Learning Module 6: Industry and Competitive Analysis

Q.117 A high-tech industry only has 3 large firms operating in it. This is *most likely* a:

A. concentrated industry.

B. fragmented industry.

C. low-cost industry.

The correct answer is **A.**

A high-tech industry with only 3 large firms operating within it is most accurately described as a concentrated industry. This classification is based on the market structure and competitive landscape of the industry. In a concentrated industry, a small number of firms hold a significant market share, which allows them to exert considerable influence over the industry's direction, pricing, and innovation.

The presence of only 3 large firms suggests that these entities likely dominate the market, making it difficult for new entrants to compete or for smaller firms to gain significant traction. This concentration can lead to higher barriers to entry, reduced competition, and potentially higher prices for consumers. However, it can also foster innovation and efficiency as the dominant firms have the resources to invest in research and development.

B is incorrect. A fragmented industry is characterized by a large number of small or medium-sized firms, none of which has a significant market share or the ability to individually influence the industry's direction. This scenario typically results in intense competition, lower prices, and a focus on niche markets or customer service as a way to differentiate. The description of an industry with only 3 large firms directly contradicts the definition of a fragmented industry, as the concentration of market power is high, not dispersed among many competitors.

C is incorrect. Labeling the industry as low-cost is misleading without additional context regarding the firms' strategies or operational efficiencies. The term "low-cost industry" generally refers to industries where firms compete primarily on price, often due to minimal differentiation in products or services. While it's possible for firms in a concentrated industry to adopt low-cost strategies, the mere presence of a small number of large firms does not inherently make an industry low-cost.

Factors such as the level of technological advancement, the scale of operations, and the competitive strategies of the firms are crucial in determining whether an industry can be classified as low-cost. Therefore, without specific information about the cost structures or pricing strategies of the firms in question, it is inappropriate to categorize the industry based solely on the number of dominant players.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.1024 While trying to develop a competitive strategy, a company opts for the leadership cost strategy. Which of the following is *most likely* one of the features of this company?

A. The company has less proportion of market share.

B. The company has a low cost of capital.

C. The company has the power to set higher commodity prices than its competitors.

The correct answer is **B.**

A company that opts for a cost leadership strategy aims to become the lowest-cost producer in its industry. The primary feature of such a company is its ability to maintain a low cost of capital. This is crucial because a low cost of capital allows the company to fund its operations and expansions at a lower cost, enabling it to offer its products or services at a lower price than its competitors while still maintaining profitability.

By achieving cost leadership, the company can attract a larger market share by appealing to cost-conscious customers. This strategy requires efficient production processes, economies of scale, and tight cost control. A low cost of capital is indicative of the company's efficiency in managing its financial resources, which is a cornerstone of the cost leadership strategy.

A is incorrect. Their lower cost structure allows them to offer competitive prices, attracting a larger customer base. Therefore, a smaller market share would not be a characteristic feature of a company pursuing cost leadership but rather an indication of challenges in executing the strategy effectively.

C is incorrect. The assertion that the company has the power to set higher commodity prices than its competitors is contrary to the essence of a cost leadership strategy. The primary goal of this strategy is not to charge higher prices, but to offer products or services at lower prices than competitors, thereby gaining a competitive advantage.

Companies employing a cost leadership strategy focus on minimizing costs to maintain profitability even at lower price points, rather than leveraging the ability to charge higher prices. This approach helps in attracting price-sensitive customers and expanding the company's market share. Therefore, the ability to set higher prices is not characteristic of a cost leadership strategy.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (e) Evaluate the competitive strategy and position of a company.

Q.1028 What happens in a situation of under capacity?

A. Demand is smaller than supply at the current prices.

B. Demand is always equal to supply in the market.

C. Demand is superior to supply at the current prices.

The correct answer is **C.**

Undercapacity refers to a scenario where the production capabilities of a company or industry are insufficient to meet the current demand for its products or services at prevailing prices. This situation often leads to several economic implications, including increased prices and higher returns on investment, as the demand for the limited supply of goods or services exceeds the available supply.

Under-capacity can be caused by various factors such as government policies that restrict expansion or importation, breakdowns of production machinery, labor issues like prolonged strikes, shortages of production inputs, and underutilization of existing plants and equipment. These factors contribute to a scenario where the supply cannot keep up with the demand, leading to a market condition where demand is superior to supply at current prices.

A is incorrect. This option suggests that demand is smaller than supply at the current prices, which describes a situation of overcapacity rather than under-capacity. Overcapacity occurs when the production capabilities exceed the demand for products or services, leading to an excess supply in the market. This condition is opposite to under-capacity, where the demand outstrips the available supply, causing prices to potentially rise as consumers compete for the limited goods or services.

B is incorrect. This option implies that demand is always equal to supply in the market, which describes a state of market equilibrium. In reality, markets frequently experience fluctuations and imbalances between supply and demand due to various external and internal factors. Under-capacity specifically refers to a situation where demand exceeds supply, not a balanced market condition. Market equilibrium is an ideal state where the quantity of goods supplied equals the quantity demanded at a specific price level, but it does not accurately describe the dynamics of under-capacity.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.1030 Drug stores can be classified as a:

A. cyclical industry.

B. growth industry.

C. defensive industry.

The correct answer is **C.**

Drug stores are classified as defensive industries because they exhibit stable demand regardless of economic fluctuations. Defensive industries are characterized by their production of goods and services that remain in constant demand, irrespective of the state of the economy. This stability is primarily because these industries provide essential commodities and services that cater to basic human needs, which do not diminish even during economic downturns.

The healthcare sector, including drug stores, is a prime example of a defensive industry. People require medications and healthcare products throughout all economic conditions, making drug stores resilient to economic changes. This inherent stability makes drug stores and similar sectors less susceptible to the economic cycles that affect other industries more significantly.

A is incorrect. The demand for healthcare products and medications remains relatively constant, regardless of economic conditions.

B is incorrect. Growth industries are characterized by their potential for above-average growth compared to the broader market. These industries are often at the forefront of innovation and may represent sectors that are developing due to new technologies or societal changes. Growth industries are expected to expand rapidly as they tap into new markets or create entirely new market segments.

Examples include the technology sector, renewable energy, and biotechnology. While drug stores may experience growth, particularly in regions with aging populations or expanding healthcare coverage, they do not exhibit the high growth rates or the innovative, market-creating characteristics typical of growth industries. Instead, their demand is driven by the consistent and essential need for healthcare products and services, aligning them more closely with the definition of a defensive industry.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.1031 Which of these characteristics best describe commodity goods?

A. High competition and high profitability.

B. High competition and low profitability.

C. Low competition and high profitability.

The correct answer is **B.**

Commodity goods are typically characterized by high competition and low profitability. This is primarily due to the nature of commodity markets, where products are largely undifferentiated and interchangeable. In such markets, the presence of numerous suppliers offering similar products leads to intense competition.

Since commodities are standardized, consumers can easily switch from one supplier to another with minimal cost or inconvenience, which further intensifies the competitive environment.

Additionally, the high competition in commodity markets often leads to price wars, as suppliers attempt to undercut each other to gain market share. This competitive pricing strategy, while potentially increasing sales volume, tends to significantly reduce profit margins.

Furthermore, the demand for commodities is often highly elastic, meaning that small changes in price can lead to significant changes in the quantity demanded. This elasticity further contributes to the low profitability of commodity goods, as suppliers have limited ability to increase prices without negatively impacting demand.

A is incorrect. While it is true that commodity markets are highly competitive, this competition typically results in low profitability rather than high. The undifferentiated nature of commodities means that suppliers have little control over pricing and are often forced to compete on price alone, which squeezes profit margins. Additionally, the ease with which consumers can switch between suppliers in a commodity market further limits the potential for high profitability.

C is incorrect. The standardized nature of commodities leads to a crowded marketplace with many suppliers offering similar products, which results in high competition. This high level of competition, combined with the price sensitivity of consumers in commodity markets, typically results in low profitability for suppliers. The notion of low competition in commodity markets contradicts the fundamental characteristics of these markets, where the ease of entry and the presence of numerous suppliers contribute to a highly competitive environment.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (c) Determine an industry's size, growth characteristics, profitability, and market share trends.

Q.1032 How does the oil industry *most likely* maintain a premium pricing strategy?

A. The threat of substitutes

B. The bargaining power of the buyers

C. Significant barriers of entry

The correct answer is **C.**

The oil industry is able to maintain a premium pricing strategy primarily due to significant barriers to entry. These barriers include the high capital investment required for exploration, drilling, and refining, as well as regulatory hurdles and the need for specialized technology and expertise. The presence of these barriers means that new competitors cannot easily enter the market, which limits competition and allows existing companies to set higher prices.

Furthermore, the global demand for oil and its products ensures a steady market for these premium-priced offerings. The strategic control over oil reserves by a few major companies and countries also contributes to the maintenance of these barriers, reinforcing the industry's ability to command premium pricing.

A is incorrect. The threat of substitutes does not directly enable the oil industry to maintain premium pricing. While alternative energy sources are emerging, the current infrastructure and technology heavily depend on oil and its derivatives. This dependency limits the immediate impact of substitutes on the industry's pricing strategy. However, in the long term, the development of viable and cost-effective alternatives could challenge the industry's ability to maintain premium prices.

B is incorrect. The bargaining power of buyers, in theory, could exert downward pressure on prices. However, due to the essential nature of oil and its products in various sectors such as transportation, manufacturing, and energy production, buyers have limited alternatives. This necessity reduces their bargaining power. Additionally, the oligopolistic structure of the oil market means that a few large entities control a significant portion of the supply, further diminishing the bargaining power of individual buyers or small groups of buyers in influencing pricing strategies.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (d) Analyze an industry’s structure and external influences using Porter’s Five Forces and PESTLE frameworks.

