

## Why External Analysis?

### Learning Objectives

External analysis allows firms to:

- discover threats and opportunities
- see if above normal profits are likely in an industry
- better understand the nature of competition in an industry
- make more informed strategic choices

1

1

## Why is the Market so Crowded?

### Barriers to Entry

- Attracted by profit potential.
  - High demand.
  - Easy to set up.
- Fast Food
- Franchise.
  - Capital Intensity.
  - Skills common.
  - Homogenous.
  - Low brand equity req.
- Petroleum
- High Regulation.
  - Specific Skills.
  - Specific Infra.
  - Assets.
  - Brand Equity.
  - Risk.
  - First mover advantage.
- 

2

2

## Why not something else?

### Substitution

#### Fast Food

- Unorganised sector
- Cloned kitchens
- Home made food.
- Pre-packed ready to eat
- 

- \* Lifestyle.
- \* Budget
- \* Quality.
- \* Convenience.
- \* Service.
- \* Impulse.
- \* Addicted.
- \* Status Symbol.

Petroleum  
- EV

3

3

## Is it difficult to make?

### Suppliers

#### Fast Food

- Farmer.
  - Dept. stores.
  - Spices
  - Veg.
  - Flour/Wheat
  - Meat
  - Packaging.
- Unorganised  
multiple players  
Bargain
- Low bargaining power.

#### Petroleum

- Organised
- Crude Oil.
  - Machinery.
  - Transport.
  - Insurance.
- High Bargaining Power.

4

4

### Do we have any Powers?

**Buyers**

Fast food.  
 - Fragmented.  
 - Switching Cost low

Indian Oil.  
 ↓  
 Petrol Pump

Petroleum.  
 - Switching Cost high.  
 - Options limited.  
 - Exclusivity.

Margins.  
 Advertisement  
 ↳ Loyalty.

Cyclicality.

5

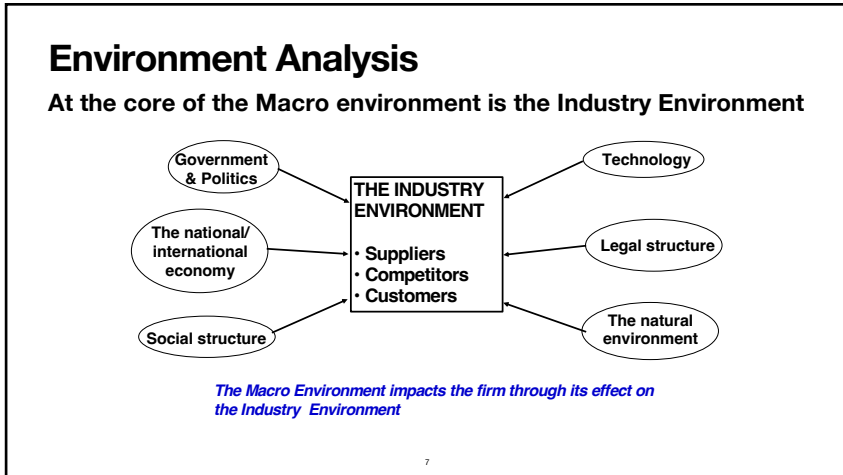
### Finally, the Competition

**Market Forces**

Fast Food  
 - Perfect competition  
 - Price War.  
 - Differentiated

Petroleum.  
 - Oligopoly.  
 - Cartel.  
 - Same product  
 - Imitation.

6



7

### Industry Structure

Analysing Industry Attractiveness

*Set prices. - Market Power.*  
*- Coke vs Pepsi.*  
*- At&T vs Jio*

	Perfect Competition	FMCG: Oligopoly	IT: Duopoly	Railways: Monopoly
Concentration	Many firms	A few firms	Two firms	One firm
Entry and Exit Barriers	No barriers	Significant barriers	High barriers	
Product Differentiation	Homogeneous Product	Potential for product differentiation		
Information	Perfect Information	Imperfect availability of information		

8

## Industry Analysis

**Industrial Economics** *SCP paradigm.*

*CCI.* The Structure-Conduct-Performance Model

- originally developed to spot anti-competitive conditions for anti-trust purposes
- came to be used to assess the possibilities for above normal profits for firms within an industry
- model of environmental threats was developed from this economic tradition

9

## Structure Conduct Performance

**The Model**

*SCP.* *given*

*M. Porter 1970s*

10

9

10

## Porters Five Forces

**Analysing Industry Attractiveness**

*low threat - opportunity*

Higher Threat → Lower Average Profits

11

## Structural Determinants of Competition

**Analysing Industry Attractiveness**

- SUPPLIER POWER**
  - Buyers' price sensitivity
  - Relative bargaining power
- BUYER POWER**
  - Buyers' price sensitivity
  - Relative bargaining power
- THREAT OF ENTRY**
  - Capital requirements
  - Economies of scale
  - Absolute cost advantage
  - Product differentiation
  - Access to distribution channels
  - Legal/regulatory barriers
  - Retaliation
- SUBSTITUTE COMPETITION**
  - Buyers' propensity to substitute
  - Relative prices & performance of substitutes
- INDUSTRY RIVALRY**
  - Concentration
  - Diversity of competitors
  - Product differentiation
  - Excess capacity and exit barriers
  - Cost conditions

12

11

12

## Threat of New Entry

### Analysing Industry Attractiveness

#### Threat from New Competition

- If firms can easily enter the industry, any above normal profits will be bid away quickly.
- Barriers to entry lower the threat of entry.
- Barriers to entry make an industry more attractive.
  - This is true whether the focal firm is already in the industry or thinking about entering.

