

# CHAPTER 2

## INDUSTRY ANALYSIS

### CHAPTER LEARNING OBJECTIVES

1. ***Be familiar with a number of frameworks used to analyze an organization's external environment and understand how the structural features of an industry influence competition and profitability.*** You have been introduced to a systematic approach to analyzing a firm's industry environment using PESTEL analysis and Porter's five forces framework. PESTEL analysis aims to identify those factors that are most likely to shape the competitive conditions within an industry. The five forces framework classifies those features of an industry that drive competition and profitability. Although every industry is unique, industry attractiveness is the result of the systematic influences of the structure of that industry.

2. ***Be able to use evidence on structural trends within industries to forecast changes in competition and profitability and to develop appropriate strategies for the future.***

The five forces framework can be used to explore future as well as current competitive conditions. It is useful for predicting industry profitability and identifying how the firm can improve industry attractiveness. Firm strategies can shape, as well as be shaped by, industry structure.

3. ***Understand the value and challenge of undertaking a remote environmental analysis and an industry analysis and be able to provide a critique of PESTEL analysis, Porter's five forces of competition framework, and the competitive positioning plot.*** Undertaking a PESTEL analysis of the remote environment allowed us to address the impact of political, economic, social, technological, ecological, and legal influences on the industry environment. It also helped to identify critical determinants of the threats and opportunities a company will face in the future. Through practical applications of Porter's five forces framework, we became aware of some of the practical challenges of using the model, in particular the problems associated with defining markets and selecting an appropriate level of analysis. We noted the possible need to augment the model by including a sixth force in certain contexts; for example, in markets where complementary products play a significant role. We also recognized the limitations of the framework in dealing with highly dynamic market conditions and in providing a complete explanation of variations in profitability between firms. Using the competitive positioning plot (CPP) helped us determine how firms are positioned within an industry as measured against the identified key success factors and the potential competitive maneuvering that could take place between them.

4. ***Be able to analyze competition and customer requirements in order to identify opportunities for competitive advantage within an industry (key success factors).*** By combining the analysis of industry competition with a close examination of customer wants, we were able to see how to identify key success factors, namely what firms need to do well to succeed in a particular industry.

## TRUE-FALSE STATEMENTS

1. Formally scanning and analyzing the whole range of external influences continuously is the best approach.

Answer: False

Difficulty: Medium

Section Reference: From Environmental Analysis to Industry Analysis

2. To understand the effect of the external environment, one must be able to rank the factors in order of importance.

Answer: True

Difficulty: Medium

Section Reference: From Environmental Analysis to Industry Analysis

3. "Consumer surplus" is the extra product consumers get through special offers and bulk discounts, when suppliers make surplus product to generate extra sales.

Answer: False

Difficulty: Medium

Section Reference: The Determinants of Industry Profit: Demand and Competition

4. Value is defined as the difference between the cost of supplying a product or service and the actual price paid by the customer for it, although not all value translates into profit.

Answer: True

Difficulty: Easy

Section Reference: The Determinants of Industry Profit: Demand and Competition

5. The level of profit in an industry is determined by three factors: the value of products to customers, the intensity of competition, and the relative bargaining power of producers and suppliers.

Answer: True

Difficulty: Easy

Section Reference: The Determinants of Industry Profit: Demand and Competition

6. When a firm dominates a specific segment in an industry, it is well-placed to earn a higher level of profit than the average.

Answer: True

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

7. Industry structure does not have much of an impact on the level of industry profitability.

Answer: False

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

8. Michael Porter's five forces model helps you identify and understand the intensity and levels of competition in an industry.

Answer: True

Difficulty: Easy

Section Reference: Analyzing Industry Attractiveness

9. For a specific product or service, the existence of close substitutes means that customers could switch to these substitutes if prices, service levels, or other factors make it in their interests to do so.

Answer: True

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

10. In a contestable market there does not always need to be actual competition to keep prices relatively low – just the threat of competitors entering the market.

Answer: True

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

11. Economies of scale, absolute cost advantages, high capital start-up costs, and access to channels of distribution are all examples of "barriers to entry".

