

3

INDUSTRY AND COMPETITIVE ANALYSIS

The future ain't what it used to be.

Often credited to Yogi Berra

An organization's ability to learn, and translate that learning into action rapidly, is the ultimate competitive advantage.

Jack Welch, CEO of General Electric (1981–2001)

CHAPTER LEARNING OBJECTIVES

Upon completion of this chapter, you will be able to

- Defend the importance of macroenvironmental analysis
- Summarize the components of the macroenvironment and their impact on business ventures
- Compare the different stages of industry development
- Apply the five forces model of competition to your new business venture
- Describe different types of competitive analyses
- Explain the process of creating a new business model

ASSESSING THE INDUSTRY

In Chapter 2, you evaluated your idea for a new or modified product, service, or business, as well as assessing the idea at the root of this innovation, the idea in search

of one or more potential opportunities. You analyzed the essential steps that need to be taken in evaluating the potential market niche. Potential adopters were next identified as those categorized as either innovators or early adopters. Issues such as the “burn rate” of your financial capital and the length of time needed to obtain sustaining sales revenues were determined. Your potential adopter screening was employed to evaluate the market viability of your proposed new business venture. Your research allowed you to define clearly how your product, service, and business create value for your potential adopters. Business to adoption was analyzed in depth to avoid attempting to create a new business that is likely to fail. Both technical and competitive risk were analyzed. Your research was not theoretical, but it was seriously analytical.

In this chapter, your analytical research continues as you master the application of macroenvironmental analysis, cross impact analysis, and environmental screening, all for the purpose of being better at recognizing the reality that most forces of change come from without. The more analytical expertise you gain, the more skilled an entrepreneur you become at the early recognition of new market opportunities, as well as serious potential threats. You will learn how to evaluate the level and nature of competitive behavior by applying Michael Porter’s “five forces model.” Competitive assessment will be determined through your asking and answering a series of questions designed to provide you with insight into the behaviors of the anticipated competitors. This analytical assessment of the behaviors of each competitor will lead to answers regarding the entrepreneur’s business model form and function.

THE MACROENVIRONMENTAL ANALYSIS PROCESS

A humbling reality is the power of the external macroenvironment to change or reshape the competitive environment of any industry. Radical and disruptive technologies have become an accepted force in many markets and within many industries. Some macroenvironmental forces, trends, and events happen gradually while others take the market by surprise. An entrepreneurial firm attuned to potential changes can benefit dramatically through developing new products or services based on where the market is trending rather than where the current market focus resides. By correctly forecasting trends, an entrepreneur can achieve rapid market penetration and high levels of profitability through having new products or services available when the market changes. Sometimes, these changes create new market niches.

“First to market” business strategies can produce outstanding profits and help establish a new business venture in the evolving market.

Critical Forces, Trends, and Events

Unfortunately, many entrepreneurs do not focus on what they choose to describe as “futuristic events.” Assessing the potential forces, trends, and events that are the foundation of the macroenvironment may be perceived to be less relevant to business leaders

than understanding the short-term competitive forces that are influencing their immediate decisions. Entrepreneurs need to recognize the value of mastering the skills that allow them to be capable of “looking both ways.” Being skilled at recognizing and tracking the forces, trends, and events that comprise the drivers of change allows the entrepreneur the time to gather and redirect a firm’s limited resources in order to develop and deliver new products and services to gain a competitive position in the emerging new market niche. In today’s competitive environment, the ability to reposition a business through superior flexibility can be a major factor in achieving and retaining market growth.

Figure 3.1 represents the interactions that exist among the major macroenvironmental forces in the competitive environment and demonstrates the dynamics of those interactions.

Observe that a change in one of the macroenvironmental factors produces changes to all the other factors. A classic example of this interaction was the development of a safe and affordable female contraceptive pill. More than just a new piece of technology, “the pill” allowed women to feel more empowered because they had greater control over their lives and reproductive health. These lifestyle changes resulted in women having an increased opportunity for higher education, increased participation in the workforce, and increased active participation in changing federal and state laws. This new piece of technology ushered in unprecedented reproductive rights, which led to changes in the legal structure of our own society, changes in the timing of family creation and to traditional familial roles, on the individual level, and changes in the redistribution of earnings among the genders, on the national level. So the invention and marketing of the pill led to changes in both the US society and economy. Globally, laws that promote equal pay for equal work in an attempt to level the economic playing field and address gender discrimination have been written and enacted in response to these changes, though there is still work to be done on this front. Clearly, the list of impacts on society could go on for pages. The key point to understand is that all components of the macroenvironment are interconnected, and these dynamic forces can result in the modification of society while creating a wide array of new business opportunities.

Cross Impact Analysis and Environmental Scanning

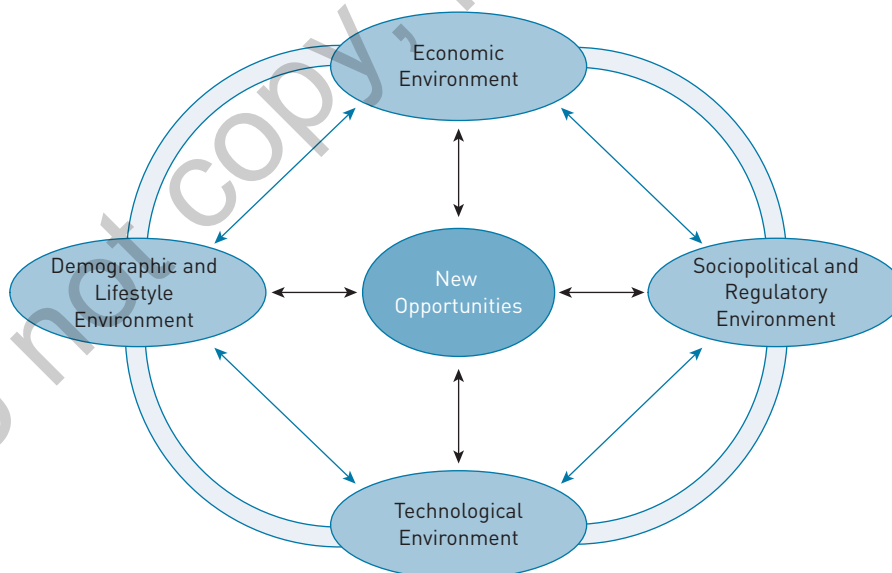
The exciting and dynamic insights provided by a macroenvironmental model lie in what is termed **cross impact analysis**. The occurrence of any single event changes the probability of the occurrence of all other events. What **cross impact analysis** does for the entrepreneur is generate an increasing awareness of the need to scan the environment actively. Environmental scanning is the process through which changes in the environmental sectors are tracked and evaluated. The goal is to identify the impact of those factors with the highest probability of influencing the future of the market niche in which you plan to compete. Scanning, evaluating, and assessing these factors is essential to determining potential impacts on the business. The value of environmental scanning is the identification of new opportunities and potential threats in time to take advantage of the first and avoid or defend against the second. Shifts in a major environmental factor, such as demographics, occur very slowly yet have a profound impact on our society. As an example, due to improvements in medicine and changes in lifestyle, Americans in the

