Entrepreneurship Development

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Industry and Competitor Analysis

Lesson Objectives

1. Explain the purpose of an industry analysis.
2. Identify the five competitive forces that determine industry profitability.
3. Explain the role of “barriers to entry” in creating disincentives for firms to enter an industry.
4. Identify the non-traditional barriers to entry that are especially associated with entrepreneurial firms.
5. List the four industry-related questions to ask before pursuing the idea for a firm.

Lesson Objectives

6. Identify the five primary industry types and the opportunities they offer.
7. Explain the purpose of a competitor analysis.
8. Identify the three groups of competitors a new firm will face.
9. Describe ways a firm can ethically obtain information about its competitors.
10. Describe the reasons for completing a competitive analysis grid.

What is Industry Analysis?

- Industry
  - An industry is a group of firms producing a similar product or service, such as airlines, fitness drinks, furniture, or electronic games.
- Industry Analysis
  - Is business research that focuses on the potential of an industry.

Why Industry Analysis is Important?

Industry Analysis

Importance

- Once it is determined that a new venture is feasible in regard to the industry and market in which it will compete, a more in-depth analysis is needed to learn the ins and outs of the industry.
- The analysis helps a firm determine if the niche market identified during feasibility analysis is favorable for a new firm.

Three Key Questions

When studying an industry, an entrepreneur must answer three questions before pursuing the idea of starting a firm.

Question 1	Question 2	Question 3
Is the industry accessible—in other words, is it a realistic place for a new venture to enter?	Does the industry contain markets that are suitable for innovation or are underserved?	Are there positions in the industry that avoid some of the negative attributes of the industry as a whole?

How Industry and Firm-Level Factors Affect Performance

- Firm Level Factors
  - Include a firm's assets, products, culture, teamwork among its employees, reputation, and other resources.
- Industry Level Factors
  - Include threat of new entrants, rivalry among existing firms, bargaining power of buyers, and related factors.
- Conclusion
  - In various studies, researchers have found that from 8% to 30% of the variation in firm profitability is directly attributable to the industry in which a firm competes.

Techniques Available to Assess Industry Attractiveness

Assessing Industry Attractiveness

Study Environmental and Business Trends	The Five Competitive Forces Model

Studying Industry Trends

- Environmental Trends
  - Include economic trends, social trends, technological advances, and political and regulatory changes.
  - For example, industries that sell products to seniors are benefiting by the aging of the population.
- Business Trends
  - Other trends that impact an industry.
  - For example, are profit margins in the industry increasing or falling? Is innovation accelerating or waning? Are input costs going up or down?

