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A critical evaluation and determination of industry suitability in a competitive business environment

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Abstract
Kennedy Chimfwembe, Lizzie Chawalika Banda, Louis Mwansa, Jessy M. Namwanja, John Kaoma and Nitta Banda who are co-authors of this article argue that the determination of industry suitability requires a firm to understand the external environment and know who the key players are. The paper identifies three key factors in this process including, identifying a firm's competitors, critically analysing its competitors, industry structure and forces of competition. Competition is one of the inevitable forces in today's business world. Competition is an accepted feature of corporate life for profit driven organisations. Managers need to have competitive information to understand the industry and its competitors, identify areas where competitors are weak and evaluate the impact of strategic actions on competitors. While managers may want a broad approach to competitor identification, to avoid competitive blind spots, they must hone in on groups of identified competitors separately in competitor analysis. While competitor identification is essentially a categorization task that involves classifying firms on the basis of relevant similarities, competitor analysis is an evaluative task that goes beyond mare classifications to compare rivals on the basis of relevant dimensions. Competitors should be analysed along various dimensions such as their size, growth and profitability, reputation, objectives, culture, cost structure, strengths and weaknesses, business strategies, exit barriers, etc. This paper provides insights for managers to use when evaluating and determining industry suitability for competitive advantage in an industry.

Keywords: competitive analysis, industry strategy, competitive advantage

1. Introduction

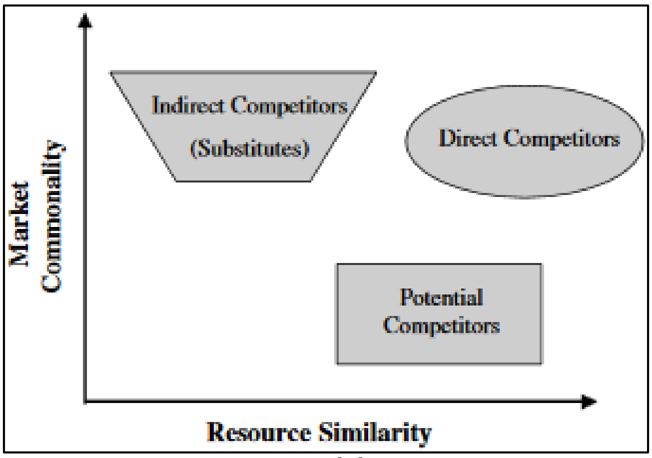
One of the greatest challenge most businesses face is competition. According to Adcock, Halborg and Ross (2007) [1] unlike the military, industry is always at war. It is compared to a battlefield where firms compete to gain competitive advantage. The failure and success of a firms depends on the level of competition in the industry. Porter (1980) [12] states that the key aspect of the firm's environment is the industry or industries in which it competes. He states that the intensity of competition in an industry is neither a matter of coincidence or bad luck, but more a question of how that industry is structured. Competition determines the appropriateness of the firm`s activities that can contribute to its performance, such as innovations, a cohesive culture, or good implementation. Kotler and Armstrong (2012) [7] note that competitive advantage requires delivering more value and satisfaction to the target customers than competitors do. Creating competitive advantage begins with a thorough understanding of competitor's strategies. But before a company can analyse its competitors, it first must identify them, a task that is not as simple as it may seem. Ibid (2012) [7] identify the following steps that can help a company to identify its competitors;

i) Identify a company's competitors
ii) Assess competitor's goals, strategies, strengths, weaknesses and reaction patterns
iii) Select which competitors to avoid or attack

2. Identifying Competitors

A company can identify its competitors as other companies offering similar products and services to the same customers at similar prices. Three types of competitors are identified including, *direct* competitors, *significant* competitors and *indirect* competitors (Kotler & Armstrong, 2012) [7]. While direct competitors offer the same products and services, significant competitors offer only some of the same products and services. Indirect competitors offer the same or similar products or services only in small number of areas, and their target customers seldom overlap. Companies can identify their competitors from an industry point of view. Peterraf &Bergen (2002) [11], amplifies this assertion and illustrates the process of identifying a firm's competitors;

