Chapter 3
External Analysis: Identification of Opportunities and Threats

What is an Industry?

Porter’s Five Forces of Competition

- Risk of entry by potential competitors
- Intensity of rivalry among established firms
- Bargaining power of suppliers
- Threat of substitute
- Bargaining power of buyers
“(Competitive) strategy is a choice on how to compete.”
- Michael Porter

Competitive Forces

- Weak competitive forces = Opportunity
  - Allows a company to earn greater profit
- Strong competitive forces = Threat
  - Depress a company’s profits

Strategic Groups in the Pharmaceutical Industry

- Proprietary Group
  - Merck
  - Pfizer
  - Eli Lilly

- Generic Group
  - Abbott Labs
  - BMY Labs
  - Watson
Strategic Groups

- Groups of companies within an industry that follow a similar strategy (have a similar business model)
- Examples:
  - “Fine Jewelers” with their emphasis on high quality/high price and the necessary working capital of an extensive inventory.
  - “Discounters” like Fred Meyer or Wal-Mart with their lower price/quality and standardized, relatively narrower product lines.

Strategic Groups (cont’d)

- The closest competitors for a company are those in its strategic group
- The most immediate threat to profitability comes from rivals within the strategic group
Strategic Groups (cont’d)

• Each strategic group may face a different set of opportunities and threats
• Varied threats include:
  – Risk of new entry
  – Degree of rivalry
  – Bargaining power of buyers and sellers
  – Competitive force of substitute and complementary goods

Changing Strategic Groups

• Moving from one strategic group to another may be difficult or impossible.
• **Mobility Barriers**: Within-industry factors that inhibit movement between strategic groups
• Example:
  – Forest Labs entering the pharmaceutical industry: they would encounter barriers because they lack resources and competencies necessary to compete

Stages in the Industry Life Cycle
Stage 1

- **Embryonic:**
  - The industry is just beginning to develop
  - Development is slow
  - Buyers are unfamiliar with product
  - High prices

Stage 2

- **Growth:**
  - Demand takes off
  - Many new customers
  - First-time demand
  - Prices fall with development and higher volume
  - Entry barriers are relatively low
  - Relatively low competition

Figure 3.4: Growth in Demand and Capacity
Stage 3

- **Shakeout:**
  - Rate of growth slows
  - Demand approaches saturation levels
  - Few potential first-time buyers
  - Rivalries become intense
  - Excess capacity may exist

Stage 4

- **Mature:**
  - Market is totally saturated
  - Demand is limited to replacement demand
  - Growth is low or zero
  - Barriers increase
  - Threat of new entries decrease
  - Competition drives prices down

Stage 5

- **Decline:**
  - Falling demand = Excess capacity
  - Growth becomes negative due to
    - Technology substitution
    - Demographics
    - International competition
Macro-Environment (as your authors see it)

- Macro-Economic Forces:
  - Forces at the national or regional level
  - Most important forces to monitor are:
    - growth rate of the economy
    - interest rate
    - currency exchange rates
    - price inflation

- Global Forces:
  - Many countries experiencing economic growth since barriers to international trade have tumbled.
  - Growth in places like Brazil, China, and India is creating large new markets for goods and services.
Macro-Environment (cont’d)

• **Technological Forces:**
  - Technological changes are destructive to some companies (threats) and creative for others (opportunities.)
  - They can effect the height of barriers of entry and reshape an industry.

• **Demographic Forces:**
  - Outcomes of change in characteristics of the population such as:
    - Age
    - Race
    - Gender
    - Sexual orientation
    - Ethnic origin
    - Social class
  - Currently there is a growing aging population, which is an opportunity for organizations to cater to an older age group.

Macro-Environment (cont’d)

• **Social Forces:**
  - Changing social mores and values affect industry, such as the trend toward health conscientiousness that causes customers to pay attention to different characteristics of products.

• **Political and Legal Forces:**
  - Changes in laws and regulations that impact managers and companies
  - Result from political and legal developments within society and significantly affect businesses.
  - Firms and industries strive to influence the regulations that government enacts.

The Role of the Macroenvironment