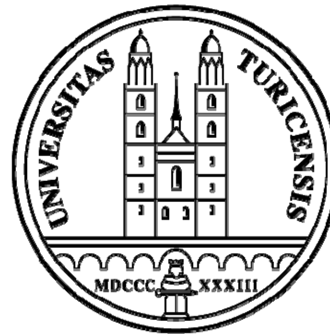
A primer in Entrepreneurship



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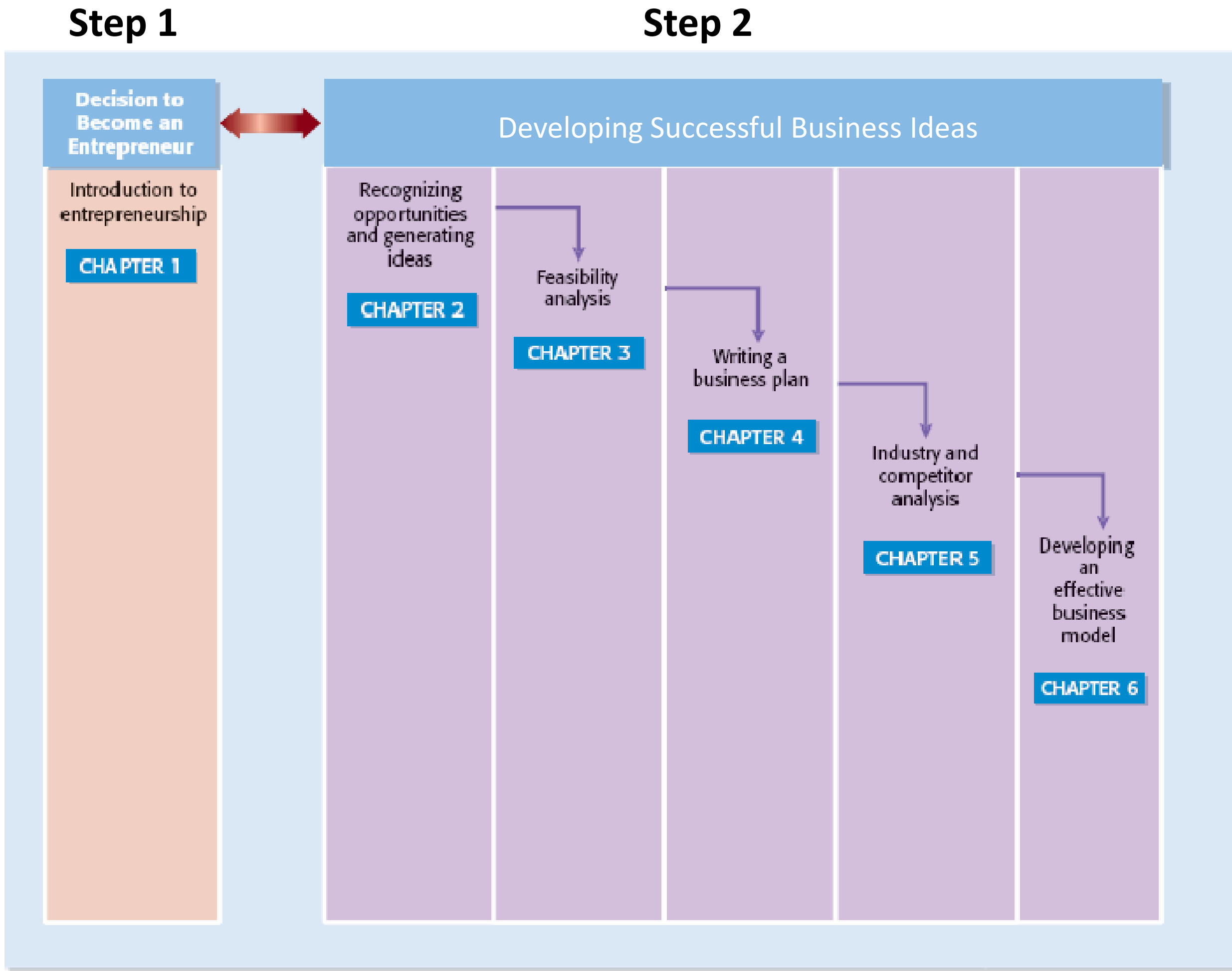
Fall Semester 2010

