Analytical Methods of Business Environment 1

Lecture 7

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Learning objectives

- Industry and market
- Industry structure
- Industry concentration
- Porter’s Five Forces model
- Strategic groups
- Customer analysis
- Market analysis
- Marketing research

Introduction

- Analysing industries involves building up a detailed knowledge of the competing organizations in the industry and the products (goods and services) they are selling.

- A market is a group of customers for specific goods or services that are essentially the same. Analyzing market involves building up a detailed knowledge of the customer and customer groups.

- Basic tool for market analysis is market research.

- The goal of market analysis is to determine the attractiveness of a market and to understand its evolving opportunities and threats of the organization.

Introduction

- An industry is any group of organizations that supplies a market.
- Markets are rarely homogeneous.
- Industry comprises of a number of markets or more precisely, market segments.
- Competition within these segments can vary as well as the profitability of individual companies within this industry.

- Analysing industries involves building up a detailed knowledge of the competing organizations in the industry and the products (goods and services) they are selling.

Key questions to ask:

1. What is our company´s industry?
2. What are the characteristics of the industry?
3. How stable are these characteristics?

Introduction

Industry structure

- Industry structure is determined by the number and relative strength of organizations in the industry. There is a variety of industry structure:
- Perfect competition;
- Monopoly;
- Monopolistic competition;
- Oligopoly.

- Industry structure can be influenced:
- By the costs incurred by business;
- By behaviour of companies in the industry and the nature and intensity of competition;
- By company performance.

Introduction

Industry concentration

- The distribution of power among organizations in an industry is assessed by the level of industry concentration. Industry concentration gives an indication of the competitive pressures in a industry.

- Industry concentration can be measured by looking at the market share of organizations in the industry. High concentration levels usually indicate low intensity competition.

- There are various ways of measuring industry concentration. The most straightforward methods are the following:
- Concentration rate – calculated by taking the share of the largest organizations in industry sales or output by value or by volume;
- Herfindahl-Hirschmann index – calculated by summing the squares of the individual market shares of all the organizations in the industry.

Porter’s Five Forces Analysis

- Author - Michael Porter from Harvard Business School
- Five Forces Model (1979) offers explanation of the sources of competition in industries.
- The model is based on determination of competitive intensity and attractiveness of a market.
- It contains 5 main forces: competitive rivalry, threat of new entry, supplier power, buyer power, and threat of substitution.
- Companies use this model to analyse the external environment and external forces such as competition, government policies, and social and cultural forces (Vining, 2011).

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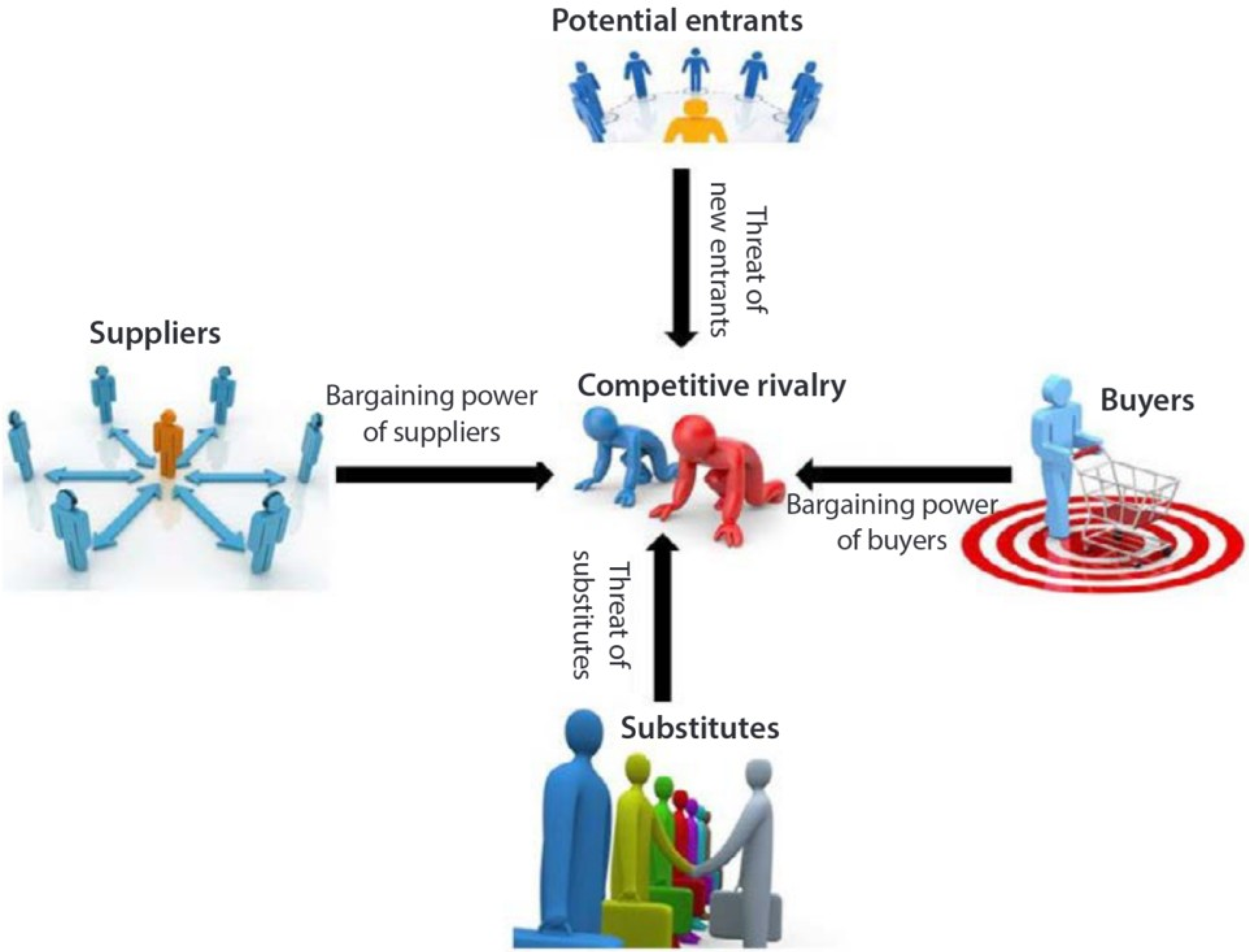
Porter's Five Forces Analysis



