

## 7 Industry and competitor analysis

### OBJECTIVES

To develop a sound strategic plan for an existing or a new business it is necessary to understand the industry in which the business will operate and the competitive forces within that industry. Questions to be answered include the following:

- What is the current size and what are the major trends in the industry?
- What are the main competitive forces?
- Who are the competitors and what are their relative strengths?
- How should the strategy be adapted to respond to changes in the industry?

This chapter introduces different concepts and frameworks for industry and competitor analysis. These can be used at different levels of detail. The industry overview sets the scene for the readers of the business plan. The industry life cycle analysis provides an understanding of the degree of maturity of the industry. Structural analysis should include at least a short review of suppliers, buyers and the threat from new entrants and substitution, as well as a scan of competitors together with their strengths and weaknesses. Lastly, the main competitors should be analysed in more detail using a key success factor ranking.

### INDUSTRY OVERVIEW

The first task is to collect some basic data about the sector you plan to operate in, including such relevant metrics as:

- annual sales in value for the last three years;
- annual unit or volume sales for the last three years;
- trend in prices for the last three years;
- a measure of capacity and possibly capacity utilisation.

Competitors should be identified by name and website and their market share should be listed. This should be combined into a measure of concentration, such as “the top 20% of competitors serve 80% of the market”.

Broad industry information is often available from government statistics, including import and export figures. It is also useful to list relevant associations that have an impact on or seek to shape the future of the industry. Industry associations are often a convenient, low-cost source of information about the industry.

This basic industry information sets the scene for the reader of your business plan and provides the raw material for more detailed structural and competitor analysis.

# THE INDUSTRY LIFE CYCLE

Industries evolve over time, both structurally and in terms of overall size. The industry life cycle (see Chart 7.1) is measured in total industry sales and the growth in total industry sales. The industry structure and competitive forces that shape the environment in which businesses operate change throughout the life cycle. Therefore a business's strategy must adapt accordingly. Chart 7.2 relates the industry life cycle to the five competitive forces:

- new entrants;
- buyers;
- suppliers;
- substitutes;
- rivalry among firms.