Where we are:



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Chapter 5: Industry and Competitor Analysis

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I. Industry Analysis

Definition

1. An industry is a group of firms producing a similar product or service, such as music, fitness drinks, or electronic games.
2. Industry analysis is business research that focuses on the potential of an industry.
3. Why important?
   a. 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 earn the ins-and-outs of the industry the firm plans to enter.
   b. This analysis helps a firm determine if the niche markets it identified during feasibility analysis are accessible and which ones represent the best point of entry for a new firm.

I. Industry Analysis

Three Important 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 ripe for innovation or are underserved?	Are there positions in the industry that will avoid some of the negative attributes of the industry as a whole?

I. Industry Analysis

It‘s All About The Position

It is useful for a new venture to think about its position at both the company level and the product or service level. At the company level, a firm’s position determines how the entire company is situated relative to its competitors.

II. The Importance of Industry Versus Firm Specific Factors

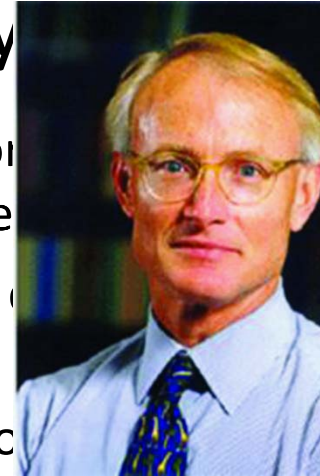
To illustrate the importance of the industry a firm chooses to enter, research has shown that both firm-specific and industry-specific factors contribute to a firm's profitability:

1. Firm-level factors include a firm's assets, products, culture, teamwork among its employees, reputation, and other resources.
2. Industry-specific factors include the threat of new entrants, rivalry among existing firms, the bargaining power of suppliers, and other factors discussed in the chapter.
3. In various studies, researchers have found that from eight to 30 percent of the variation in firm profitability is directly attributable to the industry in which a firm competes.

III. The Five Competitive Forces That Determine Industry Profitability

1. The five competitive forces model is a framework for understanding the structure of an industry and was developed by Michael Porter.
2. The framework is comprised of the forces that determine industry profitability.
3. These forces – the threat of substitutes, the entry of new competitors, rivalry among existing firms, the bargaining power of suppliers, and the bargaining power of buyers – determine the average rate of return for the firms in an industry.
4. Each of Porter's five forces has an impact on the average rate of return for the firms in an industry by applying pressure on industry profitability. Well-managed companies try to position their firms in a way that avoids or diminishes these forces in an attempt to beat the average rate of return for the industry.

III. The Five Competitive Forces That Determine Industry Profitability



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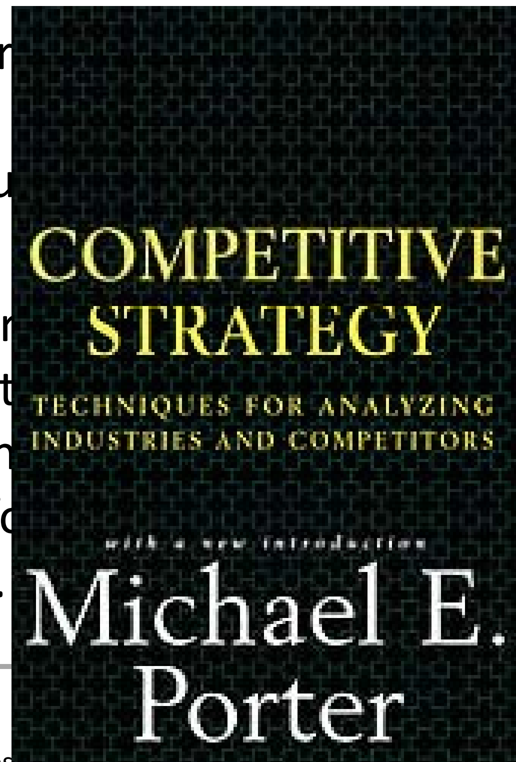