baby boom generation are living longer and staying healthy longer. Also, many are quite wealthy, as the passing of their parents' generation produced the greatest transfer of wealth in recorded history. Consequently, new market opportunities have been created to serve the needs and wants of this older, healthier, and wealthier population. For instance, a new market niche that might be termed “wealth preservation” has been created; businesses in this niche provide financial services designed to ensure that this aging population will not outlive resources.

As discussed, cross impact analysis is an analytical tool that further enriches the entrepreneur's understanding of the dynamic interactions of the macroenvironment. The occurrence of an event in the macroenvironment has the effect of potentially altering the occurrence of other events. The analysis of the “cause and effect” provides the entrepreneur with a deeper and richer understanding of the forces that continually impact to alter the macroenvironment. Scanning the macroenvironment for these **cross impact** occurrences allows the entrepreneur to recognize new opportunities early enough to possibly profit from their creation. Environmental scanning and cross impact analysis are analytical tools that, when mastered, enhance the entrepreneur's ability to achieve first mover advantage in new or evolving markets.

Your macroenvironmental analysis will need to focus on the four most critical major components: the economic environment, the technological environment, the sociopolitical environment, and the demographic and lifestyle environment. Understanding the virtually continuous interactions of these components within the overall macroenvironment will provide greater insight into current and future changes.

FIGURE 3.1 ■ Macroenvironmental Interactions



COMPONENTS OF THE MACROENVIRONMENT

Economic Environment

In a global economic environment, the entrepreneur is required to remain vigilant about any and all economic changes that have the potential to impact her or his business. As an example, the supply and demand for essential raw materials and commodities are truly global in scope. The price that an entrepreneur will be required to pay for a commodity such as oil, corn, wheat, copper, or other natural materials is determined by global supply and demand. A failure to track trends and make needed adjustments can be devastating to profit margins in a period of rapidly rising costs if an entrepreneur is unable to raise prices due to competitive pressures. Entrepreneurs who are dependent on critical commodities need to scan the futures market continually looking for trends related to needed commodities and take action to hedge their long-term cost.

On a national level, the entrepreneur is bombarded by economic factors that could be either an opportunity or a serious threat. For example, if interest rates are a critical factor in the firm's operations, it is necessary to follow closely the actions and pronouncements of the United States Federal Reserve and those of similar entities in other politically and economically dominant nations. Anticipating higher interest rates in the near future, for example, an entrepreneur might arrange for long-term borrowing to be done quickly to avoid the rising cost that higher interest rates will create. What if you discover indications of a growth in family income? How might your business be affected by this growth? Do increases in housing starts in your community impact your sales? Entrepreneurs need to develop models that reflect accurately the economic variables with positive and negative effects on their specific businesses. The next step is to identify an accurate and reliable source of economic data and forecasting that will inform their economic models of what actions need to be taken.

In reality, the number of economic variables that interact to shape the environment in which a business operates can become overwhelming. The entrepreneur does not want to experience "paralysis from analysis" in making timely decisions, but the most significant economic variables that impact critical decisions must be noted, analyzed, and integrated into the decision-making process.

Technological Environment

The past few decades has witnessed a series of one major technological breakthrough after another. By all indications, this pattern of explosive and often disruptive technological change has become the norm for our society. Technological advances are now global in scope and are a worldwide phenomenon. Facilitated by the Internet, new technologies are quickly distributed to an eagerly awaiting audience. As a global society, we have an increasing expectation that technology will solve problems and provide for a better life. Technology has, for many industries and markets, become a disruptive and volatile force driving the other components of the macroenvironmental model. Explosive technological changes have reshaped industries and created new, untapped market niches. In many of

these cases, the biggest beneficiaries have been the entrepreneurs who were prepared to enter, and even dominate, these emerging markets.

Sociopolitical Environment

Social and political forces, trends, and events are analyzed to determine the long-term societal forces that will likely affect the behavior of society. Political trends analysis attempts to forecast future laws and regulations that either support or impede a business's ability to operate efficiently and achieve its targeted growth. In America, industries and companies continually lobby lawmakers to enact legislation that will provide a positive economic environment, one that is to their competitive advantage. An entrepreneur needs to track carefully the progression of federal, state, and even local legislation to become alert to potentially damaging legislation that could negatively impact markets and products.

Changes in the makeup of society will often generate new potential market. On a very simple and basic level, the immigrants to the United States bring with them their cultural preferences for particular foods and lifestyles. Thus, new market niches in the restaurant industry are continually reflecting changing tastes and a demand for ethnically rich cuisine. When we consider a variety of societal changes in process, our analysis must provide an understanding of deep-seated trends. Professional couples with two above-average incomes and one or two children, who were motivated to ensure that the children would attend the better universities, were responsible for creating a market niche of high-end prekindergarten schools, as well as academically intensive afterschool programs designed to prepare their children for exceptional scholastic achievement. For many parents, their children's academic achievement is a positive or negative reflection of their performance as parents. Another niche market exists to serve those whose incomes allow for the search for physical perfection; body modification businesses now offer plastic surgery, nutritionists, and personal trainers to assist in shaping the body.

Society is divided into an almost unlimited number of segments based on any combination of demographic: gender, age, ethnicity, sexual orientation, income, marital status, religious orientation, and the list goes on. Entrepreneurs can often identify market niches among the nearly limitless combination of people in our society and create a business that meets their needs and wants.