Chart 7.1 Industry life cycle

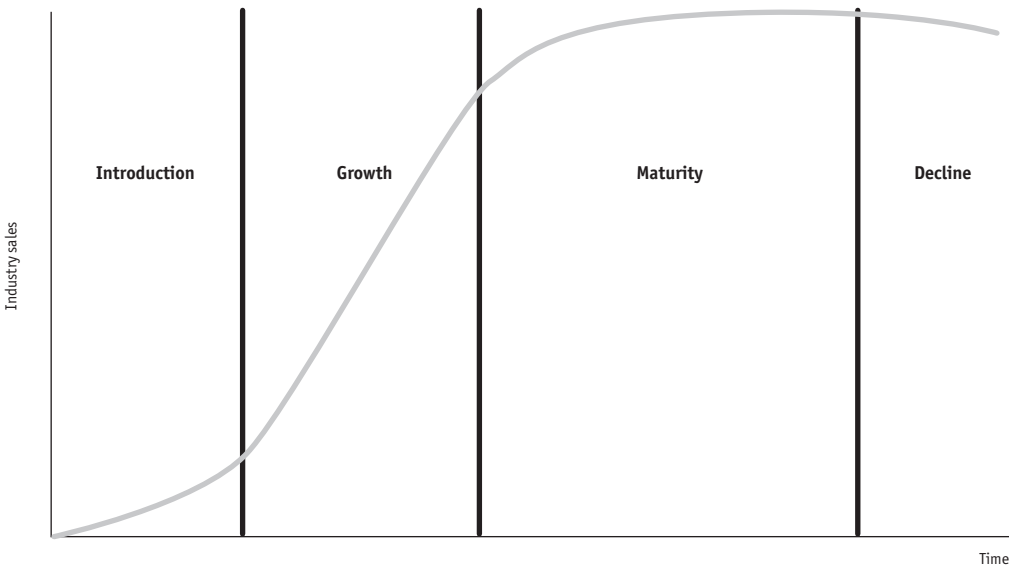


Chart 7.2 Industry life cycle and competitive forces

	<i>Introduction</i>	<i>Growth</i>	<i>Maturity</i>	<i>Decline</i>
New entrants	Few	Bandwagon effect	Consolidation	Exit
Power of buyers	Low	Very low, demand may be ahead of supply, it's a seller's market	Increasing	High, it's a buyer's market
Power of suppliers	Medium	High	Declining	Low
Threat from substitutes	Non-existent	Low	Growing	Substitutes may be the cause of decline
Rivalry among firms	Low	Low, focus on growth	Intense, as firms seek to continue to grow at the expense of rivals	Declining rivalry as some exit, firms realise that industry is declining

**Introduction**

In the introduction stage, there are few competitors and there is no threat from substitutes because the industry is so new. The power of buyers is low, because those who require the product are prepared to pay to get hold of the limited supplies. Suppliers exert some power, because volumes purchased are still low and the industry is relatively unimportant for suppliers.

**Growth**

In the growth stage, the number of competitors increases rapidly as other firms enter the growing industry. However, because at this stage growth in demand outstrips growth of capacity, rivalry among firms is kept in check. The power of buyers is still very low because demand exceeds supply. Often industry growth is associated with high profitability. Although at this stage firms may be profitable, they could still be cash absorbing and running risks as they jockey for position and market share.

**Maturity**

As the industry enters maturity, the power of buyers is increasing because capacity matches or exceeds demand. In contrast, the power of suppliers has declined because by now the volumes purchased by the industry are important to them. Losing a large customer could be very damaging to suppliers. The threat from substitutes is now growing. The industry will start to consolidate, possibly through mergers and acquisitions. Mature industries are settled, risks are low and cash is generated. However, rivalry among competitors is fierce and falling prices pose a serious threat to profitability.

**Decline**

The decline stage presents new challenges. Capacity exceeds supply thereby increasing the power of buyers. The weakest competitors will withdraw from the industry, leading to a decline in the rivalry among firms. At this stage firms may also combine forces to ask for government intervention or subsidies to help to protect the declining industry. The threat of substitutes is high; indeed substitutes are often the root cause of decline. However, if it is managed correctly, a slowly declining industry can produce attractive returns for investors because there is no new investment as the industry is gradually run down and milked for cash.

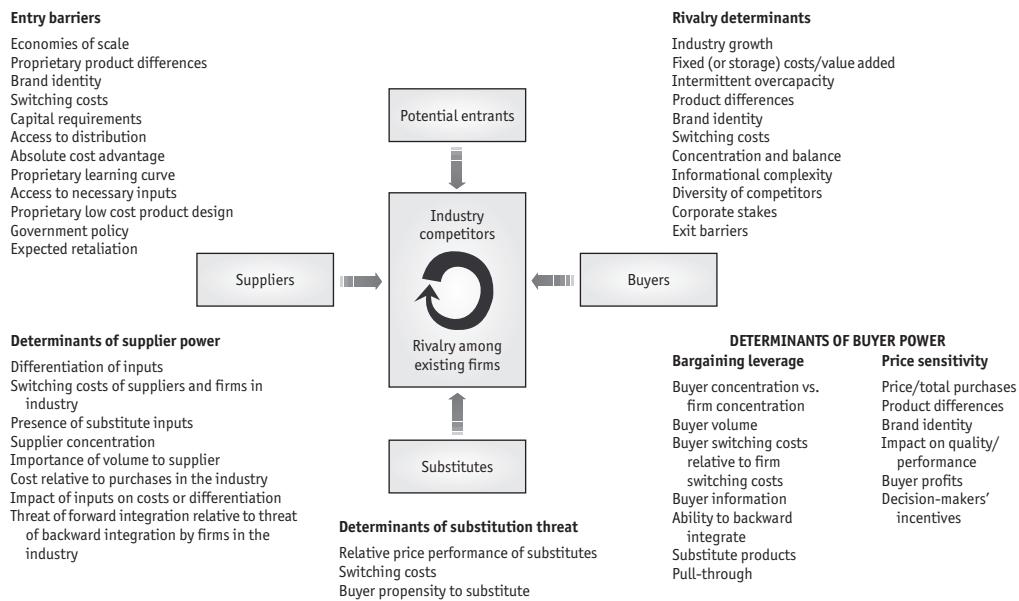
The industry life cycle is similar to the product life cycle (see Chapters 8 and 12) inasmuch as an industry is usually associated with a category of products. Industries such as shipbuilding grew to have enormous industrial importance, only to decline substantially as demand for ships fell.