Q.1033 Electricity is part of which industrial classification sector?

A. Energy

B. Utilities

C. Technology

The correct answer is **B.**

This sector encompasses companies that provide basic amenities and services to consumers and businesses. These services include the generation, distribution, and sale of electricity, as well as water and gas services.

The Utilities sector is crucial for the functioning of everyday life and the economy, as it ensures the provision of essential services that are necessary for heating, cooling, lighting, and operating machinery in various industries.

A is incorrect. While the Energy sector is closely related to the Utilities sector, it primarily focuses on the exploration, production, and marketing of energy products, including oil, natural gas, and renewable energy sources.

The Energy sector is more concerned with the supply side of energy products rather than the distribution and delivery of services to end-users, which is the main focus of the Utilities sector. Therefore, classifying electricity under the Energy sector would overlook the aspect of service provision that is central to the Utilities sector.

C is incorrect. The Technology sector encompasses companies involved in the research, development, and distribution of technologically based goods and services. This includes software companies, hardware manufacturers, and internet companies, among others.

While technology plays a significant role in the generation and distribution of electricity, especially with the advent of smart grids and renewable energy technologies, the primary function of providing electricity as a service to consumers and businesses falls under the Utilities sector. Therefore, classifying electricity within the Technology sector would not accurately reflect its role as a basic utility service.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.1359 Which of the following is the analysis of a specific branch of manufacturing, service or trade?

A. Industry Analysis

B. Company Analysis

C. Benchmarking Analysis

The correct answer is **A.**

Industry analysis is the evaluation and examination of a specific branch of manufacturing, service, or trade. This type of analysis involves a comprehensive study of the economic, political, and market factors that influence the performance and operations of companies within a particular sector.

It aims to identify the strengths, weaknesses, opportunities, and threats (SWOT) that exist within an industry, as well as to understand the competitive landscape, market trends, and potential for growth or decline. Industry analysis is crucial for investors, companies, and stakeholders to make informed decisions regarding investments, strategic planning, and competitive positioning.

B is incorrect. Company analysis focuses on evaluating the financial health, performance, strategies, and competitive position of a specific company rather than an entire industry. It involves a detailed examination of a company's financial statements, business model, products or services, market share, and competitive advantages.

The goal of company analysis is to assess the company's potential for growth, profitability, and risk. While company analysis may consider industry factors as part of its evaluation, its primary focus is on the individual company and not the broader industry in which it operates.

C is incorrect. Benchmarking analysis is a process of comparing a company's processes, performance metrics, and products against those of leading companies within the same industry or across different industries. The purpose of benchmarking analysis is to identify areas where a company can improve its operations, increase efficiency, and enhance competitive advantage by learning from the best practices of others.

Benchmarking can be internal, comparing different departments or operations within the same company, or external, comparing with other companies. Unlike industry analysis, which provides an overview of the entire industry, benchmarking analysis is focused on specific aspects of performance and operational efficiency.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (a) Describe the purposes of, and steps involved in, industry and competitive analysis.

Q.1360 Which of the following is *not* one of the uses of Industry Analysis?

A. Understand a company's business and business environment

B. Identify active investment opportunities

C. Determine the performance of a company based on industry standards

The correct answer is **C.**

Industry analysis is a crucial tool for investors and analysts to understand the broader context in which a company operates. It involves examining the economic, political, and market factors that influence an industry's performance.

This analysis helps in identifying the strengths, weaknesses, opportunities, and threats within a specific sector, enabling investors to make informed decisions. Determining the performance of a company based on industry standards is least likely a use of industry analysis.

A is incorrect. Understanding a company's business and business environment is a primary use of industry analysis. This process involves evaluating the industry's competitive landscape, regulatory environment, market trends, and economic indicators.

By gaining a deep understanding of these factors, investors and analysts can assess a company's position within its industry, its potential for growth, and the challenges it may face. This comprehensive understanding is essential for making strategic investment decisions and for advising companies on their business strategies.

B is incorrect. Identifying active investment opportunities is another significant use of industry analysis. By analyzing different sectors and understanding their growth prospects, investors can pinpoint industries that are poised for growth or sectors that are undervalued by the market.

This analysis allows investors to allocate their resources more effectively, targeting investments in industries with higher potential returns. Furthermore, industry analysis can reveal emerging trends and technologies that may disrupt traditional business models, offering early investment opportunities in innovative companies.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (a) Describe the purposes of, and steps involved in, industry and competitive analysis.

Q.1361 Which of the following is *least likely* one of the three major approaches to industry classification?

A. Market capitalization

B. Products and/or services supplied

C. Statistical similarities

The correct answer is **A.**

Market capitalization is not one of the three major approaches to industry classification. Industry classification systems are designed to categorize companies based on certain characteristics that they share, which helps investors, analysts, and other stakeholders understand the competitive landscapes, performance metrics, and risks associated with different sectors.

The three widely recognized approaches to industry classification include products and/or services supplied, business-cycle sensitivities, and statistical similarities.

B is incorrect. Products and/or services supplied is indeed one of the major approaches to industry classification. This method categorizes companies based on their primary business activities or the main sources of their revenue.

It is a fundamental approach used in various industry classification standards, such as the Global Industry Classification Standard (GICS) and the Industry Classification Benchmark (ICB), which group companies into sectors and industries based on what they produce or the services they provide. This approach helps investors and analysts compare companies with similar products or services and understand the dynamics of specific markets.

C is incorrect. Statistical similarities is also a recognized approach to industry classification. This method involves grouping companies based on the correlations of their securities' returns over time. By analyzing historical performance data, companies that exhibit similar return patterns are classified together.

This approach can reveal underlying economic or market factors that cause certain companies to move in tandem, offering insights into risk factors and investment opportunities. Statistical similarities can complement the more traditional classification methods, providing a quantitative perspective on how companies within the same or different sectors relate to each other in terms of their stock performance.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.1362 Which of the following is a company whose profits are strongly correlated with the strength of the overall economy?

A. Cyclical company

B. Positively correlated company

C. Defensive growth company

The correct answer is **A.**

A cyclical company is one whose financial performance is closely linked to the overall state of the economy. These companies tend to perform well when the economy is growing and face challenges during economic downturns. The correlation between the performance of cyclical companies and the economy's health is due to the nature of the products or services they offer, which are often considered non-essential or luxury items.

During times of economic prosperity, consumers and businesses are more likely to increase spending on these non-essential goods and services, leading to higher profits for cyclical companies. Conversely, in periods of economic decline, spending on these items is often reduced, resulting in decreased profits for these companies. This direct relationship with the economic cycle makes cyclical companies a good indicator of the economy's strength.

B is incorrect. The term "positively correlated company" is not a standard classification within the context of economic cycles. While it's true that all companies have some degree of correlation with the economy, the term does not specifically refer to companies whose profits are strongly correlated with the strength of the overall economy.

C is incorrect. Defensive growth companies, also known as non-cyclical or defensive companies, are characterized by their ability to maintain stable earnings and performance regardless of the state of the overall economy. These companies typically operate in industries that provide essential goods and services, such as utilities, healthcare, and consumer staples, which remain in demand even during economic downturns.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (c) Determine an industry's size, growth characteristics, profitability, and market share trends.

Q.1363 Which of the following is a disadvantage of a business-cycle classification?

A. It uses historical data

B. Different countries and regions of the world frequently progress through the various stages of the business cycle at different times

C. This method often results in non-intuitive groups of companies

The correct answer is **B.**

The business cycle refers to the fluctuations in economic activity that an economy experiences over a period, typically characterized by four stages: expansion, peak, contraction, and trough. One of the main challenges with applying a business-cycle classification is that different countries and regions often do not synchronize in their economic cycles.

This lack of synchronization means that while one country might be experiencing an economic expansion, another could be in a contraction phase. This discrepancy can lead to difficulties in classifying companies that operate globally, as their performance may not align neatly with a single phase of the business cycle.

Moreover, multinational companies might experience varied impacts on their operations and financial performance depending on the economic conditions in different regions, making a straightforward classification based on the business cycle problematic.

A is incorrect. The use of historical data is not inherently a disadvantage of a business-cycle classification. In fact, historical data is crucial for identifying patterns in economic activity and understanding how different phases of the business cycle can impact various sectors and companies.

Analysts rely on historical data to make informed predictions about future economic conditions and to classify companies based on their sensitivity to different economic phases. While historical data may not always perfectly predict future trends, it provides valuable insights that can inform business-cycle classifications.

C is incorrect. The claim that a business-cycle classification often results in non-intuitive groups of companies is more closely associated with the limitations of other classification methods, such as the statistical similarities approach. The business-cycle classification focuses on how companies are affected by economic cycles, which can lead to intuitive groupings based on companies' cyclical nature.

For example, consumer staples are often classified as less sensitive to economic downturns, while luxury goods and discretionary spending are more affected by economic contractions. This approach allows for a logical grouping of companies based on their performance across different stages of the business cycle, contrary to the assertion that it results in non-intuitive groups.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.1364 Which of the following is a commercial industry classification system that was jointly developed by Standard and Poor's and MSCI Barra?

A. Russel Global Sectors

B. Global Industry Classification Standard

C. Industry Classification Benchmark

The correct answer is **B.**

The Global Industry Classification Standard (GICS) is a comprehensive industry classification system that was jointly developed by Standard & Poor's (S&P) and MSCI Barra to provide a reliable, detailed framework for investment research, portfolio management, and asset allocation. Its primary purpose is to ensure that global industry comparisons are consistent and standardized across the financial community.