Demographic and Lifestyle Environment

Sociopolitical changes are closely aligned with demographic and lifestyle trends on a variety of levels. As discussed earlier, the demographics of the population change relatively slowly. Trends such as birth rates provide a steady and accurate assessment of potential market needs. For example, manufacturers and retailers of children's clothing know, with accuracy, how many children will be of a certain age next year as well as the gender of those children. Parental disposable income can be projected based on economic data. Housing trends would provide insight into where the parents and children live. In fact, the U.S. Census data can provide extremely precise and detailed demographic, societal, and economic information to guide the entrepreneur's decision making.

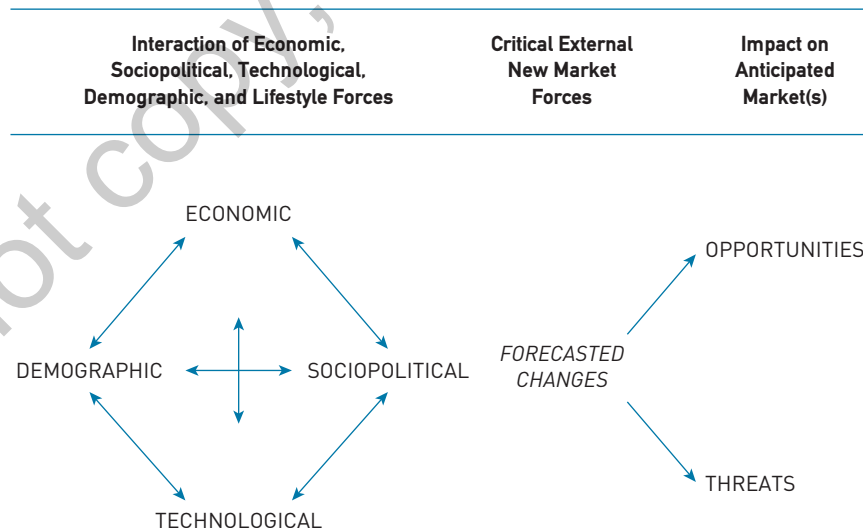
Lifestyle trends evolve at a faster pace. Some lifestyle trends begin in specific parts of the country and are adapted by other regions or specific communities later. Some lifestyle trends show signs of becoming permanent for a section of the population. An example would be exercise and fitness. Insightful entrepreneurs recognized that some women were reluctant to exercise around men due to cultural taboos, being offered unwanted male attention or advice, or just plain awkward self-consciousness. Consequently, “women only” fitness centers are thriving, driven in part by the same lifestyle trend for health that fuels the vitamin and supplement industry. As of 2018, the fitness industry, which was practically nonexistent 40 years ago, now accounts for a market worth of more than \$25 billion. Membership in a gym or health club in the United States has grown 33.6 percent since 2008, not to mention the growth in health-related apps and wearable activity trackers.¹

Demographic and lifestyle trends can be compared to a train. An entrepreneur must find out early where the “trend train” is going and decide whether or not to get on board. It is normally too late to get on board when the train has picked up speed and is roaring down the track. However, by conducting proper research, entrepreneurs can get on board early and position themselves to be at the train controls. Entrepreneurs who recognize and analyze demographic and lifestyle trends early can position themselves to gain an ever-increasing share of a growing market.

Creating Opportunities

The process of determining the interactions among the components of the macroenvironment that will produce potential opportunities for a new business venture is not complete until the entrepreneur assesses the probability of the occurrence of these

FIGURE 3.2 ■ From Macroenvironmental Analysis to Market Impacts



forces and the strength of the impact supporting the feasibility of the new venture. It is essential to remember one thing at least. Just because the interactions of the macroenvironmental forces create significant potential opportunities does not guarantee that those opportunities fit the core competencies and resources of the entrepreneur's business. The entrepreneur benefits from making a detailed and painstaking evaluation of all the relevant information regarding the nature and scope of the anticipated opportunity. Only then can it be determined to be an accurate "fit" with the firm. If the anticipated opportunity has merit for the business, a plan of action needs to be created and necessary resources allocated to move in an appropriate and timely manner. The goal is to place the firm at the "front end" of the new emerging market. The creation of a new business model in line with an emerging trend can have a sweeping impact on the market, sometimes creating entirely new niches. **Figure 3.2** illustrates how forces, trends, and events from the interactions of macroenvironmental components can produce changes in the forces that drive markets and impact how business operates. These forces can drive the creation of new opportunities or possibly create threats to existing businesses.

STAGES OF INDUSTRY DEVELOPMENT

After gaining an understanding of the role macroenvironmental forces play in changing and reshaping markets through threatening some business models while creating opportunities for others, our next step is a detailed analysis and assessment of the competitive behaviors of the industry offering a new opportunity. The first step in an industry assessment is determining the basic nature of the industry in which the entrepreneur's business will need to compete. The size, scope, and maturity of the industry all generate characteristics that need to be understood in depth.

Mature Industries

Mature industries are composed of established firms that have survived past battles. As the name of these industries implies, they compete in already-developed markets, so demand for their products and services may be slow, but it is steady, and often there is little need for innovation if they are content with the status quo. New ventures can only penetrate a mature market effectively through innovative products and services, those that challenge that status quo. Entrepreneurs can expect aggressive competitive pressure from existing firms with market positions that they need to defend. A second drawback of competing against this type of industry is the possible difficulty of gaining initial adoptions from customers who have established relationships with the current suppliers. Entrepreneurial firms must ensure that they have the resources to survive a lengthy battle in gaining a foothold in the market. The entrepreneur must have confidence in the new product, must know that it is technologically sound and that its superiority and value creation capability can be demonstrated.

Mature industries are often comprised of customers who are reluctant to change from established suppliers. Consumer products are equally well established in the minds of buyers, and you may discover that market penetration can become a lengthy and costly process. For some customers, there are deeply rooted psychological barriers that must be

overcome before switching to a different seller, good, or service. When asked why they don't change, they will often say, "I always buy that product."

Declining Industries

Declining industries are experiencing decreasing demand for their products or services. Although the demand for these industries' products or services may be in decline, there may be a few market niches experiencing growth. The entrepreneur will need to investigate very carefully to establish if this growth trend is short lived or has the potential to continue to grow. In a few cases, new competitors might have innovative products or services that can gain market share through providing the market niche with a lower-cost alternative.