Answer: True

Difficulty: Easy

Section Reference: Analyzing Industry Attractiveness

12. Retaliation against a new entrant may take the form of aggressive price-cutting, increased advertising, sales promotion, or vexatious litigation.

Answer: True

Difficulty: Easy

Section Reference: Analyzing Industry Attractiveness

13. The CR4 is the market share of the four smallest producers.

Answer: False

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

14. Excess capacity often leads firms to cut prices to attract new business.

Answer: True

Difficulty: Easy

Section Reference: Analyzing Industry Attractiveness

15. Having high fixed costs makes it hard to make a profit in a recession.

Answer: True

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

16. When competition in an industry has become more intense, the companies that are suppliers to this industry will NOT be pressured to lower prices.

Answer: False

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

17. Big Data provides insights into consumer trends and the impact this might have on the industry.

Answer: True

Difficulty: Easy

Section Reference: Applying Industry Analysis

18. Understanding the structure of the industry helps managers to work out how to make a profit in future and to possibly identify ways to change the industry structure to their advantage.

Answer: True

Difficulty: Medium

Section Reference: Applying Industry Analysis

19. Porter's 5 Forces model arguably has some deficiencies and does NOT answer all possible questions. But this is true of all models.

Answer: True

Difficulty: Medium

Section Reference: Key Issues and Challenges

## MULTIPLE CHOICE QUESTIONS

20. Understanding the external environment of a firm requires one ultimately to identify
- a) the opportunities to make profit in the industry.
  - b) the five forces identified by porter's model.
  - c) the barriers to entry and to exit in that industry.
  - d) the expected level of profit in the mid-term for that industry.

Answer: a

Difficulty: Medium

Section Reference: Introduction and Objectives

21. Given the plethora of external influences, understanding the external environment requires managers to
- a) use a framework or a system that allows them to organize information and rank factors.
  - b) monitor their rivals closely to detect signals of change in their strategies.
  - c) use all existing techniques to gather and analyze information.
  - d) work on the matter full-time.

Answer: a

Difficulty: Easy

Section Reference: From Environmental Analysis to Industry Analysis

22. PESTEL stands for
- a) power, economy, social, threats, ecological, legal.
  - b) political, economic, social, technological, ecological, legal.
  - c) power, economic, social, technological, ecological, legal.
  - d) political, economic, social, threats, ecological, legal.

Answer: b

Difficulty: Easy

Section Reference: From Environmental Analysis to Industry Analysis

23. One can view the connection between the general environment and the industry environment as
- a) the general environment is diffuse, whereas the industry environment consists of a small number of close competitors.
  - b) the industry environment consists of customers, suppliers, rivals, and new entrants, whereas the general environment comprises everything else.
  - c) the industry environment includes customers, competitors and suppliers, whereas the general environment matters to the extent that it affects the industry environment.
  - d) the critical influence of the industry environment on the wider social environment.

Answer: c

Difficulty: Medium

Section Reference: From Environmental Analysis to Industry Analysis

24. The core of a firm's business environment is determined by
- a) its relationships with customers, competitors, and suppliers.
  - b) its relationships with customers, rivals, government, and suppliers.
  - c) its relationships with its major stakeholders.
  - d) its vision and mission.

Answer: a

Difficulty: Medium

Section Reference: From Environmental Analysis to Industry Analysis

25. If top management understands the customers, suppliers, competitors, and how the general environment affects the firm's industry environment, then
- a) it will be a successful company.
  - b) a successful strategy will emerge from these factors.
  - c) they will have a sound basis for developing an effective strategy.
  - d) they can save money by not employing management consultants.

Answer: c

Difficulty: Hard

Section Reference: From Environmental Analysis to Industry Analysis

26. Value is created when
- a) the price that the customer is willing to pay for a product exceeds the firm's direct cost of production.
  - b) the surplus of value is distributed between customers and producers in the industry by the forces of competition.
  - c) the value of a product to consumers is more than they paid for it.
  - d) the price that the customer is willing to pay for a product exceeds the firm's cost.