GICS categorizes companies based on their primary business activities, making it easier for investors and analysts to compare companies, sectors, and industries worldwide. This system is widely recognized and used by the global financial community, including investors, analysts, and regulators, to facilitate a clear and common understanding of industries and sectors in the complex global market.

A is incorrect. The Russell Global Sectors classification system is used for segmenting the global equity markets into sectors and industries. While it serves a similar purpose to GICS, it is a distinct system with its own set of classifications and is not the product of a collaboration between Standard & Poor's and MSCI Barra.

C is incorrect. The Industry Classification Benchmark (ICB) is another industry classification system used globally, but it was not developed by Standard & Poor's and MSCI Barra. Instead, the ICB is a product of FTSE Russell and is used to categorize and compare companies across four levels of classification: industries, supersectors, sectors, and subsectors.

While the ICB is a widely used system for classifying stocks and other securities, it is distinct from the GICS and serves as its competitor in the market for industry classification standards.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.1366 Which of the following is a commercial industry classification system in which each company is assigned in a sub-industry based on its principal business activity?

A. Global Industry Classification Standard

B. Industry Classification Benchmark

C. Russell Global Sectors

The correct answer is **A.**

The Global Industry Classification Standard (GICS) is a comprehensive commercial industry classification system that plays a crucial role in the organization and analysis of financial markets. GICS is designed to provide a consistent, detailed framework for classifying companies based on their principal business activities.

GICS categorizes each company into one of 11 sectors, which are further divided into 24 industry groups, 69 industries, and 158 sub-industries. This hierarchical structure ensures a high level of specificity in classifying companies, allowing for a nuanced understanding of the market landscape.

The assignment of a company to a sub-industry under GICS is based on its primary revenue source, ensuring that the classification accurately reflects the company's core business operations. This precise classification system is widely adopted by investment professionals worldwide, serving as the foundation for many financial products, including indices, mutual funds, and exchange-traded funds (ETFs).

B is incorrect. The Industry Classification Benchmark (ICB) is another widely recognized industry classification system, developed through a partnership between Dow Jones and FTSE. The ICB employs a different structure, consisting of 10 industries, 19 supersectors, 41 sectors, and 114 subsectors.

While both GICS and ICB serve similar purposes in classifying companies for investment analysis, they differ in their specific categorization criteria and hierarchical organization. The ICB focuses on grouping companies primarily by their source of revenue, which, while similar to GICS, results in different classifications due to its unique structure and definitions.

C is incorrect. Russell Global Sectors is a less commonly used classification system compared to GICS and ICB. Developed by Russell Investments, it categorizes companies based on the products or services they produce.

While it shares the goal of facilitating investment analysis by grouping companies with similar business activities, Russell Global Sectors is not as widely adopted or recognized as GICS or ICB. Its classification methodology and structure differ from those of GICS, making it an alternative rather than a direct competitor to the more established industry classification standards.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by

which companies can be grouped.

Q.1367 Which of the following is *not* one of the Michael Porter's Five Forces?

A. Threat of substitute products.

B. Bargaining power of customers.

C. Government regulations.

The correct answer is **C.**

Government regulations are not one of Michael Porter's Five Forces. While government policies and regulations can significantly impact industries, they are considered an external factor that affects all the components of the Five Forces model rather than being a force within it.

Regulations can influence the intensity of competition, the entry of new players, the power of suppliers and buyers, and the threat of substitutes. However, they do so indirectly by shaping the competitive landscape and operational environment rather than directly as a force of competition.

A is incorrect. The threat of substitute products is indeed one of Porter's Five Forces. It refers to the risk that an industry's products or services can be replaced by other products or services. Substitutes limit an industry’s potential returns by placing a ceiling on the prices firms in the industry can profitably charge. The more attractive the price-performance ratio of the substitutes, the more intense is the threat.

B is incorrect. The bargaining power of customers, also known as buyers, is another force within Porter's framework. This force assesses how much pressure customers can place on businesses, affecting the prices and quality of goods and services. When customers have strong bargaining power, they can demand lower prices or higher product quality, thus squeezing the industry's profitability. This power is influenced by factors such as the number of buyers, the importance of each customer to the business, and the availability of substitutes.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (d) Analyze an industry’s structure and external influences using Porter’s Five Forces and PESTLE frameworks.

Q.1456 Earth, Sun, Moon, Star and Mars firms have market shares of 28%, 22%, 15%, 10% and 4% respectively. The 4-firm Herfindahl-Hirschman Index after the merger of the firms Moon and Star is *closest to*:

A. 1909

B. 1625

C. 1790

The correct answer is **A.**

The Herfindahl-Hirschman Index (HHI) is a commonly used measure of market concentration and is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers. It can range from close to zero to 10,000. The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases.

In this scenario, after the merger of Moon and Star, the market shares are as follows:

- Earth: 28%
- Sun: 22%
- Moon-Star: 25% (15% + 10%)
- Mars: 4%

Calculating the HHI after the merger involves squaring the market shares of each firm and then summing these squares:

$$\text{HHI} = (28^2) + (22^2) + (25^2) + (4^2) = 784 + 484 + 625 + 16 = 1909$$

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (c) Determine an industry's size, growth characteristics, profitability, and market share trends.

Q.1742 The global industry classification system is the method of grouping firms into an industry-based on the firm's:

A. size.

B. principal business activity.

C. industry life cycle.

The correct answer is **B.**

The Global Industry Classification System (GICS) is a method used to categorize companies into industries based on their principal business activities. This system is crucial for investors, analysts, and other stakeholders in the financial markets as it provides a standardized framework to classify stocks, thereby facilitating sector analysis and comparison.

The principal business activity of a firm refers to the main source of its revenue or the primary products or services it offers. This criterion is used because it reflects the company's core operations and market positioning, which are essential factors for investment decision-making. By grouping companies based on what they primarily do, GICS enables a more accurate and meaningful analysis of industry trends, performance, and potential investment opportunities.

A is incorrect. Grouping firms based on size does not accurately reflect the nature of their business operations or the industry they belong to. Company size, measured by metrics such as market capitalization, revenue, or number of employees, can vary significantly within the same industry.

For example, both a multinational corporation and a small enterprise may operate in the technology sector but differ vastly in size. Therefore, using size as a criterion for industry classification would not provide meaningful insights into the business activities or the competitive landscape of the firms.

C is incorrect. The industry life cycle refers to the stages of growth and development that an industry goes through, from its inception (emergence) to its decline. While understanding the life cycle stage of an industry can be valuable for assessing its growth potential and risk profile, it is not a suitable criterion for classifying companies into industries.

Companies operating in the same sector can be at different stages of their individual life cycles. Moreover, the industry life cycle stage does not inherently describe the principal business activities of firms. Thus, using the industry life cycle as a basis for classification would not accurately group companies according to the nature of their business operations.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.1743 In a typical industry classification system, which of the following will *most likely* be categorized under 'Basic Materials and Processing'?

A. Constructax Building Materials Corp.

B. Allegro Automotive Company.

C. James Morisson Tobacco Company.

The correct answer is **A.**

Constructax Building Materials Corp. is most accurately categorized under 'Basic Materials and Processing' due to the nature of its business. This sector typically includes companies involved in the discovery, development, and processing of raw materials. These materials range from metals and minerals to forest products and building materials.

The classification is based on the fundamental role these materials play in the initial stages of the industrial supply chain. Companies like Constructax, which provide essential materials for construction and infrastructure projects, are foundational to various economic activities, making them a perfect fit for this category.

B is incorrect. Allegro Automotive Company would not fall under 'Basic Materials and Processing' but rather under the 'Consumer Discretionary' sector. This sector includes businesses that tend to be more sensitive to economic cycles, such as those in the automotive industry.

Companies in this category manufacture goods and provide services that consumers are more likely to purchase when they have discretionary income. The automotive sector is characterized by its reliance on consumer demand and economic health, distinguishing it from the more foundational nature of basic materials and processing.

C is incorrect. James Morisson Tobacco Company is best classified under 'Consumer Staples', not 'Basic Materials and Processing'. Consumer staples encompass companies that provide goods and services considered essential for everyday living, including food, beverages, and tobacco.

These products are characterized by their consistent demand, regardless of economic conditions, distinguishing them from the cyclical nature of basic materials. Tobacco products, being non-cyclical and essential for the consumer base that uses them, align with the consumer staples sector's characteristics.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.1745 Sui Gas is a firm that provides gas to the households. Which of the following is the appropriate industry for Sui Gas?

A. Energy

B. Utilities

C. Basic Material processing

The correct answer is **B.**

The appropriate industry for Sui Gas, a firm that provides gas to households, is the Utilities sector. This classification is based on the nature of services that the company provides. The Utilities sector encompasses companies that offer essential services such as electricity, water, and gas supply. These services are fundamental to the daily operations of homes and businesses, making them indispensable.

The classification of Sui Gas under the Utilities sector reflects its role in delivering a critical service that ensures the comfort and functionality of residential and commercial spaces. By providing gas, Sui Gas plays a vital part in heating, cooking, and powering various appliances, which are essential activities in households.

A is incorrect. The Energy sector primarily includes companies involved in the exploration, extraction, refining, and distribution of energy sources like oil, coal, and natural gas. While it might seem intuitive to classify a gas supply company under the Energy sector, the key distinction lies in the nature of the operations.

Companies in the Energy sector are typically engaged in the upstream activities of energy production and raw material extraction. In contrast, Sui Gas, which focuses on the distribution of gas to end consumers, aligns more closely with the characteristics of the Utilities sector, which is concerned with the delivery of essential services.

