U N I V E R S I T E D E L A U S A N N E



E C O L E D E S H A U T E S E T U D E S C O M M E R C I A L E S

I N S T I T U T E O F S T R A T E G Y

October 20, 2005

Erkko Autio, Professor Tel +41 21 692 3332

Fax +41 21 693 3305

email erkko.autio@unil.ch

**Template for Doing Industry Analysis**

This template has been designed to provide a step-by-step guide for students in doing an industry analysis following the Porter Five Forces framework. The template has been designed to provide hands-on advice on how to proceed with the various aspects of industry analysis, and to make sure that no critical elements are missed. The need for this template arises from the dearth in the received literature of hands-on, practical advice in industry analysis. This template is ongoing work, which is up- dated on a regular basis. I hope that it will prove to be a useful learning tool.

Porter’s competitive forces (or the five forces) framework identifies five forces that shape a given in- dustry’s competitive conditions. These five forces are: (1) barriers to entry; (2) power of suppliers; (3) power of buyers; (4) threat of substitutes; and (5) industry rivalry. Porter elaborates on how these vari- ous forces work. In this template, I draw on those elaborations and focus on their practical implications. What should an industry analyst do to assess each of the five forces? What follows is a list of ques- tions to consider for each of the five forces, as well as practical advice on how to proceed with the evaluation of each.

|  |  |  |
| --- | --- | --- |
| **Threat of New Entry** | **Examples of Questions to Consider** | **How to Proceed** |
| **Economies of scale:** Marginal improvements of efficiency as the firm’s output volume increases | Are larger firms more efficient (i.e., are unit costs lower)? How steep is the relationship? Remember to consider: manufacturing; raw materials and outsourcing; sales costs; admin- istrative costs. | Get industry reports (e.g., investment banks, Datamonitor, Moody’s). Analyze representative companies’ financial data. Analyze industry reports. Assess the gradi- ent of the learning curve effect by plotting cumulative volume with unit cost. |
| **Product differentiation** | How important are brands in this sector? Do firms compete with distinctiveness? How much are brands and trademarks worth? What drives product differentiation (technology, brand, ser- vice quality, other), and how does this impact entry? | Analyze industry’s products. Identify lead- ing drivers of differentiation. Assess the cost of differentiation. Use, e.g., annual report data, industry reports. |
| **Capital requirements** | How large investments are required for entry? Consider manufacturing capability, distribution and delivery, raw material access, competence development, branding, service provisioning, licensing and regulatory, and other such costs. | List the most important capital investments required. Consider the scale of capital investments of the sector by using balance sheet data (working capital, other relevant figures). Consider alternative forms of or- ganizing (e.g., outsourcing, licensing). |
| **Switching costs** | Do the industry’s products require asset- specific investment (e.g., supporting products and services, equipment, employee training), which would lose its value if supplier is changed? Does the industry employ loyalty programs (e.g., frequent flyer programs)? Are supplier relationships based on long-term con- tracts with exit clauses? | List sources of switching costs (technical, contractual, related investment and prod- ucts, commercial, regulatory, other). As- sess the magnitude of switching costs. |
| **Access to distribution channels** | Are distribution assets competitively available in the sector? What aspects regulate access to distribution? Are exclusive distribution agree- ments commonplace? Can alternative distribu- tion channels be found? | List the main channels of distribution. Con- sider entry aspects of each. Consider al- ternative distribution channels. Consider the cost of developing these. Consider the cost of access to distribution. |

|  |  |  |
| --- | --- | --- |
| **Cost disadvantages independent of scale** | Consider alternative sources of cost advantage for incumbents: e.g., do incumbents possess proprietary technologies that need to be li- censed by others? Do they occupy favored locations? Do they enjoy privileged access to sources of supply and raw materials? Are there any other scarce resources that incumbents either control or enjoy privileged access of? | Consider the business models and activity systems of the industry. Map the structure of the value chain and supplier systems. Consider the availability of all inputs re- quired to implement an actionable busi- ness model within the sector. List the most important scarce resources and assess their deterrence effect on new entry. |
| **Government policy** | Is this a regulated industry? Does the national or local government favor incumbents? Are licensing regulations designed to deter new entry? Does the national government discrimi- nate against foreign competitors? | Consider the regulations required to oper- ate in the sector. Consider potential barri- ers against both domestic and foreign competitors. Assess the effect of each. |
| **Expected retaliation by competitors** | Is this a life-and-death situation for incumbents? Do the incumbents have a history of aggressive retaliation against de novo entries? Can incum- bents launch a price war to deter de novo en- trants? | Apply the competitor analysis template on industry incumbents to assess their reac- tion. Consider alternative strategies for entry and assess the perceived threat they may pose on incumbents. |