III. The Five Competitive Forces That Determine Industry Profitability

Bargaining Power of Customers

Threat of New Entrants

Bargaining Power of Suppliers

Competitive Rivalry within an Industry

Threat of Substitute Products

Source: http://upload.wikimedia.org/wikipedia/commons/6/66/Porters_five_forces.PNG

Supplier Power

Supplier concentration
Importance of volume to supplier
Differentiation of inputs
Impact of inputs on cost or differentiation
Switching costs of firms in the industry
Presence of substitute inputs
Threat of forward intergration
Cost relative to total purchases in industry

Barriers to entry

Absolute cost advantages
Proprietary learning curve
Access to inputs
Government policy
Economies of scale
Capital requirements
Brand identity
Switching costs
Access to distribution
Expected retaliation
Proprietary products

Rivalry

Threat of substitutes

- Switching costs
- Buyer inclination to substitute
- Price performance trade-off of substitutes

Buyer Power

Bargaining leverage
Buyer volume
Buyer information
Brand identity
Price sensitivity
Threat of backward intergration
Product differentiation
Buyer concentration vs. industry
Substitutes available
Buyers' incentives

Degree of Rivalry

Exit barriers
Industry concentration
Fixed costs/Value added
Industry growth
Intermittent overcapacity
Product differences
Switching costs
Brand identity
Diversity of rivals
Corporate stakes

Source: http://www.quickmba.com/strategy/porter.shtml

III. The Five Competitive Forces That Determine Industry Profitability

1. Threat of Substitutes

a. The price that consumers are willing to pay for a product depends, in part, on the availability of substitute products.

b. For example, there are few if any substitutes for prescription medicines, which is one of the reasons the pharmaceutical industry is so profitable.

c. In contrast, when close substitutes for a product do exist, industry profitability is suppressed because consumers will opt not to buy when the price is too high.

d. The extent to which substitutes suppress the profitability of an industry depends on the propensity for buyers to substitute between alternatives.

e. 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.

III. The Five Competitive Forces That Determine Industry Profitability

2. Threat of New Entrants

a. If the firms in an industry are highly profitable, the industry becomes a magnet to new entrants.

b. Unless something is done to stop this, the competition in the industry will increase, and average industry profitability will decline.

c. Firms in an industry try to keep the number of new entrants low by erecting barriers to entry.

d. A barrier to entry is a condition that creates a disincentive for a new firm to enter an industry.

Rockefeller example

III. The Five Competitive Forces That Determine Industry Profitability

2. Threat of New Entrants

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. For example, it now takes about two years and $4 million to develop an electronic game. Many new firms do not have the capital to compete at this level.

III. The Five Competitive Forces That Determine Industry Profitability

2. Threat of New Entrants

Barrier to Entry	Explanation
Cost advantages independent of size	Entrenched competitors may have cost advantages not related to size. For example, the existing competitors in an industry may have purchased property when it was much less expensive than a new entrant would have to pay.
Access to distribution channels	Distribution channels are often hard to crack. This is particularly true in crowded markets, such as the convenience store market. For a new sports drink to be placed on the shelf, it has to displace a product that is already there.
Government and legal barriers	In knowledge intensive industries, such as biotechnology and software, patents, trademarks, and copyrights form major barriers to entry. Other industries, such as broadcasting, require the granting of a license by a public authority.

