Universität Zürich[UZH]

Department of Business Administration - Chair for Entrepreneurship

A Primer in Entrepreneurship

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Chair of Entrepreneurship

Universität Zürich

Fall 2015

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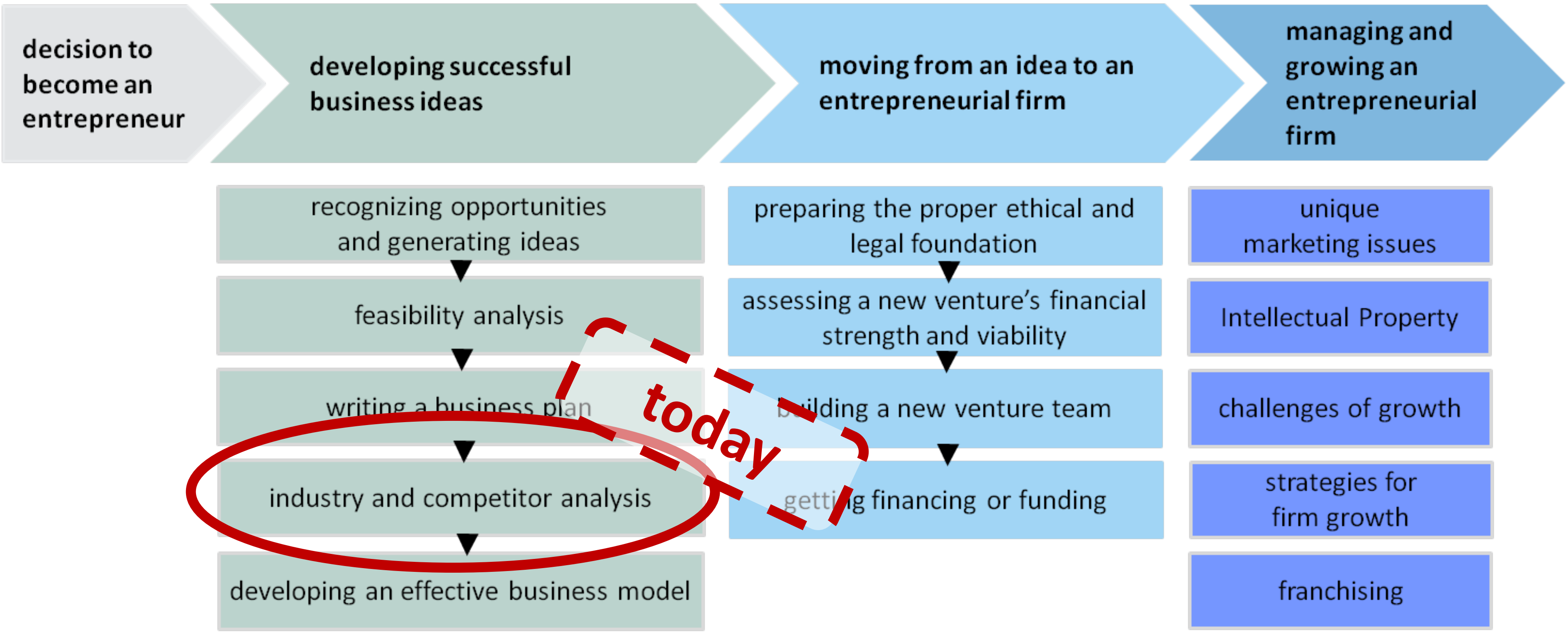
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A Primer in Entrepreneurship

Part II Developing Successful Business Ideas

Lecture 5
Industry and Competitor Analysis

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Agenda

1. **Industry Analysis**
2. **The Importance of Industry versus Firm Specific Factors**
3. **The Five Competitive Forces**
4. **The Value of The Five Forces Model**
5. **Industry Types and Opportunities**
6. **Competitor Analysis**

   6.1 Identifying Competition

   6.2 Sources of Competitive Intelligence

   6.3 Completing a Competitive Analysis Grid

Questions

? What is an industry ?
What is the purpose of industry analysis ?

? What are the Five Competitive Forces ?
How may each of the Five Forces influence industry profitability ?

? What is the next step after a firm has gained an understanding of the industry ?

…to be answered in today‘s lecture.

1 Industry Analysis

Definition

Industry

is a group of firms producing a similar product or service, such as music, fitness drinks, or electronic games.

Industry Analysis

is a business research that focuses on the potential of an industry.

1 Industry Analysis

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.

The Industry Analysis is needed ...

... to earn the ins-and-outs of the industry the firm plans to enter.

... to determine if the niche markets having been identified during feasibility analysis are accessible and which ones represent the best point of entry for a new firm.

1 Industry Analysis

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

1. Is the industry accessible – in other words, is it realistic place for a new venture to enter ?

2. Does the industry contain markets that are ripe for innovation or are underserved ?

3. Are there positions in the industry that will avoid some of the negative attributes of the industry as a whole ?

1 Industry Analysis

It's All About the Position.

It is useful for 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.

2 The Importance of Industry versus Firm Specific Factors

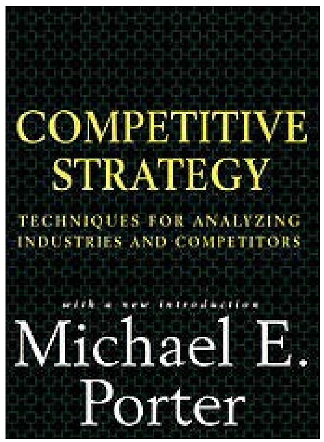
As research has shown both firm specific and industry specific factors contribute to a firm's profitability.

