11 Assessing relevant industries with the help of competitive intensity models

11.1 Basic reflections on the assessment of competitive intensity

The model for assessment of a current or target market position proposed in Chapter Three has two sides:

- assessment of market and industry attractiveness and
- assessment of competitive strength

The models proposed in this chapter are intended to help strategic planners to assess one of these two aspects. They help to evaluate the attractiveness of the industry markets served by strategic businesses. The models are based on the idea that certain features of the industry structure determine the expected intensity of competition and thus the average margin which competitors will be able to achieve. The average margin is of great importance in determining the profit which a business can be expected to make in the long term. This line of reasoning reflects what is known as the market-based view, and this is explained in Inset 11.1.

Two models for the prediction of competitive intensity will now be described, both of which were developed by Porter:

- the Five Forces model for broad analysis of an industry (Porter, 1980, p. 3f.), and
- the strategic groups model for identifying and analyzing specific sectors within the industry (Porter, 1980, p. 126f.).

These models can be used in a two-step analysis of the attractiveness of an industry.

In the first step, the Five Forces model is used to obtain a broad view of the structure of an industry and, based on this, to forecast the expected level of competitive intensity. The current and future values are collected for five features which Porter identified as central determinants of competitive intensity. In relatively uniform competitive situa-
tions, that is in industries where the competitors are all of approxi-
mately the same size and offer comparable products, this broad view
will already enable a judgment as to whether the market is attractive
enough to justify the investment required to build up or defend a market
position. This would be the case, for example, for the steel industry,
wheat wholesaling or cigarette manufacturers.

Inset 11.1: Market-based view

The market-based view is derived from findings in Industrial Eco-
nomics, a sub-discipline within Economics. The market-based view
uses the following line of reasoning:

- Each industry market has its specific structure.
- The market structure influences competitive behavior adopted by
  the companies or businesses.
- The success of a company or business is dependent on both
  market structure and competitive behavior. The relative impor-
tance of the two factors depends on the industry.

This central line of reasoning is known as the structure-conduct-
performance paradigm.

The market-based view focuses on the first factor, the industry
structure, which is considered on two levels:

- Structural analysis of industries explains the competitive intensity
  and the average rate of return of an industry in comparison to the
  average rate of return across all industries.
- The variance in profit levels among companies within a single in-
dustry is usually much greater than the variance in the average
return for different industries (Rumelt, 1987, p. 141f.). This phe-
nomenon cannot be explained by looking globally at an industry;
a more detailed structural analysis is required. The industry is
therefore divided into groups of suppliers with similar competitive
positions and strategies. The groups with attractive positions are
protected against the other competitors in the industry by entry
barriers. This is what allows them to maintain their above average
profits over the long term (Porter, 1980 p. 126f.).