2.1 Mapping the competitive terrain



Source: Peterraf & Bergen (2002) [11] competitor identification and competitor analysis; a broad-based managerial approach 23:157-169

Fig 1

Based on the illustration above, market commonality and resource similarity serve two purposes when mapping the competitive terrain. Under the category of market commonality, competitors are identified based on the degree to which they address similar needs. While under the category of resource similarity, we identify competitors based on the degree to which their resource endowment is similar in terms of type of composition. Chen (1996) [3] defines market commonality as the degree of presence that a competitor manifests in the market place it overlaps with the focal firm'. This definition serves as an indicator of a firm's direct or primary competitors and behaviour. To this effect, this definition can be broadened to take the extent that they satisfy the same customer needs. On the other hand, Cooper & Inouc (1996) [5] recognises that competitors may include firms that do not share the same technological platform. As such, the definition given above based on needs encourages managers to look beyond restrictive product market boundaries to assess competitive threats more broadly. It captures the extent to which direct and indirect competitors such as substitutes, are competition to serve the same needs.

Further, Chen, (1996) [3], defines resource similarity as the extent to which the given competitor possesses strategic endowments comparable in terms, of both type and amount, to those of the focal firm. The amount of resources can be regarded as one of the many dimensions on which a firm may claim resource superiority relative to other firms as such, resource similarity can be redefined as the extent to which a given competitor possesses strategic endowments comparable, in terms of type, to those of the focal firm.

Therefore, we utilise the two constructs of market commonality and resource similarity to categorize the competitors on the competitive field from a point of view of a focal firm. By displaying resource equivalence as an increasing function on the X-axis, and market commonality as an increasing function on the Y-axis, we can map the competitive field of a focal firm by locating candidate rivals on the grid. Firms with resource endowments similar to the focal firm that do not presently serve the same customer needs will be found on the south west corner of the grid. These are the potential entrants into the market of focal firms. Managers should know that potential competitors have similar resources has similar resources as the focal firm, but, serve different needs. Firms that occupy the south west corner of the grid score low on both dimensions. They are entirely outside the competitive set at the present although this could change over time, they are the indirect competitors, such as substitutes.

Managers therefore should pay attention to firms with similar technologies and resources when scanning their competitive environment than they do firms that are outside traditional product market boundaries.

2.2 Competitor Analysis

Sizing up a company's competitors gives managers a realistic view of the market and his or her company's position in it. Yet not every competitor warrants the same level of attention in the strategic plan. Excellent companies clearly do more and better competitor analysis than the rest (Cole, 1997). [4] Successful companies understand their competitors and predict their actions. Companies must endeavour to collect competitive intelligence information in order to keep updating their knowledge of top competitors and also maintain a solid grasp of where their significant competitors are heading. Strategic intelligent information about a company's according to Scarborough (2014) [13] can be obtained from industry trade publications, interviews with competitor's customers and suppliers, trade shows, social media and through patent searches among others.

When analysing the competitors one key aspect that managers should note is the competitor's strategy. In most industries, competitors can be sorted into groups that pursue different strategies. A strategic group is one in which firms follow similar strategies in a given target. Kotler and Armstrong (2012) [7] states that assessing a competitor's goals and objectives and overall performance helps firms to compare the company's processes to those of their competitors or leading firms in other industries to identify best practices and find ways to improve quality.

3. Industry and Competitive Analysis

An industry is a group of firms doing the same type of business operations and producing for the market products that would meet a particular need. A firm need to have an understanding of the forces operating in the industry for them to decide to remain or to enter the said industry (Kotler, 1997).[8] The strategic decision of the firm to remain operating in the industry is dependent on having a clear understanding of the forces that operates in the industry. Once the firm has a clear strategy it will help in the mobilization of resources and formulation of operational plans. Industry and competitive analysis method is a tool the firm will use to develop a competitive strategy.

