Summary

So how do we put all of these together?

To sum up, industries that have a high rivalry, high bargaining power of suppliers, buyers, and complementors, or have high entry, or substitution threats tend to be rather unattractive. This is not to say that all the forces need to be adverse for an industry to be unattractive. Just a couple of them could push an industry to an unattractive state.

On the other hand, industries where rivalry is low, and where suppliers, buyers and complements have low bargaining power, and where threats of entry or substitution are low will be attractive, increasing the average levels of profitability in that sector.

It is important to note that just examining the current state of the industry forces will not help us draw deep insights into the sector. For this analysis to be helpful for strategy formulation, we also have to be able to see how the industry structure may change and impact profitability or attractiveness in the long run. But before we look into that, a few more points are worth noting.

One, firms located in an unattractive industry are not necessarily condemned to a lifetime of low profitability. For example, as we saw civil aviation is quite unattractive. But even in that industry, there have been success stories such as SouthWest, AirAsia or IndiGo. The reverse is also true. An attractive industry does not guarantee superior performance, just by virtue of the firm being present there. The software industry generally enjoys a high level of profitability, but it also has many firms, which suffer from poor levels of profitability.

Two, industry analysis is particularly useful when firms try to enter new markets or new businesses.

Three, when Porter proposed the five forces model, there was some criticism that it was a static model. In reality, the industry structure is not a given. It is possible and firms should attempt to actively modify the structure for their own benefit. Managing the industry structure is a four step process. First, analyze the industry's current and recent levels of competition and examine its impact on profitability. Second, identify the trends that are changing the industry's structure. Third, identify how these structural changes will affect the five forces of competition and the resulting profitability of the industry. Fourth, see how these trends may be managed or reversed to keep the industry structure attractive.

The fourth and a very important point is that while the specific characteristics of an industry may differ from others, the basic points of analysis remain the same. So a mastery over this framework can help us understand why firms make certain strategic choices.

For example, consider conditions driving rivalry. Firms located in industries with low concentration and excess capacity will engage in consolidation attempts through mergers and acquisitions, joint ventures or alliances. They may even form cartels as in the case of the OPEC. Excess capacity also can be managed in this manner. Similarly, low product differentiation may be managed by increasing emphasis on innovation and value added services. High strategic stakes may be managed by diversification attempts and so on.

Also consider the case of incumbent firms in industries with very low entry barriers. They may attempt to raise barriers to entry by exploiting network effects, and economies of scale, patent production, denying new customers opportunity to scale up, and learn and so on. They can also increase entry barriers by preventing access to distribution channels, increasing customer switching cost, cornering key resources, initiating aggressive, retaliatory moves, or by lobbying for regulations with the government that make entry very difficult.

Take the case of powerful suppliers, buyers or complements. Risks from powerful suppliers, buyers and complements may be mitigated by measures such as backward or forward integration to reduce dependence and leverage. Powerful suppliers are also neutralized by developing alternate suppliers, or input materials, or by standardizing inputs. Powerful buyers, on the other hand, are managed by working on factors that reduce their intrinsic leverage or price sensitivity.

In short, successful companies do not take industry structure as given, but work on the unfavorable aspects to improve the industry's profitability. We will look at many such initiatives in the next sessions of this course.