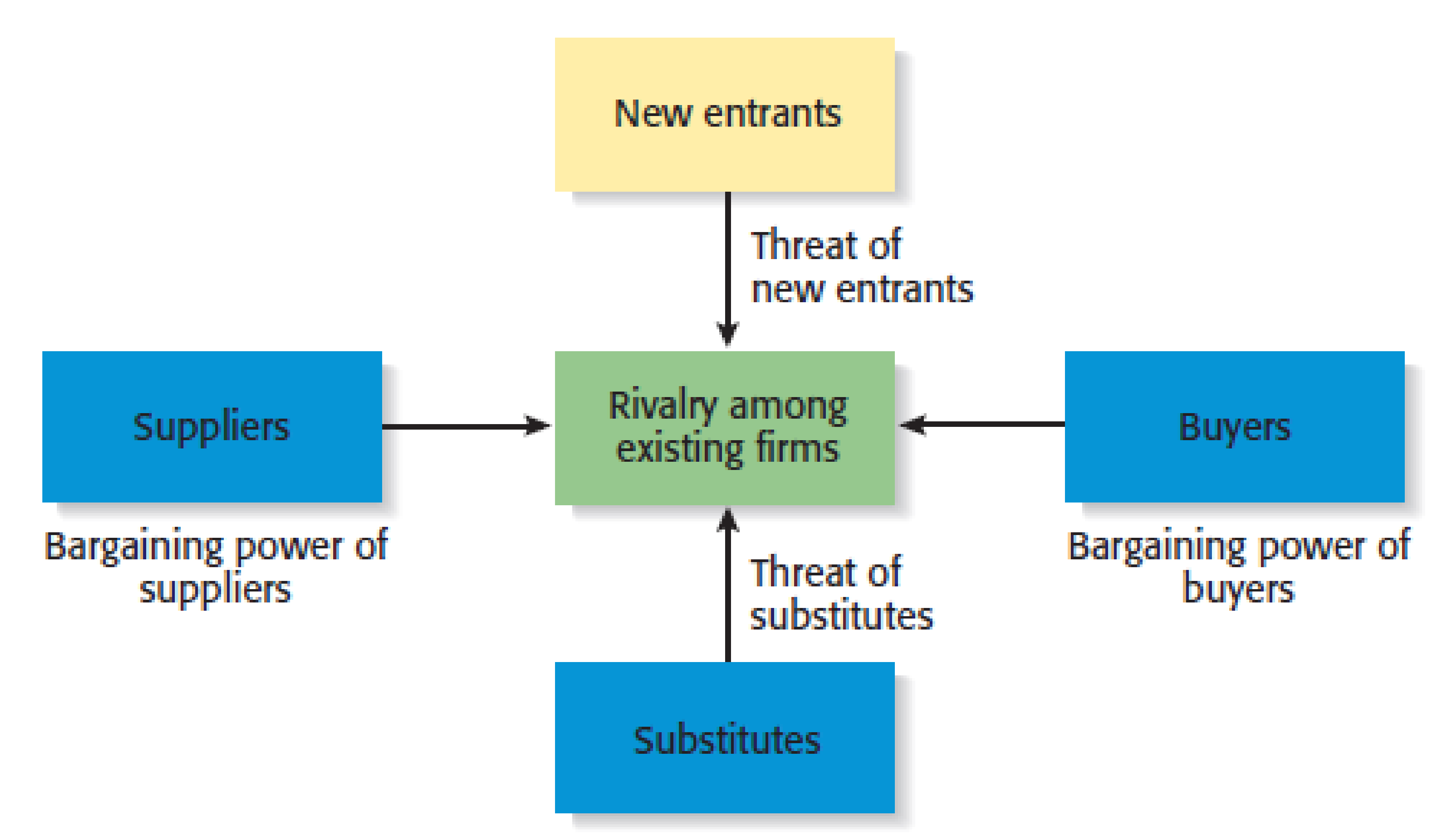
The Five Competitive Forces Model

- Explanation of the Five Forces Model
  - The five competitive forces model is a framework for understanding the structure of an industry.
  - The model is composed of the forces that determines industry profitability.
  - They help determine the **average rate of return** for the firms in an industry.

The Five Competitive Forces Model

- Explanation of the Five Forces Model (continued)
  - Each of the five-forces impacts the average rate of return for the firms in an industry by applying pressure on industry profitability.
  - Well managed firms try to position their firms in a way that avoids or diminishes these forces—in an attempt to beat the average rate of return of the industry.

The Five Competitive Forces Model



Threat of Substitutes
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- Threat of Substitutes
  - The price that consumers are willing to pay for a product depends in part on the availability of substitute products.
  - For example, there are a few if any substitutes for prescription medicines, which is one of the reasons the pharmaceutical industry is so profitable.
  - In contrast, when close substitutes for a product exist, industry profitability is suppressed, because consumers will opt out if the price gets too high.

Threat of Substitutes

- Threat of Substitutes (continued)
  - The extent to which substitutes suppress the profitability of an industry depends on the propensity for buyers to substitute between alternatives.
  - This is why firms in an industry often offer their customers amenities to reduce the likelihood that they will switch to a substitute product, even in light of a price increase.

Threat of Substitutes

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- A customer could easily get a cup of coffee cheaper at one of Starbuck’s competitors.
- To decrease the likelihood of this, Starbucks offers high-quality fresh coffee, good service, and a pleasant atmosphere.
- Starbucks has therefore reduced the threat of substitutes.

Threat of New Entrants

- Threat of New Entrants
  - If the firms in an industry are highly profitable, the industry becomes a magnet to new entrants.
  - Unless something is done to stop this, the competition in the industry will increase, and average industry profitability will decline.
  - Firms in an industry try to keep the number of new entrants low by erecting barriers to entry.
    - A barrier to entry is a condition that creates a disincentive for a new firm to enter an industry.
    - E.g. North Korea, Cuba

Threat of New Entrants

Barriers to Entry

Barrier to Entry	Explanation
Economies of Scale	Industries that are characterized by large economies of scale are difficult for new firms to enter, unless they are willing to accept a cost disadvantage.
Product differentiation	Industries such as the soft drink industry that are characterized by firms with strong brands are difficult to break into without spending heavily on advertising.
Capital requirements	The need to invest large amounts of money to gain entrance to an industry is another barrier to entry.