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Porter’s Five Forces Analysis

1 The **ease of entry** (dependent upon entry barriers),

2 The power of **buyers** and,

3 The power of **suppliers**, whereby the bargaining power of each group influences profitability,

4 The availability of **substitutes**, which could potentially include alternatives for consumers, and,

5 The degree of **rivalry** among competitors.

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Porter's Five Forces Analysis – **Competitive Rivalry**

- It describes the degree of competitiveness amongst companies.

- There are three main benefits of competitive rivalry:

1. Gaining of a larger market share
2. Companies will lower prices due to many choices available to their consumers
3. Driving the economic growth

- The intensity of competitive rivalry is determined by many factors:

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Porter's Five Forces Analysis – **Competitive Rivalry**

Factor	Information
Number of competitors in the market	Competitive rivalry will be higher in an industry with many current and potential competitors – all businesses looking to strive for market leadership.
Market size and growth prospects	Competition is always most intense in stagnating markets.
Product differentiation and brand loyalty	The greater the customer loyalty, the less intense the competition. The lower the degree of product differentiation the greater the intensity of price competition.
The power of buyers and the availability of substitutes	If buyers are strong and/or if close substitutes are available, there will be more intense competitive rivalry.
Capacity utilization	The existence of spare capacity will increase the intensity of competition.
The cost structure of the industry	Where fixed costs are a high percentage of costs then profits will be very dependent on volume. As a result there will be intense competition over market shares.
Exit barriers	Even if companies are receiving low or negative returns on investments, it is often difficult or expensive to exit an industry. The major barriers include: Specialized assets Fixed costs of exit Strategic interrelationships Emotional barriers Government and social restrictions

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Porter’s Five Forces Analysis – **Competitive Rivalry**

Airline industry example

Competition is intensive amongst rivals in the airline industry. Today, there are many options to get from A to B with different routes offered by different airlines. The airlines all offer different service levels to potential customers. For example, quality of service, food, availability of entertainment, legroom, fare price and so forth. The introduction of privatization and de-regulation within the industry has led to a host of low-cost carriers entering the industry, i.e. Easyjet, RyanAir, AirAisa, Jetstar, etc.

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Porter’s Five Forces Analysis – **The threat of new entry**

- The attractiveness of an industry is the main reason for new entry, alongside the size of the customer base.
- Organisations entering into an industry to gain market share and therefore the competition will intensify.

- There are six barriers to entry: Economies of scale, Product differentiation, Capital requirements, Cost disadvantages, Access to distribution, Government.