Porter (1980), [12] developed this approach to assist with company strategy making for competitive advantage. They noted that analysing the forces that shape an industry helps firms to predict the level of profits throughout the industry thereby increasing the likelihood of success for their business units. Porter, identified five key forces that shape a company's industry including; power of customers, relative power of suppliers, threat to substitute products, threat of new entrants and the amount of rivalries among the players in the industry;

The Five Competitive Forces that Determine Industry Profitability

Source: Kotler, P. (2003). [9] "A Framework for Marketing Management." 2nd ed. (Upper Saddle River, N.J.: Prentice Hall, 2003)

Fig 2

3.1 Competitive Rivalry

Rivalry among competing firms is usually the most powerful of the five competitive forces. There are a number of forces that may influence the intensity of rivalry among competing firms to increase. Competitive rivalry increases when consumers can switch brands easily, when barriers to leaving the market are high, when fixed costs are high, when the product is perishable, when consumer demand is growing slowly or declines, when the products being sold are commodities, when rival firms are diverse in strategies, origins, and culture, and when mergers and acquisitions are common in the industry. As rivalry among competing firms intensifies, industry profits decline, in some cases to the point where an industry becomes inherently unattractive (Scarborough, 2014) [13]. Therefore, it is important rival firms when they sense weakness to intensify both marketing and production efforts to capitalize on the "opportunity."

3.2 Threat of new entrants

Whenever new firms can easily enter a particular industry, the intensity of competitiveness among firm's increases (Kotler and Armstrong, 2012) [7]. Scarborough (2014) [13] asserts that barriers to entry can include, the need to gain economies of scale quickly, the need to gain technology and specialized know-how, the lack of experience, strong customer loyalty, strong brand preferences, large capital requirements, lack of adequate distribution channels, government regulatory policies, tariffs, lack of access to raw materials, possession of patents, undesirable locations, counterattack by entrenched firms, and potential saturation of the market.

Therefore, strategists need to identify potential new firms entering the market, to monitor the new rival firms' strategies, to counterattack as needed, and to capitalize on existing strengths and opportunities. Also when the threat of new firms entering the market is strong, incumbent firms generally may fortify their positions and take actions to deter new entrants, such as lowering prices, extending warranties, adding features, or offering financing specials (Kotler, 2003) [9].

3.3 Threat of Substitutes

The presence of substitute products puts a ceiling on the price that can be charged before consumers will switch to the substitute product. Price ceilings equate to profit ceilings and more intense competition among rivals. Coca Cola Company for example faces competition with beverage companies that produce soda drinks such as Pepsi. The magnitude of competitive pressure derived from development of substitute products is generally evidenced by rivals' plans for expanding production capacity, as well as by their sales and profit growth numbers. Competitive pressures arising from substitute products increase as the relative price of substitute products declines and as consumers' switching costs decrease. The competitive strength of substitute products is best measured by the number of competing companies offering substitutes entering into the market share those products obtain, (Kottler, 1997) [8].

3.4 Power of suppliers

The bargaining power of suppliers affects the intensity of competition in an industry, especially when there is a large number of suppliers, when there are only a few good substitute raw materials, or when the cost of switching raw materials is especially costly. It is often in the best interest of both suppliers and producers to assist each other with reasonable prices, improved quality, and development of new services, just-in-time deliveries, and reduced inventory costs, thus enhancing long-term profitability for all concerned. Firms may pursue a backward integration strategy to gain control or ownership of suppliers. This strategy is especially effective when suppliers are unreliable, too costly, or not capable of meeting a firm's needs on a consistent basis.

However, in many industries, depending on the nature of products being supplied, it may be more economical to use outside suppliers of component parts than to self-manufacture the items. Therefore, firms need to assess the power of suppliers effectively and identify cheaper sources of raw materials.

3.5 Power of Buyers

Cvellar &Gomex (2013) [2], points out that when buyers possess a strong or growing bargaining power, the market (or market segment) is unattractive. Customer's bargaining power increases when there are a few large buyers, when the product represents a significant part of the firm's costs, when the product is undifferentiated, when the cost of switching is low, when buyers are price sensitive, or when buyers can vertically integrate. To compete in this environment, firms might want to refocus and target buyers with less power, or develop offers that buyers cannot refuse.

Therefore, managers must assess the strength of each one of the competitive forces as they determine industry profitability which influence the prices, costs and the required investment of the firm in an industry. The analysis enables a company to develop a competitive strategy that best defends against the competitive forces or influences them in its favour. The key to develop a competitive strategy is to understand the sources of the competitive forces.

