

## Why External Analysis?

### Learning Objectives

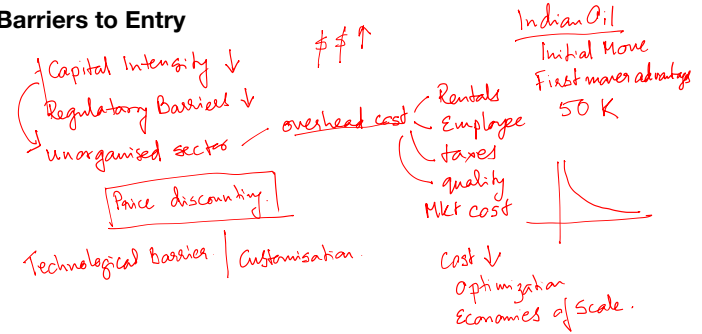
External analysis allows firms to:

- 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

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## Why is the Market so Crowded?

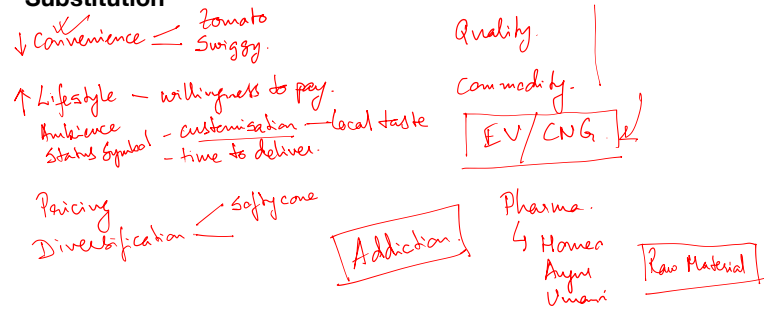
### Barriers to Entry



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## Why not something else?

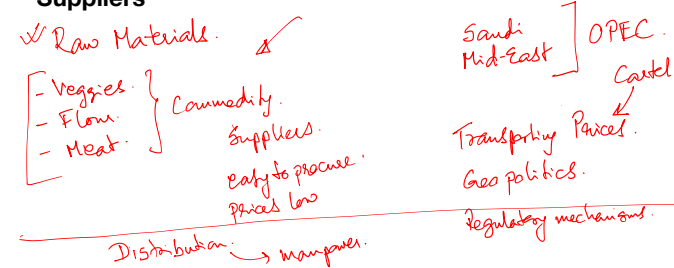
### Substitution



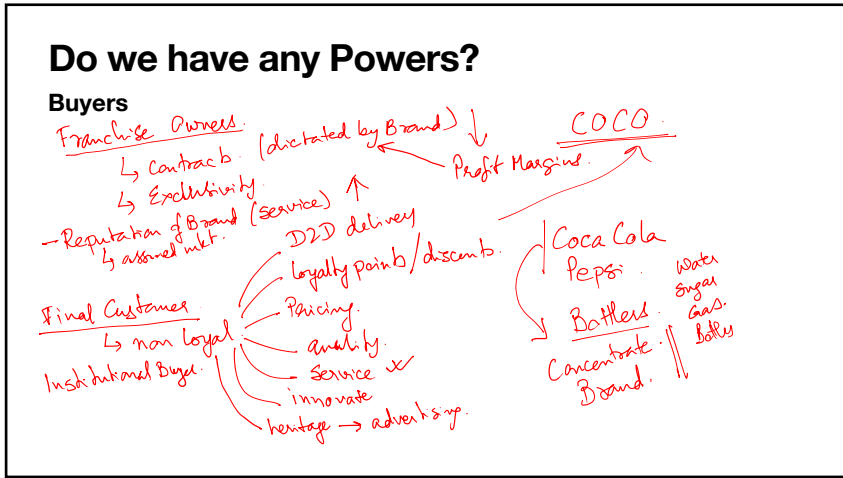
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## Is it difficult to make?