The industry life cycle is not the same as the product life cycle, because within an industry there is a constant updating of products. For example, TV manufacturers first produced monochrome TVs, then colour TVs and subsequently home entertainment systems. Within the colour TV segment, the screen technology is evolving from cathode ray displays to plasma screens.

## ANALYSING THE STRUCTURE OF THE INDUSTRY

Understanding the structure of an industry is the basis for the formulation of competitive strategy. Michael Porter's work provides an analytical framework for the analysis of the structural factors that condition competition within an industry and suggests several generic competitive strategies, which are discussed in Chapter 10. Porter's 5 forces (see Chart 7.3) provide a framework for analysis of these structural factors.

Chart 7.3 **Forces driving industry competition**



Source: Porter, M.E., *Competitive Advantage*, 1985

An industry is not a closed system. Competitors exit and enter, and suppliers and buyers have a major effect on the prospects and profitability of the industry. However, Porter points out that the structure of an industry will not change in the short term. Industry structure is something that irrespective of the general economic climate or short-term fluctuations in demand fundamentally affects return on investment. Structural change is slow and often associated with political and labour conflict. Structural factors are often cited as holding back development, and in some cases governments make funds available to mitigate social problems caused by structural change.

### Rivalry among existing firms

The intensity of competition, or rivalry, will have a significant impact on the ability to generate adequate margins. The intensity of rivalry or competition among firms competing in the same industry depends on a number of factors:

- Industries with one dominant firm are generally more stable than fragmented industries where one competitor may try to achieve dominance.

- The degree of concentration or the extent to which the industry is monopolistic has an important effect on the behaviour of competitors. For example, in an oligopolistic situation price wars should be avoided. While avoiding price fixing, competitors can send out pricing signals to move towards a new level of lower or higher prices.
- If an industry stops growing, the only way any competitor can grow is by taking market share; in other words, competition will intensify until some competitors exit or consolidation takes place.
- In the case of commodity markets – those with undifferentiated products such as grain or computer RAM – competition focuses on price, which is particularly damaging to all manufacturers. Where there is scope for differentiation, price competition will be lower.
- In markets where products or services are perishable, competition becomes more intense when sales have to be made. An example is last-minute summer holiday bookings.

### Potential entrants

New entrants to an industry add capacity, and if the capacity added is greater than growth in demand, this will reduce profitability. The threat of new entrants is low in cases where:

- industries are capital intensive;
- economies of scale are a key factor;
- access to resources is limited, for example mining concessions, limited radio spectrum, patents;
- access to distribution is problematic;
- buyers' switching costs are high.

New entrants may seek not to replicate the value chain of existing firms but to focus on certain activities where barriers to entry are lower. For example, a firm may enter the market for a product but subcontract the manufacturing to a low-cost producer and concentrate on R&D, sales and marketing, and distribution. A business that has achieved economies of scale in one industry may be able to apply these economies in another industry. An example would be an electricity retail distributor which starts to retail gas and telephone services, thus leveraging existing meter-reading staff and billing systems.

The objective of competitive strategy should be to deter new entrants if this is possible. Where scale economies matter, pricing is an important weapon. However, when pricing becomes predatory, regulators often step in to protect new entrants. In general, governments seek to foster competition and step in where structural factors prevent competition from emerging. An example is the ice cream industry in the UK, where certain manufacturers supplied freezers to retailers and prevented their use for other brands. Government intervention removed this barrier to entry. Incumbents must judge carefully how to use structural factors as a barrier to entry; used without political awareness, strategies that seek to prevent new entrants may backfire.