C is incorrect. The Basic Material Processing sector encompasses companies involved in the extraction and processing of raw materials. This sector includes industries such as mining, chemicals, forestry, and metal production. Companies in this sector are primarily engaged in the transformation of natural resources into primary or intermediate materials that are then used by other industries in the production of goods.

Sui Gas, which provides gas directly to households, does not fit into this category as it does not engage in the processing or transformation of raw materials. Instead, its operations are centered around the distribution and supply of gas, making it a better fit for the Utilities sector, which focuses on the provision of essential services to consumers.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.1746 Which of the following is *most likely* a cyclical industry?

A. Financial services

B. Telecommunication

C. Consumer staples

The correct answer is **A.**

Financial services are considered the most cyclical industry among the options provided. This is because the performance and earnings of companies within the financial services sector are highly dependent on the phase of the business cycle. During periods of economic expansion, financial services such as banking, investment services, and insurance tend to experience higher demand, leading to increased earnings.

Conversely, in times of economic downturn, these services often see a decline in demand, which can significantly impact their profitability. The cyclical nature of the financial services industry is closely tied to interest rates, consumer confidence, and investment activity, all of which fluctuate with the business cycle.

B is incorrect. The demand for these services remains relatively stable regardless of economic conditions. People continue to use their phones and internet services even during economic downturns, making the revenue streams of telecommunication companies less sensitive to the business cycle.

C is incorrect. Consumer staples, which include essential products such as food, beverages, and household goods, are also considered a non-cyclical industry. The demand for these products remains constant regardless of the state of the economy.

People need to eat, drink, and maintain their households irrespective of economic conditions, making consumer staples a stable industry with predictable demand. This stability contrasts with the cyclical nature of financial services, where demand and profitability can vary significantly with economic cycles.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.1748 Which of the following steps is *least likely* included in a thorough industry analysis guidance?

A. Analyze industry prospects based on strategic groups.

B. Classify the life-cycle stage of the industry.

C. Analyze the independence of board members.

The correct answer is **C.**

Analyzing the independence of board members is not typically included in a thorough industry analysis. Industry analysis focuses on understanding the external environment in which firms operate, including market trends, competitive dynamics, and the overall health and trajectory of the industry.

This analysis is crucial for businesses and investors to identify opportunities and threats within a specific industry and to make informed strategic decisions.

A is incorrect. Analyzing industry prospects based on strategic groups is an essential component of industry analysis. Strategic groups refer to clusters of firms within an industry that follow similar business models or strategies.

By examining these groups, analysts can gain insights into the competitive landscape, understand differentiators among competitors, and identify potential opportunities or threats. This step helps in understanding the positioning of various firms within the industry and predicting future industry trends.

B is incorrect. Classifying the life-cycle stage of the industry is another critical step in industry analysis. Industries typically progress through a life cycle that includes stages such as introduction, growth, maturity, and decline. Understanding which stage an industry is in helps analysts and investors predict future growth prospects, competitive intensity, and profitability.

For instance, industries in the growth stage may offer significant investment opportunities but also come with higher risks, while those in the maturity stage might be more stable but offer lower growth prospects. This classification aids in tailoring strategies that are appropriate for the current and anticipated conditions of the industry.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (a) Describe the purposes of, and steps involved in, industry and competitive analysis.

Q.1750 An industry where a small number of firms control a large portion of the market share is known as:

A. an industry with greater market fragmentation.

B. an industry with greater market concentration.

C. a disruptive industry.

The correct answer is **B.**

An industry where a small number of firms control a large portion of the market share is characterized by greater market concentration. This scenario typically results in a situation where these dominant firms have significant control over prices, product offerings, and overall market dynamics.

Market concentration is a key concept in understanding the structure of various industries and their competitive landscapes. It is measured using indices such as the Herfindahl-Hirschman Index (HHI), which calculates the sum of the squares of the market shares of all firms within the industry.

A high HHI score indicates a high level of market concentration, suggesting that a few firms hold a substantial portion of the market share. This can lead to reduced competition, higher prices for consumers, and potentially less innovation. However, it can also result in economies of scale and efficiencies that smaller, fragmented markets may not achieve.

A is incorrect. An industry with greater market fragmentation is characterized by a large number of firms, each holding a small portion of the total market share. This scenario is the opposite of market concentration. In a fragmented market, no single firm has significant market power to influence prices or market conditions substantially.

This often leads to intense competition, lower prices, and potentially more innovation as firms strive to differentiate themselves. Market fragmentation can benefit consumers through greater choice and competitive pricing but may also result in inefficiencies and higher costs for firms due to the lack of economies of scale.

C is incorrect. A disruptive industry refers to one that experiences significant changes due to the introduction of innovative technologies, business models, or products that fundamentally alter the competitive landscape. Disruption often leads to the displacement of established firms, products, and alliances within the industry.

While a disruptive industry can exhibit characteristics of market concentration or fragmentation depending on the stage and nature of the disruption, the term itself does not specifically describe the market share distribution among firms. Instead, it focuses on the transformative impact of innovation on the industry's structure and competitive dynamics.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.1751 Identify the factor that will increase the profitability of a firm.

A. Low barriers to entry

B. An industry with a greater market concentration.

C. Low bargaining power of suppliers

The correct answer is **C.**

Low bargaining power of suppliers can significantly increase the profitability of a firm. This is because when suppliers have low bargaining power, the firm can negotiate better terms, including lower prices for raw materials and other inputs. This reduction in input costs directly contributes to higher margins and, consequently, greater profitability.

Moreover, low supplier power allows a firm more flexibility in its operations, enabling it to respond more effectively to market changes and demands without being constrained by supplier terms. This strategic advantage can lead to cost leadership, allowing the firm to either price more competitively or enjoy higher profit margins, both of which are beneficial for its profitability.

A is incorrect. Low barriers to entry in an industry mean that it is easy for new competitors to enter the market. This increased competition can lead to price wars, reduced market share, and lower profit margins for existing firms. While it might seem that low barriers to entry could stimulate innovation and efficiency, the primary effect in terms of profitability is often negative.

B is incorrect. An industry with greater market concentration means that a few firms hold a significant share of the market. This scenario can lead to oligopolistic behavior, where the dominant firms can exert considerable control over prices, often leading to higher prices and potentially higher profitability for those firms.

However, for a firm that is not one of these dominant players, a high market concentration can be a barrier to increasing its profitability. The firm may find it challenging to gain market share or influence prices. Therefore, while greater market concentration might benefit the few dominant firms, it does not universally increase profitability for all firms in the industry.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (c) Determine an industry's size, growth characteristics, profitability, and market share trends.

Q.1752 Which of the following is the most appropriate statement regarding the under capacity of an industry?

A. Under capacity results in lower pricing power

B. Under capacity results in higher return on capital

C. Under capacity results in excess supply

The correct answer is **B.**

Under capacity in an industry occurs when the demand for a product or service exceeds the available supply. This situation often leads to several economic implications, including a higher return on capital. When companies operate under conditions of under capacity, they are essentially producing at their maximum output levels to meet the excess demand.

This scenario typically allows firms to command higher prices for their products or services due to the scarcity effect, which in turn can lead to higher profit margins and, consequently, a higher return on capital. The return on capital is a measure of a company's efficiency at allocating the capital under its control to profitable investments, and under capacity conditions can significantly enhance this metric.

A is incorrect. The scarcity of the product or service allows firms to raise prices without significantly reducing demand. Consumers, facing limited options, are more willing to pay a premium, thereby increasing the company's pricing power.

C is incorrect. The assertion that under capacity results in excess supply is fundamentally incorrect. Under capacity is characterized by a situation where the supply cannot meet the demand, not by an excess of supply.

Excess supply, or overcapacity is where the production capacity of an industry exceeds the demand for its products or services, often leading to lower prices and reduced profitability. In contrast, under capacity signifies a shortage in supply relative to demand, potentially leading to higher prices and increased profitability for companies within the industry.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (c) Determine an industry’s size, growth characteristics, profitability, and market share trends.

Q.1753 In which of the following cost strategies does a firm decrease its prices to drive out competitors and later increase its prices?

A. Price differentiation strategy

B. Switching cost strategy

C. Predatory pricing strategy

The correct answer is **C.**

Predatory pricing strategy involves a firm deliberately setting its prices low enough to incur a loss or significantly lower profit margins in the short term to eliminate or severely weaken competitors. Once the competition is reduced or eliminated, the firm then has the opportunity to increase prices, leveraging its dominant market position to achieve higher profitability.

This strategy is often scrutinized and regulated under competition laws because it can lead to monopolistic practices and harm consumer interests in the long run. The effectiveness of predatory pricing as a strategy depends on the firm's ability to sustain lower profit margins during the predatory phase and its capacity to capitalize on reduced competition thereafter.

A is incorrect. Price differentiation strategy involves setting different prices for the same product or service based on various factors such as customer segment, purchase quantity, or distribution channel. This strategy aims to maximize revenue by capturing consumer surplus and is not focused on eliminating competitors through pricing tactics. Price differentiation is used to cater to different sensitivities to price in different market segments rather than to drive competitors out of the market.

B is incorrect. The term "switching cost strategy" is a misinterpretation. Firms might increase switching costs to make it less attractive for customers to switch to competitors, thereby enhancing customer loyalty and reducing competitive pressure. This strategy does not involve lowering prices to eliminate competitors but rather focuses on creating barriers to customer migration.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (e) Evaluate the competitive strategy and position of a company.

Q.3645 Due to increased air pollution, a government recently announced subsidies for electric cars. What is the *most likely* impact of the announcement on the electric car manufacturing industry?

