

Department of Computer Science and Technology  
Faculty of Science and Technology



# IIT 241-3 Entrepreneurship



## Lecture 08

# Industry Analysis



# Introduction

## Industry

- An industry is a group of firms producing a similar product or service, such as airlines, fitness drinks, furniture, or electronic games.



# Introduction

Industries in the real world

*P&G*

Walmart 

  
Nestlé®

  
Unilever





# Introduction

## Industries in the real world - Chocolate bars





# Introduction

## Industries in the real world - Chocolate bars





# Introduction

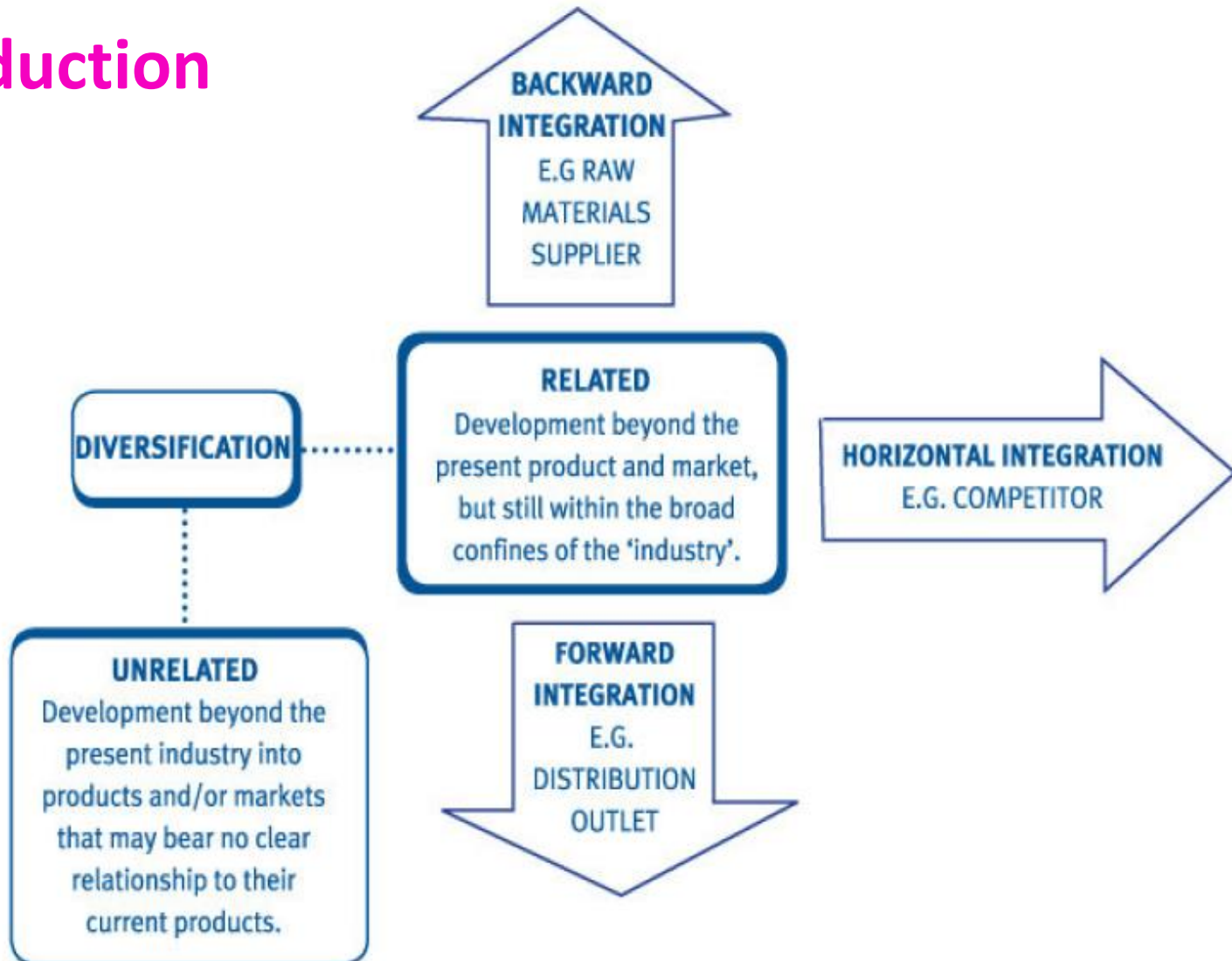
## Industries in the real world - Chocolate bars







# Introduction







# Introduction

## Industry Analysis

- Is business research that focuses on the potential of an industry.