According to Porter, there are two main prepositions in the competitive analysis school; the first preposition is based on the assumption that the stronger the forces that shape an industry, the lower the general level of returns in the industry, and secondly, the stronger the forces affecting a strategic business unit the lower the profits for that unit. One of the key advantages of the competitive analysis model is that it provides a systematic way of assessing industries and the strategic options facing strategic business units within those industries. However, the weaknesses of this approach is that, often, it is difficult to know what the industry is and what forces affect it. As such, to assess their competitors effectively, Cvellar &Gomex (2013) [2] identify two approaches; industry approach and market approach;

4. Industry based approach

This approach focuses on the structure of the industry and the products offered by all the participants. An industry is defined as a group of firms whose products and services are close substitutes of each other. Cvellar & Gomex (2013) [2] state that industries are classified according to the number of sellers involved and the degree of product differentiation. They identify the following characteristics of the industry; entry or exit barriers, cost structure, degree of vertical integration, and extent of globalisation. Based on the number of sellers and product differentiation, industries are commonly classified as; monopoly where only firm supplies a given product, oligopoly in which few firms produce the same commodity such as fuel, monopolistic completion were few firms offer differentiated products, and/ or pure competition characterised by firms producing the product or service.

5. Market Based Analysis

This approach focuses on customer needs the firm is attempting to satisfy which will provide the firm with a wider view of current and potential competitors. Firms look for competing companies that satisfy the same customer need. Usually the range of current as well as potential competitors may be broad based on brand competition, industry competition, form competition and generic competition.

6. Steps to Performing Industry and Competitive Analysis

In order to carry out an industry and competitive analysis, the firm need to develop a set of tools which will assist carry out the analysis of the external environment which will determine the strategies the firm will adopt in the process. Kuveya, & Undenge (2015) [10] outline following steps key to performing industry analysis;

6.1 Industry's Dominant traits

In order to perform industry and competitive analysis the first step is to identify the industry dominant traits. The Educating People for Tomorrow (EPT) (2010) [6] outlines some of the economic characteristics factors to be considered which includes the following:

1. Market size: The Educating People for Tomorrow (EPT) (2010) [6] refers market size to the total number of firms operating in an industry. Ibid (2010) [6] provide caution that it is important to know whether the industry is growing, static or declining. This largely depended on the position of the industry in the business cycle i.e. early development, rapid growth, early maturity, maturity, stagnation or decline.
2. Scope of competitive rivalry: This is an important factor for any organisation to know about the level of competition. It is equally key for the industry members know about the nature of future competition. For instance, in an event where a company realizes its future success depends upon diversification, product development and market expansion which in turn the organisation to initiate early planning as a proactive measure.
3. Number of competitors: Perhaps, it is important for an organisation to determine whether the industry contains too many rivals or dominated by a few large entities. In a similar manner, organisations should also pay attention various development in the industry such as mergers and acquisitions.
4. Number of buyers
5. Technology: EPT (2010) [6] notes that if the industry is characterized by rapid pace of technological change then the art of the state technology is impressive for the success of an organization. For instance industry of mobile phones requires rapid changes in the technology in order to meet the changing consumer demands.
6. Product differentiation: Ibid (2010) [6] observes that product differentiation can be used to measure ad know the dominant industry features. For example, if the industry is characterized by rapid product differentiation and short product life cycle than the research and development is very important for the success of the business. In such cases, members of the industry must come up with new products to compete effectively.
7. Ease of entry and exit
8. Capital requirements

6.2 Competitive forces are at work in the industry

The second step, is to analyse the competitive forces that are at play in the industry, whether strong or weak. These competitive forces in the industry are the fundamental contributing factor of the firm`s profitability and industry attractiveness. In order to measure the profitability and industry attractiveness, the firm must develop a model to understand these competitive forces which are at work in the industry, whether the industry operates domestically or internationally, produces a product or offer a service, all the rules of competition are embodied in Porters Five Forces as alluded in the preceding chapters.