III. The Five Competitive Forces That Determine Industry Profitability

2. Threat of New Entrants

Nontraditional Barriers to Entry:

a. It is difficult for start-ups to execute barriers to entry that are expensive, such as economies of scale, because money is usually tight.

b. 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.

III. The Five Competitive Forces That Determine Industry Profitability

2. Threat of New Entrants

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 existing industry, the name recognition that the start-up establishes may create a formidable barrier to entry.
Passion of the management team and employees	If the employees of a start-up are highly motivated by the unique culture of a start-up, and anticipate large financial rewards through stock options, this is a combination that cannot be replicated by larger firms. Think of the employees of a biotech firms trying to find a cure for a disease.

III. The Five Competitive Forces That Determine Industry Profitability

2. Threat of New Entrants

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" in regard to a specific product or service that they give a start-up a meaningful leg up in terms of e-commerce opportunities.
Inventing a new approach to an industry and executing the idea in an exemplary fashion	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.

III. The Five Competitive Forces That Determine Industry Profitability

3. Rivalry Among Existing Firms

a. In most industries, the major determinant of industry profitability is the level of competition among the firms already competing in the industry.

b. Some industries are fiercely competitive to the point where prices are pushed below the level of costs. When this happens, industry-wide losses occur.

c. There are four primary factors that determine the nature and intensity of the rivalry among existing firms in an industry:

   i. Number and Balance of Competitors;

   ii. Degree of Difference Between Products;

   iii. Growth Rate of an Industry;

   iv. Level of Fixed Costs.

III. The Five Competitive Forces That Determine Industry Profitability

3. Rivalry Among Existing Firms

Factors that determine the nature and 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. Price-cutting occurs more often when all the competitors in an industry are about the same size and when there is no clear market leader.**
Degree of difference between products	**The degree to which products differ from one product to another affects industry rivalry. For example, the firms in commodity industries (such as paper products) tend to compete on price because there is little difference between one manufacturer's products and another's.**

III. The Five Competitive Forces That Determine Industry Profitability

3. Rivalry Among Existing Firms

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

Growth rate of an industry	**The competition among firms in a slow-growth industry is stronger than among those in fast-growth industries. Slow-growth industry firms must fight for market share, which may tempt them to lower prices to gain market share. In fast-growth industries, there are enough customers to go around, making price-cutting less likely.**
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. As a result, firms with high fixed costs are anxious to fill their capacity, and this anxiety may lead to price-cutting.**

III. The Five Competitive Forces That Determine Industry Profitability

4. Bargaining Power of Suppliers

a. In some cases, suppliers can suppress the profitability of the industries to which they sell by raising prices or reducing the quality of the components they provide.

b. 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.

c. If the suppliers are powerful relative to the firms in the industry to which they sell, industry profitability can suffer.

III. The Five Competitive Forces That Determine Industry Profitability

5. Bargaining Power of Buyers

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

Supplier concentration	**When there 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.**

III. The Five Competitive Forces That Determine Industry Profitability

5. Bargaining Power of Buyers

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

Attractiveness of substitutes	**Supplier power is enhanced if there are no attractive substitutes for the product or services the supplier offers. For example, there is little the computer industry can do when Intel or Microsoft raise their prices, as there are simply no practical substitutes for their products.**
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.**

III. The Five Competitive Forces That Determine Industry Profitability

5. Bargaining Power of Buyers

a. Buyers can suppress the profitability of the industries from which they purchase by demanding price concessions or increases in quality.

b. For example, the automobile industry is dominated by a handful of large automakers that buy products from thousands of suppliers in different industries. This enables the automakers to suppress the profitability of the industries from which they buy by demanding price reductions.