Threat of New Entrants

Barriers to Entry (continued)

Barrier to Entry	Explanation
Cost advantages independent of size	Existing firm may have cost advantages not related to size. For example, the existing firms in an industry may have purchased land when it was less expensive than it is today.
Access to distribution channels	Distribution channels are often hard to crack. This is particularly true in crowded markets, such as the convenience store market.
Government and legal barriers	Some industries, such as broadcasting, require the granting of a license by a public authority to compete.

Threat of New Entrants

- Non Traditional Barriers to Entry
  - It is difficult for start-ups to execute barriers to entry that are expensive, such as economies of scale, because money is usually tight.
  - Start-ups have to rely on nontraditional barriers to entry to discourage new entrants, such as assembling a world-class management team that would be difficult for another company to replicate.

Threat of New Entrants

Nontraditional Barriers to Entry

Barrier to Entry	Explanation
Strength of management team	**If a start-up puts together a world-class management team, it may give potential rivals pause in taking on the start-up in its chosen industry.**
First-mover advantage	**If a start-up pioneers an industry or a new concept within an industry, the name recognition the start-up establishes may create a barrier to entry.**
Passion of the management team and employees	**If the employees of a start-up are motivated by the unique culture of a start-up, and anticipate large financial reward, this is a combination that cannot be replicated by larger firms.**

Threat of New Entrants

Nontraditional Barriers to Entry (continued)

Barrier to Entry	Explanation
Unique Business Model	**If a start-up is able to construct a unique business model and establish a network of relationships that makes the business model work, this set of advantages creates a barrier to entry.**
Internet Domain Name	**Some Internet domain names are so “spot-on” that they give a start-up a meaningful leg up in terms of e-commerce opportunities.**
Inventing a new approach to an industry	**If a start-up invents a new approach to an industry and executes it in new fashion, these factors create a barrier to entry for potential imitators.**

Rivalry Among Existing Firms

- Rivalry Among Existing Firms
  - In most industries, the major determinant of industry profitability is the level of competition among existing firms.
  - Some industries are aggressively competitive, to the point where prices are pushed below the level of costs, and industry-wide losses occur.
  - In other industries, competition is much less intense and price competition is subdued.

Rivalry Among Existing Firms

Factors that determine the intensity of the rivalry among existing firms in an industry.

Number and balance of competitors	**The more competitors there are, the more likely it is that one or more will try to gain customers by cutting its price.**
Degree of difference between products	**The degree to which products differ from one product to another affects industry rivalry.**

Rivalry Among Existing Firms

Factors that determine the intensity of the rivalry among existing firms in an industry (continued)

Growth rate of an industry	**The competition among firms in a slow-growth industry is stronger than among those in fast-growth industries.**
Level of fixed costs	**Firms that have high fixed costs must sell a higher volume of their product to reach the break-even point than firms with low fixed costs.**

Bargaining Power of Suppliers

- Bargaining Power of Suppliers
  - Suppliers can suppress the profitability of the industries to which they sell by raising prices or reducing the quality of the components they provide.
  - If a supplier reduces the quality of the components it supplies, the quality of the finished product will suffer, and the manufacturer will eventually have to lower its price.
  - If the suppliers are powerful relative to the firms in the industry to which they sell, industry profitability can suffer.

Bargaining Power of Suppliers

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Factors that have an impact on the ability of suppliers to exert pressure on buyers

Supplier concentration	**When they are only a few suppliers that supply a critical product to a large number of buyers, the supplier has an advantage.**
Switching costs	**Switching costs are the fixed costs that buyers encounter when switching or changing from one supplier to another. If switching costs are high, a buyer will be less likely to switch suppliers.**

Bargaining Power of Suppliers

Factors that have an impact on the ability of suppliers to exert pressure on buyers (continued)

Attractiveness of substitutes	**Supplier power is enhanced if there are no attractive substitutes for the product or services the supplier offers.**
Threat of forward integration	**The power of a supplier is enhanced if there is a credible possibility that the supplier might enter the buyer's industry.**

Bargaining Power of Buyers

- Bargaining Power of Buyers
  - Buyers can suppress the profitability of the industries from which they purchase by demanding price concessions or increases in quality.
  - For example, the automobile industry is dominated by a handful of large companies that buy products from thousands of suppliers in different industries. This allows the automakers to suppress the profitability of the industries from which they buy by demanding price reductions.

