Threat of New Entrants

- New entrants can reduce an industry's profitability
- The bigger the new entrant, the more severe the competitive effect.
- Common barriers to entry include:

(i) Capital requirements
(ii) Economies of scale
(iii) Product differentiation
(iv) Switching costs
(v) Brand identity
(vi) Access to distribution channels
(vii) Possibility of aggressive retaliation by existing players

- **Capital Requirements:** When a large amount of capital is required to enter an industry, firms lacking funds are effectively barred from that industry, thus, enhancing the profitability of existing firms.
- **Economies of Scale:** Economies of scale refers to the decline in the per-unit cost of production (or other activity) as the volume grows. A large firm that enjoys economies of scale can produce high volumes of goods at successively lower cost.
- **Product Differentiation:** Product differentiation refers to the physical or perceptual differences, or enhancements, that make a product special or unique in the eyes of customers.
- **Switching Costs:** To succeed in an industry, new entrant must be able to persuade existing customers of other companies to switch to its products.
- **Brand Identity:** The brand identity of products or services offered by existing firms can serve as another entry barrier.
- **Access to Distribution Channels:** The unavailability of distribution channels for new entrants poses another significant entry barrier.
- **Possibility of Aggressive Retaliation:** Sometimes the mere threat of aggres- sive retaliation by incumbents/existing firms can deter entry of new firms into an existing industry.

Bargaining Power of Buyers

- force becomes heavier depending on the possibility of buyers forming groups or cartels

(Industrial products)

- The bargaining power of the buyers influences not only the prices that the producer can charge but also influences costs and investments of the producer.
- This is because powerful buyers usually bargain for better services which involves more investment on the part of the producer.
- Buyers of an industry's products or services can sometimes exert considerable pressure on existing firms to secure lower prices or better services. This leverage is particularly evident when:

(i) Buyers have full knowledge of the source(s) of products and their substitutes.

(ii) Big buyers: in a position to demand favourable terms of contract.

(iii) The industry's product is not perceived as critical to the buyer's needs and buyers are more concentrated than firms supplying the product. They can easily switch to the substitutes available.

- **Industry Leader:** A strong industry leader can discourage price wars by disciplining initiators of such activity.
- **Number of Competitors:** Even when an industry leader exists, the leader's ability to exert pricing discipline diminishes with the increased number of rivals in the industry as communicating expectations to players becomes more difficult.
- **Fixed Costs:** When organisations operate with high fixed costs, they are motivated to utilize their capacity and therefore, are inclined to drop prices when they have excess capacity.
- **Exit Barriers:** Rivalry amongst competitors declines, if a few competitors leave the industry. Profitability therefore tends to be higher in industries with few exit barriers.
- **Product Differentiation:** Firms can sometimes insulate themselves from price wars by differentiating their products from those of its rivals. As a con- sequence, profitability tends to be higher in industries that offer opportunity for differentiation.
- **Slow Growth:** Industries whose growth is declining tend to face more intense rivalry.

Threat of Substitutes

- Substitute products are a latent/hidden but existing source of competition in an industry.
- Substitute products that offer a price advantage and/or performance improvement to the consumers, can drastically alter the competitive character of an industry.
- To predict profit pressure from this source of competition, firms must search for products that can perform the same, or nearly the same, functionalities as their own products.
- The threat of substitutes is great in many high tech industries as well.

Activity

Select an industry of your choice. Identify Porter's five-forces of competition in that industry. Perform a competitor analysis from the point of view of the market leader in that industry. Identify the possible strategic groups in that industry and judge the implications of such groups on the strategies of the market leader.

- Cost leadership emphasizes on producing standardized products at a very low per- unit cost for consumers who are price-sensitive.
- Differentiation is a strategy aimed at producing products and services considered unique industry-wide and directed at consumers who are relatively price-insensitive.
- Focus means producing products and services that fulfil the needs of small groups of consumers with very specific taste.

Cost Leadership Strategy

- It is a low-cost competitive strategy that aims at broad mass market.
- Striving to be a low-cost producer in an industry can especially be effective,
  - when the market is composed of many price-sensitive buyers and
  - when there are few ways to achieve product differentiation.

- **Advantages of Cost Leadership Strategy**
- Earlier we have discussed Porter's Five Forces Model in detail. A cost leadership strategy may help to remain profitable even with: rivalry, new entrants, suppliers' power, substitute products, and buyers' power.

1. Rivalry – Competitors are likely to avoid a price war, since the low-cost firm will continue to earn profits even after competitors compete away their prof- its.
2. Buyers – Powerful buyers/customers would not be able to exploit the cost leader firm and will continue to buy its product.
3. Suppliers – Cost leaders are able to absorb greater price increases from sup- pliers before they need to raise prices for customers.
4. Entrants – Low-cost leaders create barriers to market entry through their con- tinuous focus on efficiency and cost reduction.
5. Substitutes – Low-cost leaders are more likely to lower the costs to induce existing customers to stay with their products, invest in developing substi- tutes, and even purchase patents.