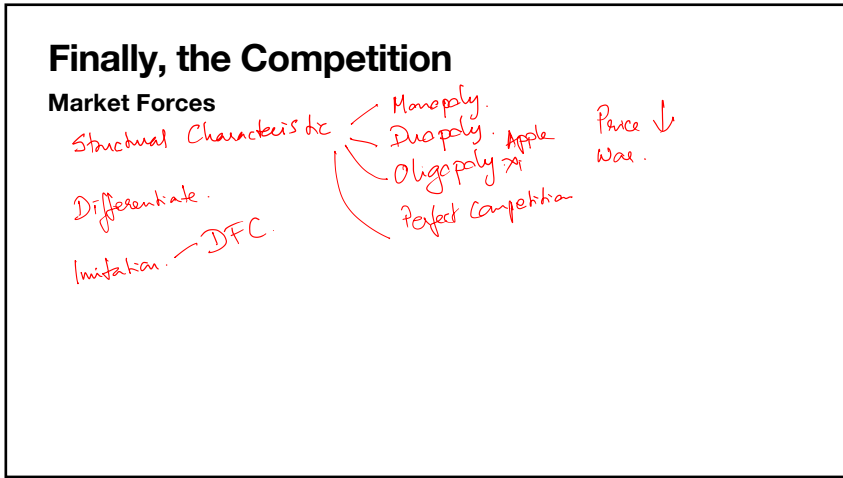
### Suppliers



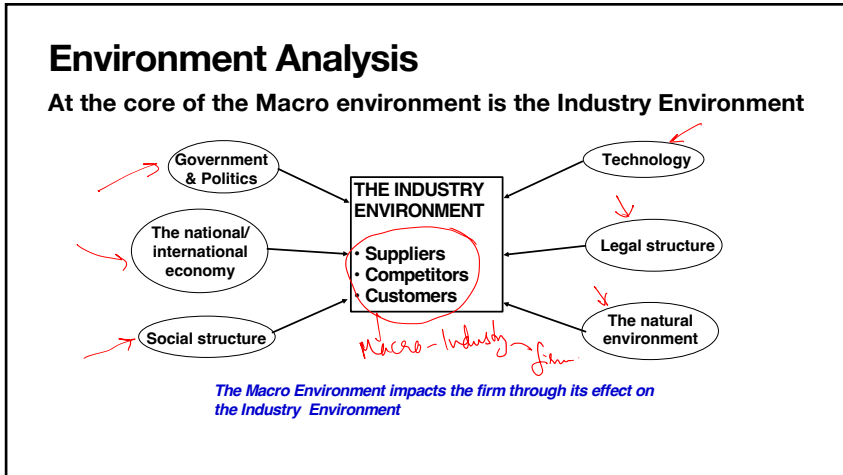
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### Industry Structure

Analysing Industry Attractiveness

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

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## Industry Analysis

### Industrial Economics

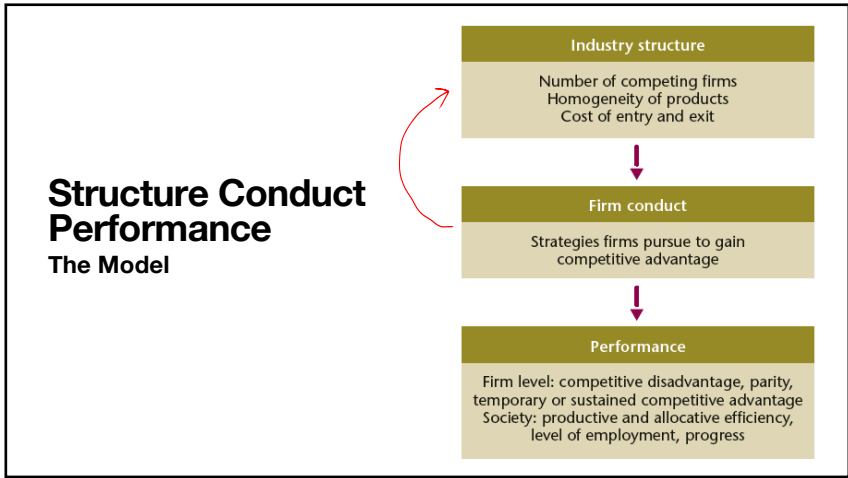
SCP paradigm.