Firm-Level Factors	firm assets, products, culture, teamwork among its employees, reputation and other resources.
Industry- Specific Factors	threat of new entrants, rivalry among existing firms, bargaining power of suppliers, etc.

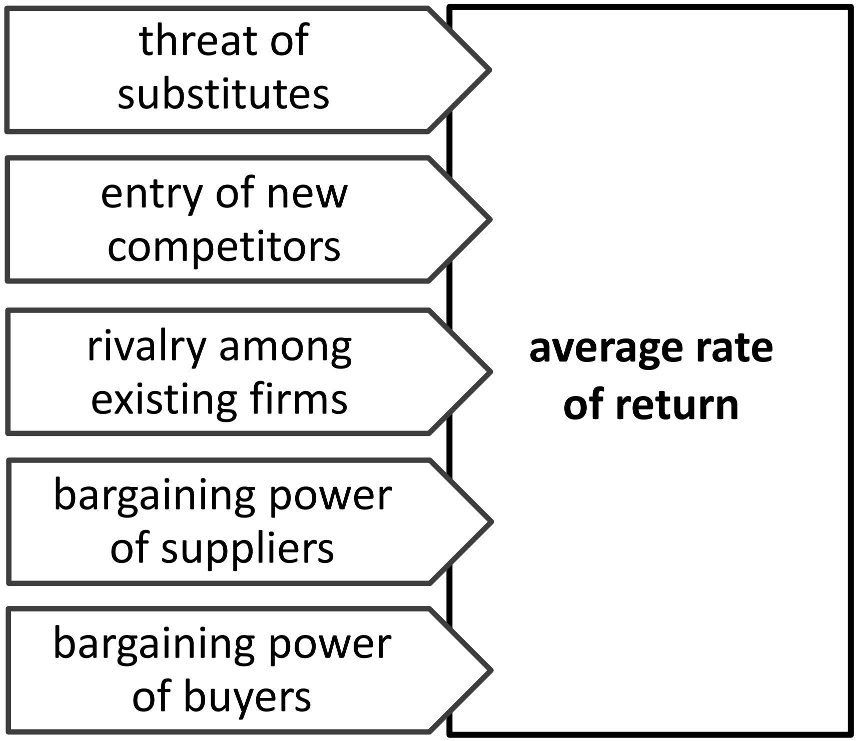
According to various studies, 8 to 30 % of the variation in firm profitability is directly attributable to the industry in which a firm competes.

3 The Five Competitive Forces

The Five Competitive forces model is a framework for understanding the structure of an industry.

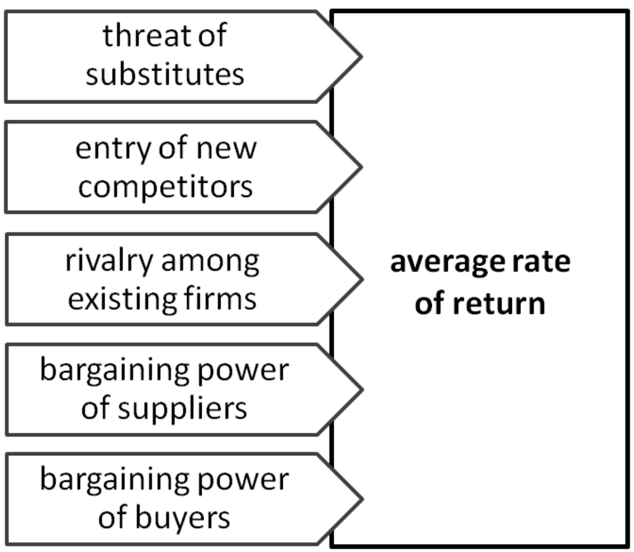


The framework was developed by Michael Porter and is comprised of the forces that determine industry profitability.



3 The Five Competitive Forces

Each of Porter's Five Forces has an impact on the average rate of return for the firms in an industry.

