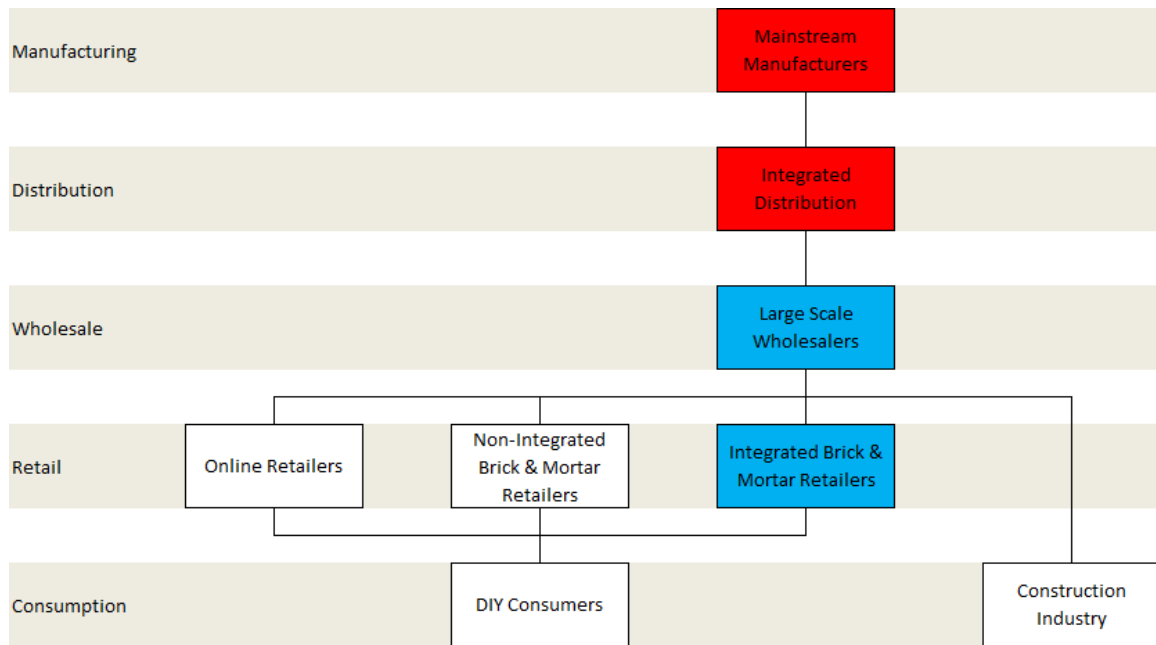
### **1.2.3 Decorative Plumbing Products Supply Chain**

There are two intertwined supply chains for decorative plumbing products, each containing five stages: manufacturing, distribution, wholesale, retail, and consumption. The first supply chain is for mainstream products. These products are manufactured by large companies with brands that are well recognized by consumers. Examples include American Standard, Kohler, and Toto. These manufacturers produce a comprehensive line of goods, covering the entire range of decorative plumbing products. In addition to their manufacturing activities, mainstream producers have forward integrated into distribution. Operating their own sales forces in the United States and Canada, these producers seek exclusive distribution agreements with large-scale plumbing wholesalers. Typically, mainstream manufacturers will select the largest wholesaler in any given territory for exclusive partnership providing the wholesaler is not already tied to a rival manufacturer.

Plumbing wholesalers service two customer groups: the construction industry and plumbing retailers. The construction industry consists of mechanical contractors purchasing plumbing products for use in new buildings and renovations. Plumbing retailers purchase products for resale to do-it-yourself (DIY) consumers who are involved in plumbing product selection, typically for renovation projects. In addition to supplying external retailers, most large-

scale plumbing wholesalers have forward integrated into retail themselves. Other retail outlets include non-integrated brick-and-mortar showrooms and online retailers such as OPR. DIY consumers may collect products directly from brick-and-mortar retailers or have products shipped to them by courier for an additional charge. Online retailers only offer courier delivery. The cost of this service is paid by the retailer and passed on to the consumer. The supply chain for mainstream plumbing products is shown below in *Figure 1*.

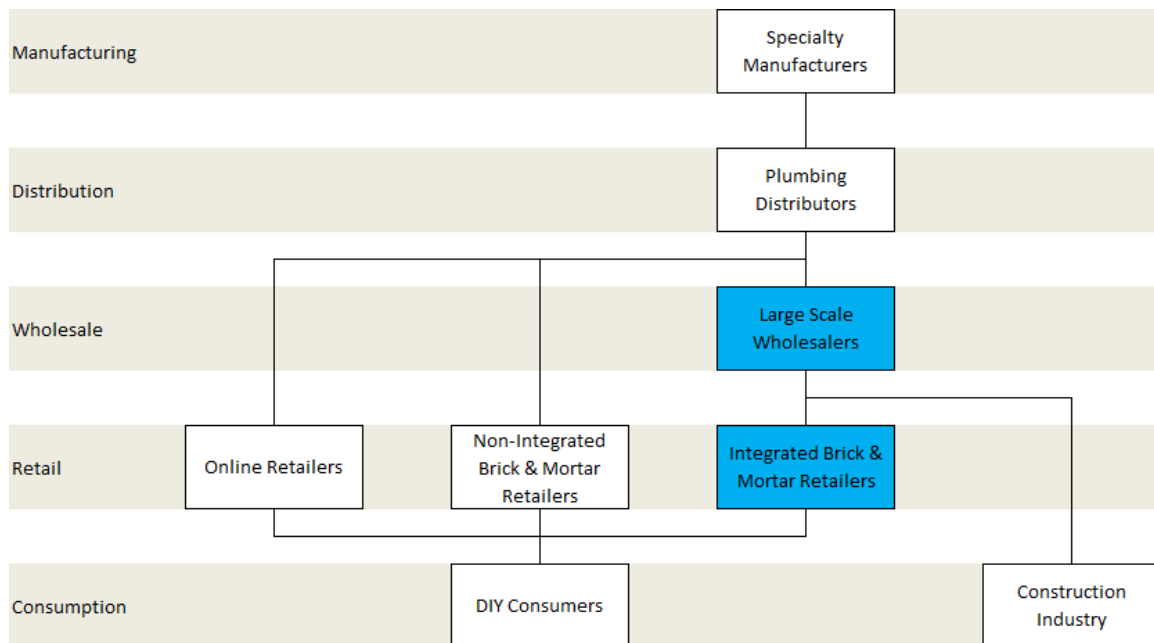
*Figure 1: Supply Chain for Mainstream Products*



Source: Author

The second supply chain for decorative plumbing products is for specialty products. Specialty manufacturers are smaller than mainstream manufacturers and lack brand recognition by consumers. These manufacturers specialize in the production of a single product line (faucets or ceramic ware for example). Because specialty manufacturers lack the scale and product range to engage in distribution internally, they sell their products to specialized plumbing distributors located throughout the world. The distributors in turn sell these products to large-scale wholesalers/integrated brick-and-mortar retailers, non-integrated brick and mortar showrooms, and online retailers within their territories. The supply chain for specialty plumbing products is shown below in *Figure 2*.

Figure 2: Supply Chain for Specialty Products



Source: Author

#### 1.2.4 Products and Customers

OPR carries a wide range of products and brands. The company retails everything from bathroom lighting fixtures to cast iron bathtubs. The company’s product range can be segmented into mainstream products and specialty products. Mainstream brands are important because they are recognized by DIY consumers and lend credibility to OPR’s website. Specialty brands, on the other hand, yield higher margins because they can be purchased directly from plumbing distributors instead of competing large-scale wholesalers. Because of this arrangement, OPR places primary importance on the sale of specialty brands and only secondary importance on the sale of mainstream brands.

Plumbing retail customers are either service-sensitive or price-sensitive. Service-sensitive customers appreciate lavish showrooms, physical interaction with products, access to trained consultants, and comprehensive after-sale support. By contrast, price-sensitive customers are willing to forego many services in exchange for lower pricing. As an online retailer, OPR does not operate a physical showroom. Personal interaction with customers is minimal and physical presentation of products is impossible. As such, it is not possible for OPR to target service-sensitive customers. However, OPR’s lack of high service levels results in low operating costs. OPR does not invest in prime real estate, extensively trained showroom consultants, or inventory.

The company is therefore able to operate at lower costs than high service retailers are. OPR's focus, then, is on price-sensitive customers. The company's product-customer matrix is illustrated below in *Figure 3* (Boardman and Vining, *Defining Your Business Using Product-Customer Matrices* 1996).

*Figure 3: Product-Customer Matrix for OPR*

		Customers	
		Price Sensitive	Service Sensitive
Products	Mainstream Brands	Secondary Offering	No Offering
	Specialty Brands	Primary Offering	No Offering

Source: Author

## **2: The Online Plumbing Retail Strategic Group**

### **2.1 Industry Definition**

There are three distinct groups of decorative plumbing product retailers: integrated brick-and-mortar retailers, non-integrated brick-and-mortar retailers, and internet retailers. In exchange for exclusive distribution rights, mainstream manufacturers require integrated brick-and-mortar retailers to maintain minimum sales quotas. A rebate incentive is also in place to motivate these retailers to achieve high target sales volumes. Integrated brick-and-mortar retailers sell specialty products only as a last resort when mainstream products are not available or not applicable.