Bargaining Power of Buyers

Factors that have an impact on the ability of suppliers to exert pressure on buyers

Buyer group concentration	**If there are only a few large buyers, and they buy from a large number of suppliers, they can pressure the suppliers to lower costs and thus affect the profitability of the industries from which they buy.**
Buyer's costs	**The greater the importance of an item is to a buyer, the more sensitive the buyer will be to the price it pays.**

Bargaining Power of Buyers

Factors that have an impact on the ability of buyers to exert pressure on suppliers (continued)

Degree of standardization of supplier's products	**The degree to which a supplier's product differs from its competitors affect the buyer's bargaining power.**
Threat of backward integration	**The power of buyers is enhanced if there is a credible threat that the buyer might enter the supplier's industry.**

First Application of the Five Forces Model

- First Application of the Model
  - The five forces model can be used to assess the attractiveness of an industry by determining the level of threat to industry profitability for each of the forces.
  - If a firm fills out the form shown on the next slide and several of the threats to industry profitability are high, the firm may want to reconsider entering the industry or think carefully about the position it would occupy.

First Application of the Five Forced Model

Assessing Industry Attractiveness Using the Five Forces Model

Competitive Force	Threat to Industry Profitability		
	Low	Medium	High
Threat of substitutes			
Threat of new entrants			
Rivalry among existing firms			
Bargaining power of suppliers			
Bargaining power of buyers			

Instructions:

Step 1 Select an industry

Step 2 Determine the level of threat to industry profitability for each of the forces (low, medium, or high)

Step 3 Use the table to get an overall feel for the attractiveness of the industry

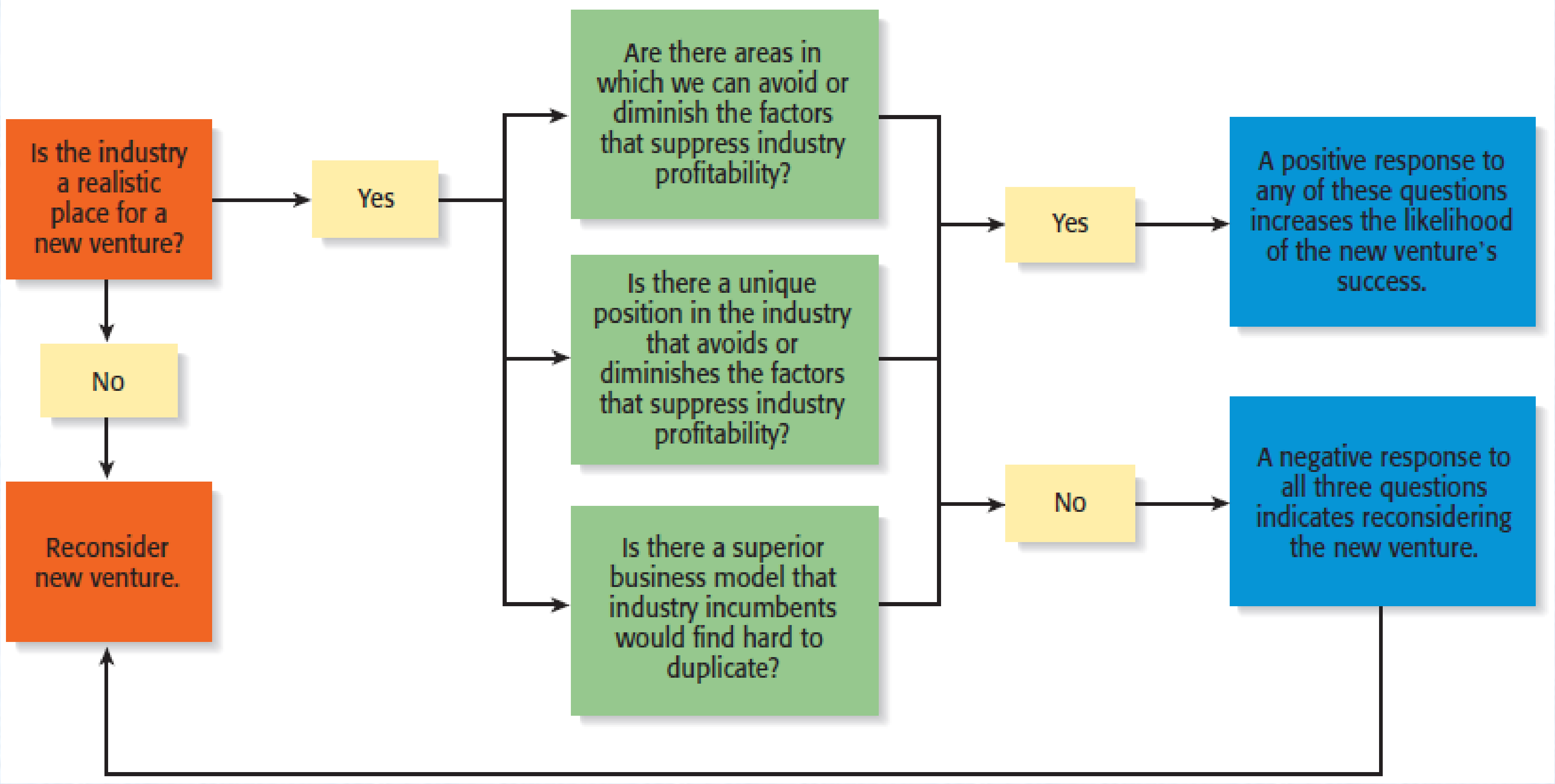
Step 4 Use the table to identify the threats that are most often relevant to industry profitability