### Substitutes

Substitute products are products that perform the same function or satisfy the same need as an existing product. The threat from substitute products is particularly severe if the

substitute product is cheaper or more cost effective. Whole industries have been wiped out by substitutes, for example in Europe the silk industry was destroyed by viscose rayon.

A strategy to deal with competition from substitutes is to start making or supplying the substitute. A substitute may threaten only part of the value chain – actually making the product – but logistics, retailing and branding remain unaffected. Such a strategy is an option when dealing with manufactured products, but it can also work in the services sector. For example, on short intercity routes Lufthansa, a German airline, offers a domestic “flight” that is actually a train journey or a bus trip.

The definition of a substitute product can be wide and can include directly competing products and even unrelated products. Disposable incomes are finite, and all companies that sell products and services to consumers compete for the same limited pot of money. To deal with this, competitors in an industry may decide to pursue jointly a generic advertising campaign, such as a campaign for French wine in general rather than for any particular brand.

### **Bargaining power of suppliers**

The balance of power between suppliers – which includes suppliers of labour – and the supplied industry is a function of the relative fragmentation. For example, in an industry with many small suppliers and few large buyers, the bargaining power of suppliers will be weak. Conversely, when there are few large suppliers their bargaining power will be strong.

In industries where inputs are commoditised and there is ample availability of substitutes, provided switching costs are reasonable, the ability of suppliers to raise prices is limited.

Certain strategies, such as just-in-time manufacturing, or even just holding low stocks, increase dependency on suppliers. To reduce the bargaining power of suppliers, strategies are to maintain a diverse base of suppliers or to make a few suppliers dependent on your business. But at the same time suppliers should not be squeezed too much. The relationship between the industry and its suppliers is symbiotic; it must work for both sides.

The operational expenditure of your profit and loss account (income statement) should be presented in sufficient detail to identify major expenditure categories. The bargaining power of suppliers for these services or goods should be addressed in detail, and ideally there should be an analysis of the trend in pricing.

### **Bargaining power of buyers**

The prices you can obtain will have the biggest impact on the profitability of your business. In most cases, buyers shop around for best prices and thus exert downward pressure on prices. There are a number of factors that increase the power of buyers:

- Switching costs are low, which is generally the case with commodity products. Therefore the extent to which products can be differentiated will have a direct impact on prices. This is particularly true for consumer products where branding is a key differentiator.

- Buyers are large compared with the supplying industry. For example, farmers selling to a few big supermarket groups suffer from this.
- In business-to-business markets, buyers have the option of producing the product in-house; that is, they extend their value chain backwards. This is not only a credible threat, but it also increases a buyer's knowledge of the suppliers' costs. Knowledge of suppliers' costs considerably increases the bargaining position of buyers.

## ANALYSING COMPETITORS

Rivalry among firms is the central force determining a business's competitive position. It is therefore necessary to analyse competitors in a similar way to how you would your own business. The elements of a competitor analysis are:

- current strategy or positioning;
- strengths;
- weaknesses;
- opportunities;
- threats;
- possible changes in strategy;
- reaction to changes in your business's strategy;
- financial strength;
- operational strength.

Of course, the analysis of competitors will be far less detailed than that of your own business, but any business strategy should demonstrate an awareness and understanding of the competition. Even if you are not yet in business, this analysis helps you and your investors to understand future rivals.

Analysis of direct competitors should start with a list of competing firms and their market share. This also provides a measure of industry concentration: what percentage of firms serve what percentage of the market. Your strategy will differ depending on whether the industry is fragmented or has two or three dominant players.

Profiles should be drawn up of the most important competitors. The current strategy or positioning of a competitor should be analysed by looking at the statement the company makes about itself and how it communicates with customers. Competitor positioning can be expressed in the context of Porter's generic competitive strategies; that is, does a competitor seek cost leadership? This analysis will also produce some insight into the strategic alternatives open to competitors and their possible reaction to your business's moves.