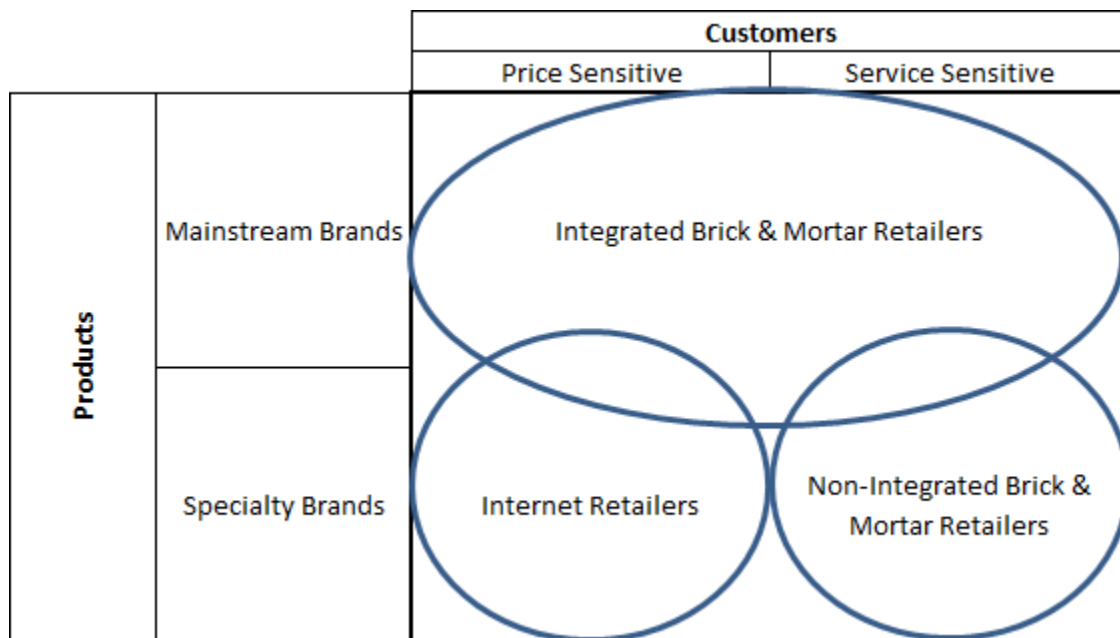
Through their showrooms, integrated brick-and-mortar retailers provide a high level of pre- and post-sale customer service. Because of their exclusive agreements with mainstream manufacturers, they also enjoy a cost advantage for those products over other retail channels. Consequently, integrated brick-and-mortar retailers are able to focus their efforts on the sale of mainstream branded products to both service and price-sensitive DIY consumers.

Non-integrated brick-and-mortar retailers must purchase mainstream branded products from large-scale wholesalers with whom they compete in retailing. This puts non-integrated brick-and-mortar retailers at a cost disadvantage for mainstream products versus integrated brick-and-mortar retailers. Specialty products, however, are available to non-integrated brick-and-mortar retailers directly from plumbing distributors for the same prices that are paid by integrated brick-and-mortar retailers. Non-integrated brick-and-mortar retailers therefore focus on the sale of specialty products.

Like integrated brick-and-mortar retailers, non-integrated brick-and-mortar retailers provide a high level of pre- and post-sale customer service through their showrooms. Unlike integrated brick-and-mortar retailers, however, they do not enjoy a cost advantage in their preferred product category. Because they must invest heavily in showrooms, staff, and inventory, non-integrated brick-and-mortar retailers are not able to service price-sensitive customers. Instead, they focus their attention on the sale of specialty products to service-sensitive DIY consumers.

Like non-integrated brick-and-mortar retailers, internet retailers are at a price disadvantage for mainstream products versus integrated brick-and-mortar retailers. Unlike non-integrated brick-and-mortar retailers, however, internet retailers are not able to offer a high level of service. Instead, these retailers focus on a relatively low cost business model to maintain lower prices than non-integrated brick-and-mortar retailers can achieve. Consequently, internet retailers focus on the sale of specialty products to price-sensitive DIY consumers. A product-customer matrix showing strategic positioning in the decorative plumbing retail is presented below in *Figure 4* (Boardman and Vining, *Defining Your Business Using Product-Customer Matrices* 1996).

*Figure 4: Product-Customer Matrix with Strategic Positioning for Decorative Plumbing Retail*



Source: Author

For the purpose of this analysis, the industry is defined as the internet retail strategic group. This group is illustrated in *Figure 4* as the circle containing ‘Internet Retailers’. It is appropriate to consider this strategic group when conducting an industry analysis because internet retailers share many characteristics and strategies which are unique to that channel (Daems and Thomas 1994). In addition to sharing positioning strategy, all internet retailers are geographically unbounded because they occupy virtual rather than physical space; they advertise in the same places; keep track of the same performance indicators; and employ sophisticated algorithms to

monitor each other's pricing. Differing entry barriers, necessary skill sets, and recruitment policies also make the strategic group the most useful industry definition.

## **2.2 Industry Overview**

### **2.2.1 Industry Growth and Life Cycle**

The online plumbing retail industry is in the growth stage of its life cycle. Conversations with management at the largest five online plumbing retailers reveal that sales are increasing as consumers become comfortable with the prospect of shopping online. Profits have turned positive some time ago and are also increasing rapidly. Innovation continues but only as incremental improvements over existing internet retail technologies. A focus on specialty products has been established with innovation designed to drive down cost and increase customers' willingness to pay. Best practices have been established and are implemented in uniform fashion across the industry. Industry concentration is high with five major competitors accounting for the vast majority of sales and using sunk cost investments in marketing and technology to create scale related barriers to entry<sup>3</sup>. Nonetheless, the online plumbing retail industry remains in an early stage of development.

The decorative plumbing retail industry as a whole is well entrenched in the maturity stage of its life cycle. Some manufacturers and large-scale wholesalers have been in continuous operation for over a century. Furthermore, plumbing products themselves have a very specific use. It is therefore impossible to find new markets for them. Because of this situation, increased sales in the online plumbing retail industry are coming at the expense of sales in the other two plumbing retail industries. Overall demand for plumbing fixtures in the United States is expected to grow 2.6% annually to \$5.9 billion by 2013. These gains will be driven by rising consumer demand for upscale products such as jetted bathtubs, hot tubs, and spas, and increasing interest in homes with multiple bathrooms (Plumbing Fixtures & Fittings 2009).

### **2.2.2 Industry Structure**

Given the online plumbing retail industry's early stage of development, it is difficult to categorize its structure. The closest fit is an oligopoly with a competitive fringe. The largest five

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<sup>3</sup> The online plumbing retail industry is dominated by privately held companies. As such, there is no literature available to determine the exact industry concentration level. However, conversations with several industry managers suggest that the largest five online plumbing retailers account for greater than 80% of industry sales.

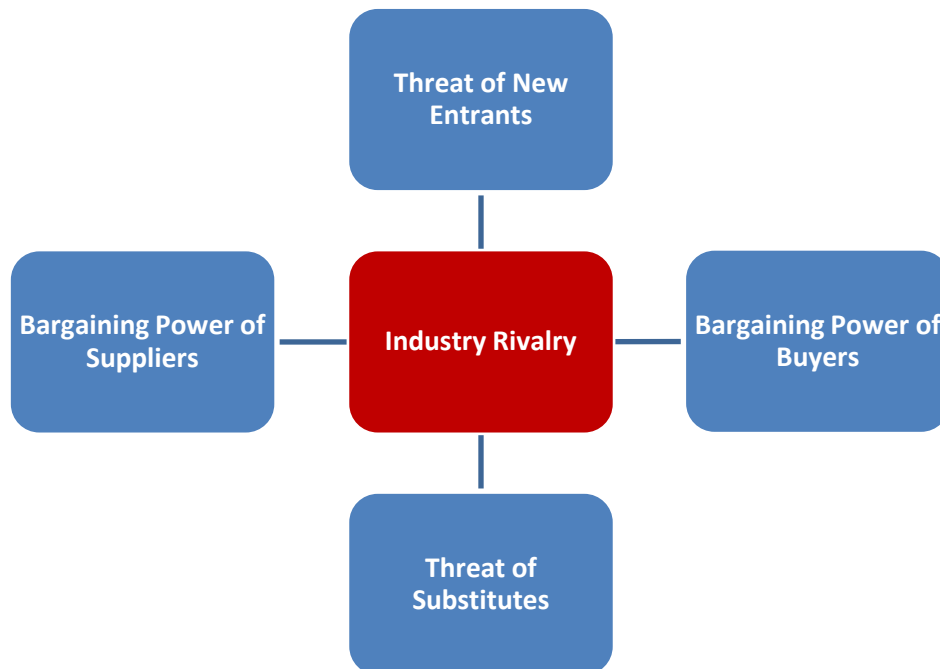


online plumbing retailers account for the vast majority of industry sales. Their dominant positions are protected by heavy investments in marketing and process automation technology which create scale related barriers to entry into the industry. Each now earns sufficient revenue to draw the attention of even the largest integrated retailers.

## 2.3 Five Forces Analysis

Michael Porter's Five Forces framework is designed to assess the attractiveness of an industry based on the threats to economic profits from various stakeholders (Porter, *Competitive Strategy: Techniques for Analysing Industries and Competitors* 1980). It serves to answer the fundamental question of what determines industry profitability. The model is presented below in *Figure 5*.