A. Increase in the threat of substitute products

B. Increase in the threat of new entrants

C. Decrease in the bargaining power of customers

The correct answer is **B.**

The announcement of subsidies for electric cars by the government is most likely to increase the threat of new entrants in the electric car manufacturing industry. Government subsidies can significantly lower the initial financial barriers to entry for new firms, making it more attractive for them to enter the market. These subsidies might cover various costs associated with the production of electric cars, such as research and development, manufacturing, and marketing.

As a result, the industry could see an influx of new companies looking to capitalize on the favorable conditions created by the subsidies. This increased competition could lead to innovation, more choices for consumers, and potentially lower prices, but it also poses a challenge for existing manufacturers who will have to compete with a larger number of rivals.

A is incorrect. The announcement of subsidies for electric cars is unlikely to increase the threat of substitute products. In fact, the subsidies are intended to make electric cars more competitive against their substitutes, such as gasoline-powered vehicles, by lowering their relative cost and encouraging adoption.

Therefore, rather than increasing the threat of substitutes, the subsidies are likely to decrease it by making electric cars a more attractive option for consumers.

C is incorrect. The announcement of subsidies for electric cars does not directly decrease the bargaining power of customers. Instead, by potentially increasing the number of manufacturers in the market due to lower barriers to entry, the subsidies could actually increase the bargaining power of customers.

With more companies competing in the electric car market, customers might have more options to choose from, which could lead to better prices and services as companies strive to attract and retain customers. Therefore, the effect of government subsidies is more aligned with increasing competition and potentially empowering customers rather than diminishing their bargaining power.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (d) Analyze an industry's structure and external influences using Porter's Five Forces and PESTLE frameworks.

Q.3648 In a given industry, if barriers to entry are low and barriers to exit are high, then the firms will:

A. have a higher pricing power.

B. have a lower pricing power.

C. be able to make abnormal profits.

The correct answer is **B.**

When barriers to entry are low, it means that new competitors can easily enter the industry. This increases the level of competition among firms. On the other hand, high barriers to exit mean that firms cannot easily leave the industry, even if they are not profitable. This situation often leads to overcapacity and further intensifies competition.

In such a competitive environment, individual firms have less control over the prices they can charge for their products or services, leading to lower pricing power. The increased competition forces firms to lower their prices to attract or retain customers, which reduces their ability to set prices above competitive levels.

A is incorrect. Higher pricing power is typically associated with less competition, which is not the case when barriers to entry are low and barriers to exit are high. In such scenarios, the market becomes more saturated with competitors, making it difficult for any single firm to exert significant influence over market prices.

The assumption that firms would have higher pricing power under these conditions misunderstands the dynamics of competition and market saturation.

C is incorrect. The ability to make abnormal profits is usually associated with high barriers to entry and low barriers to exit. High barriers to entry prevent new competitors from entering the market, while low barriers to exit allow unprofitable firms to leave easily, reducing competition.

In contrast, low barriers to entry and high barriers to exit create a highly competitive environment with overcapacity, making it difficult for firms to achieve abnormal profits. Instead, the intense competition and inability to exit the market easily lead to reduced profitability and potentially even losses for the firms involved.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (d) Analyze an industry's structure and external influences using Porter's Five Forces and PESTLE frameworks.

Q.4275 If a specific industry is characterized by high competitive rivalry and strong bargaining power of buyers, which of the following implications is *most likely* true regarding the profitability trajectory of companies within that industry?

A. It results in identical profitability for all industry participants.

B. It ensures that all industry participants have the same competitive strategy.

C. It leads to the same demand and supply opportunities and risk factors for all industry participants.

The correct answer is **C.**

High competitive rivalry and strong bargaining power of buyers are two of the forces identified in Porter's Five Forces model that can significantly impact the profitability trajectory of companies within an industry. These forces can exert a downward pressure on the profitability of companies by increasing competition and empowering buyers to demand lower prices or higher quality, thereby squeezing the profit margins of the companies.

When an industry is characterized by these dynamics, it generally leads to a more challenging environment for companies to maintain high profitability levels. Companies may find themselves in a position where they need to continuously innovate, improve efficiency, or reduce costs to stay competitive and protect their profit margins.

This competitive environment does not guarantee identical profitability for all industry participants, nor does it ensure that all participants will adopt the same competitive strategy. Instead, it creates a scenario where companies are pushed to differentiate themselves through various means to survive and thrive.

A is incorrect. Suggesting that high competitive rivalry and strong bargaining power of buyers result in identical profitability for all industry participants oversimplifies the complex dynamics of competitive industries. While these forces can indeed pressure profitability, companies can still differentiate themselves through innovation, cost leadership, or niche strategies.

Management quality, operational efficiencies, brand strength, and other factors can lead to significant variations in profitability among companies within the same industry. Therefore, it is not accurate to assume that all industry participants will experience identical profitability.

B is incorrect. The statement that high competitive rivalry and strong bargaining power of buyers ensure that all industry participants have the same competitive strategy is also misleading. In reality, companies respond to competitive pressures and buyer power in various ways, depending on their strengths, weaknesses, and strategic priorities.

Some may focus on cost leadership to offer lower prices, while others may pursue differentiation strategies to offer unique products or services that justify higher prices. The diversity in competitive strategies is a reflection of the different paths companies can take to navigate the challenges posed by competitive rivalry and buyer power.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.4276 Based on Porter’s Five Forces analysis, which of the following is *least likely* to influence the profit potential of an industry?

A. Collective economic power of customers.

B. Intensity of advertising campaigns.

C. Threat posed by potential new entrants.

The correct answer is **B.**

Based on Porter's Five Forces analysis, the intensity of advertising campaigns is least likely to directly influence the profit potential of an industry. The five forces identified by Porter that determine industry attractiveness and long-term profitability are:

1. the bargaining power of buyers,
2. the bargaining power of suppliers,
3. the threat of new entrants,
4. the threat of substitute products or services, and
5. the intensity of competitive rivalry.

While advertising can play a role in shaping consumer perceptions and can influence competitive dynamics, it is not one of the primary forces that Porter identifies as directly affecting industry structure and profit potential.

A is incorrect. The collective economic power of customers, or the bargaining power of buyers, is a critical component of Porter's Five Forces analysis. This force assesses how much pressure customers can place on businesses, affecting prices, quality, and the overall competitive environment.

High bargaining power of buyers can limit the profit potential of an industry by driving down prices or demanding higher quality or more services, which can increase costs for companies within the industry.

C is incorrect. The threat posed by potential new entrants is another fundamental aspect of Porter's Five Forces analysis. This force examines how easy or difficult it is for new companies to start competing in an industry. Barriers to entry, such as high startup costs, access to distribution channels, or regulatory hurdles, can protect existing companies from new competitors.

However, when barriers to entry are low, new entrants can increase the competitive pressure, reduce market share, and constrain profitability for all players in the industry. Therefore, the threat of new entrants is a crucial factor in determining the profit potential of an industry.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (d) Analyze an industry’s structure and external influences using Porter’s Five Forces and PESTLE frameworks.

Q.4277 An analyst looking to understand the broader growth prospects of an industry rather than the potential of a specific company would *most likely* adopt which approach?

A. Focus on the competitive strategies of top-tier companies.

B. Emphasize on the PESTLE analysis of the leading company.

C. Opt for a 'basket approach' considering a range of companies within the industry.

The correct answer is **C.**

An analyst aiming to gauge the broader growth prospects of an industry rather than focusing on the potential of a specific company would most likely adopt a 'basket approach'. This method involves considering a range of companies within the industry, thereby offering a diversified and comprehensive perspective on the industry's potential growth.

By analyzing multiple companies, the analyst can identify common trends, challenges, and opportunities that may not be apparent when examining a single company. This approach allows for a more robust analysis of the industry's growth prospects, taking into account the performance and strategies of various players within the market.

A is incorrect. Focusing solely on the competitive strategies of top-tier companies limits the analysis to the practices and outcomes of a few leading players. While understanding the strategies of industry leaders can provide valuable insights, it does not offer a complete picture of the industry's overall growth prospects.

Smaller and emerging companies can also significantly influence the industry's direction and growth potential. Therefore, an analysis that exclusively focuses on top-tier companies may overlook critical factors and trends that are shaping the industry at a broader level.

B is incorrect. Emphasizing the PESTLE analysis of the leading company narrows the scope of the analysis to the external factors affecting a single company. While PESTLE analysis (which examines Political, Economic, Social, Technological, Legal, and Environmental factors) is a valuable tool for understanding the macro-environmental context in which a company operates, it does not provide a comprehensive view of the industry's growth prospects.

Different companies within the same industry may face unique challenges and opportunities based on their market position, resources, and strategies. Therefore, relying on a PESTLE analysis of just one company may result in a skewed understanding of the industry's broader growth potential.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.4278 Which of the following is least likely a challenge associated with industry classification schemes?

A. Deciding whether to include substitute products or services.

B. Classifying companies that operate in more than one industry.

C. Deciding whether to include companies that do not sell products or services.

The correct answer is **C.**

An industry is a group of companies that are related in terms of their primary business activities. In the context of industry definition and classification, companies are typically grouped together based on the similarity of their product or service offerings. Therefore, companies that do not sell products or services would not typically be considered part of an industry.

A is incorrect. Deciding whether to include substitute products or services is indeed a challenge in defining an industry. Substitute products or services are those that can be used in place of one another. For example, butter and margarine are substitute products. Deciding whether to include such substitutes in the same industry can be challenging, as they may have different production processes, target markets, and other factors.