Declining industries may have market components with the potential for rapid growth, or they may offer opportunities that the existing competitors are not capable of servicing or even willing to make the effort to serve. In this scenario, an innovative entrepreneur with a fresh idea would experience limited competitor resistance. Competitors might choose to leave the market due to their assessment that it is in steep decline, thinking they would benefit by reallocating their efforts elsewhere. In other cases, an entrepreneur might find a market niche large enough to be viable, even in a declining market, if he or she is able to focus a product or service on the specific needs and wants of that unserved or underserved niche. However, you should be aware of how the most aggressive firms in the industry are working to avoid the overall decline. These firms are striving to avoid obsolescence by reinventing themselves with new products or services. Your goal is to become their new supplier with products or services that meet their new needs.

Fragmented Industries

Fragmented industries are normally easy to enter because the industry is comprised of firms of relatively equal size. There are no dominant competitors to oppose the entry of the entrepreneur's business, but there are equally no barriers to entry by other new competitors. The potential opportunity may be in the introduction of a business model that is so attractive that the firm can rapidly achieve a leadership position in the market and erect barriers to potential "copycat" competitors. As an example, an entrepreneur may create growth and market share through franchising. Outback Steakhouse, Olive Garden, Hooters, and the Tilted Kilt have built national chains in the highly fragmented restaurant industry.

The fragmented industry has what might be considered behavioral or operational norm. The businesses in such an industry all operate with similar performance expectations. A new business venture that can significantly exceed the standard norms of behavior and operation can "stand out" from competitors. These businesses are able to establish and maintain practices viewed by the market as superior to those of the other competitors. The customers determine what the most important criteria are in any market niche, but often it will be operational behaviors—such as superior quality, honesty in all dealings, or friendly and courteous service—that enable your customers to recognize your superiority. Delivery of the criteria important to customers will give you the opportunity to grow your business rapidly. (This subject is investigated in depth in the chapter on marketing.)

Emerging Industries

Emerging industries are normally viewed as providing the best opportunities for new ventures. When an entrepreneur has products or services that serve a previously unrecognized or unmet customer need, these will face fewer established competitors. In an ideal situation, the new venture achieves what is termed “first mover advantage” and becomes recognized by the market niche as the firm best suited to meet these new needs. The analytical question to be studied is the demand stability of the market niche. Will the niche continue to grow? Is the niche still evolving, and if so, to where and at what pace? The greatest source for identifying emerging industries is almost always macroenvironmental analysis, as discussed previously. New market niches can be traced directly to the emergence of the trends produced by the interaction of the external environment.

Global Industries

Global industries are market niches that have common characteristics in multiple nations. In most cases, some modifications of the firm’s products or services need to be made to tailor these to the unique requirements of each potential market. At times, product or service modifications may be superficial in nature. Opportunities for growth in sales can occur rapidly through mastering strategies supportive of global market growth. One of these, termed a **multi-domestic strategy**, emphasizes responsiveness to the local requirements of multiple domestic markets, adapting products and services to fit these

Uber

Launched in 2010 by Internet entrepreneur Travis Kalanick, Uber has grown into a company with one of the highest market valuations in the world, with a valuation greater than Tesla, Ford, or General Motors. In spite of internal challenges, the company continues a trajectory of growth; 2016 gross bookings by users of the service exceeded \$20 billion. Although reported 2016 net revenues exceeded \$6.5 billion, the company’s net losses were \$2.8 billion. Dara Khosrowshahi has now become the CEO

of Uber although its founder, Travis Kalanick, remains as a member of the company’s board of directors. Khosrowshahi’s vision for continued disruption in the transportation space has now begun to take shape through the development and deployment of autonomous driving vehicles. Because of the company’s execution of its mission to decrease the costs for dispatched taxis from central service providers, Uber had attained a market valuation of \$62 billion by the first quarter of 2018.

Sources:

Eric Newcomer, “Uber, Lifting Financial Veil, Says Sales Growth Outpaces Losses,” *Bloomberg*, April 14, 2017, <https://www.cnbc.com/2018/05/23/uber-q1-financial-data-increased-sales-valuation-with-new-tender-offer.html>.

Jillian D’Onfro and Josh Lipton, “Uber Posts Big Sales Jump in First Quarter and Boosts Valuation to \$62 Billion,” *CNBC: TECH*, May 23, 2018, <https://www.cnbc.com/2018/05/23/uber-q1-financial-data-increased-sales-valuation-with-new-tender-offer.html>.

“Leadership,” Uber website, <https://www.uber.com/>.

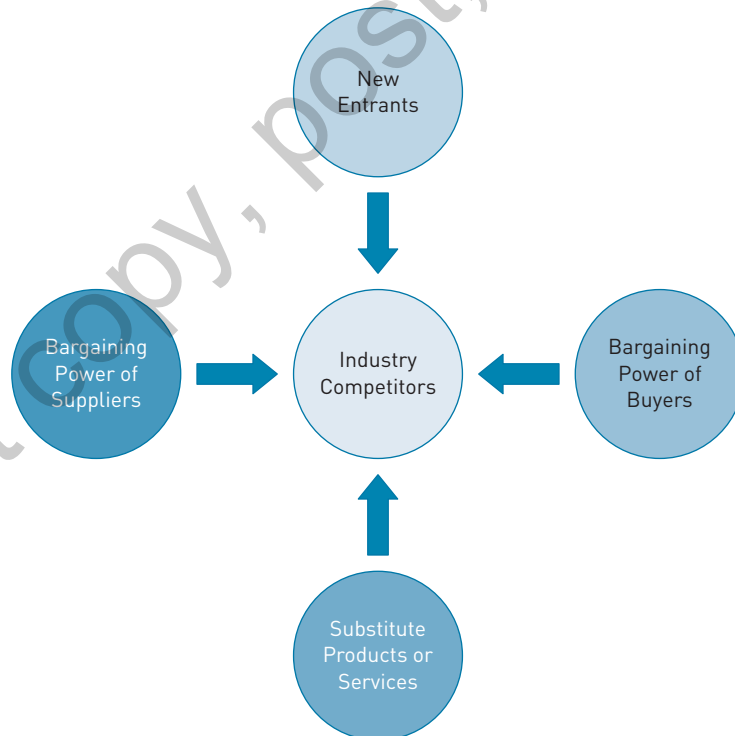
markets. At the opposite end of the spectrum is a truly global strategy that sacrifices responsiveness to local requirements in favor of efficiency and does not make too many modifications of the firm's products or services. Serving global industries can become potentially complicated, whatever strategy a company follows. The entrepreneur must factor in issues such as government laws and regulations, cultural differences, and economic factors, for example, the customers' ability to pay and the company's ability to force payment in a foreign country.