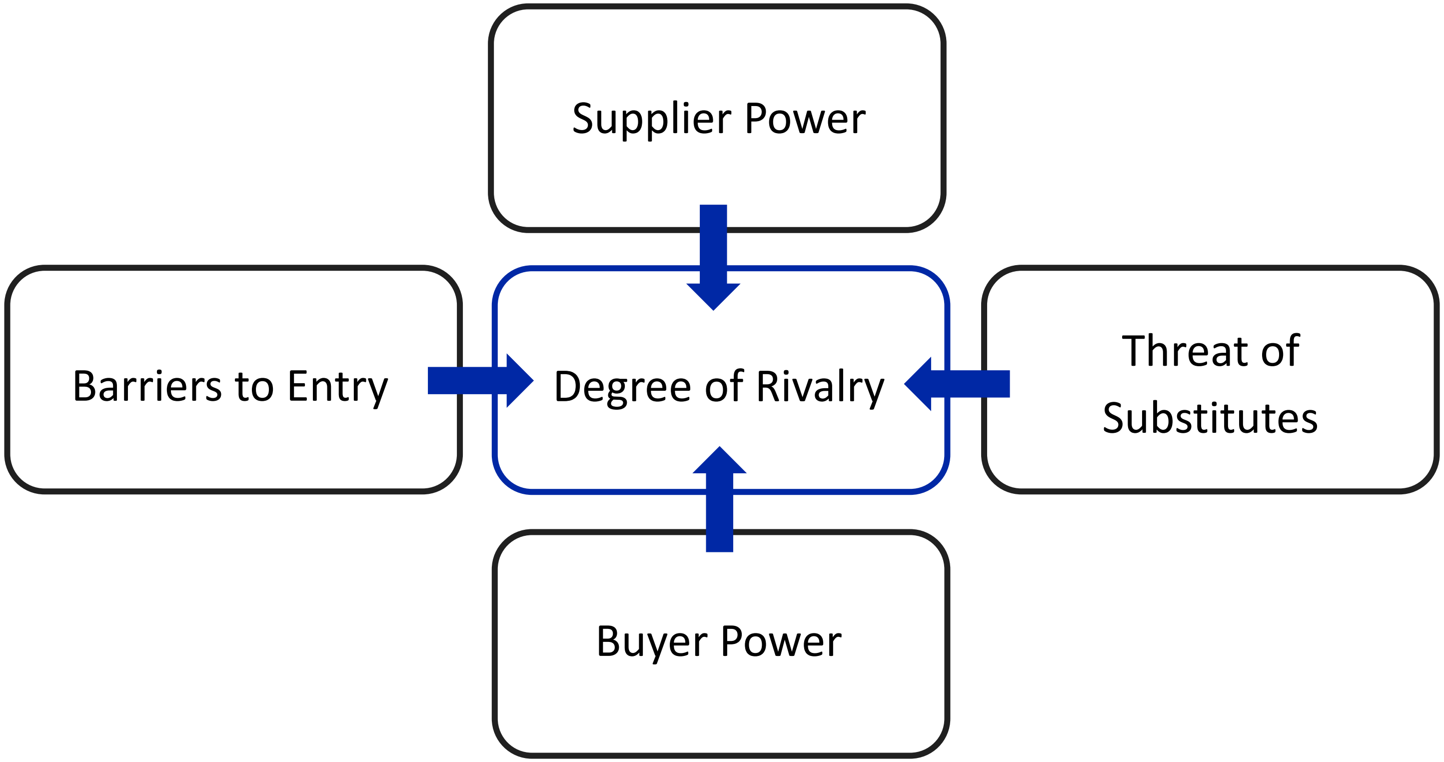


Each of Porter's Five Forces applies pressure on industry profitability.

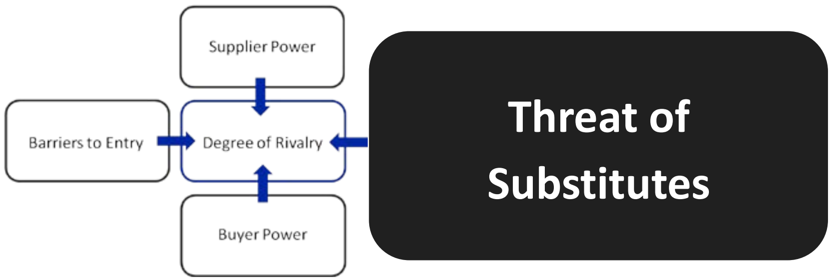
Well-managed companies try to position their firms in a way that avoids or diminishes these forces in an attempt to beat the average rate of return for the industry.

3 The Five Competitive Forces

Porter's Five Forces determine industry profitability.



3 The Five Competitive Forces

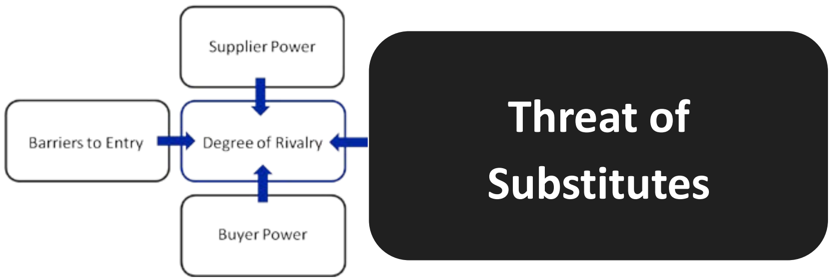


- switching costs
- buying inclination to substitute
- price performance trade-off of substitutes

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

That 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.

3 The Five Competitive Forces

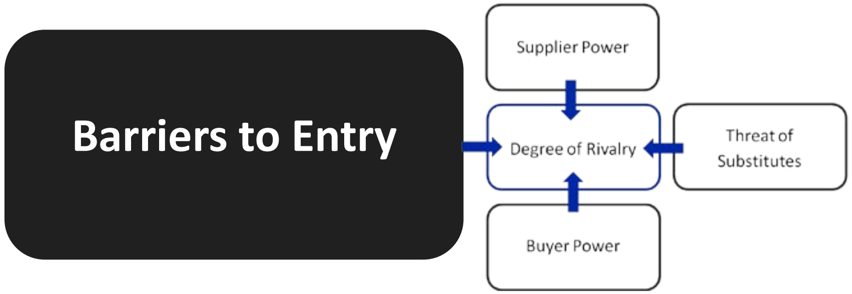


The price that consumers are willing to pay for a product depends, in part, on the availability of substitute products.

availability of substitutes	industry profitability
none, or just a few	high profitability
close substitutes	suppressed profitability; consumers will opt not to buy when the price is too high