Answer: d

Difficulty: Medium

Section Reference: The Determinants of Industry Profit: Demand and Competition

27. Once value is created, it is, in general,
- a) equally shared between customers and producers.
  - b) not equally shared between customers and producers.
  - c) distributed to the firm's shareholders.
  - d) reinvested into the firm or put aside as a reserve.

Answer: b

Difficulty: Medium

Section Reference: The Determinants of Industry Profit: Demand and Competition

28. "Consumer surplus" is
- a) the difference between the price customers expect to pay, and the price they would have

been willing to pay.

- b) the total of all the differences between the price each customer actually pays and the maximum price they would have been willing to pay, all other things being equal.
- c) the difference between the costs incurred in serving customers, and the revenue that they generate.
- d) the amount of extra product consumers buy because of the difference between the normal price and a special offer price.

Answer: b

Difficulty: Hard

Section Reference: The Determinants of Industry Profit: Demand and Competition

29. In an industry, the profits earned by firms are determined by

- a) the overall economic situation, and porter's five forces of competition.
- b) the degree of concentration of the industry.
- c) the existence of barriers to entry in the industry.
- d) the value of the product for customers, the intensity of competition, and the relative bargaining powers of producers, their suppliers and their buyers.

Answer: d

Difficulty: Medium

Section Reference: The Determinants of Industry Profit: Demand and Competition

30. The basic premise of industry analysis is that

- a) competition can be assessed between monopoly and perfect competition within the spectrum of industry structures.
- b) the level of profitability within an industry is largely determined by the industry structure.
- c) the internal variables of the firm determine a firm's performance within the industry.
- d) profits are squeezed by powerful suppliers.

Answer: b

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

31. The idea with Porter's 5 Forces is to

- a) quantify the 5 forces, to ideally produce a mathematical model of the industry.
- b) identify which forces are relatively more powerful, and to assess their impact on competition and industry profitability.
- c) work out how management can eliminate these forces.
- d) use it to construct a plan to achieve monopoly power.

Answer: b

Difficulty: Hard

Section Reference: Analyzing Industry Attractiveness

32. A barrier to entry is

- a) anything that facilitates the entry of would-be new entrants in a specific industry.



- b) capital requirements, cost advantages, and product differentiation.
- c) a law restricting trade.
- d) anything that makes entry into an industry as a new competitor more difficult, more costly, slower or even impossible.

Answer: d

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

33. If an industry earns a return on capital in excess of its cost of capital,

- a) incumbents will earn abnormal profit, and build entry barriers.
- b) the government needs to make sure that competition will increase.
- c) it is likely to attract the attention of firms looking to enter the industry, which may eventually lead to the return on capital falling.
- d) it will attract firms outside the industry, but the incumbents will have erected entry barriers.

Answer: c

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

34. Industries such as pharmaceuticals earn very high returns on investment. Such industries

- a) tend to be protected from competition by legal restrictions.
- b) can only maintain such high returns for short periods.
- c) always exist when intangible products are traded.
- d) tend to have high entry barriers and differentiated products.

Answer: d

Difficulty: Hard

Section Reference: Analyzing Industry Attractiveness

35. Economies of scale are a barrier to entry because

- a) new entrants do not know where they are positioned on their learning curve.
- b) new entrants do not yet understand the scale economies so they cannot precisely determine their selling price.
- c) new entrants face a risk of price retaliation from the incumbents which could occur immediately on a large scale.
- d) new entrants face the cost and risk of creating large scale capacity to start with or a severe cost disadvantage if they enter on a smaller scale.

Answer: d

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

36. For a manufacturer, access to distribution is a barrier to entry because

- a) new entrants face a disadvantage from retailers who are reluctant to carry their new products.

- b) retailers have limited capacity of distribution to offer to new entrants.
- c) retailers are risk-averse.
- d) carrying new products induces fixed costs.

Answer: a

Difficulty: Easy

Section Reference: Analyzing Industry Attractiveness

37. Are barriers to entry effective?

- a) Yes, because long-term empirical evidence shows that industries with high barriers to entry exhibit higher returns on investment on average.
- b) Yes, because once established they are irreversible.
- c) No, because firms can overcome these barriers by modifying their strategies.
- d) No, because higher returns attract more new entrants who want to benefit from higher returns than in non-protected industries.