6.3 Competitive forces and their strengths

The standard of formulating a competitive strategy is to relate the firm to its environment. Although the appropriate environment is broad, which incorporates the social factors as well as other economic forces and the key aspects of the environment in which the industry participates. The way the industry is structured has a strong influence in determining competitive rules of the game as well as the strategies available to the firm. The intensity of the competition is not a matter of luck, however, the competition is rooted in the economic structures that goes beyond the behavior of the current rivals. The state of competition in an industry depends on the five competitive forces. The collective potential strength of these five competitive forces determines the ability of the firms in an industry to earn, on average, rates of return on investment in excess of the cost of capital. The strength of these forces varies from industry to industry profit made, whereas profitability is measured as the return on the capital invested.

7. Common Drivers of change across industries:

- Technology
- Competition
- Customer needs
- Regulations and policies
- Economic environment
- Regulatory influences and government policy changes/politics
- Interest rates

8. Which companies are in the strongest/weakest positions?

After, scrutinized the dominant traits of the industry, together with the strength of the competitive forces, and having identified the driving forces, the fourth step in industry and competitive analysis is to study the market positions of rival firms and the method used is called group mapping. Strategic group mapping is used to study the market position of competing firms with similar positions in the industry.

9. Observe, Assess and Evaluate Competitors' Strategies

It is imperative to study the actions, behaviors and industry position of the closest competitors by profiling each one of them to ascertain their direction. The strategies of the industry may sometimes change, because a firm can destroy the industry structure and profitability as readily as it can improve it. For example, a new product design may undercut the entry barriers or increases the volatility of the competitors and this can undermine the long-run profitability of an industry. So it is important for the firm use price differential to be sustained. Generics may enhance the price sensitivity of buyers, trigger price competition, and erode the high advertising barriers that have kept out new entrants.

10. Key Factors for Competitive Success

It is often, said that satisfying the buyer needs is at the core of the success in the business endeavor. Buyer must be willing to pay at a given price for which a firm product exceeds its costs of production and the industry will survive. The threat of substitutes also determines the extent to which some other product can meet the same buyer's needs, and thus places a ceiling on the amount a buyer is willing to pay for the industry`s product. The industry structure determines what proportion of the value a product creates for many buyers. If the industry does not create much value for its buyers, then there is little that the firm can capture regardless of the other elements of structure. These factors of the strategy are related to the action approaches and the firm must pay close attention to these factors in order to produce specific outcomes which are critical to the success or failure of a company.

For example

- Marketing – skilled sales team
- Technology – expertise in a given IT field
- Skills –related – design expertise
- Organizational – superior IT systems
- Distribution – low distribution costs
- Manufacturing – low cost plant locations…. etc.

11. Industry attractiveness

The final review of the overall industry situation and develop rational decisions about the short and long term attractiveness/unattractiveness of the industry. The central question in determining industry and competitive analysis strategy is the position of the firm in the industry. Positioning determines whether the firm is profitable or average. A firm that can position itself well may earn high rates of return even though industry structure is unfavourable and the average profitability of the industry is therefore, modest. The fundamental basis of the above-average performance in the long run is sustainable competitive advantage. The firm must consider the following factors during the review:

- Industry's growth potential
- Potential for entry/exit of major firms
- Stability/dependability of demand
- Severity of issues facing industry as a whole
- Degree of risk/uncertainty in industry's future

12. Conclusion

The paper has presented some of the concepts key to gaining competitive advantage on the market. The process of strategic management is broad and one that requires environmental scanning. This paper looked at the external or industry environment and how an organisation can analyse it to succeed. Competitor identification, competitor analysis, and industry structure and competitive forces are some of the important factors that characterise a successful industry analysis to determine suitability and competition. This process is critical and fundamental to strategy formulation and as such, managers should endeavour to understand the environments in which they intend to operate from if the firms are to achieve maximum profitability. The main purpose of strategy is to use concepts needed to effectively formulate and efficiently implement a strategic plan or a game plan that can lead to sustainable competitive advantage for any type of business and how to perform industry competitive analysis. The firms gather strategic information (input) to evaluate the internal operations and external environmental issues facing an industry (matching), and then craft a strategy to make strategic decision.

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