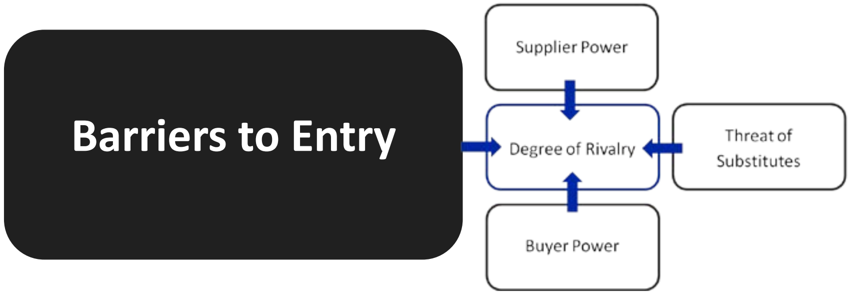
3 The Five Competitive Forces

- 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



3 The Five Competitive Forces

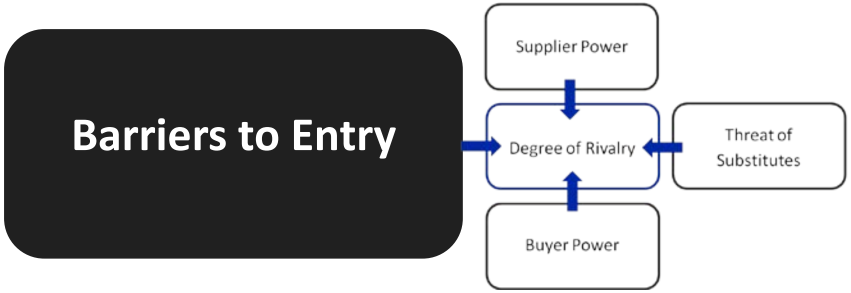
Firms in an industry try to keep the number of new entrants low by erecting barriers to entry.



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

highly profitable firms in the industry → industry becomes a magnet to new entrants → competition in the industry will increase; the average industry profitability will decline

3 The Five Competitive Forces



Barriers to Entry

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 advantage.

Product Differentiation

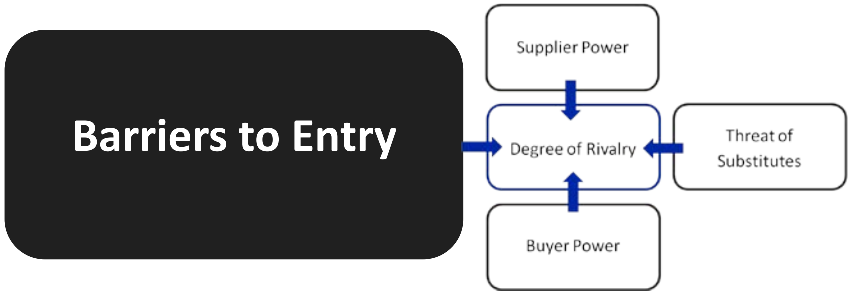
Industries such as the soft drink industry that are characterized by firms with strong brands are difficult to break into without spending heavily on advertising.

Capital Requirements

I.e. it now takes about 2 years and $4 million to develop an electronic game. Many new firms do not have the capital to gain entranced to the industry and to compete at this level.

3 The Five Competitive Forces

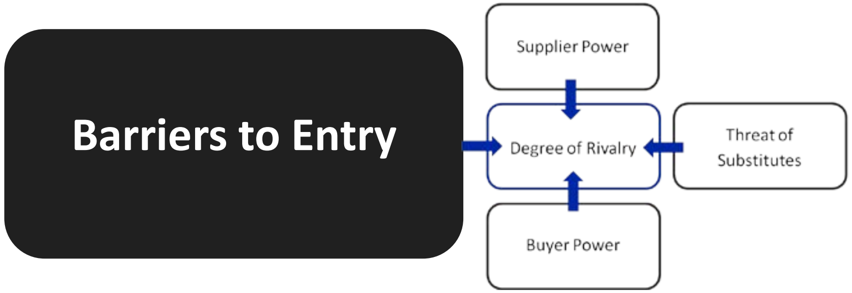
Barriers to Entry



Cost Advantages independent of size	Entrenched competitors may have cost advantages not related to size. I.e. 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.

3 The Five Competitive Forces

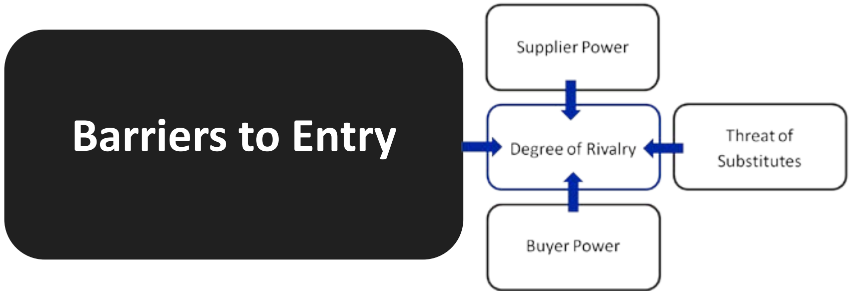
Start-ups rather have to rely on nontraditional barriers to entry to discourage new entrants.



It is difficult for start-ups to execute barriers to entry that are expensive (i.e. economies of scale), because money is usually tight.

Nontraditional barriers to entry include, for example, assembling a world-class management team that would be difficult for another company to replicate.