13

13

## Threat of New Entry

### Analysing Industry Attractiveness

#### Barriers to Entry:

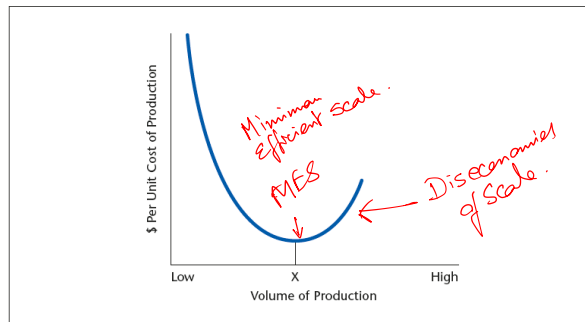
- **Economies of scale**—firm that can't produce the minimum efficient scale will be at a disadvantage.
- **Product differentiation**—entrants are forced to overcome customer loyalties to existing products.
- **Cost advantages independent of scale**—incumbents may have learning advantages, and so on.
- **Government policies**—governments may impose trade restrictions and/or grant monopolies.

14

14

## Economies of Scale

### Cost of Production



15

15

## Rivalry between Established Competitors

### Analysing Industry Attractiveness

*The extent to which industry profitability is depressed by aggressive price competition depends upon:*

- Concentration (number and size distribution of firms)
- Diversity of competitors (differences in goals, costs strategies, etc.)
- Product differentiation
- Excess capacity and exit barriers
- Cost conditions
  - Ratio of fixed to variable costs
  - Extent of scale economies

16

16

## Threat of Substitutes

### Analysing Industry Attractiveness

*Extent of competitive pressure from producers of substitutes depends upon:*

- Buyers' propensity to substitute
- The price-performance characteristics of substitutes.

17

17

## Bargaining Power of Buyers

### Analysing Industry Attractiveness

The extent to which buyers are able to depress profitability in an industry depends upon:

**Buyer's price sensitivity**

- Importance of item in relation to buyers' total costs.
- Differentiation of the purchased item
- Intensity of competition among buyers
- Whether item is critical to the quality of buyers' own output

**Relative bargaining power**

- Size and concentration of buyers relative to sellers.
- Buyer's information .
- Ability to backward integrate.

*NOTE: analysis of supplier power is symmetric*

18

18

## Industry Analysis to Strategy

### Five-forces analysis to forecast industry profitability

*Forecasting Industry Profitability*

- If we can forecast changes in industry structure we can predict likely impact on competition and profitability.

*Strategic Positioning*

- Once we know which structural features of the industry support profitability and which depress profitability, we can choose a favorable positioning within the industry.

*Strategies to Improve Industry Profitability*

- Which of the structural variables that are depressing profitability can we change by individual or collective strategies?

19

19

## Identifying Key Success Factors

### Developing Competitive Advantage

Pre-requisites for success

What do customers want?

*Analysis of demand*

- Who are our customers?
- What do they want?

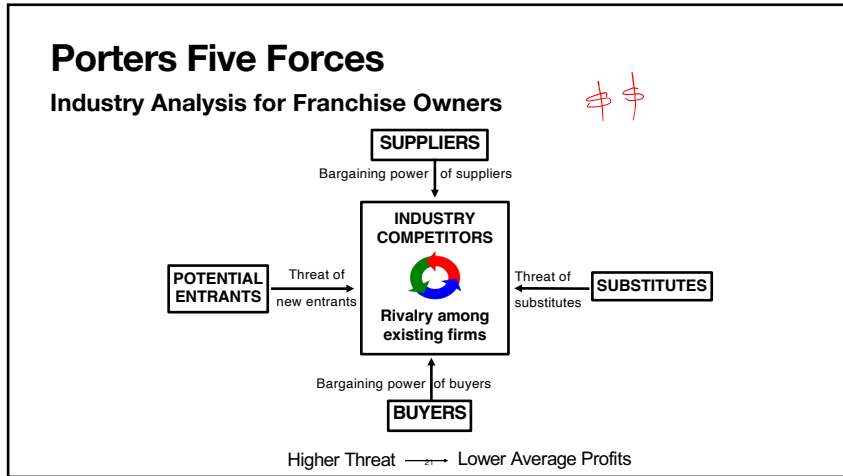
How does the firm survive competition?

*Analysis of competition*

- What drives competition?
- What are the main dimensions of competition?
- How intense is competition?
- How can we obtain a superior competitive position?

**KEY SUCCESS FACTORS**

20



21

### Summarise

#### External Analysis

- How firms can create and exercise market power
- Understanding the external environment (industry, PESTLE) important to predict performance of a firm
- External environment gives us the **THREATS** and **OPPORTUNITIES** facing a firm
- Porters 5 forces broke the SCP paradigm. Conduct can alter Structure and thereby Performance
- Role of regulators vital in controlling Structure

*Set the prices.*

22