

Effects of technology: entertainment industry



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1. Introduction

Entertainment industry was rapidly changed in the past decade because of the progress in technology and the pirate products. Today, most of the people surprise when a buyer go to record stores to buy CD or DVD as downloading music and movies from the internet either legally or illegally became a culture. In this situation, traditional record store should become extinct. However HMV still operates two hundreds and eight-five stores in the United Kingdom and five stores in Hong Kong which means there should be a core competency that help the company survive in the industry. Therefore the objective of this essay is to find out whether there is a sustainable competitive advantage and focus on the Hong Kong entertainment market.

2. Company Profile

HMV was found in 1921, a FTSE SmallCap Index Company listed on the London Stock Exchange. The company is the largest entertainment chain in the United Kingdom, entered the Hong Kong market since 1994 and it was the first record stores that offered in-store digital kiosks in Asia to let customers listen to the sample CDs before they make the purchase. Today, HMV has five stores in Hong Kong and a local territory e-commerce website selling entertainment products that categorized into five segments:

- Music CDs
- DVDs
- MP3 music
- Games
- Accessories and books

The competitors of HMV Hong Kong are kind of complicated as the company is facing competitors in various levels – Hong Kong Records is the major local rival while amazon. com and the iTunes store are the global rivals of HMV Hong Kong. On the other hand, the pirate products and illegally download caused the most fatal impact on HMV's business and that is the most challenging for the company to deal with.

3. Literature Review

In order to perform a strategic analysis of HMV Hong Kong, certain tools are required to understand the internal and external factors that affect the strategies of the company.

3. 1. Environment Analysis

The aim of environment analysis is to identify the environmental factors in order to hold the opportunities by its strength, and change the strategies to cope with the threats and improve the weak area. The analysis includes scanning the relevant information, monitoring the nature of the factors and analyzing the data for forecasting the possibilities that will impact the organization's decision making.

3. 1. 1. Strategic Environment

A basic analysis on the Hong Kong entertainment market by defining the market, analyzing the market size and growth, and find out the market share of HMV Hong Kong (Lynch 2009 pp79).

3. 1. 2. General Environment

PESTEL will be used to analyze the factors of general environment that surrounding HMV Hong Kong. The objective is to analyse and forecast the impact of factors in six areas – Political, Economic, Socio-cultural, Technological, Environment and Legal (Lynch 2009 pp82) that will influence HMV Hong Kong in deciding the strategies and designing contingency strategies to face the likely future.

3. 1. 3. Industry Environment

The industry environment analysis is to use Porter's Five Forces to examine the internal and external forces that influencing HMV Hong Kong. Aim of the analysis is to find out the attractiveness of the industry and develop the competitive advantage by recognizing the current position among the rivals in order to develop opportunities in the industry environment for survival and defeating the rivals (Lynch 2009 pp96 – 97).

3. 2. Sustainable Competitive Advantage Analysis

It is important to examine the resources and capability of HMV Hong Kong because the two elements lead to the core competence of the company that enables a competitive advantage. In order to obtain a sustainable competitive advantage, the resources and capabilities should be valuable, rare, costly to imitate and capable of being exploited. The section will start with surveying the resources and capability of the company and use the VRIO framework to examine the sustainability of its competitive advantage.

3. 2. 1. Resources and Capabilities

The available resources including all the tangible and intangible assets as well as the human resources enable and increase the capabilities that enhance the core competencies of a company. In the resource-based view, strategic resources are the basis for competitive advantage for outperforming the competitors. Aim of the resources and capabilities analysis is to identify the profitability for survival as the company is operating in a highly competitive industry.

3. 2. 3. Financial Performance

The objective is to use the data from its financial ratios to analyse and compare the productivity, gearing and management efficiency of HMV group with amazon. com to evaluate whether the company is operating at industry standard.

3. 2. 4. The VRIO Framework

This part is an assessment of the competitiveness of resources and capabilities of HMV in order to identify whether the company has a core competency in order to deliver sustainable competitive advantage.

4. Environment Analysis

4. 1. Strategic Environment

4. 1. 1. Market Definition

Core business of HMV Hong Kong is retailing music and video products and most of HMV's products are classified in the other consumer goods sector (Census and Statistics Department 2010). Retailers in this segment act as

the distributor of the record labels and film makers in the home entertainment sector.