ANALYZING INDUSTRY BEHAVIOR

Porter's Five Forces Model

Michael Porter of Harvard University developed the *five forces model of competition*. This model is a powerful tool for assessing the anticipated level of competition that will exist in an industry. Figure 3.3 illustrates this analytical method.² Using the "five forces," an entrepreneur can evaluate the likelihood of a proposed venture surviving and prospering

FIGURE 3.3 ■ Five Forces Model



Source: Based on Michael E. Porter. "The Five competitive Forces That Shape Strategy," *Harvard Business Review*, January, 2008, pp.86–104.

under a variety of difficult competitive situations. Each element of the model provides the entrepreneur with a series of potential strategic challenges, which have the power to shape the intensity of the rivalry that exists in the industry.

The threats experienced by new market entries are determined by economic factors that include economies of scale and brand identity. Competitors who possess absolute cost advantage, high capital requirements that restrict entry, and high switching costs, as well as those with proprietary technologies and intellectual property, further inhibit the market entry of new firms. Each of these components is tangible and measurable. The economics of the industry and the existence of established competitors who can exercise power to restrict entry into the industry need to be understood.

This analysis is far from theoretical. As an entrepreneur, you can evaluate any industry that you are considering entering to determine objectively the nature of the competitive forces you are likely to encounter. The conclusions you are able to reach based on your assessment will serve to assist you in determining the potential of strategic success and strategies for attaining it. Porter's five forces model is a highly valued analytical tool for the assessment of new venture success.

Impact of Suppliers

Suppliers have power to influence the competitive environment of a business when they are highly concentrated and control potential access to needed components. In many cases, their economic power allows them to set prices. Suppliers have no motivation to negotiate due to their ability to control product prices; therefore new ventures need to be concerned about the stability of supply under conditions in which suppliers can artificially limit or withhold vital components. The new venture might not be able to purchase needed critical components if it does not pay a supplier's "asking price." Suppliers will normally demonstrate a preference for their larger and long-term customers. This preference is a very serious issue that could be harmful to revenue and success.

Impact of Buyers

Buyers possess the power to negotiate lower prices when a new business venture needs their orders to survive. Typically, buyers who make larger than normal purchases have the capability to exercise strength in negotiating lower prices in the form of volume discounts. Entrepreneurs quickly discover that their assumptions regarding their "proposed product price" and associated profitability are proving to be unrealistic.

The negotiating power of larger buyers normally exists due to the economic reality that it is less expensive to sell in high volume. New ventures will always be at a disadvantage until they are on a more equal footing with the buyers. The new venture will have a negotiating advantage when their products or services are uniquely superior to those of competitors. A new venture can gain additional economic power when products possess intellectual property protection, such as patents, copyrights, and trademarks.

Impact of Substitute Products or Services

Another component of the five forces model that impacts the intensity of competition is the threat of **substitute products or services**. Competition is enhanced when the industry players feel pressure from a potential competitor who is capable of offering

products or services comparable to their own. The closer these substitutes are in price and quality to those of the entrepreneur wanting to enter the industry, the greater the competitive pressure.

Competitive pressure is one of the factors determining the profitability of an industry. There is no logical reason to invest in a business venture that will operate in an industry where competitive pressures produce unacceptable profits. The entrepreneur needs to search for market niches that have less competitive pressures and the potential to achieve higher profit margins. Thus, entrepreneurs must evaluate the operational components of their business models and the dynamics of the industries in which they are considering competing to determine if proposed ventures have the potential to meet their profitability expectations.

COMPETITIVE ANALYSES AND COMPETITIVE PROFILE MATRICES

If the entrepreneur finds the characteristics of the industry to be favorable, the second step is the evaluation of the competitors currently or potentially in the market niche the business intends to enter. A detailed competitor analysis requires the collection of what is described as *competitive intelligence*. Competitive intelligence focuses on gathering and evaluating all of the information that can be learned about each competitor's capabilities and behaviors. For publicly traded companies, there is an abundance of information through such sources as these:

- Required SEC filings
- Competitors' websites
- Third-person analyses of other firms
- Discussions with suppliers and vendors who serve the market niche
- Publications of the trade associations in which the companies are members
- Current customers of the competitors
- Industry conferences and trade shows, which are normally sponsored by the relevant trade associations
- Speeches and reports by the executives of competitive firms

Much of this research is available through the assistance of a qualified research librarian. There are many completely ethical sources of competitive intelligence. Entrepreneurs have no reason to enter a market without conducting a modestly sophisticated analysis of the competitors in the market.

Competitive Critical Factors

Competitive intelligence is not complex or even overly sophisticated. Competitive intelligence involves the collection of critical information about the businesses with whom

Lyft

Serial entrepreneurs Logan Green and John Zimmer cofounded and launched Lyft in 2012 as a logical outgrowth of their earlier ride-sharing venture, Zimride, which was begun in 2007. Created in the disruptive space of on-demand personal transportation replacing traditional taxi and limousine services, Lyft has grown to provide over 1 million rides daily and expanded its business operations to include all 50 states in the United States. In 2017, the company began its expansion into Canada with the

launch of services in Toronto. The company's cofounders, having grown a substantial, profitable business, have now turned their attention to another disruptive business offering. Working in partnerships with General Motors, Ford, Waymo, and NuTonomy, Lyft has begun the development of autonomous driving vehicles. Through the insightful and directed leadership of its cofounders Green and Zimmer, Lyft reached a market valuation of \$7.5 billion in April 2017.

Sources:

Biz Carson, "Lyft Doubled Rides in 2017 as its Rival Stumbled," *Forbes*, January 16, 2018, <https://www.forbes.com/sites/bizcarson/2018/01/16/lyft-doubled-rides-in-2017/>.

See also the Lyft website and blog: <https://www.lyft.com/> and <https://blog.lyft.com>.