B is incorrect. Classifying companies that operate in more than one industry is also a challenge in defining an industry. Many companies operate in multiple industries, making it difficult to classify them into a single industry. For example, a company might manufacture both automobiles and aircraft, which are typically considered separate industries. Deciding how to classify such a company can be challenging.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.4279 In the context of industry classification, companies are often grouped by geography. Which of the following is *most likely* a typical basis for classifying companies by country?

A. The country where the issuer is incorporated.

B. The country where the company's largest office is located.

C. The country where the company's products or services are most popular.

The correct answer is **A.**

Companies are typically classified by the country where the issuer is incorporated. This classification method is crucial because the country of incorporation establishes the legal framework within which a company operates. This framework encompasses corporate governance standards, tax laws, and regulatory oversight, all of which significantly influence a company's operations, financial performance, and risk profile.

The country of incorporation provides a consistent and objective basis for comparing companies across different industries. It also aids in identifying potential risks and opportunities associated with specific countries or regions, making it a vital criterion for investors and analysts when classifying companies by geography.

B is incorrect. The size or prominence of an office does not necessarily reflect the legal jurisdiction under which a company is incorporated. Companies often have significant operations in multiple countries, and the location of the largest office may change over time or not accurately represent the company's overall business structure and regulatory framework.

C is incorrect. While market presence and brand popularity are important business considerations, they are highly variable and subject to change due to consumer preferences, market competition, and other factors. These aspects do not provide a stable or legally relevant basis for classification compared to the country of incorporation, which determines the core legal and regulatory environment for the company.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.4280 Which of the following is *most likely* true regarding defensive companies? Their sales growth, profitability, and valuations are:

A. less affected by changes in broad macroeconomic activity.

B. more affected by changes in broad macroeconomic activity.

C. not affected by changes in broad macroeconomic activity.

The correct answer is **A.**

Defensive companies are those whose sales growth, profitability, and valuations are less affected by changes in broad macroeconomic activity. These companies are often involved in industries that provide essential goods or services, such as utilities, healthcare, and consumer staples.

Because the demand for these goods and services is relatively stable, regardless of the state of the economy, these companies tend to have more stable revenues and earnings. This makes them less sensitive to changes in the business cycle, hence the term "defensive."

Investors often turn to defensive stocks in times of economic uncertainty or downturns as they offer a degree of protection against market volatility. The stability of their revenues and earnings also often leads to more predictable and reliable dividend payments, which can be attractive to income-focused investors.

B is incorrect. Companies whose sales growth, profitability, and valuations are more affected by changes in broad macroeconomic activity are typically referred to as cyclical companies, not defensive companies.

Cyclical companies are those that are sensitive to the business cycle and whose performance tends to mirror the overall economy. These companies are often involved in discretionary industries, such as consumer discretionary, technology, and industrials.

C is incorrect. It is unrealistic to say that a company's sales growth, profitability, and valuations are not affected by changes in broad macroeconomic activity. All companies operate within the broader economy and are therefore subject to macroeconomic forces to some degree.

Even defensive companies, while less sensitive to changes in the business cycle, are not completely immune to macroeconomic changes. For example, while the demand for their goods or services may be relatively stable, they can still be affected by factors such as inflation, interest rates, and changes in consumer behavior.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.4281 Which of the following is *most likely* the most effective way to measure industry profitability?

A. By estimating the size of the industry

B. By calculating the historical growth rate of the industry

C. Through a time series of the distribution of returns on invested capital

The correct answer is **C.**

The most effective way to measure industry profitability is through a time series of the distribution of returns on invested capital (ROIC). ROIC is a profitability ratio that measures how effectively a company uses its capital to generate profits. It is calculated by dividing net income by the total capital invested in the business. By analyzing a time series of the distribution of ROIC, one can gain insights into the profitability trends of an industry over time.

This method allows for a more comprehensive understanding of industry profitability as it takes into account both the returns generated by companies in the industry and the capital invested to generate those returns. It also allows for comparisons across different industries, as it normalizes for differences in the size and capital structure of companies in different industries.

A is incorrect. Estimating the size of the industry is not an effective way to measure industry profitability. The size of an industry, in terms of its total revenue or total assets, does not provide information about the profitability of the companies within the industry. A large industry can be less profitable than a smaller one if the companies in the larger industry have lower profit margins or higher capital requirements. Therefore, the size of the industry is not a good indicator of industry profitability.

B is incorrect. Calculating the historical growth rate of the industry is not the most effective way to measure industry profitability. While growth is an important aspect of a company's performance, it does not necessarily translate into profitability. A company or an industry can grow rapidly without being profitable, especially if the growth is driven by high levels of investment that do not generate sufficient returns. Therefore, the historical growth rate of the industry does not provide a comprehensive measure of industry profitability.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (c) Determine an industry's size, growth characteristics, profitability, and market share trends.

Q.4282 Which of the following is *most likely* the use of Herfindahl-Hirschman Index (HHI) used in industry analysis?

A. Measuring the profitability of the industry.

B. Calculating the historical growth rate of the industry.

C. Measuring the degree of industry concentration.

The correct answer is **C.**

The Herfindahl-Hirschman Index (HHI) is used to measure the degree of industry concentration. The HHI is a commonly accepted measure of market concentration. It is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers.

A is incorrect. The HHI is not used to measure the profitability of the industry. While industry concentration can have an impact on profitability, the HHI itself does not provide information on profitability. Profitability is typically measured using ratios such as return on assets (ROA), return on equity (ROE), or net profit margin.

B is incorrect. The HHI is not used to calculate the historical growth rate of the industry. The historical growth rate of an industry is typically calculated by looking at changes in total industry sales or output over time, not by looking at market concentration. The HHI is a static measure that does not take into account changes over time.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (c) Determine an industry's size, growth characteristics, profitability, and market share trends.

Q.4283 If the intensity of Porter's Five Forces is high, which of the following is the *most likely* impact on the industry's profitability?

A. The industry is likely to be highly profitable.

B. The industry's profitability will remain unaffected.

C. Almost no company within the industry will earn attractive returns on capital.

The correct answer is **C.**

When the intensity of these forces is high, it signifies a highly competitive market environment. Such competitiveness often leads to aggressive pricing strategies, increased operational costs, and significant barriers to sustaining high-profit margins. Companies operating in industries characterized by high intensity of the Five Forces face relentless pressure that can erode profitability.

This competitive pressure can lead to a scenario where almost no company within the industry can earn attractive returns on capital, as they are constantly investing in competitive strategies, innovation, and customer acquisition and retention efforts.

A is incorrect. High intensity of these forces indicates a competitive market environment where firms are likely to experience increased costs and reduced pricing power. This competitive dynamic pressures profit margins, making it unlikely for the industry to be highly profitable.

The assumption that high competition could lead to high profitability disregards the direct and indirect costs associated with sustaining competitive advantages in such environments.

B is incorrect. The Five Forces are specifically designed to assess how competitive forces influence profitability. A high intensity of these forces typically results in a highly competitive environment, which directly impacts firms' ability to maintain profitable operations.

Increased competition often leads to price wars, higher operational costs, and the need for continuous investment in innovation and customer service, all of which can significantly affect profitability. Therefore, it is inaccurate to suggest that the industry's profitability will remain unaffected in the face of high competitive intensity.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (d) Analyze an industry’s structure and external influences using Porter’s Five Forces and PESTLE frameworks.

Q.4284 Which of the following is *most likely* the primary focus of a PESTLE analysis in comparison to Porter's Five Forces?

A. Assessing the structure of an industry.

B. Assessing the determinants of industry profitability.

C. Evaluating the industry's evolution and market share dynamics.

The correct answer is **C.**

PESTLE analysis is a strategic tool used to understand the macro-environmental factors that impact an organization. It stands for Political, Economic, Social, Technological, Legal, and Environmental factors. This analysis helps businesses in identifying the broader external factors that may influence their operations, strategies, and potential for growth.

Unlike Porter's Five Forces, which focuses on the competitive environment and industry-specific challenges, PESTLE analysis provides a broader view of the external environment that a business operates in. It helps in understanding how external factors like changes in government policies, economic trends, social shifts, technological advancements, legal changes, and environmental concerns can affect an industry's evolution, market share dynamics, and overall growth rate.

A is incorrect. While assessing the structure of an industry is crucial for understanding competitive dynamics, it is not the primary focus of a PESTLE analysis. The structure of an industry, including aspects like the number of competitors, market entry barriers, and product differentiation, is more directly addressed by Porter's Five Forces analysis.

PESTLE analysis, on the other hand, looks at the broader external environment that might indirectly influence these structural factors through changes in policy, economy, society, technology, legal frameworks, and environmental conditions.

B is incorrect. Assessing the determinants of industry profitability is a key objective of Porter's Five Forces analysis, not PESTLE analysis. Porter's Five Forces framework is designed to evaluate how various forces within an industry—such as the bargaining power of suppliers and buyers, the threat of new entrants, the threat of substitute products, and the intensity of competitive rivalry—affect the potential for profitability.

PESTLE analysis, in contrast, focuses on external macro-environmental factors that could impact the industry and its players in a more indirect manner, influencing long-term strategies and growth opportunities rather than immediate profitability determinants.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (d) Analyze an industry’s structure and external influences using Porter’s Five Forces and PESTLE frameworks.

Q.4285 Which of the following is *most likely* the definition of "innovator's dilemma" in the context of disruptive innovation? It refers to the challenge faced by:

A. new entrants in creating disruptive innovations.

B. incumbents in creating sustaining innovations.

C. incumbents in deciding whether to invest in disruptive innovation.

The correct answer is **C.**

The "innovator's dilemma" refers to the significant challenge that incumbent firms face when deciding whether to invest in disruptive innovations. These innovations have the potential to accelerate the decline of their current business models or, if ignored, risk losing market share to competitors who adopt these new technologies.