4. 1. 2. Market Size

According to The Recording Industry World Sales report (IFPI 2005), the sales amount of music and video in 2004 is HKD631. 6 million and the total sales of other consumer goods (Census and Statistics Department 2004 Table 2) is HKD14, 213 million, which means the industry contributes approximate 4. 5% to the value of retail in the other consumer goods type. However, as introduced in chapter 3, the pirate products and illegally download caused huge negative impact to the industry and the sales revenue would be higher if the pirate products were not existed.

4. 1. 3. Market Growth

Assuming the music and video sales contribute 4. 4% to the total value of other consumer goods, the assumed sales revenue of the industry and growth as shown in figure 1 below.

The assumed total growth is around 48% in the past five years and the average growth rate is 8. 4%. Since the sales revenue in figure 1 is not the actual number, the market growth data is an overview and for reference only.

4. 1. 4. Market Share

Annual report of HMV pointed out that the international sales revenue is £253 million, approximately HKD3, 036 million in 2009 but it did not mention the sales revenue from Hong Kong. Assuming the 125 stores in Canada, 2 stores in Singapore and 5 stores in Hong Kong contributed an equal share to

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the total revenue, the sales of HMV Hong Kong is around HKD115 million in 2009 and that means the estimated market share of HMV Hong Kong is 12.3%.

4. 2. General Environment

4. 2. 1. Political Environment

Forbes ranks Hong Kong number one in trade freedom as the level of government intervene in business activities is low. Hong Kong is also well known for the low and simple taxation structure and the system is fair to both Hong Kong residents and non-residents. As a foreign company, there is not much barrier for HMV to do business in Hong Kong. In addition, the risk in political change in Hong Kong is low and it is not likely to have sufficient change in business environment, though the government is promoting the progress in election system which will not cause impact in business development. Hence, the political environment is not the most important concern for HMV develop in Hong Kong.

4. 2. 2. Economic Environment

Since HMV's products are not necessity, people only spend more in this kind of consumer goods when they have high disposable income. According to the Census and Statistics Department as shown in figure 2, the GDP of Hong Kong started to decline from 2008 but the assumed growth of the industry is still high because the economic environment was quite positive until the collapse of Lehman Brother in the forth quarter and it can be tell by the monthly value index. The number of the market growth started to slightly climb in 2009 while the GDP turn positive from the fourth quarter, also the growth of both the industry and GDP is rapidly increase from 2010.

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The data shows that the economic environment directly impacts the sales performance of the industry. Apparently the economic is getting positive, unfortunately, risk of economic down turn is still highly possible, turbulence is still exist and may cause negative influence to economic growth in Hong Kong.

4. 2. 3. Socio-cultural and Technological Environment

The shift of culture is causing a fatal damage to HMVs business development and it ties with the technological environment. In the old days, people went to the shop to buy their favorite music long-playing record albums. The technology enables music labels and film makers to turn music and video to digital, CD and VCD became the most convenient way to sell the entertainment products to end user since the 90s. However, the progress lead to illegal copying and pirate products and the situation goes worst since MP3 went popular in the late 90s. Today, most of the people go online and download music and video instead of going to the shop to buy a copy of CD or DVD. In addition, since the iTune store launched in 2003 and this provided a more convenient way to buy the products.

The technology progress changes the culture that negatively influence HMV Hong Kong, the company is not capable to make any change of this kind of culture but still has to focus on this area to cope with the environment when deciding the strategies for survival and future development.

4. 2. 4. Environmental

Currently concern of the environmental factors in Hong Kong for retailing music and video records is minimal. However, CD and DVD are made of

materials that hard to be recycled, distributing the products through internet may replace record stores in future. The e-commerce website of HMV Hong Kong is now distributing MP3 music album online, expansion in this area is getting more critical to the company's growth and wins the competitors in the retailing industry.

4. 2. 5. Legal Environment

Hong Kong is setting the minimum wage law and settled at HKD28 per hour, the bill is now seeking approval from the Executive Council (The Standard 2010) and it is highly possible to launch in the near future. The new law is going to impact the frontline employee of HMV Hong Kong and the company may have to change its pay system to meet the requirement of the minimum wage law. The most important to the company is to carefully handle this issue as it may cause conflict between the employees and HMV.

Hong Kong has the law to prevent business users in using piracy software, the law also forbids manufacturing and uploading intellectual property. However, it cannot completely avoid people downloading from the internet, even if there is law prohibit people from illegally download these products, certain difficulties and obstacles are the major challenges in the execution of the law.