An important output of a competitor analysis should be a SWOT (strengths, weaknesses, opportunities and threats) analysis of the main competitors (see Chapter 9). Note that the opportunities and threats may not be the same as for your business. For example, increased regulation in the telecoms sector is aimed at large incumbent players, those deemed to have significant market power. It is a threat to the large incumbents but an opportunity for smaller players.

### Competitor ranking by key success factors

David Aaker<sup>1</sup> proposed a model to rank a business against its competitors based on key success factors (KSF). He suggested that no more than ten KSFs should be used for which adequate information is available.

Once the KSFs are established they must be ranked. An importance weight should be assigned to each KSF with the sum of the weights adding up to 1. The weighting is judgmental and so requires a good understanding of the industry. Next, a strength rating is assigned to each KSF, ranging from 1 (weak) to 5 (strong). Again, this is a subjective process, but some proxies can be used if adequate numerical information is available. For example, the number of outlets a competitor has can be used as a proxy of relative strength in distribution. Lastly, the importance weight is multiplied by the strength rating to produce a score for each KSF for each competitor. Chart 7.4 shows an example for a hypothetical industry and gives an overall competitive strength score for each competitor (that is, the sum of the scores for each KSF). Because the importance weighting for the different KSFs totals 1, the maximum possible KSF score is 5.

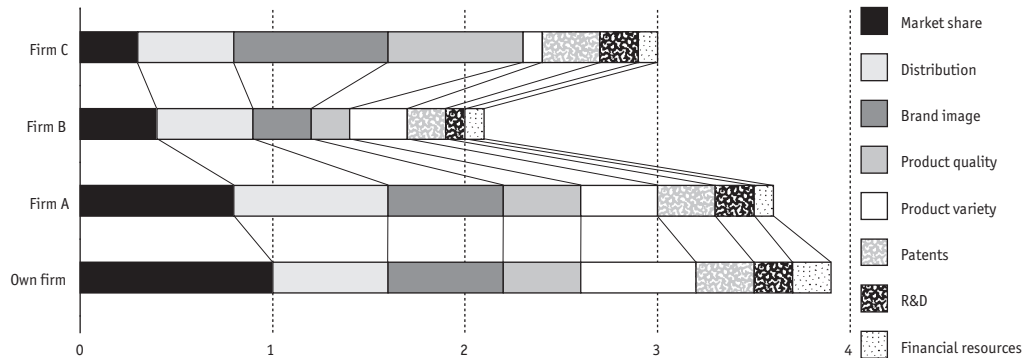
Chart 7.4 KSF competitor ranking

KSF	Importance weight	— Own business —		— Competitor A —		— Competitor B —		— Competitor C —	
		Strength rating	Firm strength	Strength rating	Firm strength	Strength rating	Firm strength	Strength rating	Firm strength
Market share	0.25	4.0	1.0	3.0	0.8	1.5	0.4	1.2	0.3
Distribution	0.20	3.0	0.6	4.0	0.8	2.5	0.5	2.3	0.5
Brand image	0.16	4.0	0.6	3.9	0.6	2.0	0.3	5.0	0.8
Product quality	0.13	3.0	0.4	2.8	0.4	1.6	0.2	5.0	0.7
Product variety	0.11	5.0	0.6	3.9	0.4	3.0	0.3	1.0	0.1
Patents	0.08	4.0	0.3	4.0	0.3	2.0	0.2	4.0	0.3
R&D	0.04	4.0	0.2	4.0	0.2	2.0	0.1	4.0	0.2
Financial resources	0.03	5.0	0.2	4.0	0.1	3.0	0.1	2.0	0.1
Overall	1.00		3.8		3.6		2.1		2.9

The result of the KSF competitor ranking can be plotted on a chart (see Chart 7.5 on the next page). The chart shows not only the relative overall competitive strength, but also the factors that contribute to it. In the example, your business could improve its competitive position dramatically if distribution was improved. Your nearest rival is weaker in almost all aspects except the second most important KSF, distribution. Management effort should therefore focus on this issue.