Second Application of the Five Forces Model

- Second Application of the Model
  - The second way a new firm can apply the five forces model to help determine whether it should enter an industry is by using the model to answer several key questions.
  - The questions are shown in the figure on the next slide, and help a firm project the potential success of a new venture in a particular industry.

Second Application of the Five Forced Model

Using the Five Forces Model to Pose Questions to Determine the Potential Success of a New Venture in an Industry



Industry Types and the Opportunities They Offer

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- Emerging Industries
  - Industries in which standard operating procedures have yet to be developed.
    - Opportunity: First-mover advantage.
- Fragmented Industries
  - Industries that are characterized by a large number of firms of approximately equal size.
    - Opportunity: Consolidation.

Industry Types and the Opportunities They Offer

- Mature Industries
  - Industries that are experiencing slow or no increase in demand.
    - Opportunities: Process innovation and after-sale service innovation.
- Declining Industries
  - Industries that are experiencing a reduction in demand.
    - Opportunities: Leadership, establishing a niche market, and pursuing a cost reduction strategy.

Industry Types and the Opportunities They Offer

- Global Industries
  - Industries that are experiencing significant international sales.
    - Opportunities: Multidomestic and global strategies.

Competitor Analysis

- What is a Competitor Analysis?
  - A competitor analysis is a detailed analysis of a firm's competition.
  - It helps a firm understand the positions of its major competitors and the opportunities that are available.
  - A competitive analysis grid is a tool for organizing the information a firm collects about its competitors.

Identifying Competitors

Types of Competitors New Ventures Face

Direct Competitors	Indirect Competitors	Future Competitors
Businesses offering identical or similar products	Businesses offering close substitute products	Businesses that are not yet direct or indirect competitors but could be at any time

Sources of Competitive Intelligence

- Collecting Competitive Intelligence
  - To complete a competitive analysis grid, a firm must first understand the strategies and behaviors of its competitors.
  - The information that is gathered by a firm to learn about its competitors is referred to as competitive intelligence.
  - A new venture should take care that it collects competitive intelligence in a professional and ethical manner.

Sources of Competitive Intelligence

Ethical ways to obtain information about competitors

- Attend conferences and trade shows.
- Purchase competitor's products.
- Study competitors' Web sites.
- Set up e-mail alerts.
- Read industry-related books, magazines, and Web sites.
- Talk to customers about what motivated them to buy your product as opposed to your competitor's product.

Sources of Competitive Intelligence

- Many companies attend trade shows to not only display their products, but to see what their competitors are up to.
- This is a photo of the the 2008 Consumer Electronics Trade Show in Las Vegas.