4. 2. 6. Findings in General Environment

Generally speaking the political risk of doing business in Hong Kong is rather low, the major concerns in the general environment are the fluctuating economic environment, shifting culture, negative influences from technological progress and the new minimum wage law. These factors are

now impacting the business of HMV Hong Kong and immediately implement certain strategies are required to cope with the environment in order to survive in the industry.

4. 3. Industry Environment

4. 3. 1. Bargaining Power of Suppliers

To some extent, the suppliers are powerful in the industry because they are the music labels and film makers who do the manufacturing, and normally these manufacturers assign sole distributor that means HMV Hong Kong cannot choose their own suppliers. However, the manufacturers and distributors do not directly sell to end users and they have to distribute the products through the retailers. In this industry, there is a close bond between the suppliers and retailers because each party cannot do without the others. In case of the music labels, film makers and distributors stop supplying the products to HMV Hong Kong, the company will have nothing to sell. On the other hand, bear in mind the company owns approximately 12.3% of the market share and the retailer is one of the most influencing channels to promote the product to end users. If HMV does not support the supplier, they will lose a large distribution channel.

4. 3. 2. Bargaining Power of Buyers

The buyers are weak as these are consumer products and there are large number of buyers and retailers in the market. In addition, HMV Hong Kong has an advantage as the company is selling records from overseas music labels and film makers and the products in this area are differentiated which cause switching cost for buyers. For example, buyers can buy a new released DVD of a television series called The Pacific from amazon.com at USD42.99

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(about HKD335) but the buyer has to pay extra USD29.99 (about HKD234) for a fast delivery or wait one month shipping time while they can buy at HKD539 from HMV Hong Kong. Therefore, buyers cannot easily switch to other suppliers.

4. 3. 3. The Threat of Potential New Entrants

There are not much barriers for entering the records retailing industry. Low capital is required and the switching cost for buyers is not a concern because the buyers can switch to buy from a new entrant anytime. As mentioned in last section, HMV Hong Kong differentiate its products by selling records from overseas music labels and film makers while the local competitors have difficulties to access to the distribution channels in this area. Hence, the threat of potential new entrants is not hundred percent high because of the differentiation.

4. 3. 4. The Threat of Substitute

Large numbers of substitutes are available, Apple's iTunes offer a channel for buyers to legally purchase their favorite music or rent a movie online through the iTunes store, buyers can also choose to buy one song instead of entire album from this channel. The illegal download and pirate goods can be seen as another substitute of HMV's products and this kind of substitute is causing fatal impact to the records retailing industry. Buyers can download their favorite MP3 music or watch movies online without paying a dime.

4. 3. 5. Rivalry amongst Competing Firms

The competition in the industry is highly intense and complicated as summarized in figure 3. The large numbers of local and global retailers in the

industry increase the level of rivalry, these retailers are competing for the same group of customers and generally the switching cost for buyers is not too high. In addition, there is only one supplier for each music label or film maker, switching supplier is almost impossible unless the retailer choose to reduce its product range. The illegal download changes the culture from buying a copy of the records to get the products via a personal computer at no cost. Overall the music and video retailing industry is not attractive, the competition in the industry is highly intense which created a negative environment for the retailers in the industry.

5. Sustainable competitive advantage

5. 1. Resources and Capabilities

The five HMV stores located in the major shopping districts in Hong Kong and the e-commerce website that allow the company increase the exposure and reach its customers via different channels anytime. HMV has a strong brand name that affiliated to music and visual entertainment, the company is famous for the professional customer service team with extensive product knowledge that can help customers shopping in the stores. Customers can also listen to the CD before they purchase, even the CD is not available in the in-store digital kiosks. The professional team also enables a superior service level to acquire and retain loyal customers.

The company made a lot of efforts in leveraging the relationships with artists and suppliers to strengthen the supply base and agreements with its key suppliers are made secure the supply in order to ensure the ability to trade its core products. Most of western music and visual products that available in HMV cannot be found in other retailers in Hong Kong as its competitors focus

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on offering products of local music labels and film makers and HMV's wide range of products lead to a differentiation. Being differentiate can help reducing the bargaining power of buyers as they cannot easily switch to other suppliers and keeps the customers coming to buy from the company.