# Introduction

## Purpose

In the case of new firms...

- 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 it identified during feasibility analysis is favorable for a new firm.



# Techniques Available to Assess Industry Attractiveness

Study Environmental  
and Business Trends

The Five Competitive  
Forces Model





# Techniques Available to Assess Industry Attractiveness

## Study Environmental and Business 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 declining? Are input costs going up or down?



# Techniques Available to Assess Industry Attractiveness

- Business Trends

- Other trends that impact an industry.

**Business trends** working in Warby Parker's favor include:

- (1) increasing ease in manufacturing products in low-cost foreign countries to be sold in the United States and
- (2) increasing ease in selling products online and shipping them inexpensively to consumers.



# Techniques Available to Assess Industry Attractiveness

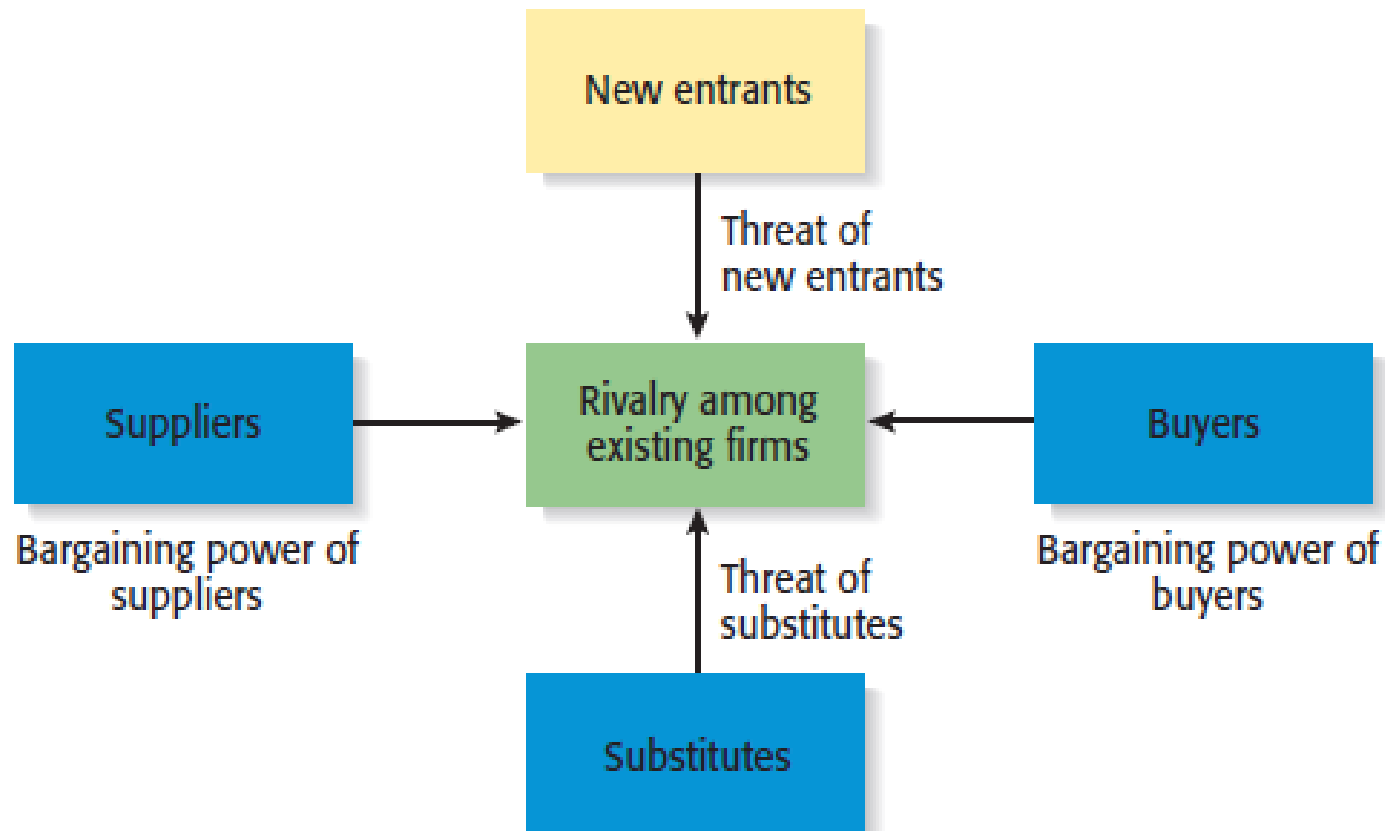
## The Five Competitive Forces Model

- Used to analyze/diagnose the competitive pressures in an industry
- Analyzes the strength and importance of each force in a given industry
- The five competitive forces model is a framework for understanding the structure of an industry.
- The model is composed of the forces that determine industry profitability.
- Well managed firms try to position their firms in a way that avoids or diminishes these forces.





# Techniques Available to Assess Industry Attractiveness





# Techniques Available to Assess Industry Attractiveness

## Threat of Substitutes

- The **price** that consumers are willing to pay for a product **depends on the availability of substitute products**.
- **The price/performance trade-off** – Threat of substitutes is high when good substitutes are readily available and have similar and better performance features.
  - In contrast, when close substitutes for a product exist, industry profitability is suppressed, because consumers will opt out if the price gets too high.
  - For example, there are few if any substitutes for prescription medicines, which is one of the reasons the pharmaceutical industry is so profitable.



# Techniques Available to Assess Industry Attractiveness

## Threat of Substitutes

**What are the examples for substitutes you know???**





# Techniques Available to Assess Industry Attractiveness

## Threat of Substitutes

- **Switching cost (in terms of money and time)** – 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 their customers switch to substitutes, even in light of a price increase.



# Techniques Available to Assess Industry Attractiveness

## 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 creating **barriers to entry**.



# Techniques Available to Assess Industry Attractiveness

## Threat of New Entrants

### Barriers to Entry

- Product differentiation