|  |  |  |
| --- | --- | --- |
| **Power of Suppliers** | **Examples of Questions to Consider** | **How to Proceed** |
| **Supplier market domi- nated by few large suppliers** | Is the supplier market competitive? How many alternative suppliers of core components exist? How big a share of the end-user value-added do they represent? | Review the suppliers of different compa- nies within the sector. Assess the competi- tive situation between these. Assess the market share of each supplier. Assess the criticality of suppliers’ components. |
| **Availability of substi- tutes** | Can supplier components be replaced easily? Do they require idiosyncratic investments in, e.g., technology, competencies, supporting services? Are there long-standing supplier con- tracts, with difficult-to-break exit clauses? | List alternative components and their avail- ability. Assess the need of supporting in- vestments. Assess supplier switching costs. |
| **Industry not a signifi- cant customer** | How big a share of the total supplier output is bought by industry companies? | State the total output of supplier compa- nies. Compare this with the total procure- ment by industry companies. Use industry- level figures to determine this. |
| **Supplier goods’ criti- cality** | How important are supplier components for value perceived by end customer? Do supplier components’ features represent an important selection criterion for industry customers? Are they essential for the functionality of the final product offering? | Assess value perceptions by industry cus- tomers. Assess the criticality of supplier components to product functionality. |
| **Supplier good differ- entiation** | Do suppliers have strong brands that are known to industry customers (e.g., Intel Inside)? Are their deliveries highly differentiated? | List supplier brands (if any). Assess the strength of these. Identify and assess the sources of differentiation between suppli- ers. |
| **Supplier switching costs** | Do the suppliers’ components require asset- specific investment (e.g., supporting products and services, equipment, employee training), which would lose its value if supplier is changed? Do suppliers employ loyalty programs or other devices to increase switching costs?Are supplier relationships based on long-term contracts with strict exit clauses? | List sources of switching costs (technical, contractual, related investment and prod- ucts, commercial, regulatory, other). As- sess the magnitude of switching costs. |
| **Supplier forward inte- gration threat** | Are suppliers’ competencies such that they could easily be extended for effective operation within the industry under evaluation? Does ex- tension to industry support their business model? Could suppliers easily acquire the nec- essary resources and competencies to compete within the industry? Does the industry suffer from low customer loyalty? | Assess suppliers’ competence bases. As- sess their ability to downstream integrate. Consider the essential drivers of competi- tion within the sector: can suppliers meet them? |

|  |  |  |
| --- | --- | --- |
| **Power of Custom- ers** | **Examples of Questions to Consider** | **How to Proceed** |
| **Customer market dominated by few large customers** | Is the customer market fragmented? Or do we have an oligopoly customer situation? How many alternative customers of core compo- nents exist? How big a share of the end-user value-added does the Industry represent forcustomers? | Review the customers of different compa- nies within the sector. Assess the competi- tive situation between these. Assess the purchasing share of each customer. As- sess the criticality of industry’s products forcustomer value creation. |
| **Availability of substi- tutes** | Can industry products be replaced easily by customers? Or, do these products require idio- syncratic investments in, e.g., technology, com- petencies, supporting services? Are there long- standing delivery contracts, with difficult-to- break exit clauses? | List alternative products and their availabil- ity. Assess the need of supporting invest- ments. Assess customer switching costs. |
| **Customers not a sig- nificant share of pur- chasing activity** | How big a share of the total industry output is bought by customer companies? | State the total output of industry compa- nies. Compare this with the total procure- ment by customers in any given sector. Use industry-level figures to determine this. |
| **Industry goods’ criti- cality** | How important are industry products for value perceived by end customers? Do industry prod- ucts’ features represent an important selection criterion for customers’ customers? Are they essential for the functionality of customers’ product offering? | Assess value perceptions by customers’ customers. Assess the criticality of industry products to customer offering’s functional- ity. |
| **Customer good dif- ferentiation** | Does the industry have strong brands that are known to customers’ customers (e.g., Intel In- side)? Are industry deliveries highly differenti- ated? | List industry brands (if any). Assess the strength of these. Identify and assess the sources of differentiation between industry operators. |
| **Customer switching costs** | Do the industry products require asset-specific investment (e.g., supporting products and ser- vices, equipment, employee training), which would lose its value if customer changes to another supplier? Do industry manufacturers employ loyalty programs or other devices to increase switching costs? Are customer rela- tionships based on long-term contracts with strict exit clauses? | List sources of switching costs (technical, contractual, related investment and prod- ucts, commercial, regulatory, other). As- sess the magnitude of switching costs. |
| **Customer forward in- tegration threat** | Are customers’ competencies such that they could easily be extended for effective operation within the focal industry? Does extension to focal industry support their business model?Could customers easily acquire the necessary resources and competencies to compete within the focal industry? Does the focal industry suf- fer from low customer loyalty? | Assess customers’ competence bases. Assess their ability to upstream integrate. Consider the essential drivers of competi- tion within the sector: can customers meet them? |
| **Customer market dominated by few large customers** | Is the customer market competitive? How many alternative customers of core components ex- ist? How big a share of the end-user value- added do they represent? | Review the customers of different compa- nies within the sector. Assess the competi- tive situation between these. Assess the market share of each customer. Assess the criticality of customers’ components. |