This concept was introduced by Clayton M. Christensen in his seminal work, "The Innovator's Dilemma". Christensen's research highlights a critical paradox in the business strategy of established companies. On one hand, investing in disruptive technologies can seem counterintuitive because these technologies often target smaller, less profitable market segments and may not meet the immediate financial objectives of large organizations.

On the other hand, these disruptive innovations have the potential to redefine industry standards and consumer expectations, eventually growing to dominate the market. This puts incumbent firms in a precarious position: choosing to invest in disruptive technologies might cannibalize their existing products and erode current profit margins, yet ignoring these innovations could lead to obsolescence and loss of market dominance as new entrants or more agile competitors leverage these technologies to gain a competitive edge.

A is incorrect. The innovator's dilemma does not primarily concern the challenges faced by new entrants in creating disruptive innovations. Contrary to the struggles of incumbent firms, new entrants often have the flexibility and strategic advantage to pursue disruptive innovations aggressively. Without the burden of existing products or services to protect, new entrants can focus on exploiting emerging technologies and market opportunities, potentially disrupting established industries and capturing market share from incumbents.

B is incorrect. While incumbent firms indeed face challenges in creating sustaining innovations, this is not what the innovator's dilemma refers to. Sustaining innovations are improvements to existing products or services that meet the current demands of the market. Incumbent firms are typically adept at executing sustaining innovations as they align with the company's existing business model and market understanding.

The dilemma arises not from the difficulty in creating sustaining innovations but from the strategic decision-making process regarding whether to pursue disruptive innovations, which may initially seem unattractive or incompatible with the company's current success but have the potential to redefine the market landscape.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (d) Analyze an industry’s structure and external influences using Porter’s Five Forces and PESTLE frameworks.

Q.4286 Which of the following best describes an unintentional competitive strategy? It is a strategy that:

A. is a result of company-wide planning.

B. arises from different teams within a company pursuing their own incentives.

C. is demonstrated by a company's history of value addition for its stakeholders.

The correct answer is **B.**

An unintentional competitive strategy typically emerges from the actions and decisions of different teams within a company as they pursue their own goals and incentives. This type of strategy is not the result of deliberate, company-wide planning but rather develops organically from the varied objectives and actions of individual teams or departments.

These teams may be focused on achieving specific short-term targets or responding to immediate challenges, without necessarily considering the broader strategic implications of their actions. Over time, the cumulative effect of these individual actions can coalesce into a coherent strategy that the company follows, albeit unintentionally. This phenomenon underscores the complexity of organizational dynamics and the importance of aligning departmental objectives with the company's overall strategic goals.

A is incorrect. A strategy that results from company-wide planning is indicative of an intentional strategy. Intentional strategies are characterized by a deliberate process of formulation and implementation, guided by the company's leadership and strategic planning departments.

These strategies are developed through a systematic approach that includes setting long-term objectives, analyzing the competitive environment, and devising specific plans to achieve desired outcomes. The key distinction here is the element of conscious design and purposeful direction, which is absent in unintentional strategies.

C is incorrect. The description of a strategy demonstrated by a company's history of value addition for its stakeholders does not inherently distinguish between intentional and unintentional strategies. Value addition can occur as a result of both deliberate strategic initiatives and the aggregate outcome of various independent actions within the company.

While intentional strategies may explicitly aim to create value for stakeholders through carefully planned efforts, unintentional strategies can also lead to value creation, albeit without a preconceived plan or coordinated effort.

Therefore, this option does not specifically characterize an unintentional strategy, as value addition can be a feature of both intentional and unintentional strategic approaches.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (e) Evaluate the competitive strategy and position of a company.

Q.4287 Which of the following is *least likely* one of the dimensions considered in evaluating a competitive strategy on a forward-looking basis?

A. Maximization of short-term profits.

B. Defense against the five industry forces.

C. External industry influences as identified in the PESTLE analysis.

The correct answer is **A.**

Maximization of short-term profits is the least likely dimension to be considered in evaluating a competitive strategy on a forward-looking basis. A robust competitive strategy should be sustainable, focusing on long-term growth and profitability rather than merely achieving short-term financial gains. Prioritizing short-term profits can lead to detrimental outcomes, such as compromising product quality, neglecting customer satisfaction, and overlooking necessary long-term investments.

B is incorrect. Defense against the five industry forces is a critical aspect of a competitive strategy. Michael Porter's Five Forces framework provides a valuable tool for analyzing a company's competitive environment, including the threat of new entrants, the bargaining power of suppliers and buyers, the threat of substitute products or services, and the intensity of competitive rivalry.

A strategy that effectively addresses these forces can help a company sustain its competitive advantage, making it an essential dimension for forward-looking strategy evaluation.

C is incorrect. Considering external industry influences, as identified in the PESTLE analysis, is crucial for a forward-looking competitive strategy. PESTLE analysis examines the Political, Economic, Social, Technological, Legal, and Environmental factors that can impact a company's operations and strategic direction.

A competitive strategy that aligns with these external factors can enable a company to capitalize on opportunities and mitigate potential risks, thereby enhancing its competitiveness and long-term success. Therefore, external industry influences are a significant dimension in evaluating a competitive strategy on a forward-looking basis.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (e) Evaluate the competitive strategy and position of a company.

Q.4288 In the context of three well-known competitive strategies: cost leadership, differentiation, and focus, which of the following *best* describes a company that is "stuck in the middle"? The company is:

A. a cost leader, differentiated and focused.

B. not a cost leader, not differentiated, and not focused.

C. a cost leader, but not differentiated and not focused.

The correct answer is **B.**

According to Michael Porter's generic strategies, a company that is "stuck in the middle" is one that is not a cost leader, not differentiated, and not focused. This means that the company has not successfully implemented any of the three competitive strategies. It is not a cost leader because it does not have the lowest costs in the industry. It is not differentiated because its products or services are not unique or superior in some way that is valuable to customers. It is not focused because it does not concentrate its efforts on a particular market segment, product line, or group of customers.

Being "stuck in the middle" is a dangerous position for a company because it means that the company is not competitive in any particular way. It is likely to be outperformed by competitors who are either cost leaders, differentiated, or focused. Therefore, Porter advises companies to avoid being "stuck in the middle" and to choose and implement one of the three competitive strategies effectively.

A is incorrect. A company cannot be a cost leader, differentiated, and focused at the same time. These are distinct strategies that require different resources, capabilities, and strategic choices. For example, being a cost leader often requires large-scale operations and cost efficiencies, while being differentiated often requires innovation and high-quality products or services. Being focused requires a deep understanding of a specific market segment or group of customers. Therefore, it is unlikely that a company can successfully implement all three strategies at the same time.

C is incorrect. A company that is a cost leader but not differentiated and not focused is not "stuck in the middle". Instead, it has chosen the cost leadership strategy. This means that it competes on the basis of having the lowest costs in the industry. While it may not be differentiated or focused, it can still be competitive by offering lower prices than its competitors.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (e) Evaluate the competitive strategy and position of a company.

Q.4289 Which of the following *most likely* is the best way to judge the effectiveness of a competitive strategy?

A. Based on the company's current market share.

B. Prospectively, based on the company's future plans.

C. Retrospectively, based on the company's past performance.

The correct answer is **C.**

The effectiveness of a strategy can be judged retrospectively based on the company's past performance. This is because a strategy's effectiveness is demonstrated by its ability to create value over time. This value creation can be measured in various ways, such as economic profits, return on investment, or shareholder value added.

By examining a company's historical performance, we can assess whether its strategy has been effective in creating value. This retrospective analysis allows us to understand the impact of the strategy on the company's performance and to identify the factors that have contributed to its success or failure. It provides a solid basis for evaluating the strategy and for making decisions about its future direction. However, it is important to note that past performance is not always a reliable indicator of future performance and that a strategy that has been effective in the past may not necessarily be effective in the future.

A is incorrect. Judging the effectiveness of a strategy based on the company's current market share is too narrow a perspective. While market share is an important indicator of a company's competitive position, it does not necessarily reflect the effectiveness of its strategy.

A company may have a large market share due to factors other than its strategy, such as favorable market conditions or lack of competition. Moreover, a strategy may be effective in creating value even if it does not result in a large market share.

B is incorrect. Judging the effectiveness of a strategy prospectively, based on the company's future plans, is speculative and uncertain. While it is important to consider the company's future plans in evaluating its strategy, these plans are not yet realized, and their outcomes are uncertain. Therefore, they cannot provide a reliable basis for judging the effectiveness of the strategy.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (e) Evaluate the competitive strategy and position of a company.

Q.4290 In the context of competitive strategies, what does a "defense against the five industry forces" imply? The strategy should protect the company from:

A. competition, new entrants, supplier power, buyer power, and the threat of substitute products or services.

B. economic downturns, political instability, social changes, technological advancements, legal changes, and environmental factors.

C. internal conflicts, communication issues, coordination problems, lack of resources, and lack of capabilities.

The correct answer is **A.**

In the context of competitive strategies, a "defense against the five industry forces" implies that the strategy should protect the company from competition, new entrants, supplier power, buyer power, and the threat of substitute products or services. These five forces are part of a model developed by Michael Porter to analyze the competitive environment of a company. The model suggests that the profitability of an industry depends on these five forces.

A good competitive strategy should help a company to defend against these forces, thereby improving its competitive position and profitability.

B is incorrect. While economic downturns, political instability, social changes, technological advancements, legal changes, and environmental factors can affect a company's competitive position, they are not part of the five industry forces as defined by Porter's model. These factors are part of the broader business environment and are typically considered in a PESTEL analysis (Political, Economic, Social, Technological, Environmental, and Legal).