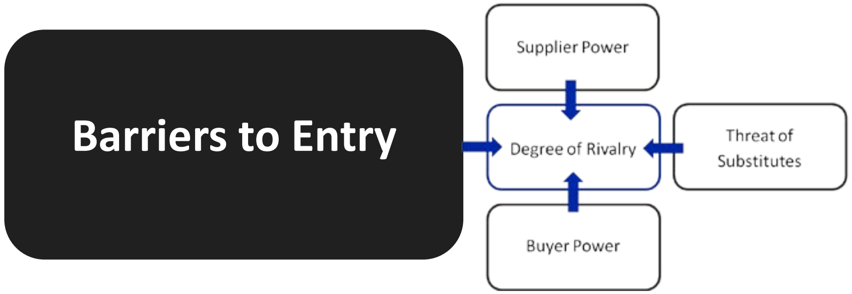
3 The Five Competitive Forces



Nontraditional Barriers to Entry

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 anticipated large financial rewards through stock options, this is a combination that cannot be replicated by larger firms. Think of the employees of biotech firms trying to find a cure for a disease.

3 The Five Competitive Forces



Nontraditional Barriers to Entry

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.

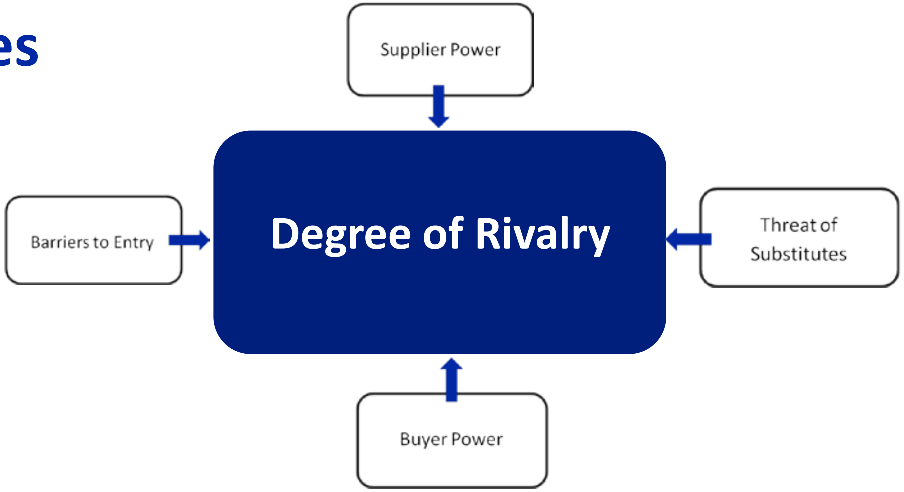
Internet Domain Name

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.

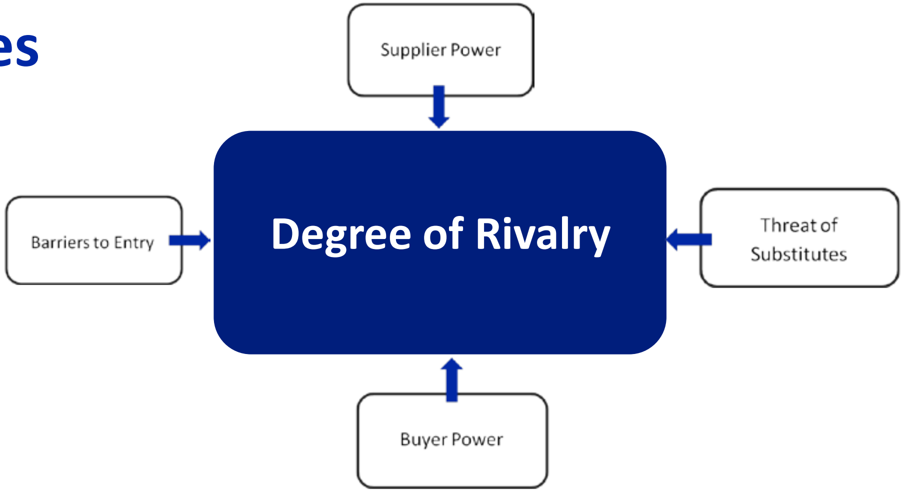
3 The Five Competitive Forces



- exit barriers
- industry concentration
- fixed costs / value added
- industry growth
- intermittent overcapacity
- product differences
- switching costs
- brand identity
- diversity of rivals
- corporate stakes

3 The Five Competitive Forces

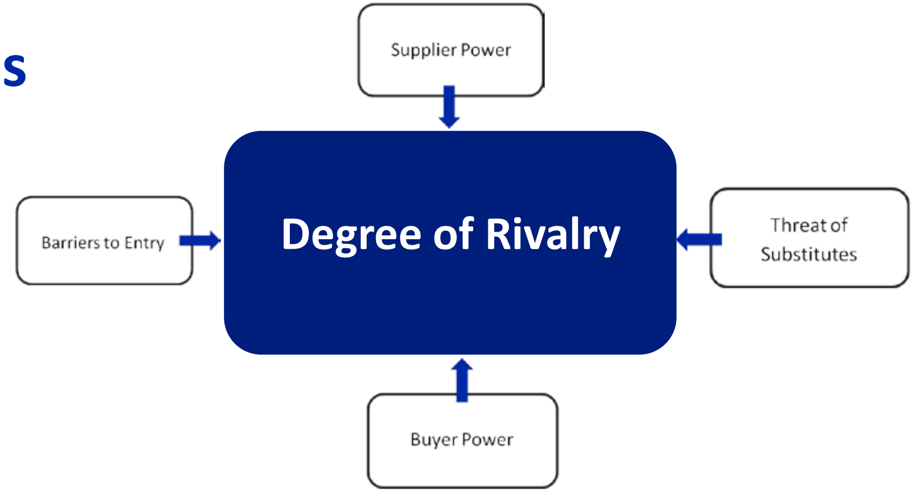
In most industries, the major determinant of industry profitability is the level of competition among the firms already competing in the industry.