III. The Five Competitive Forces That Determine Industry Profitability

5. Bargaining Power of Buyers

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

Buyer group concentration	**If the buyers are concentrated, meaning that 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 they pay. For example, if the component sold by the supplier represents 50% of the cost of the buyer's product, the buyer will bargain hard to get the best price for that component.**

III. The Five Competitive Forces That Determine Industry Profitability

5. Bargaining Power of Buyers

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

Degree of standardization of supplier's products	**The degree to which a supplier's product differs from its competitors affects the buyer's bargaining power. For example, a buyer who is purchasing a standard product, like the corn syrup that goes into soft drinks, can play one supplier against another until it gets the best combination of price and service.**
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.**

IV. The Value of the Five Forces Model

Along with helping a firm understand the dynamics of the industry it plans to enter, the five forces model can be used in two ways to help a firm determine whether it should enter a particular industry and whether it can carve out an attractive position in that industry:

1. Industry attractiveness
2. Potential success

IV. The Value of the Five Forces Model

1. Industry attractiveness

First, the five forces model can be used to assess the attractiveness of an industry or a specific position within an industry by determining the level of threat to industry profitability for each of the five forces (see following slide).

IV. The Value of the Five Forces Model

2. Potential success

Is the industry a realistic place for a new venture?

Yes

No

Reconsider new venture.

Are there areas in which we can avoid or diminish the factors that suppress industry profitability?

Is there a unique position in the industry that avoids or diminishes the factors that suppress industry profitability?

Is there a superior business model that industry incumbents would find hard to duplicate?

Yes

No

A positive response to any of these questions increases the likelihood of the new venture's success.

A negative response to all three questions indicates reconsidering the new venture.

V. Industry Types and the Opportunities They Offer

Types of industries

1. Emerging Industries: industries in which standard operating procedures have yet to be developed.
   Opportunity: first-mover advantage.
2. Fragmented Industries: industries that are characterized by a large number of firms of approximately equal size.
   Opportunity: consolidation.
3. Mature Industries: industries that are experiencing slow or no increase in demand.
   Opportunities: Process innovation and after-sale service innovation.
4. Declining Industries: industries that are experiencing a reduction in demand.
   Opportunities: leadership, establishing a niche market, and pursuing a cost reduction strategy.
5. Global Industries: industries that are experiencing significant international sales.
   Opportunities: multi-domestic and global strategies.

VI. Competitor Analysis

1. After a firm has gained an understanding of the industry and markets in which it plans to compete, the next step is to complete a competitor analysis.
2. A competitor analysis is a detailed analysis a firm's competition. It helps a firm understand the positions of its major competitors and the opportunities that are available to obtain a competitive advantage in one or more areas.
3. A competitive analysis grid is a tool for organizing the information a firm collects about its primary competitors.

VI. Competitor Analysis

a. Identifying the Competition

Types of Competitors New Ventures Face

VI. Competitor Analysis

b. Sources of Competitive Intelligence

i. To complete a meaningful competitive analysis grid, a firm must first understand the strategies and behaviors of its competitors.

ii. The information that is gathered by a firm to learn about its competitors is referred to as competitive intelligence.

iii. The following are examples of ways a firm can ethically obtain information about its competitors:

(1) Attend conferences and trade shows; Full business plan
(2) Read (study) industry related books, magazines, and Web sites;
(3) Talk to customers about why they bought your product rather than your competitors;
(4) Study competitors' Web sites;
(5) Purchase competitors products to study their features, benefits and shortcomings;
(6) Study Web sites that provide information about companies.

VI. Competitor Analysis

c. Completing a Competitive Analysis Grid

i. A tool for organizing the information a firm collects about its competitors.

ii. A competitive analysis grid can help a firm see how it stacks up against its competitors, provide ideas for markets to pursue, and identify its primary sources of competitive advantage.

VI. Competitor Analysis

c. Completing a Competitive Analysis Grid

Name	Activision	Electronic Arts	Infograms	LucasArts	Eidos	THQ
Product features						
Brand-name recognition						
Compatibility of products with popular platforms						
Access to distribution channels						
Quality of products						
Ease of use						
Price						
Marketing support						
Quality of Customer service						