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Porter's Five Forces Analysis – **The threat of new entry**

1 **Economies of scale** – as the organization produces more, their average costs fall. This makes it more difficult for new and smaller firms to enter the market and be competitive.

2 **Product differentiation** – organizations are forced to increase their spending to overcome customer loyalty to a certain brand. Loyalty is considered as a barrier to entry because some organizations have high degrees of brand loyalty and their consumers stay loyal to a product and their chosen organization. The consumer becomes attached to the brand over time (Shugan, 2005).

3 **Capital requirements** create barriers because to operate organizations require financial resources, such as infrastructure, employees, research and development, advertising and sales. Larger organizations often have the financial support but for smaller organizations this makes it very difficult to enter certain industries, such as technology, manufacturing etc.

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Porter's Five Forces Analysis – **The threat of new entry**

4 **Cost disadvantages** – independent of scale, this includes factors such as access to raw materials, favourable locations, government subsidies, experience curve and so forth. These will allow existing organizations to have a competitive edge because those trying to enter the industry's marketplace will not be able to replicate the cost advantage.

5 **Access to distribution** channels is a potential barrier if the new organization has not secured distribution of their product or service.

6 The **government** is a key player because the government is the formal institution which has substantial and unrivalled power to limit or prevent entry to industries with various controls (Grimm, 2006).

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Porter's Five Forces Analysis – **The threat of new entry**

Airline industry example

Due to the fact that an airline requires a phenomenal amount of capital to be invested, the threat of new entrants is low. An existing airline such as British Airways thrives on the credibility of their reputation, a loyal customer base, routes available all over the world (both short and long-haul), high standards of safety, etc. making them more attractive to customers than an emerging company. Also, government regulations within the airline industry, such as security, health and safety, licenses required for new routes, etc, often make it difficult for new entrants because of regulations.

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Porter’s Five Forces Analysis – **Buying power**

- It involves customers who collectively formed a group.
- A powerful group of customers exert pressure to either drive the prices down or
- increase the quality of goods for the same price, and thus
- reduces the profits in the industry.

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Porter’s Five Forces Analysis – **Buying power**

- Factors determining the bargaining power of customers:

1. Goods or services bought in large quantities.
2. The goods being purchased are standard or undifferentiated, so customers can ‘shop around’ for better deal.
3. The buyers are large and supplier small.
4. Substitutes available from related industry.
5. Threats of vertical integration – if demand not met by the suppliers, buyers threaten to provide their own supplies.

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Porter's Five Forces Analysis – **Buying power**

Airline industry example

When customers make a choice about who to fly with, they often prioritise their time and their financial costs – who will transport them from A to B in the fastest time? In other words, the customer wants the fastest route at the cheapest rate. However, customers also take into account where they can buy the tickets (online versus travel agent), what class of flight they are looking for (economy, business or first) etc. Each airline has different unique selling points, for example EasyJet prides itself in low cost fares whereas Emirates is renowned for the food it offers on its flights. Therefore the bargaining power of buyers is a low threat to the airline industry.