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

3 The Five Competitive Forces

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



1. number and balance of competitors

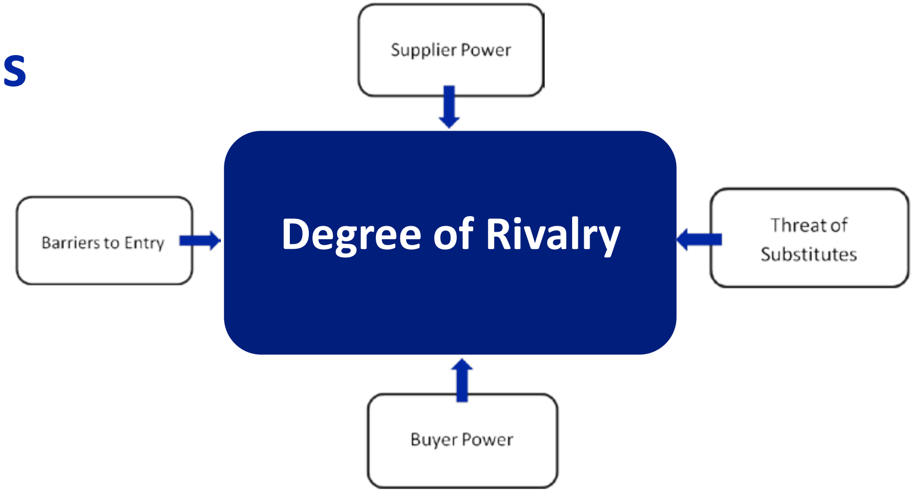
The more competitors there are, the more likely it is that one or more will try to gain customers by cutting its price. Price-cutting occurs more often when all the competitors in an industry are about the same size and then there is no clear market leader.

2. degree of difference between products

The degree to which products differ from one product to another affects industry rivalry. I.e., the firms in commodity industries (i.e. paper products) tend to compete on price because there is little difference between one manufacturer's products and another's.

3 The Five Competitive Forces

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



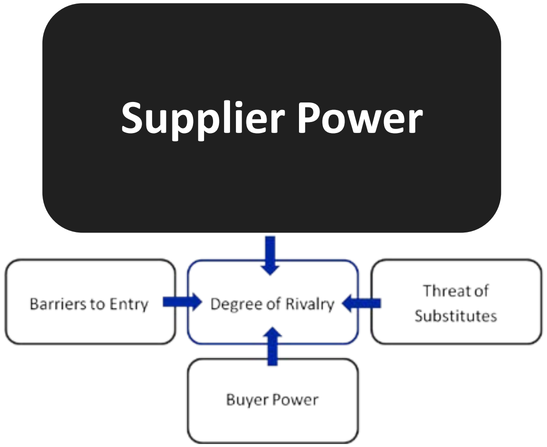
3. growth rate of an industry

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. In fast-growth industries, there are enough customers to go around, making price-cutting less likely.

4. 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.

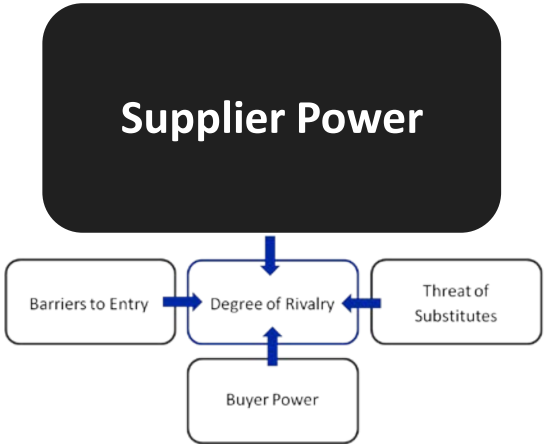
3 The Five Competitive Forces



- 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 integration
- cost relative to total purchases in industry

3 The Five Competitive Forces

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.

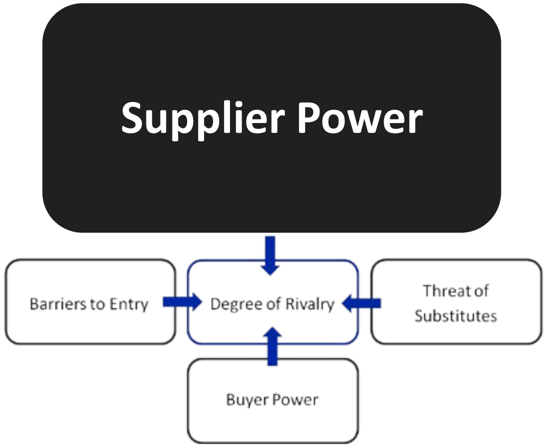


If a supplier reduces the quality of the components it supplies, the quality of the finished product will suffer, and the manufacturer will eventually have to lower its price.

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

3 The Five Competitive Forces

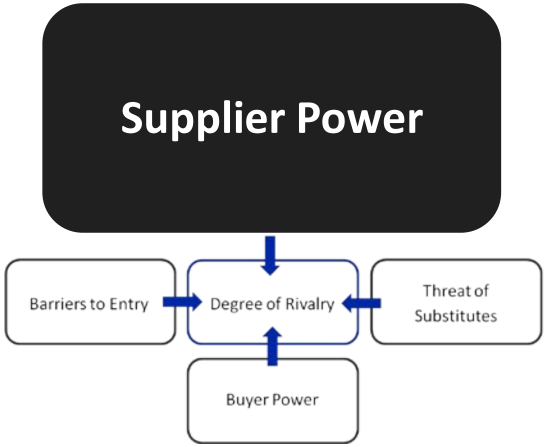
Several factors have an impact on the ability of suppliers to exert pressure on buyers and suppress the profitability of the industry they serve.