|  |  |  |
| --- | --- | --- |
| **Threat of Substi- tutes** | **Examples of Questions to Consider** | **How to Proceed** |
| **Customer market dominated by few large customers** | Is the customer market fragmented? Or do we have an oligopoly customer situation? How many alternative customers of core compo- nents exist? How big a share of the end-user value-added does the Industry represent forcustomers? | Review the customers of different compa- nies within the sector. Assess the competi- tive situation between these. Assess the purchasing share of each customer. As- sess the criticality of industry’s products forcustomer value creation. |
| **Customers face few switching costs** | Do the industry products require asset-specific investment (e.g., supporting products and ser- vices, equipment, employee training), which would lose its value if customer changes to another supplier? Do industry manufacturers employ loyalty programs or other devices to increase switching costs? Are customer rela- tionships based on long-term contracts with strict exit clauses? | List sources of switching costs (technical, contractual, related investment and prod- ucts, commercial, regulatory, other). As- sess the magnitude of switching costs |

|  |  |  |
| --- | --- | --- |
| **Substitute product’s price is lower** | Do substitute products depict lower price, higher performance, or a lower price- performance ratio? | List the most important performance met- rics of industry products (technical, com- mercial, environmental, service-related, other). Compare the technical merits of both existing products and substitute prod- ucts. |
| **Substitute product’s quality and perform- ance characteristics are equal to or greater than those of the com- peting product** | See above. | See above. |

|  |  |  |
| --- | --- | --- |
| **Intensity of Rivalry** | **Examples of Questions to Consider** | **How to Proceed** |
| **Numerous or equally balanced competitors** | Do companies in the sector have equal capabili- ties? Are they equal in terms of size and re- sources? Are strategic offensive moves by in- dustry companies heating up competition and putting pressure on rivals to respond with offen- sive or defensive moves? | Review different companies within the sec- tor. Compare their size, resources, capa- bilities. Calculate size differentials from largest to next largest, from next largest to third largest, and so on. Calculate the in- dustry concentration ratio. |
| **Slow growth industry** | Is the market a slow-growing or fast growing market? Is the buyer demand expanding and at which pace? How is the demand changing and what triggers changes? Is there excess capacity in the industry? What drives the growth of this industry? | Review data on the development of indus- try output during recent years. Study de- terminants of industry growth. Assess the cyclicality of this growth and determine what causes this cyclicality. |
| **High fixed costs** | Is this industry characterized by high fixed costs (e.g., sizeable capital equipment, large manu- facturing plants, high location costs, high licens- ing costs, high employee costs)? | Gather several annual reports of industry companies. Assess the cost structure.Determine the most important sources of fixed and variable costs. |
| **High storage costs** | Is this industry characterized by high storage costs (large volume of semi-finished and fin- ished goods in supply and delivery chain, highly perishable goods, slow inventory turnover). | Calculate average industry working capital. Calculate raw materials, semi-finished goods, and finished goods inventories.Calculate associated turnover rates. As- sess the importance of perishable goods, price erosion, and the rate of technological obsolescence driving non-currency of sup- plies. |
| **Lack of differentiation or switching costs** | Do the industry products require asset-specific investment (e.g., supporting products and ser- vices, equipment, employee training), which would lose its value if customer changes to another supplier? Do industry manufacturers employ loyalty programs or other devices to increase switching costs? Are customer rela- tionships based on long-term contracts with strict exit clauses? | List sources of switching costs amongst competing companies within the sector (technical, contractual, related investment and products, commercial, regulatory, other). Assess the magnitude of switching costs. |
| **Capacity added in large increments** | Is industry capacity added in large increments? Can individual plant investments have a signifi- cant impact on total industry capacity? Is there a long delay between investment decision and the time when the investment becomes active? | Study how industry output capacity is struc- tured. Calculate output concentration ratio. Assess the lag between investment deci- sion and the time when the capacity be- comes active. |
| **High strategic stakes** | Are there many large players within the industry for whom continued presence is a ‘life-and- death’ question? Are some large players emo- tionally, regulatorily, or in some other ways attached to the sector? Are there incumbents whose other business activities would suffer significantly if the company were to withdraw from the sector? | Assess industry incumbents’ business portfolios and the importance of the focal industry for other business activities. Esti- mate the degree of emotional, regulatory, and other such attachments. Assess the flexibility with which incumbents can move to other sectors. |
| **High exit barriers** | What types of exit barriers are there in the in- dustry, (e.g. fixed costs of exit (e.g. labour agreements), strategic interrelationships (other operations would suffer if you withdraw), spe- cialized assets that are of little value in other uses? Are there government or social restric- tions for exit? | Assess barriers to exit (largely mirror barri- ers to entry). Assess the importance of labor agreements, asset specificity, strate- gic interrelationships, social and govern- ment barriers to exit. |