Threats of new entrants

Let's analyze the first of these forces threats of new entrants. Have you ever considered why there is only one Facebook?

What prevents others from entering this industry?

Is it scale requirements, capital requirements or specialized technology or something else that we have not yet thought of?

You should be able to answer this question after we complete this analysis.

Threats to entry are evaluated by looking at entry barriers. Entry barriers protect an industry from newcomers. We can visualize it as a large wall that protects the industry. How can we size up the threat of new entry? We ask a number of questions. For instance, are there economies of scale? Do cost go down as the scale of operations increase? And if economies of scale do exist where does it come from, at the supply side or demand side?

On the supply side, fixed cost sometimes spread over more units which necessitates any potential new entrants to come in with a higher capacity or face cost disadvantages. You see that in production, marketing, research, distribution or logistics, etc.

Economies of scale also could be from the demand side as we would visualize in the telecom sector due to network effects. With high supply-side economies of scale or high demand side benefits of scale, entry barriers increase significantly as in the case of automobiles or the telecom sector. The other questions we need to ask are how easy is it for a customer to switch to a new entrance product. The easier it is, the lower the barrier to entry.

What are the capital requirements? The higher the capital requirements, greater the difficulty for others to enter the industry has maybe witnessed in the case of aircraft manufacturing or microchip manufacturing or refining and so on.

Next, are there any incumbency advantages which are independent of scale? In other words, do existing players have proprietary technology, exclusive access to necessary inputs or high levels of brand identity and product differentiation and so on?

Are there access to distribution channels equal for all? That is, can a new entrant access a distribution channel easily? Are there restrictive government policies? If government policies are restrictive, as in the case of defense and space and so on, you would find the barriers to entry are higher. And finally, what is the expected level of retaliation by incumbents. Higher the level of expected retaliation, higher would be the barrier to entry.