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.

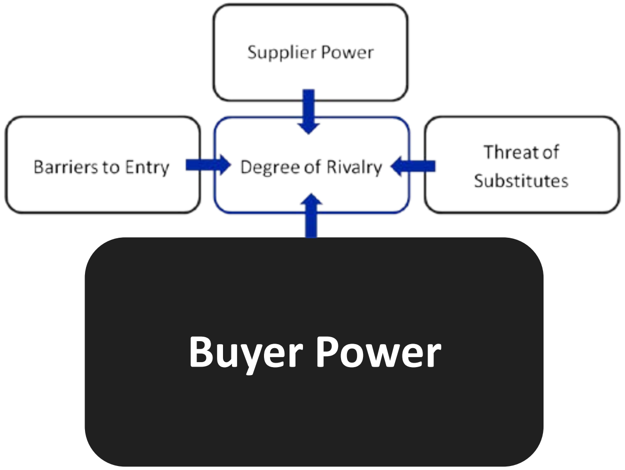
3 The Five Competitive Forces

Several factors have an impact on the ability of suppliers to exert pressure on buyers and suppress the profitability of the industry they serve.



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.

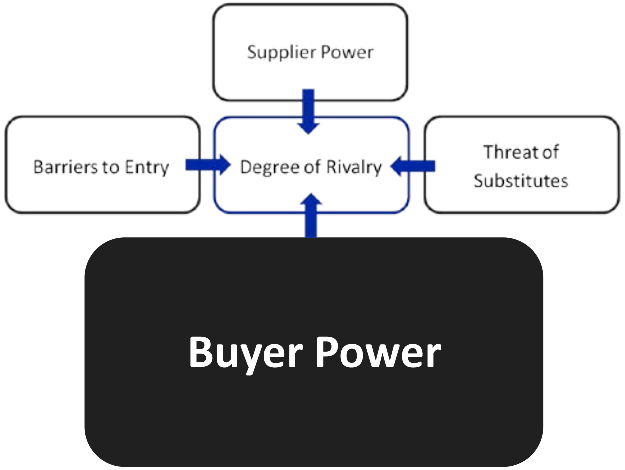
3 The Five Competitive Forces



- bargaining leverage
- buyer volume
- buyer information
- brand identity
- price sensitivity
- threat of backward integration
- product differentiation
- buyer concentration vs. industry
- substitutes available
- buyers' incentives

3 The Five Competitive Forces

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

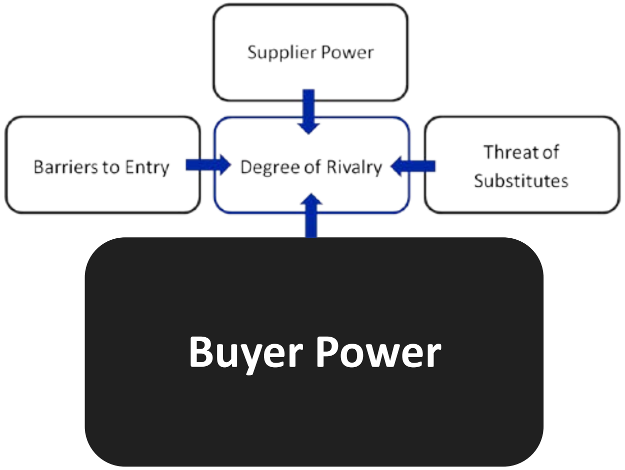


Bargaining Power of Buyers - An Example

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.

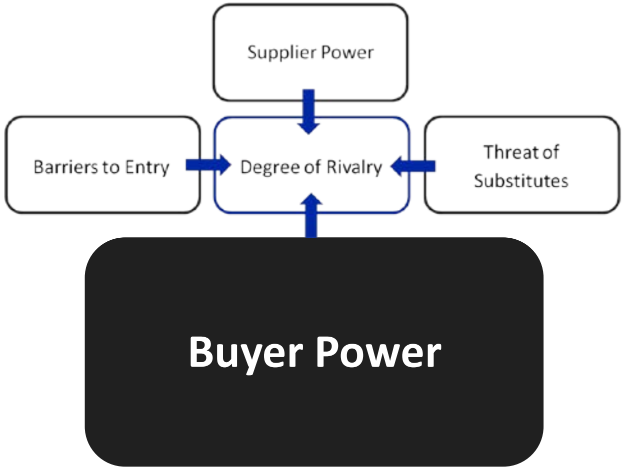
3 The Five Competitive Forces

Several factors affect buyers' ability to exert pressure on suppliers and suppress the profitability of the industries from which they buy.



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.

3 The Five Competitive Forces



Several factors affect buyers' ability to exert pressure on suppliers and suppress the profitability of the industries from which they buy.