Andrew J. Hawkins, "Ford and Lyft Will Work Together to Deploy Autonomous Cars," *The Verge*, September 27, 2017, <https://www.theverge.com/2017/9/27/16373574/ford-lyft-self-driving-car-partnership-gm>.

Eric Newcomer, "KKR Among Lyft Investors at \$7.5 Billion Valuation for Startup," *Bloomberg*, April 11, 2017, <https://www.bloomberg.com/news/articles/2017-04-11/kkr-among-lyft-investors-at-7-5-billion-valuation-for-startup>.

your new venture will compete. Ask yourself, these questions. What must I know about each of these potential competitors? How can I structure my findings in order to reach the most accurate conclusions about each competitor?

Researching the industry you are about to enter and your potential competitors in that industry is just common sense. Why would any entrepreneur not be willing to conduct this research and analysis prior to investing in a new business venture? Here are some specific questions to help guide your research:

1. What are the sources of any competitive advantages that the competitor demonstrates in the market? Does the competitor possess a unique set of skills and capabilities? Can these skill sets be legally replaced or replicated, and at what cost?
2. What strategies and tactics does the competitor demonstrate in the market niche? What are their stated objectives?
3. How has the competitor previously responded to significant market changes created by the interactions of the macroenvironment? How effective have these responses been?
4. How has the competitor previously responded to new ventures attempting to enter the market? Identify any strategies ranging from acquisition to other more competitive behaviors.

5. Does the competitor have the resources to mount a vigorous defense of its market position if a new entry challenges? What are these resources?
6. Does the competitor have any weaknesses that make it vulnerable? What, specifically, are these weaknesses?
7. How are the competitor's products or services positioned in the market in comparison with those the entrepreneur intends to introduce?
8. How would you rate each competitor's leadership?
9. Does the competitor have customers who are historically loyal to its products or services? If so, who are they and what percentage of the competitor's sales do these customers represent? (Even long-term customers can have unfulfilled needs. If you can cultivate clients from competitors based on your provision of innovative solutions, testimonials from these customers about why your solution is better than the status quo is a powerful marketing tool for any entrepreneurial start-up firm.)
10. Does the competitor have extremely loyal suppliers who might not be willing to supply the entrepreneur's firm if the competitor asked them not to?
11. How valuable to the competitor is the market niche that you wish to enter? How vigorously will the competitor defend this market niche? How would you evaluate the "cost/benefit" of attempting to enter the market niche?
12. Based on what you have learned about the competitor, how vulnerable will your new venture be to that competitor's response to your market entry?

Based on a positive analytical result from the questions posed in the competitor intelligence process, the entrepreneur must formulate a market entry strategy. The market entry strategy needs to recognize those critical components of all the competitors' products that generate superior performance. If the entrepreneur's products are superior to those of the competitors, the entrepreneur can compete on a "head-to-head" basis. Are there shared core competencies among the current market leaders? Will the new business venture be able to meet or exceed competitors on these capabilities? The new venture will also need to possess these core competencies, unless the entrepreneur anticipates a significant change in the market that will result in negating the importance of these core competencies, thus creating the need to replace them with others.

Reflect on the discussion of the characteristics of an industry, and remember the importance of many of the essential tangible and measurable conditions associated with success. Some of these strategic components include a large amount of initial capital, specialized equipment, and the achievement of economies of scale and operations, or having proprietary technology. In some market niches, a new business venture will fail if it ignores critical market realities.

Constructing a Competitive Profile Matrix

A *competitive profile matrix* needs to be constructed based on what the entrepreneur learns from the competitive intelligence analysis. The competitive profile matrix focuses

FIGURE 3.4 ■ Competitive Profile Matrix: An Example

Critical Success Factor	Relative Weight	Your Venture's Rating Score	Company 1	Company 2	Company 3
Highly efficient low-cost production	.30				
Established and efficient distribution system	.20				
Innovative products	.20				
Competitive prices	.10				
High-quality product	.10				
Loyal customers	.05				
Excellence in management	.05				
Total	1.00				

on a critical set of factors, as well as on the relative impact of each factor on the achievement of success. This analytical tool allows for each firm to be rated and compared on all of these specific factors critical to success in this market niche. **Figure 3.4** provides an example of a competitive profile matrix.

If you apply evaluation process illustrated in **Figure 3.4**, the ratings for each critical success factor could be a maximum of 4 if the firm has a major strength on the specific success factor, of 3 if the firm has a minor strength, of 2 if the firm has a minor weakness, and of 1 if the firm has a major weakness. The score for each firm is then calculated according to the assigned relative weight of each factor. These weights are determined by an assessment of each factor's significance in impacting success in each targeted market niche. In other words, the score you assigned to each of the critical success factors is multiplied by the factor weighting that was assigned to that specific factor. The maximum score that a firm could earn in the example given in **Figure 3.4** is a 4.0, as the sum of the relative weighting numbers is 1.0.

The competitive profile matrix is just one additional analytical tool to assist the entrepreneur in the task of assessing the feasibility of a proposed new venture. The entrepreneur can determine the probability of success for the new venture in the targeted market niche based on a side-by-side comparison of competitors and can further the likelihood of this success by recognizing and employing the critical factors needed to flourish in that market niche.

Value Chain Analysis

Another analytical tool that sheds light on the viability of a business model is a very simplified version of *value chain analysis*. The focus of value chain analysis for an entrepreneurial firm needs to be on the relative cost advantages or disadvantages a new venture could encounter. A new venture's relative cost in comparison to that of competitors affects the firm's profit margin. In most markets, all firms have a similar value chain that is comprised of all the activities necessary to produce and deliver what it is selling and to service the customer base.

FIGURE 3.5 ■ Value Chain Analysis			
Total Sales Revenue			100%
Cost of All Supplies	10%		
Cost of Production	40%		
Cost of Marketing and Distribution	25%		
Customer Service Cost	10%		
Overhead Cost	10%		
Total Cost			95%
Net Profit			5%

Components of the value chain would normally include the cost of all supplies, production costs, marketing and distribution costs, customer service expenses, and all overhead expenses. Profitability is based on sales revenues that exceed the total cost that is incurred in creating and delivering the firm's product or services. **Figure 3.5** is a simple illustration of the value chain; percentages have replaced actual dollars for the purpose of this illustration.