C is incorrect. Internal conflicts, communication issues, coordination problems, lack of resources, and lack of capabilities are internal factors that can affect a company's performance, but they are not part of the five industry forces. These factors are typically considered in a SWOT analysis (Strengths, Weaknesses, Opportunities, and Threats), which looks at both internal and external factors affecting a company.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (d) Analyze an industry’s structure and external influences using Porter’s Five Forces and PESTLE frameworks.

Q.4607 Which of the following attributes is *most likely* characteristic of the industry, rather than being specific to a particular company?

A. Size

B. Business model variation

C. Sensitivity to the business cycle

The correct answer is **C.**

Sensitivity to the business cycle exemplifies a factor that has an influence on the entire industry. It is a characteristic that demonstrates the degree to which the performance of companies within a specific industry is influenced by changes in the broader economic environment.

A is incorrect. The size of companies within an industry can vary significantly. Industries often comprise both large and small companies, and size is typically a company-specific attribute rather than a defining characteristic of the industry.

B is incorrect. Different companies within the same industry often adopt diverse business models to achieve competitive advantages or respond to specific market demands. Business model variations are more likely to be company-specific attributes, reflecting the unique strategies and approaches taken by individual firms.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (a) Describe the purposes of, and steps involved in, industry and competitive analysis.

Q.4608 Which of the following actions are *most likely* performed in the forecasting company analysis stage?

A. Determining business model

B. Evaluating key risks and uncertainties

C. Analyzing industry structure and external influence

The correct answer is **B.**

Evaluating the key risks and uncertainties is one of the activities that are performed in the forecasting company analysis stage. The others include determining forecast objects and approaches, forecasting revenue, forecasting operating profitability and working capital, and forecasting capital investments and capital structure.

A is incorrect. Determining the business model is a task of the past and present company analysis stage. The other tasks in this stage include analyzing revenue and revenue drivers, analyzing operating profitability and working capital, and analyzing capital investments and capital structure.

C is incorrect. Analyzing industry structure and external influence is a task under the industry and competitive analysis stage. The other tasks include defining Industry, analyzing size, growth and character, profitability, market share trends, and evaluating company's competitive strategy and positioning and determining if company has a competitive advantage.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (a) Describe the purposes of, and steps involved in, industry and competitive analysis.

Q.4609 Which of the following is *least likely* a limitation of third-party industry classification schemes?

A. Industry classifications always account for geographical variations

B. Some industries may contain companies with diverse business models

C. Companies engage in the production and sale of multiple products or services

The correct answer is **A.**

Industry classifications may not always account for geographical variations. Some industries are influenced by regional factors, and companies operating in different parts of the world may face distinct market conditions. Failure to consider these geographical nuances in industry classification systems may lead to oversimplification of the industry landscape.

B is incorrect. Industry classification systems often categorize companies based on their primary business activities. However, some industries may contain companies with diverse business models or those that offer substitute products and services. This diversity within the same industry category can make it challenging for analysts to draw accurate conclusions about the overall health or performance of the industry.

C is incorrect. Many companies engage in the production and sale of multiple products or services. Industry classification systems often assign a company to a specific sector based on its predominant business activity. However, this can be problematic when dealing with conglomerates or diversified companies that operate across various segments. The primary focus of a multi-product company might not be accurately represented by its industry classification.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.4610 The method of grouping companies based on industry or product is just one approach among several, and its utility may diminish when applied in contexts beyond industry analysis. Which of the following is *least likely* an approach used in contexts such as index construction and investment performance evaluation?

A. Geography

B. Statistical differences

C. Sensitivity to the business cycle

The correct answer is **B.**

Statistical similarities and not differences is an approach used contexts such as index construction and investment performance evaluation. It is the application of clustering analysis to categorize companies based on shared financial ratios and market data, or the correlated movements of their securities' investment returns. This method encompasses grouping by size, considering factors such as market capitalization or other distinctive characteristics.

A is incorrect. Geographical classification involves organizing companies based on their respective countries, which are then grouped into broader categories like developed, emerging, and frontier markets. Companies are typically classified according to the country of incorporation, the primary listing of equity securities, the location of their headquarters, or market perception.

C is incorrect. Companies can be classified based on their sensitivity to the business cycle, categorized as either "defensive" or "cyclical." Defensive companies experience relatively minimal impact on sales growth, profitability, and valuations in response to changes in broad macroeconomic activity (e.g., GDP growth). Conversely, cyclical companies are more susceptible to such fluctuations.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (b) Describe industry classification methods and compare methods by which companies can be grouped.

Q.4611 Which of the following industries *most likely* be classified under cyclical and mature under the industry growth style box?

A. Software

B. Natural gas

C. Pharmaceuticals

The correct answer is **B.**

Natural gas is classified as a cyclical and mature industry under the industry growth style box. Cyclical industries are those that experience significant fluctuations in demand based on the economic cycle. Mature industries are characterized by slower growth rates and well-established market presence. Other examples of industries in this category include crude oil and freight transportation.

A is incorrect. Software is classified under growth and defensive industries. Growth industries are characterized by rapid growth and innovation, while defensive industries are those that provide consistent performance regardless of economic cycles. Other industries in this category include biotechnology and gaming.

C is incorrect. Pharmaceuticals are also classified under growth and defensive industries. These industries tend to perform well during various phases of the economic cycle due to the consistent demand for their products. Other industries in this category include utilities and beverages.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (c) Determine an industry's size, growth characteristics, profitability, and market share trends.

Q.4612 The semi-conductor market in the country consists of four firms with the following market shares, 33%, 24%, 22% and 21%. The Herfindahl-Hirschman Index (HHI) is *most likely*?

A. 0.2590

B. 2590

C. 50.89

The correct answer is **B.**

The Herfindahl-Hirschman Index (HHI) is used to gauge industry concentration. It is computed by summing the squares of individual competitor market shares:

$$HHI = \sum_{i=1}^{\infty} S_i^2$$

$$HHI = 33^2 + 24^2 + 22^2 + 21^2 = 2590$$

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (c) Determine an industry's size, growth characteristics, profitability, and market share trends.

Q.4615 Porter's Five Forces is a framework for assessing industry structure. Which of the following is *least likely* one of Porter's five forces?

A. Threat of substitutes

B. Threat of new entrants

C. Threats of new regulations

The correct answer is **C.**

"Threats of new regulations" is less likely to be considered one of Porter's Five Forces. The traditional five forces focus on aspects such as competition, bargaining power, and market dynamics rather than regulatory threats.

Porter's Five Forces framework assesses the competitive forces within an industry that can impact its attractiveness and competitiveness. The five forces are:

i. Threat of substitutes
ii. Threat of new entrants
iii. Bargaining power of buyers
iv. Bargaining power of suppliers
v. Intensity of competitive rivalry

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (d) Analyze an industry's structure and external influences using Porter's Five Forces and PESTLE frameworks.

Q.4616 Which of the following factors in the PESTLE analysis *most likely* include the analysis in changes in GDP or personal income, inflation, interest rates and exchange rates?

A. Political influences

B. Economic influences

C. Technological influences

The correct answer is **B.**

Economic factors affecting an industry encompass fluctuations in GDP and personal income, variations in inflation, interest rates, and exchange rates. These influences may be linked to the business cycle, exhibiting cyclical patterns, or they can be structural, reflecting differences in longer-term population and productivity growth rates among countries, thereby impacting the sales and costs of companies operating in different regions.

A is incorrect. Political factors affecting an industry involve shifts in fiscal and monetary policies, direct selling and purchasing activities by governments, alterations in regulations, and geopolitical conditions and actions.

C is incorrect. Technological advancements have the potential to introduce novel or enhanced products while making existing ones obsolete, leading to significant transformations in industries and companies. These technological changes can be categorized into two types: sustaining innovations and disruptive innovations.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (d) Analyze an industry's structure and external influences using Porter's Five Forces and PESTLE frameworks.

Q.4617 Which of the following is *most likely* a characteristic of cost leadership under the generic competitive strategies?

A. Premium pricing

B. Firms invest in advertising

C. Firms have economies of scale

The correct answer is **C.**

Cost leadership is a characteristic of cost leadership, and it typically involves achieving the lowest cost of production and operation in the industry. This allows the firm to offer products or services at lower prices than competitors while maintaining acceptable quality.

A is incorrect. Premium pricing is not characteristic of cost leadership. Cost leadership usually focuses on offering products or services at competitive or lower prices. Premium pricing is a characteristic of differentiation.

B is incorrect. Firms invest in advertising under the differentiation strategy of the generic competitive strategies. Advertising expenses can contribute to higher costs, which is contrary to the cost-cutting approach of cost leadership.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (e) Evaluate the competitive strategy and position of a company.

Q.4618 Which of the following industry characteristics is the cost leadership strategy most appropriate?

A. Capital intensive

B. Customers value distinctiveness

C. Price is not foremost concern for customers

The correct answer is **A.**

Cost leadership is most appropriate in capital intensive industries as cost leadership strategies often involve achieving economies of scale and cost efficiencies. Larger production volumes may lead to cost advantages.

B is incorrect. Differentiation strategy is most appropriate in industries where customers value distinctiveness and unique features in products or services. This strategy focuses on offering something unique or perceived as unique by customers, which allows a company to command premium prices and build brand loyalty.

C is incorrect. Price is not the foremost concern for customers under the differentiation strategy. Customers are willing to pay a premium for the unique features, qualities, or brand image associated with the differentiated product or service.

CFA Level 1, Topic 6 - Equity Investments, Learning Module 6: Industry and Competitive Analysis, LOS (e) Evaluate the competitive strategy and position of a company.