- Capital requirements
- Economies of Scale
- **Cost advantages independent of size??**
- Access to distribution channels
- Government and legal barriers
- Expected retaliation





# Techniques Available to Assess Industry Attractiveness

## Non Traditional Barriers to Entry

- Strength of management team
- First-mover advantage
- Passion of the management team and employees - unique culture and employees anticipate large financial reward
- 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. E.g. Netflix
- Internet Domain Name – e.g. [www.bodybuilding.com](http://www.bodybuilding.com)
- Inventing a new approach to an industry - If a start-up invents a new approach to an industry and executes it in an exemplary fashion, these factors create a barrier to entry for potential imitators. E.g. Cirque du Soleil - Canadian entertainment company. Largest theatrical producer in the world



# Techniques Available to Assess Industry Attractiveness

## Rivalry Among Existing Firms

- Competitive pressures for better market position, increased sales, market share and competitive advantage resulting in both *offensive* and *defensive* moves among existing firms
- In most industries, the major determinant of industry profitability is the level of competition among existing firms.
- Some industries are fiercely competitive, to the point where prices are pushed below the level of costs, and industry-wide losses occur.



# Techniques Available to Assess Industry Attractiveness

## Rivalry Among Existing Firms

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

- Number and balance of competitors
- Degree of difference between products
- Growth rate of an industry
- Level of fixed costs
- High-exit barriers



# Techniques Available to Assess Industry Attractiveness

## Bargaining Power of Suppliers

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

- Supplier concentration
- Switching costs
- Attractiveness of substitutes
- Threat of forward vertical integration
- Product differentiation



# Techniques Available to Assess Industry Attractiveness

## 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.





# Techniques Available to Assess Industry Attractiveness

## Bargaining Power of Buyers

Buyer group concentration

Switching costs

Threat of backward vertical integration

Standardized or differentiated



## Application of the Five Forces 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 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.
  - to identify its strengths and weaknesses relative to the industry
  - an effective competitive strategy takes offensive or defensive action in order to create a *defendable* position against the five competitive forces



# Application of the Five Forces 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



# Application of the Five Forces Model

Assessing Industry Attractiveness Using the Five Forces Model

e.g.