The Structure-Conduct-Performance Model

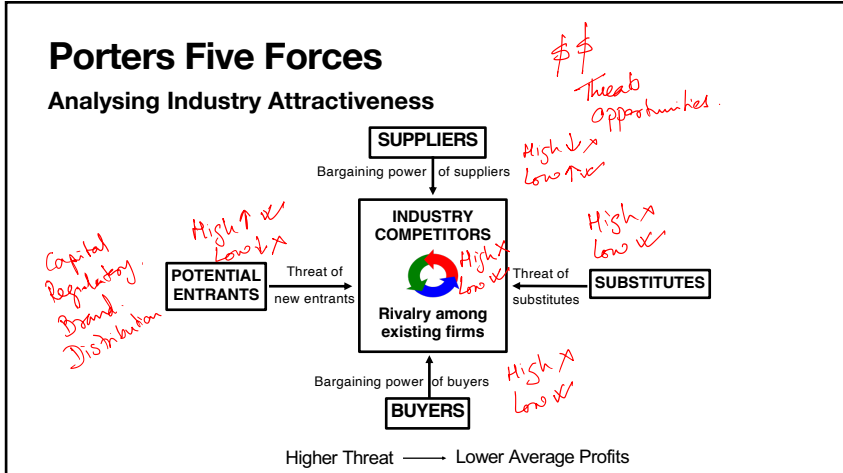
CCI.

- 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

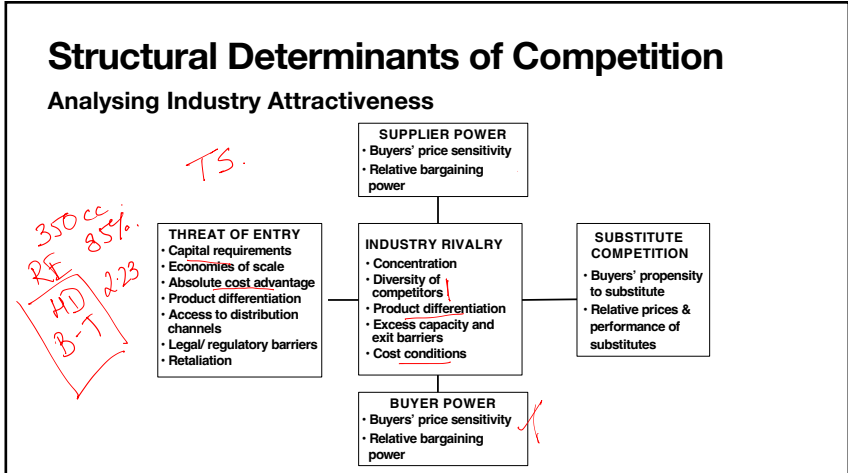
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## Threat of New Entry

### 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.

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## Threat of New Entry

### Analysing Industry Attractiveness

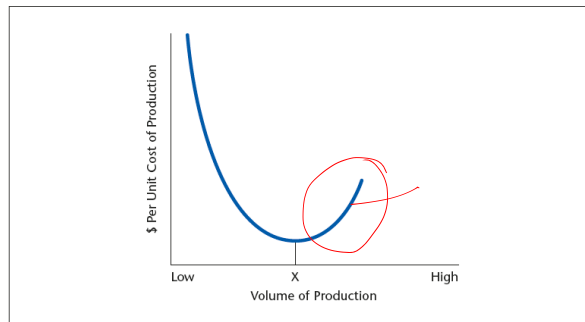
#### Barriers to Entry:

- **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.

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## Economies of Scale

### Cost of Production



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## 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

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## 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.

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## Bargaining Power of Buyers

### Analysing Industry Attractiveness

*Oil* *Textiles*

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

*ATF Kerogene*

**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*

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## 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?

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## 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*

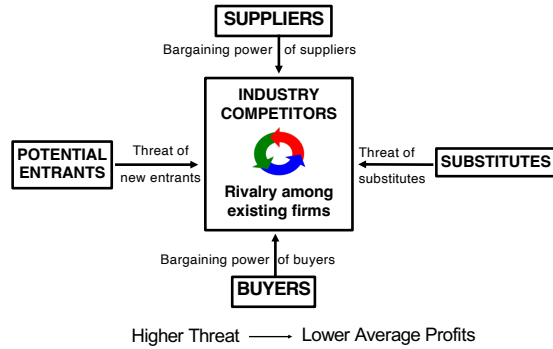
- What drives competition?
- What are the main dimensions of competition?
- How intense is competition?
- How can we obtain a superior competitive position?

**KEY SUCCESS FACTORS**

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## Porters Five Forces

### Industry Analysis for Franchise Owners



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## 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

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