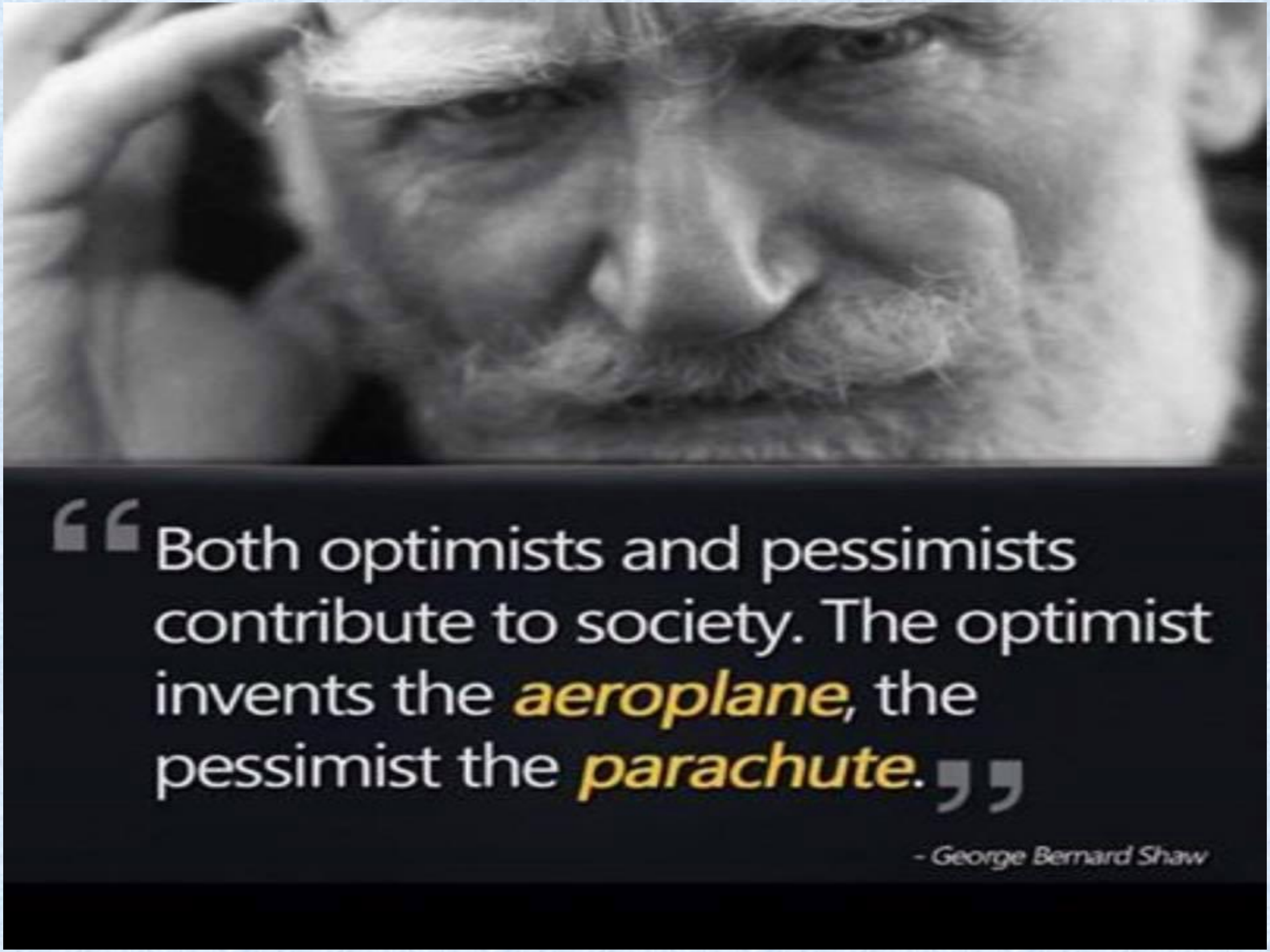
Completing a Competitive Analysis Grid

- Competitive Analysis Grid
  - A tool for organizing the information a firm collects about its competitors
  - A competitive analysis grid can help a firm see how it stakes up against its competitors, provide ideas for markets to pursue, and identify its primary sources of competitive advantage.

Competitive Analysis Grid for Expresso Fitness

Table 5.5 COMPETITIVE ANALYSIS GRID FOR EXPRESSO FITNESS

Name	Expresso Fitness	Cybex	Star Trec	Nautilus	Life Fitness
Product features	Advantage	Advantage	Even	Even	Disadvantage
User engagement	Advantage	Even	Even	Disadvantage	Disadvantage
Durability	Even	Even	Even	Disadvantage	Disadvantage
User feedback	Advantage	Advantage	Even	Even	Even
Health benefits	Even	Even	Advantage	Even	Advantage
Price	Disadvantage	Disadvantage	Even	Advantage	Advantage
Customer service	Even	Even	Even	Advantage	Even


Both optimists and pessimists contribute to society. The optimist invents the aeroplane, the pessimist the parachute.
- George Bernard Shaw