*Figure 5: Michael Porter's Five Forces Model*



Source: Michael Porter: *Competitive Strategy: Techniques for Analysing Industries and Competitors* (1980)

### 2.3.1 Threat of Substitution (Low and Stable)

Substitutes to the online plumbing retail industry are the integrated brick-and-mortar retail industry and the non-integrated brick-and-mortar retail industry. Both of these industries

operate on a national scale and are capable of providing the exact same plumbing products as the online plumbing retail industry. Though each industry focuses on different products and customers, substitution is still possible.

The online plumbing retail industry must purchase mainstream branded products from large-scale wholesalers. As a result, it is not able to undercut integrated brick-and-mortar retailers in the sale of these products. Furthermore, because the industry is positioned towards price-sensitive customers, it faces a high threat of substitution for these products.

The online plumbing retail industry is able to purchase specialty products directly from plumbing distributors for approximately the same prices as the two substitute industries do. Furthermore, because internet retailers employ a lower cost business model than brick-and-mortar retailers, they are able to undercut the substitute industries in the sale of specialty products. As such, the online plumbing retail industry is exposed to a low degree of substitution risk for these products. Because the online plumbing retail industry is primarily focused on the sale of specialty products, the threat of substitution within the industry as a whole is low.

### **2.3.2 Bargaining Power of Buyers (Very Low and Stable)**

Buyers to the online plumbing retail industry are DIY consumers. More specifically, they are price-sensitive DIY consumers. This distinction is made to differentiate them from service-sensitive consumers who patronize the substitute retail industries.

DIY consumers rarely establish themselves as repeat customers. Unlike consumers in the construction industry, this customer group will only engage in a very limited number of plumbing related renovations over the course of a lifetime. As a result, the online plumbing retail industry generates revenue through many customers making small purchases rather than few customers making large purchases. Because individual customers' purchases represent only a miniscule portion of industry revenues, and because DIY consumers lack the ability to operate in a coordinated fashion, buyer power in the online plumbing retail industry is virtually zero.

Because DIY consumers are not plumbing professionals, they are uneducated about plumbing products and the plumbing industry. A primary source of information for this customer group is the internet. Not surprisingly, the richest sources of information available are the websites of the online plumbing retailers themselves. This high degree of control over the information which is available to customers further reduces buyer power in the online plumbing retail industry.

### **2.3.3 Bargaining Power of Suppliers (Low and Stable)**

Suppliers to the online plumbing retail industry are plumbing distributors and large-scale plumbing wholesalers. Distributors supply specialty products. Wholesalers supply mainstream branded products.

Online plumbing retailers are geographically unbounded. They operate across the entire United States of America, giving them access to the largest possible customer base. As a result, dominant online retailers are able to generate relatively large sales volumes. Only the largest integrated brick-and-mortar retailers rival them in volume of purchases from plumbing distributors. Because plumbing distributors rely on high volumes from few customers, they wield little supplier power in the face of internet retailer purchasing power.

Online plumbing retailers carry a wide array of products including identical products from multiple plumbing distributors. These products are offered to DIY consumers by direct shipment from distributors. Because online plumbing retailers do not invest in inventory, they are not committed to selling any particular product from any particular supplier. Switching cost between suppliers is virtually zero. By changing the pricing, positioning, or visibility of specific products on their websites, online plumbing retailers can direct customers towards the products in which they have an advantage. As a result, supplier power remains low in the industry.

Mainstream branded products are recognized by DIY consumers and lend credibility to retail websites. This is the only reason they are offered by online plumbing retailers. Mainstream products must be purchased from large-scale wholesalers who would rather sell them at retail prices through their integrated brick-and-mortar retail chains than at wholesale prices to internet retailers. As a result, internet retailers pay premium prices for these products to the point where they cannot be price competitive against integrated brick-and-mortar retailers. Technically, this represents a high degree of supplier power. In reality, however, it is more important for online retailers to present mainstream branded products than it is actually to sell them. Because these products represent such a small portion of sales in the online plumbing retail industry, overall supplier power is low.

### **2.3.4 Threat of New Entrants (High and Stable)**

New entrants into the online plumbing retail industry are any companies which could present decorative plumbing products for sale on the internet. These companies must target but

are not restricted to targeting the specialty product-price-sensitive customer quadrant of the industry product-customer matrix (*Figure 4*).

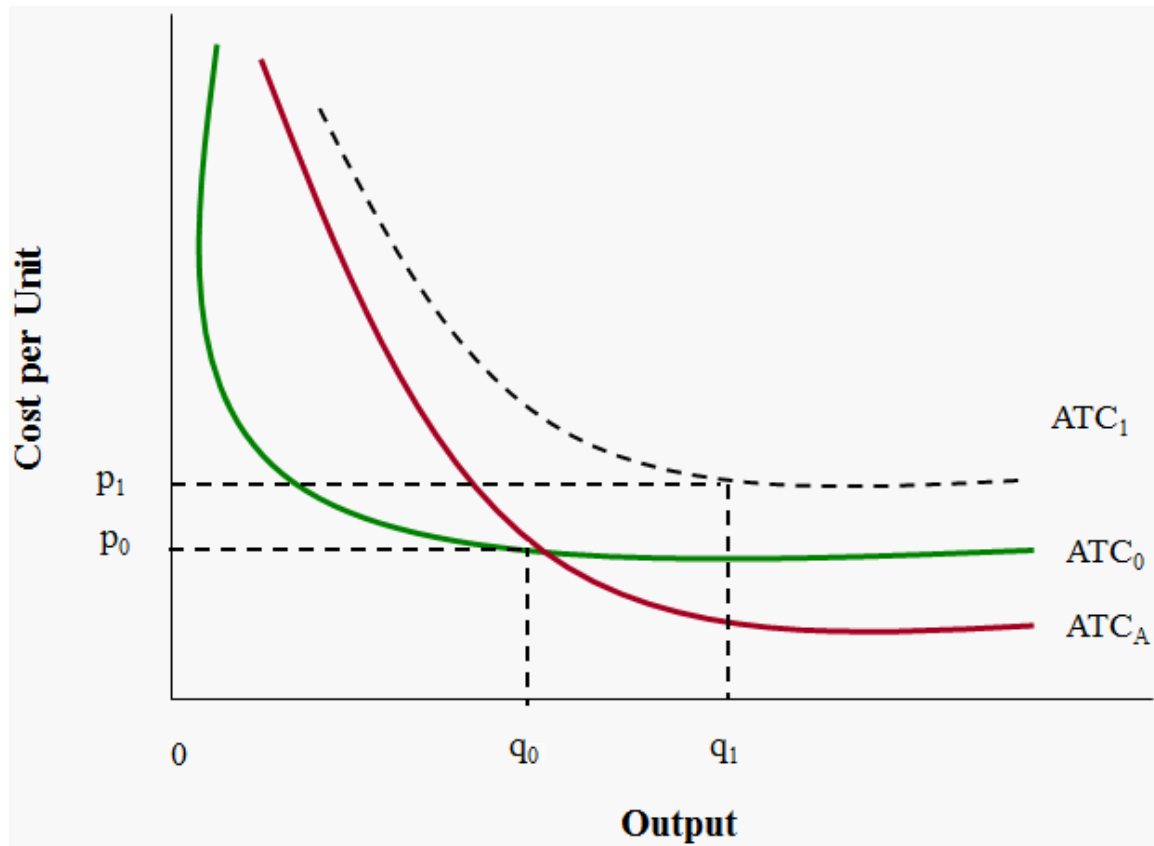
Online plumbing retail is relatively non-capital intensive. Unlike integrated and brick-and-mortar retailers which must invest heavily in prime real estate and inventory, online retailers can operate from virtually any location with relatively low overhead costs. The only requirements to enter the industry are an account with a plumbing distributor and the ability to set up an online store.

While it is a relatively simple matter to enter the online plumbing retail industry, it is another matter to become a dominant participant within it. Scale serves as a major barrier to entry into this top tier of online plumbing retailers. Economies of scale in purchasing drive down input costs from product and technology suppliers, while necessary investments in marketing and product presentation technology drive up minimum efficient scale<sup>4</sup>. Because new entrants lack the scale to invest heavily in marketing and technology, they are unlikely to achieve industry dominant status. This situation is demonstrated graphically in *Figure 6*.  $ATC_0$  represents average total cost if no investment were made in operations and marketing. Under such conditions, minimum efficient scale is achieved at  $q_0$  units of output.  $ATC_A$  represents the average total cost of OPR's investment in marketing and technology. This curve continues to decline as output increases.  $ATC_1$  represents the new average total cost curve which includes OPR's investment in operations and marketing. These investments increase minimum efficient scale from  $q_0$  to  $q_1$ . Because  $q_1$  units is beyond the output of small industry participants, they would incur relatively high average costs if they matched OPR's investment in operations and marketing. As a result, they will make little or no investment in these fixed cost activities. OPR is then left with a significant advantage in gaining the attention and confidence of consumers. As such, it will be impossible for these new entrants to partake in the economic profits available in the industry. The threat of entry from this group is low.

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<sup>4</sup> Because all dominant online plumbing retailers are private companies, it is not possible to determine their marketing-to-sales ratios. However, conversations with management at these companies suggest that the need to invest heavily in marketing and technology represents the greatest barrier to significant entry into the industry.