Answer: a

Difficulty: Easy

Section Reference: Analyzing Industry Attractiveness

38. Barriers to exit are

- a) the non-recoverable costs of quitting or scaling down capacity in an industry.
- b) legal restrictions which prevent a firm from leaving an industry.
- c) the opposite of barriers to entry.
- d) of no consequence if you don't plan to leave the industry.

Answer: a

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

39. Firms in any industry can be said to operate in two major markets:

- a) the labour market and the output market.
- b) as a buyer in the supplier market, and as a seller in the customer market.
- c) the labour market and the input markets.
- d) the product market divided at least in two segments (such as mid-size car and SUV market segments).

Answer: b

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

40. The overall bargaining power of buyers depends on

- a) the buyer's price sensitivity.
- b) the intensity of rivalry among sellers and the willingness of the buyer to exploit this.
- c) the buyer's price sensitivity and the relative bargaining power between the seller and the buyer.
- d) the intensity of rivalry among buyers and the ability to vertically integrate.

Answer: c

Difficulty: Easy

Section Reference: Analyzing Industry Attractiveness

41. Bargaining power rests, ultimately, on

- a) the negotiating skills of the buyer versus the seller.
- b) historic and accidental events.
- c) the respective effectiveness and cohesion of top management teams.
- d) the perceived or real threat for one party to refuse to deal with the other party.

Answer: d

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

42. The relative bargaining power of buyers depends on

- a) the size and concentration of buyers relative to suppliers.
- b) a buyer's access to information about products and costs.
- c) the ability or threat to integrate vertically.
- d) all of the above.

Answer: d

Difficulty: Easy

Section Reference: Analyzing Industry Attractiveness

43. The bargaining power of suppliers is likely to be high

- a) when the suppliers' industry is concentrated.
- b) when suppliers are supplying differentiated products.
- c) when "our" (the customer's) industry is relatively fragmented.
- d) all of the above.

Answer: d

Difficulty: Hard

Section Reference: Analyzing Industry Attractiveness

44. Analyzing key success factors leads one to ask the following two questions:

- a) What do customers want which we could supply profitably and what should the firm do to survive competition?
- b) What do customers want and what type of operational changes should a firm implement to survive competition?
- c) Which of the five forces of competition are critical for a firm's survival and how could the firm deal with them?
- d) How should managers analyse information collected from the market and what should they do about it?

Answer: a

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

45. The question “What do customers want?”

- a) is not relevant because customers will show their preferences through their behaviour.
- b) must be asked by managers, and an accurate answer obtained and understood, since it's the driving force behind generating profit.
- c) can be outsourced to a market research company.
- d) is best answered by ensuring that certain managers are educated in Marketing.

Answer: b

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

46. The question “What does a firm need to survive competition?”

- a) can be addressed through analysis of competitors using all possible means, even at the edge of legality and ethics.
- b) can be addressed by studying very carefully the two largest rivals in the industry.
- c) requires an understanding of the current and future basis of competition specific to the industry.
- d) Can never be answered clearly, because competitors will not divulge what they are doing.

Answer: c

Difficulty: Medium

Section Reference: Analyzing Industry Attractiveness

47. The value to managers of understanding key success factors is

- a) self-evident.
- b) legitimate because it is accepted by the academic world.
- c) that it generates “generic strategies” which guarantee success.
- d) to help maintain a strategic perspective of what needs to be done to survive, and help them avoid degenerating into a fire fighting approach.

Answer: d

Difficulty: Hard

Section Reference: Analyzing Industry Attractiveness

48. The analytical tools described in the text

- a) must be used if one is to understand the industry structure.
- b) are simply that; just tools. their value depends on the skill with which they are deployed.
- c) should really only be used by academics.
- d) both a and c.