The objective of value chain analysis is to identify expenses and costs that can be reduced, resulting in a higher net profit. As an example, if a new venture possesses unique competencies that result in producing a product at an equal or higher quality than is standard but at a significantly lower cost, these superior production techniques, skills, or capabilities result in operating proficiencies that lower production cost and simultaneously increase the firm's profits.

Sometimes, firms lower costs by outsourcing noncore organizational functions, especially in the area of overhead items, to firms whose superior competencies in these areas allow the outsourcer to lower the entrepreneur's total cost and increase the firm's profits. An example might be a publisher outsourcing shipping and distribution. The entrepreneur should always be searching for a core competency that the new venture can create, as these can produce a competitive advantage. If the firm's core competencies are extremely difficult or impossible for competitors to duplicate, the new venture has the foundation for a lasting, sustainable competitive advantage.

Benchmarking

Another useful analytical tool used to determine whether a firm's value chain activities are competitive in comparison to those of its rivals is **benchmarking**. The benchmarking process entails attempting to measure the actual cost and efficiency of each component in the value chain in an attempt to identify specific superior actions or tactics, which are then termed *best practices*. Benchmarking involves the entrepreneur using the same sources of information employed in the competitive intelligence process. Competition requires that every firm continually search for improved operational technologies and methods that will achieve lower cost, superior performance, or both.

When entrepreneurs conduct value chain analysis and benchmarking prior to entering a market, they might be able to determine that the unique capabilities and core

ENTREPRENEURIAL SPOTLIGHT

MIKE LINDELL—MYPILLOW

Mike Lindell is a highly successful entrepreneur who has traveled a difficult path on his way to success. Mike was a heavy drug user before turning his life around. Today, you cannot watch television without seeing one of his commercials for MyPillow. Lindell developed his product in 2000. He sold his product at trade shows and state fairs. Above all, Lindell and his family believed deeply in the product, and his confidence in it motivated his drive to succeed. As an example, he ordered 30,000 plastic bags with the company logo printed on each before the final prototype was completed.

Cash flow was an issue, as most start-up firms discover. In response, he mortgaged the

family home to obtain enough funding to continue. The product, MyPillow, is the result of 90 different trials before it satisfied the founder. Actually, Lindell went on to invent the machine that automatically fills his pillows. In 2011, the *Minneapolis Star Tribune* published a feature article on Mike Lindell and MyPillow, resulting in a surge of sales. He expanded his advertising from print media to the infomercials now shown nationwide.

The bottom line: MyPillow today has sales of over \$280 million, and it had sold more than 26 million pillows by early January 2017. The firm employed over 1,400 people in its home state of Minnesota in the spring of 2017.

Sources:

The Mike Lindell Story—An American Dream, directed by Joe Brandmeier (New York and Los Angeles: LightBeaMedia, 2016), documentary, 59 min.

Patrick Kennedy, "MyPillow Lays Off 140 Workers Because of Slower Sales," *Minneapolis Star Tribune*, April 25, 2017, <http://www.startribune.com/my-pillow-lays-off-140-workers-because-of-slower-sales/420422463/>.

Josh Dean, "The Preposterous Success Story of America's Pillow King," *Bloomberg Businessweek*, January 11, 2017, <https://www.bloomberg.com/businessweek>.

competencies their firms possess will allow them to achieve an early competitive foothold. A firm's core competencies—those that apply to performance and the firm's markets—are the foundation upon which its competitive strategies and tactics need to be based.

CREATING YOUR BUSINESS MODEL

In the previous chapter and in this one, we have addressed the critical issues of the birth of an idea for a new product or service; the application of creativity and innovation; the analytical evaluation of an idea to determine if it is a viable opportunity; the assessment of the opportunities created by the interactions of the components of the macroenvironment; the assessment of the industry in which a new product or service might compete; the competitive behaviors of industries; and, finally, the assessment of competitors. Now the entrepreneur must create a business model based upon the results of this comprehensive analysis. The new venture's business model will be based on the findings from all of the analyses. The business model needs to be unique and not simply a copy of a competitor's model. Any venture's business model needs to be

deeply rooted in the basic values and vision of that venture, as well as in its unique competencies and resources. The business model illustrates how the entrepreneur plans to enter the selected market niche after having assessed an amalgamation of its competitive components. Once the business model is established, the entrepreneur then formulates core business strategies. These strategies are themselves based on the analysis that has been previously completed. Effective business strategies address the characteristics and behavior of the targeted market niche, as well as assessments of the strategies and weaknesses of competitors. The critical and tangible components of market dynamics are the building blocks of strategy. The strategies of the entrepreneurial firm must be sufficient to meet the needs of the market customers in a superior fashion to that of the firm's competitors.

The Value of Strategic Thinking

Strategic thinking gives rise to how the entrepreneur's new venture will choose to compete. Strategic thinking requires the ability to understand all aspects of the competitive landscape. Thinking strategically helps entrepreneurs avoid becoming myopic and short-sighted, and it is the mental foundation upon which the firm's strategic planning process is developed. The resulting strategic plan is used to integrate all components of the firm. Creating an effective business plan begins with the development of a clear vision for the business and the translation of that vision into the final mission statement. A mission statement addresses a series of essential questions, including the following:

1. What are the basic beliefs and values of the new business venture?
2. What are the products and services the firm plans to offer?
3. What are the purchasing characteristics of the specific targeted customers?
4. What are the specific needs and wants of the targeted customers that our product or services must satisfy?
5. How do our products or services meet or exceed the expectations of our targeted customer base?
6. How, specifically, does our product or service create value for the targeted customers?

Applying Critical Driving Forces

The firm's mission statement makes crystal clear what the business is and what market niches it is focused on. The mission statement also enables entrepreneurs to recognize and describe what are termed the *critical driving forces* of the new venture. Here are two examples of critical driving forces:

1. Unique or superior knowledge upon which the firm's products or services are based.
2. Detailed knowledge of the markets, customers, and their buying behaviors.

These driving forces serve to keep the entrepreneur focused on where the new venture has a competitive advantage, so this step serves to help and establish the scope of the business.

To ensure that the new venture maximizes its strengths and avoid its weaknesses, the entrepreneur develops an *internal factor evaluation matrix*. This analytical tool allows for a focus on the firm's strengths that have the potential for the greatest impact on achieving successful market penetration and potential profitability. With the specific market niche in focus, what are the most critical strengths that must be present within the new business venture to achieve success? The internal factor evaluation matrix begins with the firm's key internal strengths and weighs the relative importance of each in the achievement of success.