Figure 6: Fixed Cost Barrier to Entry



Source: Author

The greatest threat of new entry is actually posed by integrated wholesalers/retailers. These companies already enjoy preferential pricing from plumbing distributors and have a high degree of familiarity with decorative plumbing products. The companies also command sufficient financial resources to make necessary sunk cost investments in marketing and technology. Potential new entrants would incur losses until scale and experience are established.

It is also expected that by entering the online plumbing retail industry, integrated wholesalers/retailers will cannibalize a portion of their own sales. These sales would come from consumers on the border between price and service sensitivity on the industry product-customer matrix (Figure 4). However, this sacrifice would be more than recouped by the ability to target the entire specialty product-price sensitive customer quadrant of the product-customer matrix through internet retail. Consequently, the threat of new entry into the online plumbing retail industry is high.

### **2.3.5 Industry Rivalry (Moderate and Stable)**

Rivals in the online plumbing retail industry are any companies which offer decorative plumbing products for sale on the internet. These companies vary widely in scale with the largest five industry participants generating the vast majority of industry revenues. As a result, it is useful to talk about industry rivalry among these five firms.

Online plumbing retailers target price-sensitive customers. As a natural outgrowth of this strategy, price is a major competitive factor for rival companies. Each online retailer keeps close tabs on the prices offered by their competitors and quickly makes adjustments accordingly. Because all online retailers receive roughly the same pricing from plumbing distributors, none of them is able to maintain a price advantage for any extended period. In fact, the pricing strategies adopted by the big five online plumbing retailers suggest some level of tacit collusion. Pricing is matched across competitive websites but not generally undercut. The online retailers have even gone so far as to pressure plumbing distributors to implement ‘minimum advertised price’ policies. These policies require plumbing distributors to punish online retailers who advertise products below pre-established levels.

Differentiation strategies are largely unsuccessful in the online plumbing retail industry. The first major concern for internet retailers is gaining consumer confidence. Each of the dominant industry participants has achieved this goal through affiliation with the Better Business Bureau, participation in third-party reviews, and presentation of extensive customer reviews. No major online plumbing retailer is any better or worse at this task than its competitors are.

The second major concern for online plumbing retailers is to convince customers to buy from their website as opposed to the website of a competing company. Here again, differentiation strategies are largely unsuccessful. All major online plumbing retailers base their operations on a framework of best practices developed in the literature and conference proceeding of the greater internet retail industry. By drawing on the same sources and relying on the same consultants, these companies end up with largely convergent differentiation strategies. Furthermore, because online plumbing retailers constantly monitor competitive websites, any innovative activities are quickly identified and replicated.

Overall rivalry within the industry is moderate. Competitors must keep pace with product and service innovations, but price-cutting is kept to a minimum. Because no competitor has a significant advantage over the others, this trend will continue.

### **2.3.6 Industry Attractiveness**

The attractiveness of the online plumbing retail industry is ultimately a matter of scale. Small industry participants lack the size to demand preferential pricing from suppliers. They also lack the resources to engage effectively in marketing and competitive intelligence activities. As such, they are left charging higher prices for inferior services. The online plumbing retail industry is unattractive to a participant of this scale. This is unlikely to change as the industry grows because incumbents continue to increase marketing and technology spending as a proportion of sales. In the future, the industry's oligopolistic features will become more pronounced.

Dominant online plumbing retailers all enjoy preferential pricing from suppliers and sufficiently large operational budgets. Tacit collusion and supplier enforced pricing policies maintain high prices while the ineffectiveness of differentiation strategies prevents excessive spending on these activities. The economic profits which are created are protected by the company scale necessary to participate in this elite group of retailers. The online plumbing retail industry is therefore attractive to companies capable of operating at or above the minimum efficient scale.

### **3: Competitive Advantage at OPR Inc.**

Competitive advantage defines a firm's ability to earn economic profits. According to Michael Porter, there are two generic sources of competitive advantage: cost leadership and differentiation (Porter 1985). It is possible to use these strategies individually or in unison. Cost leadership is successful when a company is able to lower its average cost relative to customers' willingness to pay compared to the industry average. Differentiation is successful when a firm is able to increase customers' willingness to pay relative to its average cost compared to the industry average. A mixed strategy is successful when customers' willingness to pay is increased to more than the industry average while average cost is reduced to less than the industry average.

Companies create cost leadership and differentiation through the activities they undertake to convert inputs into outputs. Furthermore, whether a company uses cost leadership or differentiation, it must always look to the sustainability of any advantage it has created. If a company is not able to protect its competitive advantage from competition or appropriation, rivalry within the industry will erode any economic profits earned.

#### **3.1 Value Chain Analysis**

A useful tool to describe and assess a company's activities is Michael Porter's value chain model (Porter 1985). Value chains break down activities within a firm into primary activities which describe how a company transforms inputs into outputs, and secondary activities which describe how a company coordinates and integrates its operations. The value added by each activity (reducing cost or increasing customers' willingness to pay) is identified to give a full understanding of how a company creates competitive advantage.

##### **3.1.1 Primary Activities**

Primary activities at OPR are those that are directly involved in the provision of retail service to DIY consumers. The first stage in this process is inbound logistics. A feature of OPR's business model is that inbound and outbound logistics are outsourced to third party courier companies, who are responsible for transporting products directly from suppliers to customers. Outsourcing these activities has three advantages. First, freight costs are minimized because it is



not necessary to ship products from suppliers to OPR and again to customers. Second, the system alleviates the need for OPR to warehouse and process inventory internally. Finally, direct shipment minimizes transit time to customers who are eager to receive their orders. Because all online plumbing retailers use the same direct shipment model, inbound and outbound logistics do not yield any competitive advantage for OPR.

There are two aspects to operations at OPR: activities which are directly related to the e-commerce website and activities which are performed in support of it. Primary functions of the e-commerce website and its related systems include presentation of products for sale, processing of credit card payments, and transmission of order details to suppliers. Activities which are directly related to these functions include: programming and upgrading the user interface and other software systems; monitoring the performance of the website, and monitoring competitive websites for new features and service offerings. These activities are designed to increase customers' willingness to pay. OPR works with web analytics company, Adobe Online Marketing, to track performance statistics such as conversion rates, click-through rates, and bounce rates<sup>5</sup>. These are just three of the hundreds of parameters constantly monitored to ensure customers are moving smoothly towards a purchase. Similarly, OPR monitors competitive websites to ensure that customers are not being lost due to inferior website design or service offerings. In both cases, weaknesses are identified and corrected to improve purchase rates.

The second type of operations activities that are performed at OPR are those that are conducted in support of the e-commerce website. These activities include the operation of a call centre and the provision of pre-sales customer service. Here again, activities are geared towards increasing customers' willingness to pay. Any customer who is unsure about ordering online may speak to a live representative. If a customer needs product information which is not presented on the website, he may request it from OPR staff. This interaction between the customer and OPR may be conducted via telephone, mobile text message, or online chat. These support services add costs to OPR's primarily web based business model. However, they are considered necessary to create trust and to build confidence with customers.

In practice, operations activities fail to create any real competitive advantage within the online plumbing retail industry. All competitors are able to provide the same type of support services offered by OPR. Major rivals can also replicate operations activities directly related to the e-commerce website. Skilled programmers, complex monitoring and analytics software, and

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<sup>5</sup> These statistics constitute internet data which is measured, collected, analyzed, and reported for the purpose of understanding and optimizing web usage (About Us - Web Analytics Association n.d.).

trained analysts are costly. Consequently, small players in the online plumbing retail industry are not able to fine-tune their websites to the same degree as their larger competitors. Therefore, they are not able to increase customers' willingness to pay as effectively as their larger competitors are. This apparent relative advantage is nullified, however, when one considers that the online plumbing retail industry is highly concentrated. The vast majority of revenues generated within the industry flow to the dominant participants who can afford systems at least as sophisticated as OPR's. Therefore, the relative advantage gained over minor industry participants is not consequential.

Marketing and sales is by far the most important primary activity at OPR. This activity is divided into two types: standard practices and creative practices. Standard practices are largely centred on search engine optimization (SEO) and cost-per-click (CPC) advertising. SEO is the practice of optimizing a website for visibility on internet search engines. Target demographics are established and their search histories are analysed. Keywords and phrases are then selected from the data gathered. Armed with a strong understanding of the algorithms used by major search engines, OPR is able to optimize the content on its website such that it will be found easily when these keywords and phrases are searched. CPC advertising takes a more direct approach to achieving the same objective. Advertisements containing links to OPR's website appear on search engines whenever the pre-established keywords and phrases are searched. Whenever search clients click on these advertisements, OPR incurs a predetermined charge from the search engine operator. Advertising budgets are set by the day. Once any search engine has charged out OPR's budget for that day, all ads are removed automatically until the following day. SEO and CPC advertising are classified as standard practices because they are available to and practiced in some form by all online plumbing retailers.

Standard marketing practices add value by increasing customers' willingness to pay. They accomplish this task by introducing potential customers to OPR. This increases customers' willingness to pay from zero where it would theoretically have remained had they never been introduced to the company. Although these practices are available to and practiced by all online plumbing retailers, in reality, they are practiced with varying degrees of effectiveness. The sophistication of search analytics systems, the adaptability of website parameters, and the ability to fund continued CPC advertising are all dependent on the resources available to individual firms. For example, in 2009, OPR spent \$500,000 on CPC advertising alone. However, because all major industry rivals command sufficiently large marketing budgets to compete in this arena, OPR does not gain any competitive advantage from standard marketing practices.