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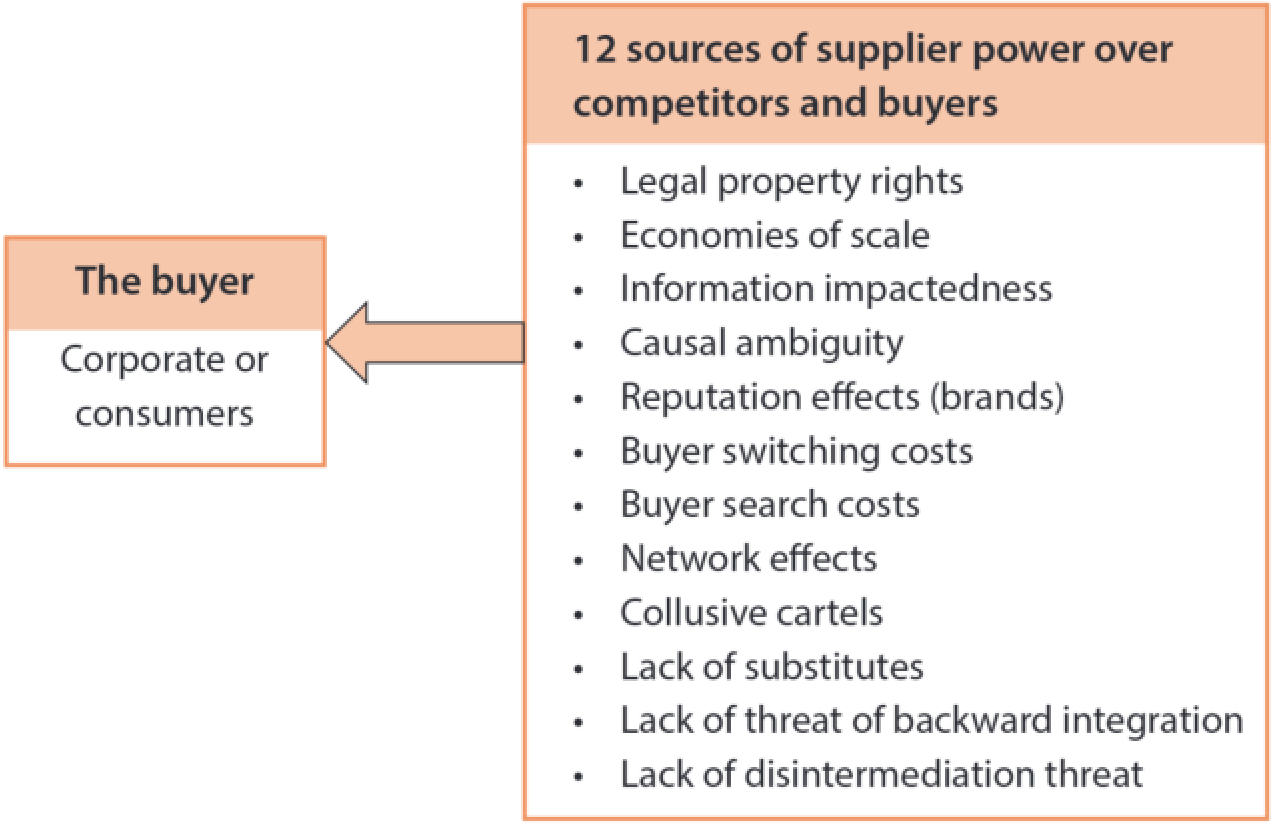
Porter's Five Forces Analysis – **Supplier power**

- The suppliers have power to sell their products at higher prices.

- Example is fast food restaurants suppliers.

- Factors determining the power of suppliers



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Porter's Five Forces Analysis – **Supplier power**

Airline industry example

There are only two firms that supply the airline industry – Airbus and Boeing. This makes it very difficult for airline companies to switch suppliers. Most firms have long term contracts with their suppliers.

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Porter’s Five Forces Analysis – **Threat of substitutes**

- Substitutes are goods or services produced by organizations in an apparently different industry, and
- delivering same or a similar service to the customer by different function.
- Substitutes are easy to overlook, because they may look very different from the industry´s product.
- Substitutes nearly always exist.

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Porter's Five Forces Analysis – **Threat of substitutes**

- The extent of the substitutes' threat depends on the following:

1. **Switching costs** – if there are no switching costs, chances to move to a more attractive substitute is higher. Example is consumer switching from reading hardcopies of books to reading books online, they can do it without any additional fees or costs for the switch.

2. **Product price** – if the price of substitutes is lower or at a fairer rate.

3. **Product quality** – if the substitute is of higher quality than any other product in the market, then consumers switch to that substitute.

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Porter's Five Forces Analysis – **Threat of substitutes**

Airline industry example

People who are travelling to domestic destinations, for example Glasgow to Aberdeen, have a variety of substitutes to choose from – train, car, aeroplane and bus. Each will have different journey times and costs will vary. However, when travelling to international destinations or long distances there are fewer options available. It may be that to achieve an alternative route, passengers would have to switch mode of transportation, possibly several times, increasing both travel time and cost to a point where the alternative route is so unattractive as to be unviable. Airplanes in this context surpass other modes of transport on cost, convenience and more often quality.

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Porter's Five Forces Analysis – **Complementors – the sixth force**

- **Complementors** are companies that sell or offer goods or services that are compatible with, or complementary to, the goods or services produced and sold in a given industry.
- **Complementary goods** offer more value to the consumer together than apart.
- When one product or service complements another there exists a condition called **complementarity**; a sort of commercial symbiosis.
- **Complementors** are often considered the sixth force of Porter's industry analysis framework and can benefit or hurt the companies competing in the industry.

https://strategiccfo.com/articles/accounting/complementors-sixth-force-of-porters-five-forces/

Porter’s Five Forces Analysis – **Criticism**

- It doesn’t help to identify and leverage unique sustainable advantages (unique process, a patent, specialist skills) for companies.
- The model does not focus on why some companies are able to get an advantageous position.
- It overstress competition over the cooperation of companies.
- The model does not adapt to the ever-changing and evolving environment.