Answer: b

Difficulty: Hard

Section Reference: Applying Industry Analysis

49. To forecast industry profitability consistently and accurately, professional analysts have to
- a) look at the link between performance and industry structure, then to identify major trends and to examine the link between these trends and the forces of competition.
  - b) look at the probability of new entries in the industry, to determine the major trends, and to forecast the probable overall industry profit.
  - c) determine the five largest players in the industry and their relative bargaining power in regards to their buyers and customers, and to identify their strengths and weaknesses.
  - d) develop a deep understanding of how the industry creates value now and in the future, whether they use the tools described in the chapter or not.

Answer: d

Difficulty: Hard

Section Reference: Applying Industry Analysis

50. An industry's current profitability
- a) on its own tends to be a poor predictor of future profitability.
  - b) is an excellent predictor of its future profitability
  - c) explains the past in that industry.
  - d) is determined by the forces of competition and so many other factors that gaining insights into its causes is almost impossible.

Answer: a

Difficulty: Easy

Section Reference: Applying Industry Analysis

51. Understanding the competitive forces in an industry is
- a) a largely futile exercise for managers.
  - b) is of academic interest, but does not bring any value for strategic management.
  - c) a way to enable managers to allocate their resources where competition is the strongest.
  - d) a way to enable managers to position the firm where its particular capabilities can be deployed to best advantage.

Answer: d

Difficulty: Hard

Section Reference: Applying Industry Analysis

52. Suppose that an industry's profitability is zero or negative overall,
- a) then all firms in the industry are performing badly.
  - b) then no firm in the industry can be performing well.
  - c) then the biggest firm in the industry is performing badly.
  - d) then even so it's entirely possible that some firms are making very good profits.

Answer: d

Difficulty: Hard

Section Reference: Key Issues and Challenges

53. “The market” and “the industry” are

- a) related but not the same thing.
- b) unrelated and different.
- c) exactly the same concept, and can be used interchangeably.
- d) exclusively used in marketing and strategic management respectively.

Answer: a

Difficulty: Easy

Section Reference: Key Issues and Challenges

54. Market and industry are

- a) very specific economics terms which must be rigidly adhered to.
- b) are concepts which require careful consideration of their philosophical underpinning to use correctly.
- c) somewhat flexible in scope depending on what aspect of business you are considering.
- d) close concepts where market is identified with broader sectors, while industries refer to specific technologies.

Answer: c

Difficulty: Hard

Section Reference: Key Issues and Challenges

55. A market’s boundaries are defined by

- a) the geographies of the markets that are supplied by the incumbents.
- b) the type of product which is sold, and the type of customers willing to pay for the product.
- c) substitutability on the demand side and on the supply side.
- d) substitutability on both the demand side and the supply side, combined with an element of judgment depending on context and purpose.

Answer: d

Difficulty: Hard

Section Reference: Key Issues and Challenges

56. In practice, drawing the boundaries of industries and markets is

- a) a matter of personal preference on behalf of top managers.
- b) almost impossible to carry out with rigor because it requires many “rules of thumb” and approximations.
- c) largely a matter of judgment and experience contingent on the purpose of the analysis.
- d) critical to the output of the analysis and therefore should only be undertaken with the help of an academic or consultant.

Answer: c

Difficulty: Medium

Section Reference: Key Issues and Challenges

57. A 6<sup>th</sup> force—complements—should arguably be added to Porter’s 5 Forces Model

because

- a) Porter's original analysis was inadequate.
- b) it's clear that since Porter devised his model, Complementers have evidently become more important.
- c) Porter's model was developed over 30 years ago, so is old-fashioned.
- d) b and c.

Answer: b

Difficulty: Medium

Section Reference: Key Issues and Challenges

58. Porter's 5 Forces model was based on a static, stable view of industry which ignores dynamic forces

- a) because industries in Porter's day were not very dynamic.
- b) which can easily be dealt with by taking a dynamic perspective of the forces e.g. Innovation is a consequence of Rivalry.
- c) and so has outlived its usefulness, and should be replaced with something more up to date.
- d) which was Porter's intention, because you have to "walk before you can run".

Answer: b

Difficulty: Hard

Section Reference: Key Issues and Challenges

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