MGMT 390 Industrial Condition Analysis

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Defining Industries: Where to Draw the Boundaries

Industries and Markets

* Economists define an industry as ***a group of firms that supplies a market***.
* With five forces analysis, the industry profitability being determined by competition in two markets
  + Product markets
  + Supply markets
* Industries are identified with relatively broad sectors
* Markets are related to specific products
* Geographical boundary also related to the industry and market issue
* To identify and define an industry
  + Start with an idea of a market: which firms compete to supply a particular product or service?
  + This approach may lead to question conventional concepts of industry boundary
    - i.e. what is the industry commonly referred as banking?
      * Retail banking or Corporate banking

Defining market: Substitution in Demand and Supply

* The central issue in defining industries is to establish who is competing with whom.
* To define industries, we have to draw upon the principle of *substitutability*
  + substitutability on demand
  + substitutability on supply
* The key test of the geographical boundaries of a market is price
  + If price differences for the same product between different locations tend to be eroded by demand-side and supply-side substitution, then these locations lie within a single market.
* Drawing the boundaries of markets and industries is a matter of judgment that depends on the purposes and context of the analysis
* The longer term are the decisions being considered, the more broadly should we define the relevant industry
  + Substitutability is higher in the long run than in the short run

North America Industry Classification System 2012

<http://www.statcan.gc.ca/subjects-sujets/standard-norme/naics-scian/2012/introduction-eng.htm>

* An industry classification system developed by the statistical agencies of Canada, Mexico and the United States.
* Based on supply-side or production-oriented principles to ensure that industrial data, classified to NAICS, are suitable for the analysis of production-related issues such as industrial performance
* At highest level, it divided the economy into 20 sectors
* At lower level, it further distinguishes the different economic activities in which businesses are engaged
* Based on a single production-oriented concept
  + Definition of production process refers to the combination of inputs used in producing a certain quantity of outputs.
  + Producing units are grouped into industries according to similarities in their production processes
* The structure of NAICS is hierarchical. It is composed of sectors (two-digit codes), subsectors (three-digit codes), industry groups (four-digit codes), and industries (five-digit codes).

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Industry Analysis and Competitive Analysis

* Four question for designing viable strategy
  + What are the boundaries of the industry
  + What is the structure of the industry
  + Which firms are our competitors
  + What are the major determinants of competition

Industry Boundaries

* Industry
  + A group of companies that provide similar products and services
* Similar product
  + Customers perceive the substitutable product
* Why is it important to define the boundary
  + Help executives determine the arena in which their firm is competing
  + A definition of industry boundaries focuses attention on the firm’s competitors
    - Defining industry boundaries enables the firm to identify its competitors and producers of substitute product
    - Critical to the firm’s design of its competitive strategy
  + A definition of industry boundaries helps executives determine key factors for success
* Executives use that definition to forecast demand for their firm’s products and services

Problems in Defining Industry Boundaries

* Requires caution and imagination
* Caution
  + Necessary because there are no precise rules for this task and because a poor definition will lead to poor planning
* Imagination
  + Necessary because industries are dynamic
* The difficulty from three sources:
  + The evolution of industries over time creates new opportunities and threats. Compare the financial services industry as we know it today with that of the 1990s, and then try to imagine how different the industry will be in the year 2020.
  + Industrial evolution crates industries within industries. The transformation allows some firms to specialize and others to compete in different, related industries
  + Industries are becoming global in scope.
* The technology can quickly redefine an industry or lead directly to the creation of new one.

Developing a Realistic industry Definition

* The starting point is a definition of the industry in global terms; that is, in terms that consider the industry’s international components as well as its domestic components.
* Executives need to select the scope of their firm’s potential market from among these related but distinct areas.
* To understand the makeup of the industry, executives adopt a longitudinal perspective.
  + Examine the emergence and evolution of product families
  + Executives have to identify the five issues
    - Which part of the industry corresponds to our firm’s goals
    - What are the key ingredients of success in that part of the industry
    - Does our firm have the skills needed to compete in that part of the industry? If not, can we build those skills?
    - Will the skills enable us to seize emerging opportunities and deal with future threats
    - Is our definition of the industry flexible enough to allow necessary adjustments to our business concept as the industry grow?