Business Strategies

The entrepreneur has already developed a competitive profile matrix, which is revisited during the process of developing a business strategy in order to identify clearly each competitor's areas of weakness. Business strategies are normally most effective when they are focused on competitors' weaknesses. These strategies serve to lay out a roadmap that guides a firm to achieve its objectives. Effective business strategies are firmly rooted in the specific and highly focused application of the firm's unique core competencies to meet the measurable needs and wants of the targeted market niche the entrepreneur wants to penetrate. Distinctive market-focused competencies, then, are the foundation of the firm's success. A successful business strategy is comprehensive and integrates all of the firm's core competencies to focus on the key factors necessary for success in the market as the "point" of the competitive spear.

For new business ventures, the most effective business strategies are normally a combination of what are termed focus and differentiation strategies. The focused component of the firm's strategy is a recognition that the firm is attempting to gain initial penetration in a specific and possibly limited market niche. The differentiation component recognizes that successful market penetration requires that the product or service have unique capabilities that are superior to those of its competitors.

A *focus strategy* recognizes that not all markets are homogeneous. In any large market, there are normally many different segments or niches—each with different needs, wants, and characteristics. A focus strategy, as the name suggest, identifies the customers special needs, wants, and interest while offering them goods and services that meet or exceed these unique needs and wants. The products or services create value for a specific market niche. The differentiation strategy seeks to build customer loyalty by creating and distributing products and services that are unique. The *differentiation strategy* attempts to create superior value for the customer through making modifications in the product or service that result in valued uniqueness. One key to a successful differentiation strategy is that it is built on a distinctive competency of the firm. Also, the product or service differentiation must actually create value in the eyes of the customer, and customers must actually be able to afford to purchase the differentiated product or service. Typically, an entrepreneur can differentiate market offerings through producing a product or service that is of higher quality, has unique and valued features, or is more reliable

and dependable. Another avenue to differentiation is for the firm to provide superior customer service.

To conclude, we have discovered that entrepreneurs research the market both to identify market niches in which their products or services will be successful and to develop strategies that best present their firms to those unique markets. This is the essence of the firm's business model. The business model is tangible and based on the firm's unique distinctive competencies that are capable of producing value for the market the firm serves. In a competitive world, the firm needs to have a business model that clearly communicates its uniqueness and value creation to its targeted market niches.

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ENTREPRENEURIAL EXERCISES

The remainder of this chapter encourages you to complete exercises that allow you to apply the material in the chapter to a proposed business venture of your choosing. These practical exercises will help you determine whether your proposed business venture may prove to be a winner.

Entrepreneurial Exercise 3.1

Part 1

Please describe in detail the interactions of the macroenvironment that you believe will take place over the next five (5) years and what opportunities you believe these interactions will create during that time.

Major macroenvironmental forces, trends, and events that you believe will occur over the next five years include the following:

- 1.
- 2.
- 3.
- 4.
- 5.

Based on these predictions what do you see as potential opportunities?

1. New opportunity:
2. New opportunity:
3. New opportunity:
4. New opportunity:

Part 2

How do the new opportunities that you identified in Part 1 impact your proposed new business venture?

Entrepreneurial Exercise 3.2

Part 1

Please describe how cross impact analysis of the components of the macroenvironment and of their interactions has resulted in your identification of significant changes in market opportunities.

Part 2

Have the results of cross impact analysis and your consequent assessment of market changes affected your proposed business venture? If so, how? If not, why not?

Environmental Exercise 3.3

What are the primary research tools and measures that you plan to employ in scanning components of the macroenvironment?

1. Economic environment:
2. Technological environment:
3. Sociopolitical environment:
4. Demographic and lifestyle environment:

Entrepreneurial Exercise 3.4

Part 1

What is the industry or industry segment in which your proposed new business venture plans to compete? Please describe it in as much detail as possible.

Part 2

Using Michael Porter's five forces model guides the entrepreneur toward a measure of the competitive intensity of a proposed market. Please use this model to evaluate the anticipated competitive intensity in the industry or industry segment in which your business venture plans to operate.

1. New entry of competitors:

2. Bargaining power of buyers:

3. Substitute products or services:

4. Bargaining power of suppliers:

Part 3

List and describe the favorable and unfavorable characteristics of the industry.

Favorable	Unfavorable
1.	1.
2.	2.
3.	3.
4.	4.
5.	5.

Entrepreneurial Exercise 3.5

Based on a competitive analysis of the industry segment or segments in which you plan to compete, conduct an analysis of the **three major competitors** your research has identified. **Please use the format below for each of the three competitors:**

Part 1

Competitor: _____

Estimated market share:

Competitor's nature:

Sources of competitor's advantages:

- 1.
- 2.
- 3.

Competitor's strategies:

- 1.
- 2.
- 3.

Competitor's historic ability to respond to changes in the market niche:

- 1.
- 2.
- 3.

Competitor's historic ability to respond effectively to new market entries:

- 1.
- 2.
- 3.

Competitor's resources that will allow it to respond effectively to new competitors:

- 1.
- 2.
- 3.

Competitor's weaknesses that might be exploited by a new market competitor:

- 1.
- 2.
- 3.

Quality of the competitor's leadership (please describe):

Competitor's top three existing customers based on their loyalty to the competitor:

- 1.
- 2.
- 3.

Entrepreneurial Exercise 3.6

Competitive profile matrix: please create a competitive profile matrix similar to that illustrated in **Figure 3.4**, and compare your proposed new business venture with your top three competitors, which you identified in Exercise 3.5.

Entrepreneurial Exercise 3.7

Internal factor evaluation matrix: please create an internal factor evaluation matrix for your proposed new business venture. Make sure the matrix allows for an assessment of your firm's key internal factors, those that will contribute to success.

Entrepreneurial Exercise 3.8

In this exercise, you will create your new business venture's business model.

Part 1

Describe in detail the business model for your new proposed business venture.

Part 2

How have you incorporated your values and beliefs into your proposed firm's vision and its mission statement?

Part 3

At this point in the evaluation of your proposed new business venture, how confident are you of the firm's success?

Part 4

Do you have any reservations about your proposed firm's success? If so, what are they? If not, why not?