Suppliers – weak

Customers – Weak

Barriers to entry – High

Substitutes – Few

Rivalry – little/low

**Higher industry profit**



## Application of the Five Forces Model

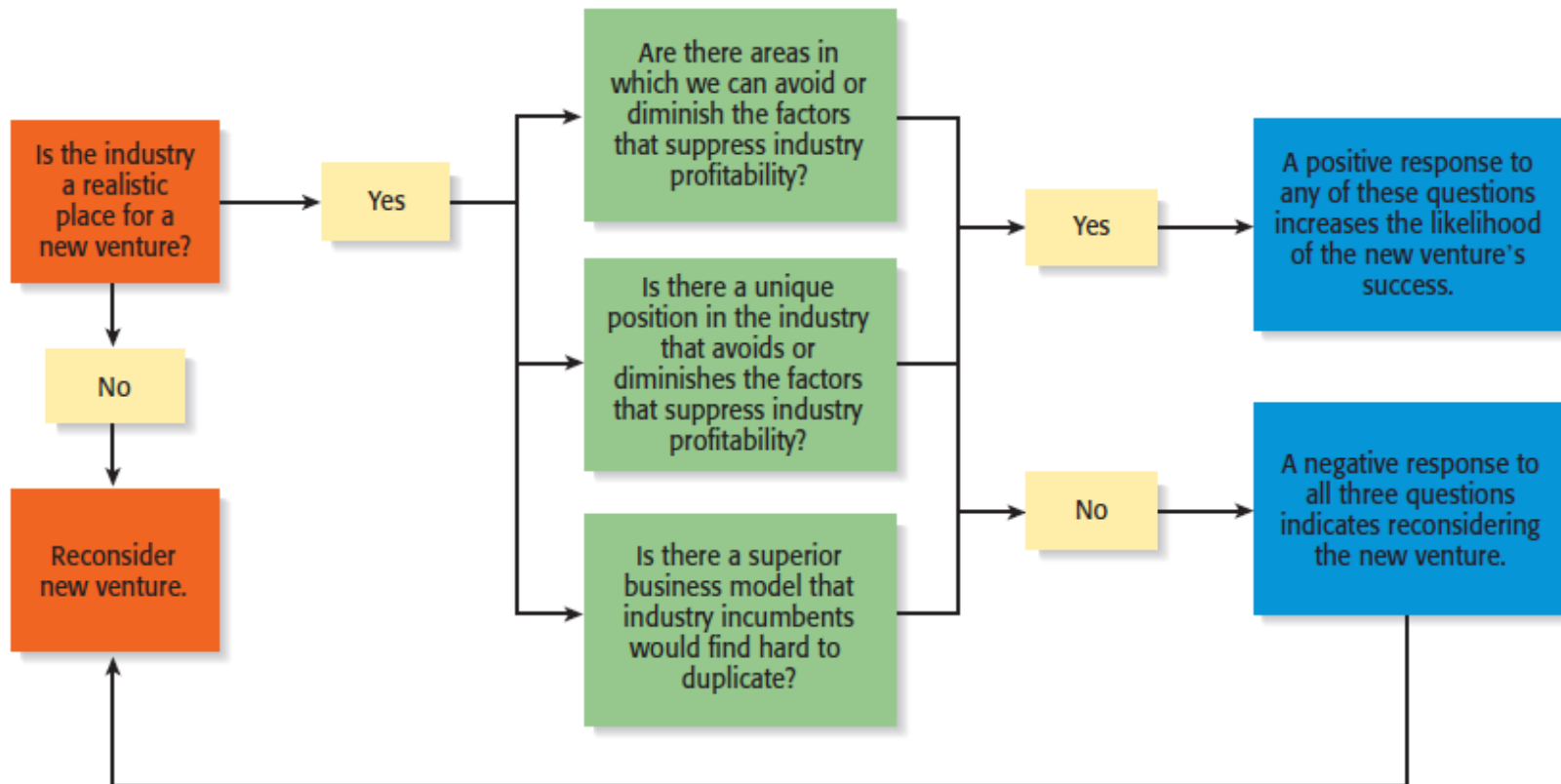
- The second way a new firm can apply the five forces model to help determine whether it should enter an industry is by using the model to answer several key questions.





# Application of the Five Forces Model

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





## Limitations of the Five Forces Model

Overlooks the role of complements – Substitutes lower the value of products offered by a firm whereas complements increase it.

This model assumes a zero-sum game, determining how a firm can enhance its position relative to the forces. This overlooks potential benefits of developing win-win relationships with customer and supplier.



Thank you