Chart 7.5 KSF competitor comparison



### Sources of competitor information

It is easy to find information about competitors because they have to communicate with potential customers in order to sell to the market. The internet is a good place to start, enabling you to gather brochures, price lists, company reports, press cuttings, advertisements and so on. In many cases there will be too much information rather than too little.

Most small and medium-sized enterprises are incorporated and will have to file at least minimal accounts, which will be available from the relevant authority. For larger companies, annual reports and accounts and in many cases more detailed information such as analysis briefings are available on investor relations web pages. The information filed can be used to calculate key financial ratios and trends.

Do not forget to study the directors' report and other statements a competitor makes about itself. These often give a good picture of its corporate culture and overall strategic direction.

### Benchmarking

The analysis of competitors also provides benchmarks against which a business plan can be measured. Benchmarks can be financial (balance sheet, profit and loss account) and operational ratios such as staffing ratios, number of sales per outlet and other relevant measures. Operational benchmarks are variables that are relevant to the industry in which a business operates, such as number of retail outlets, number of product lines, media advertising and so on. Some industries are driven by key ratios: for example, hotels measure occupancy rates, airlines measure load factors and TV channels measure viewer ratings.

Benchmarking is useful both for business planning and to develop strategic objectives:

- Typically, bankers and other financial investors will evaluate your business against known numbers from your competitors. If key ratios in your business plan are substantially different from the industry norm, you must provide a good reason for this.
- Competitor benchmarks can provide inputs for your business plan if you are unsure of what values to use.

- Benchmarks identify a best of class competitor and provide you with a target for improvement. For example, if a competitor achieves higher annual sales per retail outlet, this higher number can become an objective in your strategic plan. You know that it is achievable because a competitor has achieved it.

There are companies that specialise in providing industry financial ratios, such as Datastream, Dun & Bradstreet (Key Business Ratios), ValuationResources.com ([www.valuationresources.com](http://www.valuationresources.com)) or BizMiner ([www.bizminer.com](http://www.bizminer.com)). Banks and stock analysts also produce industry reports with benchmark data, but mostly on publicly quoted companies.

In some cases, competitors within an industry have formed a “benchmarking club”. Benchmarking clubs are usually operated by a trusted third party. Typically, competitors would supply agreed operational statistics at certain intervals to the trusted third party. The trusted third party would compute values for the “best in class”, the average and the worst, without identifying the company to which the data relates. This amalgamated data is fed back to all club members so that they can make a comparison on how well they are doing against competitors. The advantage is that the benchmarks are well defined and usually not available from any other source. The disadvantage of the approach is that the competitors are not identified.

There are public sources of benchmark information. For example, in the UK the Department of Trade and Industry has set up the United Kingdom Benchmarking Index. This is a national benchmarking service for small and medium-sized enterprises (SMEs):

*Its objective is to bring high quality benchmarking information and advice within easy reach of SMEs. A company completes an assessment covering Financial, Management and Business Excellence measures. This information is then compared against the UK Benchmarking Index central database. Company performance can be compared locally, nationally, or for a particular sector. A report is then generated which analyses company performance in detail, focusing attention on areas of the company where there is room for improvement.<sup>2</sup>*

## USES OF OUTCOMES IN THE BUSINESS PLAN

A business plan must demonstrate an awareness of the wider industry, the threats from new entrants and substitutes, and the competitive environment. An understanding of the strengths and weaknesses of your competitors will help to define your business’s strategic options.

At the very least your business plan should contain all relevant metrics, such as total industry sales value and volumes for the size of the industry and the trend, as well as a list of competitors and their market share.

Detailed financial and operational ratios from competitors will provide a set of benchmarks that can be used to make comparisons with your own business plan and

eliminate any assumptions that are implausible. Benchmarks can also be useful in quantifying objectives for your business.

### References

- 1 Aaker, D., "How to select a Business Strategy", *California Management Review*, Vol. XXVI, No. 3, 1984
- 2 [www.dti.gov.uk/support/ukbi.htm](http://www.dti.gov.uk/support/ukbi.htm)

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