Creative sales and marketing activities are far more diverse. They include everything from the writing of blogs, to the use of social media, to the formation of strategic partnerships. In 2009, OPR collaborated with plumbing distributor, Cheviot Products Inc., on a campaign to increase customer reviews on OPR's website. For every review that was written during the month of the campaign, both companies donated five dollars to the American Cancer Society. By the end of the month, over \$10,000 was raised for cancer research, more than 1,000 new product reviews were written, and OPR had gained valuable visibility with consumers. This example highlights just one instance of creative marketing. In reality, the options for creative marketing are virtually limitless. Often times, creative marketing is also relatively inexpensive. The cost to create and maintain an online community using social media tools such as Facebook are largely limited to time (Marks 2009). As such, these tools are within the reach of all industry participants. The important distinction here is between standard and creative marketing. Unlike standard marketing, creative marketing is not practiced by all online plumbing retailers, nor is it practiced uniformly by the ones that do.

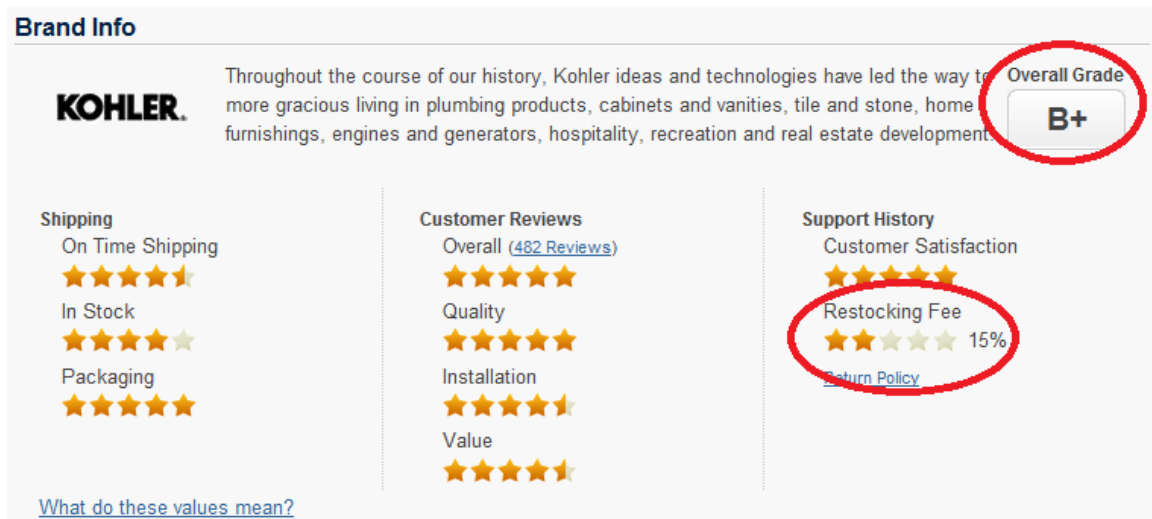
Creative marketing practices can be used to introduce customers to OPR, but also to increase willingness to pay amongst potential customers who are already familiar with the company. The availability of customer reviews, the existence of an online support community, and affiliations with respected institutions all serve to assure and inspire customers to shop at OPR. In practice, however, the effectiveness of these practices is often difficult to quantify. Consequently, creative marketing practices are considered riskier than SEO and CPC advertising which are preferred by OPR. If creative marketing is performed, it is performed in addition to and not instead of standard marketing. Most participants within the online plumbing retail industry share this perspective. Despite its low cost, creative marketing is overlooked even by small players with limited financial resources. Consequently, creative marketing practices yield little in the way of significant comparative advantage for OPR.

After-sales service at OPR is relatively basic. Customer service representatives are familiar with the basic specifications of products sold by OPR and have a passing understanding of technical plumbing issues. The two major after-sales service functions they perform are liaising with technical experts at plumbing distributors and coordinating the return and refund process. The technical support function is a cost saving measure. Rather than investing in trained technical staff or advanced training for existing staff, customer service representatives at OPR are instructed to contact plumbing distributors for complex technical support issues. This process can become tedious as information and instructions are relayed from the distributor to OPR to the

customer and back. Nonetheless, because OPR benefits from relatively little repeat business, company management feels that investments in advanced technical training for customer service staff are not justified. In practice, this mode of operation is employed by all major online plumbing retailers and therefore does not yield any relative advantage for OPR.

The returns and refunds activity at OPR adds value by increasing customers' willingness to pay. Considering that OPR's customers are not educated purchasers of plumbing products and have never physically inspected the products they are buying, they are assuming some degree of risk by shopping online. This risk is somewhat mitigated by OPR's lower prices, but also by its generous returns policy. By refusing to turn return requests away, OPR alleviates customers' fears of buyer's remorse. The cost to the company is often significant, including return freight from the customer to the distributor and restocking charges of up to 25% of cost. In return, however, OPR is able to offer a "money back guarantee" which increases many customers' willingness to pay. The value added by this type of money back guarantee is, however, difficult to quantify. As a result, it is not common practice for online plumbing retailers to implement the policy. Instead, most large industry participants are pressuring plumbing distributors to implement similar policies from their end and bear the costs of doing so. An example of how online plumbing retailers pressure suppliers to cover the costs of returns is presented in *Figure 7*. To date, this strategy has not been successful. No distributor of significant size has agreed to such an arrangement. Nonetheless, the fact that industry rivals have chosen not to follow OPR's lead in offering a money-back guarantee suggests that the policy does not effectively create competitive advantage.

Figure 7: Pressure from Online Retailers on Suppliers to Bear Costs of Returns



Source: [http://www.fixtureunivers.com/clawfoot-tubs/kohler-727-2w-33-iron-works-tellieur-clawfoot-tub\\_g164590.html?isku=995054](http://www.fixtureunivers.com/clawfoot-tubs/kohler-727-2w-33-iron-works-tellieur-clawfoot-tub_g164590.html?isku=995054)

### **3.1.2 Secondary Activities**

Firm infrastructure at OPR is arranged to reduce costs. The retailer's storefront is virtual, not physical. As such, the company attaches little value to costly, high-profile real estate. The company continues to operate from a mostly residential neighbourhood in suburban Boston. The building is best described as industrial. Little attention is given to aesthetics or creature comforts for the benefit of customers. Offices are small and clustered together to accommodate OPR's flat hierarchy and to facilitate efficient decision-making. This low cost strategy has gained OPR some advantage relative to industry competitors. Of the five dominant participants in the online plumbing retail industry, only OPR and eImprovement.com have been able to maintain such a low cost culture successfully. Improvement Direct and Allied Trade Group have both moved towards lavish office facilities and extensive employee amenities in order to attract top talent.

Financial management is a key feature of OPR's business model. Most brick-and-mortar retailers must purchase products from suppliers, hold products in inventory, and eventually sell products to customers. At OPR, the order of operations is reversed. Customers purchase products from OPR's website, the retailer collects the customer's money, and the distributor ships products directly to the consumer. Payment is due from OPR to distributors 30 days from the date on which the product is shipped. This arrangement yields two cost saving advantages for OPR. First, there is a 30 day gap between the time payment is collected from the customer and the time payment is made to the supplier. Interest accrued during that time reduces the average cost of the product sold. Second, OPR has no cash tied up in accounts receivable and inventory. Payments are taken upfront by credit card and products are shipped directly from suppliers. This system of financial management is used by all online plumbing retailers and consequently does not yield any competitive advantage for OPR.

At OPR, human resources management is designed to drive down costs. Most employees are hired from the greater Boston area and perform highly standardized tasks. OPR employs a very flat organizational structure which gives Allan Smith a great deal of control over frontline activities and alleviates the need for costly middle management. Mr. Smith himself is an effective motivator and strong personality within the internet retail community. OPR employees are typically highly loyal to, and identify strongly with the company's low cost culture. This is due almost entirely to the leadership of Allan Smith. By contrast, most industry rivals now employ

several layers of brand and segment managers to oversee operations. In this way, OPR has managed to minimize its HR costs and motivate its employees to cut other costs where they can. Because this situation is attributed to the leadership of a single person, it is not immediately imitable by competitors within the industry and has yielded some competitive advantage for OPR.

Technology development at OPR creates value in two ways. First, it increases customers' willingness to pay. One of the major disadvantages of online retail compared to brick-and-mortar retail is that customers cannot physically interact with the products they wish to purchase. OPR uses technology to partially overcome this disadvantage. Many products are now presented with multiple photographs in different settings. Three-dimensional models have been created for some products which allow customers to spin and rotate products to be viewed from all angles. Most product pages also allow customers to view products in all available colours. While the provision of these new technologies is a primary operations activity, their initial development is a secondary activity. This function continues to evolve with the introduction of new consumer technologies such as 3D displays and advanced smartphones. Technological advancements are designed to alleviate the customers' need to physically interact with products prior to purchase. In theory, they increase customers' willingness to pay. In practice, however, there is no switching cost for customers to move back and forth between online retailers. As such, the provision of these pre-sales services does not yield OPR any comparative advantage. Customers can visit OPR's website to gain confidence in products and then purchase the products from a lower price competitor.