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

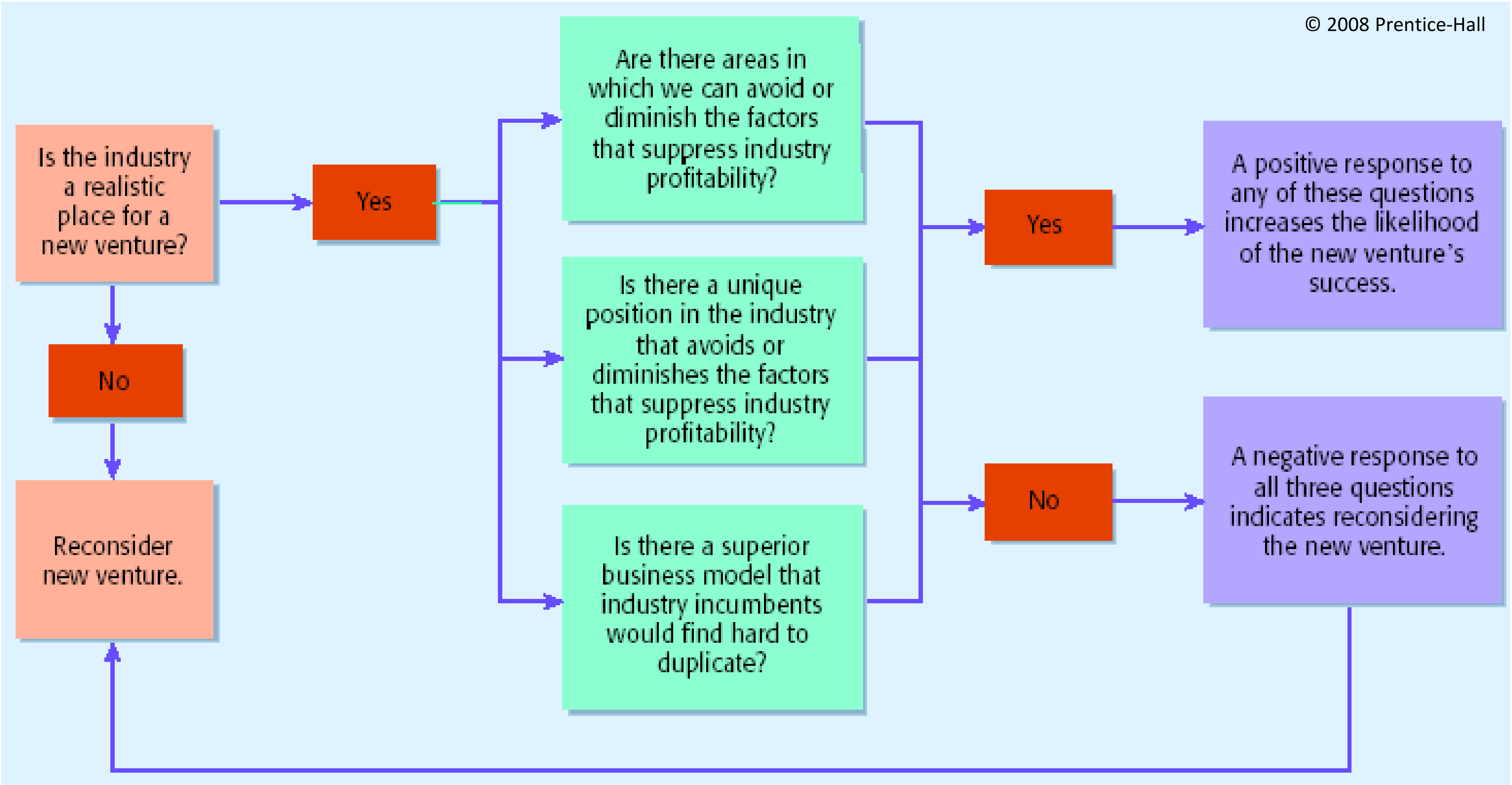
The power of buyers is enhanced if there is a credible threat that the buyer might enter the supplier's industry.

4 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**

4 The Value of The Five Forces Model



5 Industry Types and Opportunities

	characteristics	opportunity
Emerging Industries	standard operating procedures have yet to be developed	first-mover advantage
Fragmented Industries	large number of firms of approximately equal size	consolidation
Mature Industries	slow or no increase in demand	process innovation and after-sale service innovation
Declining Industries	reduction in demand	leadership, establishing a niche market, and pursuing a cost reduction strategy
Global Industries	significant international sales	multi-domestic and global strategies

6 Competitor Analysis

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.

Competitive 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.

Competitive Analysis Grid is a tool for organizing the information a firm collects about its primary competitors. 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.

6.1 Identifying the Competition

There exist three different types of competitors a business will 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

6.2 Sources of Competitive Intelligence

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

Competitive Intelligence is the information that is gathered by a firm to learn about its competitors.

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

- attend conferences and trade shows
- read/ study industry related books, magazines, and websites
- talk to customers about why they bought your product rather than your competitors'
- study competitors' websites
- purchase competitors' products to study their features, benefits and shortcomings
- study websites that provide information about companies

6.3 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						

Do you know the answer ?

?! What is an industry ?
What is the purpose of industry analysis ?

?! What are the Five Competitive Forces ?
How may each of the Five Forces influence industry profitability ?

?! What is the next step after a firm has gained an understanding of the industry ?

…test yourself.

References

Barringer, B. and D., Ireland (2008): Entrepreneurship - Successfully Launching New Ventures, Pearsons Prentice-Hall.

Outlook

decision to become an entrepreneur

developing successful business ideas
- recognizing opportunities and generating ideas
- feasibility analysis
- writing a business plan
- industry and competitor analysis
- developing an effective business model

moving from an idea to an entrepreneurial firm
- preparing the proper ethical and legal foundation
- assessing a new venture's financial strength and viability
- building a new venture team
- getting financing or funding

managing and growing an entrepreneurial firm
- unique marketing issues
- Intellectual Property
- challenges of growth
- strategies for firm growth
- franchising

next week