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Strategic groups

- Strategic groups are organizations within an industry or sector with similar strategic characteristics, following similar strategies or competing on similar bases.

- Strategic characteristics are different from those in other strategic groups in the same industry or sector.

- There are many different characteristics that distinguish between strategic groups.

- Strategic groups can be mapped onto two dimensional maps – positioning maps – an useful analysis tool.

Strategic groups - **Characteristics for identifying strategic groups**

- Scope of activities
- Extent of product diversity;
- Extent of geographical coverage;
- Number of market segments served;
- Distribution channels used.

- Resource commitment:
- Extent of branding;
- Marketing effort;
- Extent of vertical integration;
- Goods and services quality;
- Technological leadership;
- Size of organizations.

Strategic groups - **Uses of strategic groups analysis**

- **Understanding competition** – enables focus on direct competitors within a strategic group, rather than on the whole industry.

- **Analysis of strategic opportunities** – helps to identify attractive strategic spaces (gaps) within an industry.

- **Analysis of mobility barriers** – obstacles to a movement from one strategic group to another. These barriers can be overcome to enter more attractive groups. Barriers can be built to defend an attractive position in a strategic group. (You can read more: https://ceopedia.org/index.php/Mobility_barriers)

Customer Analysis

- Customers needs and wants and buying motives are usually not obvious.
- To gain deep and fresh insights into customers needs and wants we need good marketing information.

- Customer analysis provides the collection and evaluation of data associated with customer needs and market trends, through market research, customer satisfaction measurement, field testing etc.

- Customer analysis helps to understand of how each of the market segments behave, analyse customer motivations, and explores their unmet needs.

Market Analysis

- **A market** is the set of actual and potential buyers of a product or service. These buyers share a particular need or want that can be satisfied through exchange relationships.

- Analyzing market involves building up a detailed knowledge of the customer and customer groups.

- Basic tool for market analysis is marketing research.

- The goal of market analysis is to determine the attractiveness of a market and to understand its evolving opportunities and threats for the organisation.

- Dimensions of a market analysis:
    - Market size;
    - Market growth rate;
    - Market profitability;
    - Market trends.

Marketing research

- **Marketing research** is the systematic design, collection, analysis, and reporting of data relevant to a specific marketing situation facing an organization

- Companies use marketing research to have insights into customer motivations, purchase behaviour, and satisfaction.

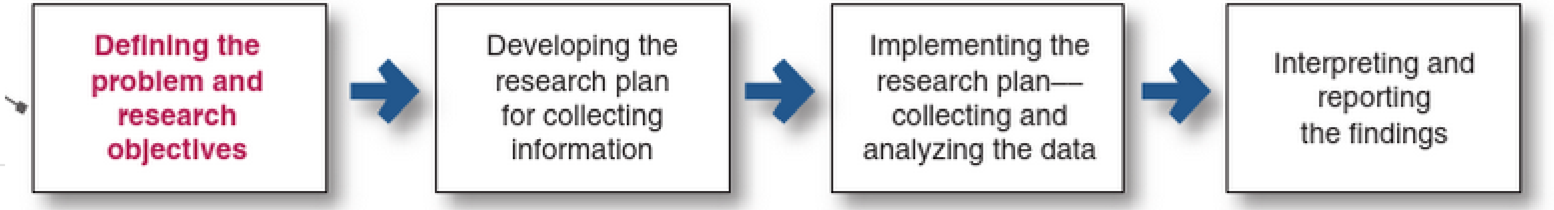
- Marketing research helps companies to assess market potential and share or measure the effectiveness of pricing, product, distribution and promotion activities.

Marketing research

- Steps in the Marketing Research Process

https://www.youtube.com/watch?v=JOlYEzpLDbU

Marketing research process



- **Defining the problem and research objectives**
    - Determine and clarify management s information needs;
    - Redefine the decision problem as a research problem;
    - Establish research objectives.
- **Development the research plan for collecting information**
    - Determine the research design and data sources;
    - Determine the sample plan and sample size;
    - Determine the measurement issues and scales.
- **Implementing the research plan**
    - Collecting and processing data;
    - Analysing data;
    - Transforming data structures into information.
- **Interpreting and reporting the findings (results)**

Armstrong, G., & Armstrong, G. (2020). *Principles of marketing, ebook, global edition*. Pearson Education, Limited.