The technology development activities described above may be ineffective at creating relative advantage by increasing customers' willingness to pay, but they are effective at creating advantage by reducing costs. By providing comprehensive product information on its website, OPR minimizes the personal interaction it must have with customers. This in turn minimizes the number of customer service representatives which must be employed. Technology development also reduces cost through automation. By automating the process of money collection, order processing, purchasing, and order tracking, OPR has further minimized labour costs. The cost saving measures described above are dependent upon a minimum volume of customer service traffic. As such, technology development provides OPR with a relative advantage over small-scale industry participants, but not over key rivals with high sales and customer service volumes.

Procurement at OPR is focused singularly on the reduction of costs. Because of its high purchase volume, the company is able to demand preferred pricing from plumbing distributors. For most product lines, OPR's cost of goods sold is comparable to that of large-scale

wholesalers/retailers. This situation is not, however, unique to OPR. All major participants in the online plumbing retail industry have sufficient purchase volumes and therefore sufficient buyer power to demand such pricing.

### 3.1.3 Leadership as Source of Competitive Advantage

OPR’s sources of competitive advantage are summarized below in *Figure 8*. Primary activities which yield competitive advantage do so by increasing customers’ willingness to pay. Effective secondary activities create competitive advantage by reducing average cost.

*Figure 8: Value Chain for OPR*

<b>Firm</b>				
<b>Infrastructure:</b>		1. Suburban Boston	2. Industrial	3. Low Cost
<b>Financial</b>		1. Funds Collected	2. Funds Paid at 30	
<b>Management:</b>		Upfront	Days	
<b>Human Resource</b>		1. Flat		
<b>Management:</b>		Organizational	2. Low Cost Culture	
<b>Technology</b>		1. Interactive	2. Process	
<b>Development:</b>		Technologies	Automation	
<b>Procurement:</b>		1. High Volume Purchasing		
<b>Inbound Logistics</b>	<b>Operations</b>	<b>Outbound Logistics</b>	<b>Marketing and Sales</b>	<b>After-Sales Service</b>
1. Outsourced	1. Directly related to storefront 2. Support functions	1. Outsourced	1. SEO 2. CPC Advertising 3. Creative Marketing	1. Tech Support 2. Returns
Competitive Advantage: <span style="background-color: #92d050; display: inline-block; width: 100px; height: 15px;"></span>				

Source: Author

OPR creates competitive advantage over key rivals through the decision-making of its senior management. Firm infrastructure is kept low-cost and corporate culture has been cultivated to promote a cost cutting mind-set. By contrast, most key rivals now operate from lavish office buildings and focus on exercising buyer power as a primary means of reducing costs. OPR also employs a very flat organizational structure. Again, most key rivals have now moved to complex structures which include several layers of brand and segment managers. As such, OPR is better suited structurally and culturally to minimize average total cost than are its key rivals.

### **3.1.4 Sustainability of Competitive Advantage**

OPR's leadership advantage is clearly unsustainable. Allan Smith's leadership style can be imitated. Corporate restructuring and cultural change take time. Nonetheless, if senior management at another industry dominant company were committed to the task, OPR's low cost structure and culture could be replicated. If this were to happen, OPR's competitive advantage would be negated.



## **4: Situational Assessment and Prognosis**

### **4.1 Current External Environment**

The online plumbing retail industry is attractive to incumbent participants. Sales are highly concentrated among five dominant industry participants and are growing rapidly compared to sales through brick-and-mortar retail channels. Because each industry participant has the ability to monitor competitors' pricing, price advantages are short lived. As a result, the industry has adopted an unspoken policy of matching but not undercutting competitive pricing. In this way, industry participants use tacit collusion to maintain pricing which is above equilibrium levels. Supplier enforced minimum price policies do the same but in a more formal manner.

Scale functions as the barrier to entry which allows incumbent industry participants to earn economic profits. Large sunk cost investments in marketing and operations make minimum efficient scale beyond the reach of most new entrants. Marketing must be conducted on a large scale to compete for the attention of new customers. Operations activities must be well funded to fine-tune the website and funnel potential customers through to sales. Most potential new entrants simply cannot afford the sunk costs necessary to participate in the online plumbing retail industry. The most serious concern for incumbent industry participants is the mobility threat posed by integrated plumbing wholesalers/brick-and-mortar retailers.

### **4.2 Most Likely Future External Environment**

In the future, it is expected that large-scale plumbing wholesalers will enter the online plumbing retail industry to create integrated online plumbing retailers. The most likely mode of entry will be acquisition. This course of action is logical as it will allow new entrants to immediately join the industry at or above minimum efficient scale. The alternative would be to incur losses due to necessary sunk cost investments until minimum efficient scale is achieved.

Integrated online plumbing retailers would have access to specialty products at the same costs as their non-integrated competitors and access to mainstream products at the same costs as large-scale wholesalers. Integrated online retailers will also experience cost savings by integrating technology systems for many secondary value chain activities such as financial management, human resources management, and procurement with large-scale wholesalers. These two factors

will combine to give the new entrants lower average costs than it is possible for incumbent competitors to achieve.

Integrated online plumbing retailers will have access to the branding and infrastructure of large-scale wholesalers. Their retail websites will carry names such as Wolseley, Ferguson, and Hajoca which are recognized and trusted by DIY consumers. Furthermore, because large-scale wholesalers already stock many products in distribution centres across the country, transit times faced by consumers will be reduced. It will also be possible to process returns locally which will save customers' having to ship products back to distributors if they experience buyer's remorse. These two factors will increase customers' willingness to pay in a way which is not imitable by incumbent industry competitors.

In the future, the online plumbing retail industry will become less attractive to industry incumbents than is currently the case. These companies will be faced with new entrants that are capable of simultaneously achieving lower average costs and higher customer willingness to pay than is possible for incumbents. As such, all online plumbing retailers will be at a competitive disadvantage compared to their integrated rivals.

### **4.3 OPR's Current Position**

OPR currently holds an average position in the online plumbing retail industry. The key success factor in the industry is minimum efficient scale. With scale, it is possible to drive down costs through buyer power and process automation technology, and drive up customers' willingness to pay through marketing and operations activities. However, because each of its rivals has also achieved minimum efficient scale, OPR does not realize any competitive advantage. In reality, no industry participant currently has any sustainable competitive advantage versus its rivals.

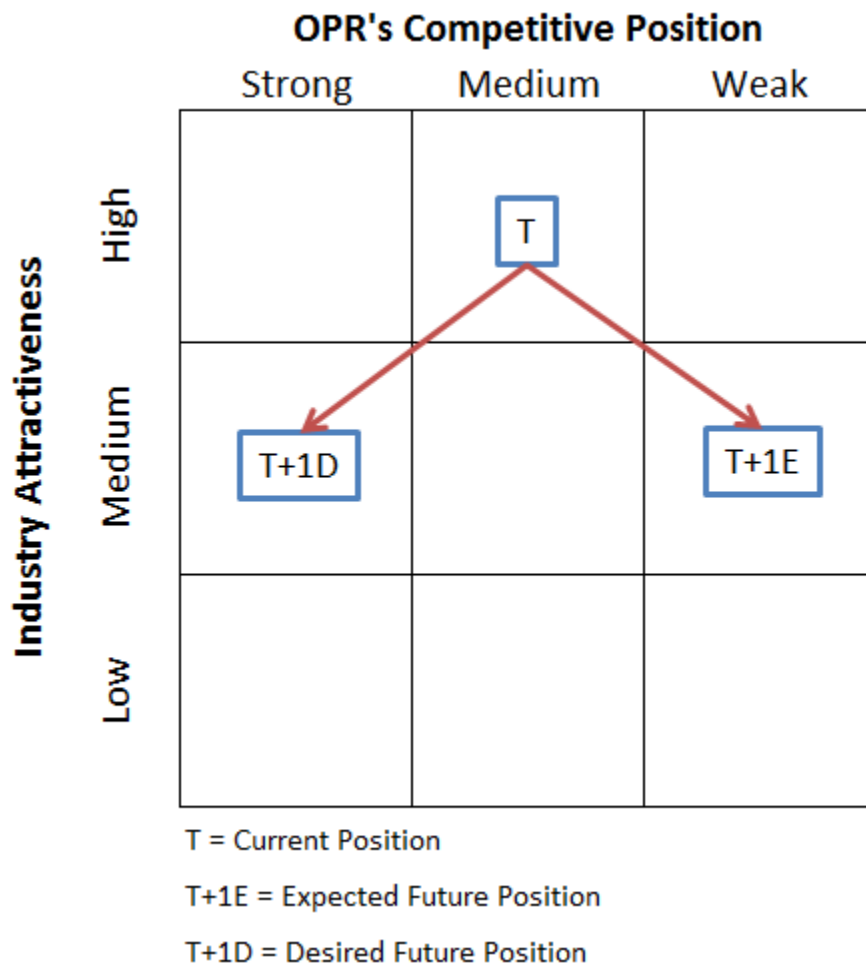
### **4.4 OPR's Most Likely Future Position**

As integrated online retailers enter the online plumbing retail industry, OPR will find itself in a position of competitive disadvantage. Though its operations are low cost, the company will not be able to match the average costs of the new entrants. Furthermore, because OPR lacks the brand recognition and physical infrastructure of large-scale wholesalers, it will fall behind integrated online retailers in the creation of willingness to pay from customers. The key success

factors in the industry will grow to include physical infrastructure and brand recognition. OPR will not be able to meet the new competitive requirements.

