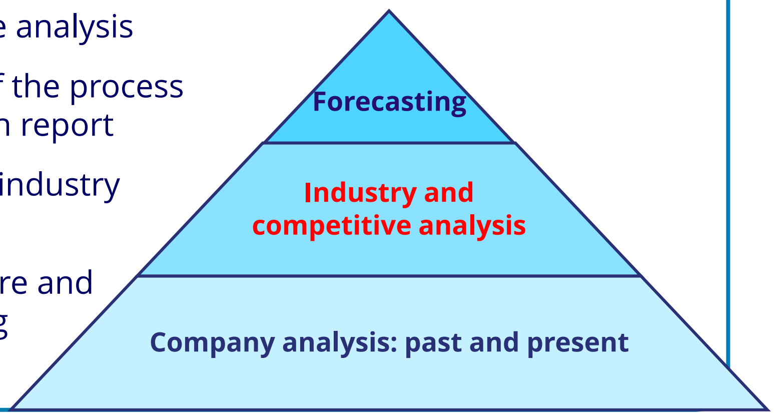
Equity

Industry and Competitive Advantage

Exam Focus

Industry and competitive analysis

- Forms the next layer of the process of producing a research report
- Study of the drivers of industry size, profitability
- Company's market share and competitive positioning



Industry and Competitive Analysis: Steps

Define industry
- E.g., with GICS
- Subjective

Industry survey
- Size, growth, trends

Industry structure
- Porter's Five Forces

External influences
- PESTLE

Competitive analysis
- Comp. strategy
- Competitive advantage

Characterizing Industry Growth: Style Box

Historic **growth rate** enables analyst to consider if growth can continue or slow to closer to GDP growth (mature), or even begin to decline

Sensitivity to business cycle driven by whether product is discretionary, capital vs. recurring, interest rate exposure

Consider:

Freight

Pharmaceuticals

Gaming

Semiconductors

Digital advertising

	Mature	Growth
Defensive		
Cyclical		

Market Share: Example

- Competitive intensity reduces profitability.
- HHI is a common measure of industry concentration (lower concentration means more competitive intensity).

An industry has 5 firms with 35%, 25%, 20%, 15%, and 5% market share. Show the impact on the HHI if the two smallest firms merge.

HHI before merger = $35^2 + 25^2 + 20^2 + 15^2 + 5^2$ =
(implies highly concentrated as 2,500 or more)

HHI after merger = $35^2 + 25^2 + 20^2 + 20^2$ =

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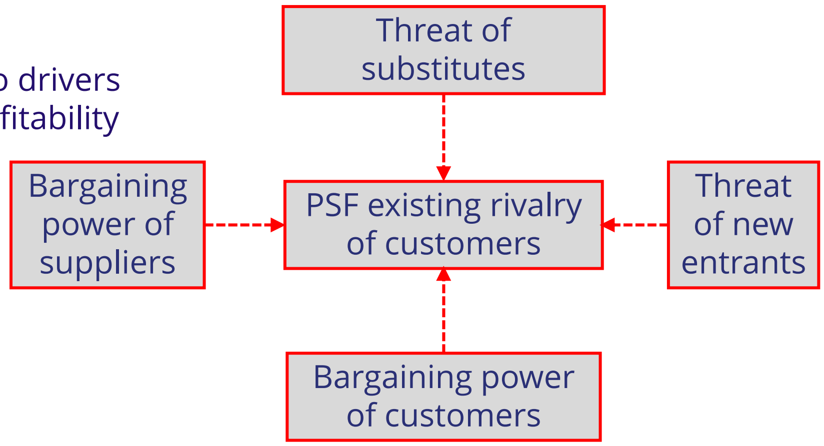
Porter’s Five Forces

- Strong forces mean low industry profitability
- Analyst can be alert to drivers of future industry profitability



Application of Porter’s Five Forces: Example

Consider how the model would characterize the forces on the U.S. retailing industry (low/moderate/high):

Threat of new entrants: Very high—few barriers, little regulation, easy to set up online retailers

Threat of substitutes: Low—not easily to replace goods

Bargaining power of customers: Moderate—no large groups, but customers are price sensitive and price comparison is easy

Bargaining power of suppliers: Low/moderate as many suppliers available, but higher for branded goods

Rivalry among existing competitors: High—crowded marketplace, fierce competition, and promotions/discounting

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External Influences on Industry Growth

- Whereas Porter's Five Forces focuses on industry profitability, PESTLE can be used to consider the potential longer-term industry growth rate:
  - **P**olitical
  - **E**conomic
  - **S**ocial
  - **T**echnological
  - **L**egal
  - **E**nvironmental

Allow analysts to isolate themes or narratives that investors may want exposure to/avoidance of

Competitive Positioning

An analyst should assess a company strategy on three dimensions:

1. Does the strategy create a defense against the five industry forces?
2. Does the strategy benefit from (at least not be at odds with) PESTLE influences?
3. Does the company have the resources and capabilities to execute the strategy?

Three successful "generic strategies" are based on Professor Porter's work on competition (see next slide). Don't get "stuck in the middle."

Generic Competitive Strategies

	Cost Leadership	Differentiation	Focus
How?	• Economies of scale/scope • Access to raw materials • Cost control	• Invest in brand, service, advertising • Quality • Unique features • Premium pricing	• Proximity to customers • Understanding of customer needs
Risks	• Cost inflation • Technological change • Desire for premiumization	• Imitation • Buyers demand changes • Price pressure too much for buyers • May limit market share	• Larger competitors outcompete on price • Group loses distinctive features
Defends against which forces?	• Threat of new entrants • Customer power • Industry rivalry	• Threat of new entrants and substitutes • Customer power • Supplier power	• Threat of new entrants and substitutes • Customer power

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Solutions

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An industry has 5 firms with 35%, 25%, 20%, 15%, and 5% market share. Show the impact on the HHI if the two smallest firms merge.

HHI before merger = $35^2 + 25^2 + 20^2 + 15^2 + 5^2$ = 2,500
(implies highly concentrated as 2,500 or more)

HHI after merger = $35^2 + 25^2 + 20^2 + 20^2$ = 2,650

-2