5. 2. Financial Performance

HMV headquartered in the United Kingdom listed in the London Stock Exchange market and the key ratios of the past five years as shown in figure 4 below. Since the company is not listed in Hong Kong, the analysis is for the entire HMV group.

5. 2. 1. Profitability

The numbers show that the profit margin is continuously increasing since the rapid downturn in 2007. The operating margin of amazon. com was 5. 09% in 2005, declined to 3. 63% in 2006 and the ratio back to 4. 61% in 2009.

Comparing the ratios of the two companies, it is clear that the profitability of HMV is not as strong as the amazon. com and it is highly possible that the fix costs for operating the large numbers of chain stores are high.

5. 2. 2. Solvency Ratios

The gearing ratios stay low which makes perfect sense as HMV is in the retailing industry, inventories are mean to move fast and all the sales transactions are settled by cash payment, the inventories turn to cash in high speed.

5. 2. 3. Management Effectiveness

The return on equity (ROE) ratio keeps declining that probably means the management in HMV is getting less effective. However, compare to the ROE

of amazon. com which declined from 3821. 30% in 2005 to 22. 75% in 2009, the performance of HMV is acceptable and it means that the management effectiveness of HMV is better than the amazon. com.

5. 3. The VRIO Framework

5. 3. 1. Valuable

The brand name and the relationships between HMV and its suppliers are the most valuable resources of HMV. It requires a lot of investment and efforts to build up the brand name for a positive impression in its potential customers' mind, so do the relationship with the suppliers. Procuring the resources is time consuming and these resources cannot be purchased, they also can be exploited and will elaborate in section 4. 3. 4.

5. 3. 2. Rare

The differentiate products that available in HMV Hong Kong are not easy to be found its local competitors which make a rare resource for the company. However, the resources can only help the company outperform the local competitors that doing the business in the legal way but buyers can still get them through illegally download. Buyers can also purchase these products from the global retailers, overall the resources are not actually rare.

5. 3. 3. Costly to Imitate

HMV's in-store digital kiosks used to be an advantage of the company but the Hong Kong Records quickly imitate the feature to offer the same service to the customers. Its wide product range that benefit from the well developed relationship with the suppliers is the hardest part to imitate. Local retailers may not be able to copy from HMV as it requires connections for

developing this kind of relationship, it also takes a long period of time to do so.

5. 3. 4. Exploited

HMV is able to exploit its available resources to generate more sales revenue. For instant, the company frequently organizes CD signing events in the stores that can sell more CDs while helping the artists to promote their new music record, it also further strengthen the relationships with the music labels and artist. The company also working on related diversification to offer more products to the customer through the current sales channels.

5. 4. Sustainable Competitive Advantage of HMV Hong Kong

Findings from the VRIO analysis as summarized in figure 5, it shows that the available resources in HMV are valuable, costly to imitate and exploited but they are not rare. In conclusion, the company does not have a sustainable competitive advantage because one of the most important features is missing.

6. Recommendations

6. 1. Corporate Level

This level of strategy is to increase the related diversification in order to the market share by 5% and increase 40% sales revenue in 3 years. The diversification is to focus on increasing the product range in elaborating the e-commerce to let customer purchase online and legally download the products via the website. More related products in the retail stores are highly recommended in order to utilize the resources and customer base.

6. 2. Business Level

Aim of the business level strategy is to acquire customers and the first priority for HMV Hong Kong is to increase the level of differentiation in products and customer services. The company should consider about adding its live experiences service to organize concert for western artists in Hong Kong, especially those new artists who are not well known enough in Asia to organize a concert by themselves. This actually can create a win-win situation as the artists can get more exposure while HMV gets the profit by selling the ticket. It can also increase the differentiation and develop rare resources which cannot be replaced by piracy products in order to achieve a sustainable competitive advantage.

7. Conclusion

Overall the growth of music and video retailing industry is slow as it is directly impacted by the economic environment, and the swift in cultural environment from buying to illegally download the products caused a negative impact to the growth of the industry and the legal environment has a limited power to protect the industry. Rivalry is highly intensive, apparently the industry is not attractive especially in the current general environment. In addition, HMV Hong Kong does not have a sustainable competitive advantage as the resources are not rare. At this point, HMV may have to consider giving up but it is not a good choice to retreat while there is still chance to increase the competitiveness by utilizing the resources. HMV Hong Kong should reallocate its resources to increase the diversification and differentiation in order to achieve a sustainable competitive advantage to outperform the rivals.