OPR's current, expected future, and desired future positions are shown on the performance matrix in *Figure 9*. The company currently holds a position of average competitiveness in an attractive industry (T). It is expected that the industry will become less attractive as integrated online retailers enter and that OPR will lose the ability to maintain key success factors. This is represented as a shift from T to T+1E. If OPR hopes to maintain its current level of profitability, it will have to develop some competitive advantage. This situation is represented by a shift from T to T+1D.

Figure 9: Performance Matrix for OPR



Source: Author

## **4.5 Best Course of Action for OPR**

It is expected that the entry of integrated online retailers into the online plumbing retail industry will put OPR into a position of competitive disadvantage from which it cannot recover. The company's ability to earn economic profits will be destroyed and it will face declining market share. As OPR will have moved into the position of a weak company in an industry of only average attractiveness, Robert Smith's best course of action will be to divest the company (Ballantine and Brignall 1996). Chapter 5 focuses on the consideration of specific alternative ways to pursue this course of action and the evaluation of these alternatives according to their effects on Robert Smith's objectives.

## **5: OPR Exit Strategy Solution Analysis**

### **5.1 Evaluation Criteria**

Robert Smith's primary concern is the maximization of OPR's share value. As he is exploring options for divesting the company, this objective translates into a desire to maximize the compensation he receives in exchange for the company. Mr. Smith gives this criterion 65% weight in his decision making process.

Robert Smith's secondary concern is the minimization of risk. The company represents Robert Smith's largest personal investment. As a result, OPR will pass up high risk-high reward opportunities in favour of low to moderate risk opportunities which yield lower payoffs. This trade-off between risk and profit is accounted for in the 35% weight Mr. Smith assigns to this criterion in his decision making process.

### **5.2 Strategic Alternatives**

As Robert Smith looks to divest OPR Inc, there are three strategies which he may consider. Maintenance of the status quo is also presented as a baseline for comparison.

#### **5.2.1 Maintain the Status Quo**

If OPR were to maintain the status quo, it would continue to offer a wide range of specialty products to price conscious DIY consumers across the United States and Canada. All primary and secondary value chain activities will continue unchanged.

#### **5.2.2 Sell OPR to an Integrated Wholesaler/Retailer**

OPR could be sold to a supplier. This could be either a plumbing distributor or a large-scale wholesaler. Plumbing distributors would not be interested in such an arrangement because it would put them in direct competition with their largest customers, large-scale wholesalers. Large-scale wholesalers on the other hand, would be very interested in purchasing a company like OPR. By doing so, they could enter the online plumbing retail industry at a volume above minimum

efficient scale. This implies less risk for large-scale wholesalers than entering the industry on the small scale and then attempting to achieve minimum efficient scale.

### **5.2.3 Sell OPR to a Rival Online Plumbing Retailer**

OPR could be sold to another plumbing retailer. Acquisition by an integrated brick-and-mortar retailer would amount to the previous alternative and non-integrated brick-and-mortar retailers lack the resources to acquire a company the size of OPR. This leaves only fellow online plumbing retailers.

### **5.2.4 Liquidate OPR**

The final strategic alternative available to Robert Smith is to simply shut down operations at OPR and liquidate the company.

## **5.3 Possible Scenarios**

It is not known with certainty by OPR if or how integrated wholesalers/retailers will enter the online plumbing retail industry. As a result, it is necessary to consider several possible scenarios. In reality there are only two integrated wholesalers/retailers which possess the scale and geographic scope to pose a significant threat to OPR: Wolsley plc and Hajoca Corporation. It is believed that if one enters the online plumbing retail industry, the other will follow, employing the same mode of entry.

### **5.3.1 Integrated Wholesalers/Retailers Enter the Industry through Acquisition**

The most likely scenario is one in which integrated wholesalers/retailers enter the online plumbing retail industry through acquisition of existing internet retailers. This option is attractive to new entrants because it would allow them to enter the industry at a volume above minimum efficient scale. The operation would be immediately profitable to the acquiring company. This mode of entry is less risky than entering the industry in the small scale and then attempting to achieve minimum efficient scale. As such, a probability of 90% has been attached to the entry of large-scale wholesalers into the online plumbing retail industry through acquisition of an existing industry participant.

### **5.3.2 Integrated Wholesalers/Retailers Enter the Industry through Greenfield Investment**

The second most likely scenario is one in which integrated wholesalers/retailers enter the online plumbing retail industry through greenfield investment. This option is attractive because it allows integrated wholesalers/retailers extend their exiting cultures, policies, and operating norms into their online retail divisions without resistance or the need to merge disparate organizations. This benefit would, however, be costly as the company would be forced to sustain losses until it was able to gather the experience and market presence necessary to achieve minimum efficient scale. Because of this cost, a probability of only 8% has been attached to large-scale wholesalers entering the online plumbing retail industry through greenfield investment.

### **5.3.3 Large-Scale Wholesalers do not Enter the Industry**

The least likely scenario is that large-scale wholesalers do not enter the online plumbing retail industry at all. In this case, the relationship between online plumbing retailers and large-scale wholesalers would remain unchanged. While very unlikely, this scenario is not impossible. A probability of only 2% has been attached to this outcome.

## **5.4 Analysis of Strategic Alternatives and Scenarios**

### **5.4.1 Evaluation Matrix**

*Figure 10* combines the four strategic alternatives and two ownership objectives presented above in an evaluation matrix (Hammond, Keeney and Raiffa 1999). Each ownership objective is given a weight depending on its importance to Robert Smith and each strategic alternative is given a rating of low, low/medium, medium, medium/high, or high against each objective. Weighted average scores will be calculated for each strategic alternative to determine how OPR should proceed. The following values will be used for the purpose of this calculation: low = 1, low/medium = 2, medium = 3, medium/high = 4, high = 5.

Figure 10: Evaluation Matrix for OPR Industry Exit

Goals	Strategic Alternatives			
	(1) Maintain Status Quo	(2) Sell to Integrated Wholesaler/ Retailer	(3) Sell to Rival Online Plumbing Retailer	(4) Liquidate
Maximize Share Value (w=0.65)				
Minimize Risk (w=0.35)				
<b>Score</b>				

Source: Author

#### 5.4.2 Integrated Wholesalers/Retailers Enter the Industry through Acquisition

OPR's evaluation matrix if integrated wholesalers/retailers enter the online plumbing retail industry through acquisition is presented in *Figure 11*. This scenario has a 90% probability of occurring.

Figure 11: OPR's Evaluation Matrix with I-W/R Entry through Acquisition

Goals	Strategic Alternatives			
	(1) Maintain Status Quo	(2) Sell to Integrated Wholesaler/ Retailer	(3) Sell to Rival Online Plumbing Retailer	(4) Liquidate
Maximize Share Value (w=0.65)	Low-Medium 2	High 5	Low-Medium 2	Low 1
Minimize Risk (w=0.35)	Low 1	High 5	High 5	High 5
<b>Score</b>	<b>1.65</b>	<b>5.00</b>	<b>3.05</b>	<b>2.40</b>

Source: Author

If integrated wholesalers/retailers enter the online plumbing retail industry through acquisition of existing industry participants, OPR's evaluation score is maximized when it is



acquired by an integrated wholesaler/retailer. Share value would be maximized because OPR would not be forced to compete against the threatening new integrated online retail model. Instead, the company would adopt the new model itself and threaten industry incumbents. Furthermore, because acquisition represents the ideal mode of entry for integrated wholesalers/retailers and because these companies command more than enough resources to undertake such an endeavour, Robert Smith would not be required to give OPR away at a very steep discount. It is likely that integrated wholesalers/retailers will pit existing online plumbing retailers against each other for acquisition. However, OPR has two major advantages in its favour. First, OPR is currently one of the lowest cost online plumbing retailers in the industry. Although this advantage is based on company leadership and is not sustainable in the long run, it would save the integrated wholesaler/retailer the time and cost of restructuring the company they acquire. Second, OPR is geographically positioned in close proximity to both potential acquiring integrated wholesalers/retailers. OPR is located in Massachusetts while Wolseley's US operations are headquartered in Virginia and Hajoca is headquartered in Pennsylvania. This proximity will reduce the cost and increase the control with which the integrated wholesaler/retailer can manage its new subsidiary. For these reasons, the maximization of share value has been rated as high for this strategic alternative. This strategic alternative also has the advantage of alleviating any risk for Robert Smith. Because he would be selling the company, his payoff would be perfectly clear and predictable. Thus, a rating of high has been assessed for the minimization of risk for this alternative.

If Robert Smith were to sell OPR to a rival online plumbing retailer, he would receive considerably less than he would if he sold the company to an integrated wholesaler/retailer. Incumbent online plumbing retailers are of roughly equivalent size and it is unlikely that any one of them commands the resources necessary to acquire OPR at full market value. Even if a rival in the online plumbing retail industry had the resources to purchase OPR at full price, it would not be logical for them to do so. Because OPR does not have any competitive advantage versus its rivals, the only advantage to purchasing the company is that it reduces the number of competitors in the industry. However, this advantage would be paid for by one competitor and shared by all competitors. Consider for example that each of the five major industry rivals possess roughly 20% market share and that none have competitive advantage. If one rival were to acquire another, four rivals would remain with 25% market share each. As such, the acquiring company will have paid for a company with 20% market share in order to gain 5% market share. Finally, even if OPR was sold to a rival, the acquiring company would still face the threat of the new integrated online plumbing retail model. As such, a rating of low-medium has been given for the

maximization of share value for this strategic alternative. Risk would be minimized because OPR's sale price would be determined prior to any transaction. A rating of high has been assessed here.

If OPR were to shut down operations, Robert Smith would be left with the liquidation value of whatever equity is left in the company. A rating of low has been given for the maximization of share value because this alternative negates the possibility of OPR earning any income in the future. The minimization of risk has been given a rating of high due to the certainty of Robert Smith's personal payoff if OPR were to shut down operations.

OPR's evaluation score is minimized when the company maintains the status quo. In this case, the company could operate profitably for some period of time after integrated wholesalers/retailers enter the online plumbing retail industry. However, because OPR would not possess any competitive advantage, the window of profitability would be short. A score of low-medium has therefore been given for the maximization of profit for this strategic alternative. This strategic alternative also entails a high degree of risk. OPR's status quo includes large sunk-cost investments in marketing and technology. These investments would have to be made despite the uncertainty surrounding OPR's future profitability. As such, a score of low has been assessed for the minimization of risk for this strategic alternative.

#### **5.4.3 Integrated Wholesalers/Retailers Enter the Industry through Greenfield Investment**

OPR's evaluation matrix if integrated wholesalers/retailers enter the online plumbing retail industry through greenfield investment is presented in *Figure 12*. This scenario has an 8% probability of occurring.

Figure 12: OPR's Evaluation Matrix with I-W/R Entry through Greenfield Investment

Goals	Strategic Alternatives			
	(1) Maintain Status Quo	(2) Sell to Integrated Wholesaler/ Retailer	(3) Sell to Rival Online Plumbing Retailer	(4) Liquidate
Maximize Share Value (w=0.65)	Medium 3	-	Low-Medium 2	Low 1
Minimize Risk (w=0.35)	Low-Medium 2	-	High 5	High 5
<b>Score</b>	<b>2.65</b>	-	<b>3.05</b>	<b>2.40</b>

Source: Author

If integrated wholesalers/retailers enter the online plumbing retail industry through greenfield investment, OPR's evaluation score is maximized when the company is sold to a rival online plumbing retailer. As in the previous scenario, if OPR were to follow this course of action, Robert Smith would have to give the company away at a significant discount. Rivals within the industry lack the resources and motivation to purchase the company at full price and doing so does not resolve the problem of competition from new integrated online plumbing retailers. As a result, maximization of share value has been given a rating of low-medium for this strategic alternative. Minimization of risk has been given a rating of high because Robert Smith will know OPR's sale price prior to any transaction.

If OPR were to maintain the status quo, it would continue to earn profits until the new integrated online plumbing retailers are able to ramp up scale and experience and fully exercise their competitive advantage. This window of profitability would be longer than if integrated wholesalers/retailers were to enter the industry through acquisition. As a result, the maximization of share value rating has been upgraded to medium for this strategic alternative. The minimization of risk score has also been upgraded to low-medium. OPR will have time to monitor and react to the actions of integrated online retailers as they grow and learn. This would not be the case if integrated wholesalers/retailers entered by acquisition.

OPR's evaluation score is minimized when the company is liquidated. A maximization of share value rating of low is given for this strategic alternative because it precludes the possibility of any future income being earned by OPR. A minimization of risk rating of high has been

assessed because Robert Smith’s personal payoff would be predictable prior to any action being taken.

The sale of OPR to an integrated wholesaler/retailer would be impossible because, in this scenario, that group would be entering the online plumbing retail industry through greenfield investment. As a result, no rating has been given for the maximization of share value or the minimization of risk for this strategic alternative in this scenario. The consequences of this situation will be discussed as part of the “cross scenario” evaluation in the next section.

#### 5.4.4 Integrated Wholesalers/Retailers do not enter the Industry at All

OPR’s evaluation matrix if integrated wholesalers/retailers do not enter the online plumbing retail industry at all is presented in *Figure 13*. This scenario has a 2% probability of occurring.

*Figure 13: OPR's Evaluation Matrix with no I-W/R Entry at All*

Goals	Strategic Alternatives			
	(1) Maintain Status Quo	(2) Sell to Integrated Wholesaler/ Retailer	(3) Sell to Rival Online Plumbing Retailer	(4) Liquidate
Maximize Share Value (w=0.65)	High 5	-	Low-Medium 2	Low 1
Minimize Risk (w=0.35)	Medium-High 4	-	High 5	High 5
Score	4.65	-	3.05	2.40

Source: Author

If integrated wholesalers/retailers do not enter the online plumbing retail industry, OPR’s evaluation score is maximized when the company maintains the status quo. Under this course of action, OPR would continue to earn economic profits and enjoy the protection of scale related barriers to industry entry. Share value maximization and risk minimization scores of high and medium-high have been assessed respectively.

If OPR were to seek acquisition by a rival in the online plumbing retail industry, Robert Smith would face the same challenges discussed previously. Industry rivals lack the resources and

motivation to purchase the company. A rating of low-medium has been assessed for the maximization of share value for this strategic alternative. A rating of high has been assessed for the minimization of risk because OPR's sale price will be determined prior to any transaction.

OPR's evaluation score is minimized when the company shuts down operations and liquidates. A maximization of share value rating of low is given for this strategic alternative because it precludes the possibility of any future income being earned by OPR. A minimization of risk rating of high has been assessed because Robert Smith's personal payoff would be predictable prior to any action being taken.

Because, in this scenario, integrated wholesalers/retailers would not be entering the online plumbing retail industry at all, the sale of OPR to that group would not be possible. As a result, no rating has been given for the maximization of share value or the minimization of risk for this strategic alternative in this scenario. The consequences of this situation will be discussed as part of the "cross scenario" evaluation in the next section.

## **5.5 Cross-Scenario Evaluation of Strategic Alternatives**

OPR's cross-scenario evaluation matrix is presented in *Figure 14*. Cross-scenario evaluation scores are determined by using scenario probabilities to calculate the probability weighted average evaluation score for each strategic alternative.

Recall that if integrated wholesalers/retailers enter the online plumbing retail industry through greenfield investment or fail to enter the industry at all, the sale of OPR to that group receives no evaluation score. In compiling the cross-scenario evaluation matrix, these "no scores" have been set to zero. This decision was made to simplify the calculation of cross-scenario evaluation scores.

Figure 14: OPR's Cross-Scenario Evaluation Matrix

Scenarios	Strategic Alternatives			
	(1) Maintain Status Quo	(2) Sell to Integrated Wholesaler/ Retailer	(3) Sell to Rival Online Plumbing Retailer	(4) Liquidate
I-W/R Entry by Acquisition (w=0.9)	1.65	5.00	3.05	2.40
I-W/R Entry by GFI (w=0.08)	2.65	0.00	3.05	2.40
No I-W/R Entry (w=0.02)	4.65	0.00	3.05	2.40
<b>Cross-Scenario Score</b>	<b>1.79</b>	<b>4.50</b>	<b>3.05</b>	<b>2.40</b>

Source: Author

OPR's cross-scenario evaluation score is maximized when the company is acquired by an integrated plumbing wholesaler/retailer. Though the strategic alternative is not applicable in two of the three scenarios presented, it prevails on the strength of its score in the most likely future scenario.

## **6: Recommendations and Conclusion**

The online plumbing retail industry is oligopolistic with no participant possessing sustainable competitive advantage over its rivals. Scale-related barriers to entry allow tacit collusion and supplier enforced minimum price policies to maintain economic profits within the industry. As such, new entrants will wish to join the online plumbing retail industry if they can overcome the existing barriers to entry. At present, integrated wholesalers/retailers represent the only entrant group which meets this requirement.

Three scenarios of integrated wholesaler/retailer actions were considered: entry through acquisition; entry through greenfield investment; and no entry. It was determined that the most likely scenario was the one in which integrated wholesalers/retailers enter the industry through acquisition. This course of action is logical because it would immediately overcome industry barriers to entry and alleviate the need for new entrants to build industry experience. In the face of new entry by integrated wholesalers/retailers, it was determined that OPR Inc. should exit the online plumbing retail industry.

In addition to maintenance of the status quo, three strategic alternatives were considered for OPR to exit the online plumbing retail industry: acquisition by an integrated plumbing wholesaler/retailer; acquisition by a rival online plumbing retailer; and liquidation. Each alternative was evaluated under each scenario according to its impact on the goals of OPR's owner. The results were then considered across all three scenarios to arrive at a recommended course of action for OPR.

It is recommended that OPR pursue exit of the online plumbing retail industry through acquisition by an integrated wholesaler/retailer. Share value will be maximized as OPR is sold to a much larger company before the detrimental entry of other integrated online plumbing retailers. Risk will be minimized as Robert Smith will be fully aware of OPR's sale price prior to the transaction. Although this course of action applies in only one of the three integrated wholesaler/retailer action scenarios presented, the one in which it does apply is by far the most likely. As such, the benefits of acquisition by an integrated plumbing wholesaler/retailer outweigh those of all other strategic alternatives.

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