CHAPTER 3 The Environment for Entrepreneurship

The central task facing an organization which has entrepreneurial aspirations is to take advantage of the opportunities from change that appear in its environment.
—Sharon Oster

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Summary

LEARNING OBJECTIVES

After reading this chapter, you will understand

- the components of the *business environment*.
- the *process* of business environment analysis.
- the six segments of the *macroenvironment*, and the issues presented by each of them.
- what changes in the macroenvironment can become *sources of opportunity* for the entrepreneur.
- the five elements of the *industry environment*, and the components that affect each of these segments.

PERSONAL PROFILE 3

Getting Ideas from Books

Alex Zoghlin never stops learning, never stops scanning, and is always on the lookout for entrepreneurial opportunities. His recognition process is very successful.

Zoghlin is a high school dropout who earned his GED in the U.S. Navy, and then went on to study Mandarin Chinese and statistical economics at the University of Illinois. He is a voracious reader, a master scuba diver, and a black belt in Tae Kwon Do. He goes to work in downtown Chicago dressed in blue jeans, with his hair in a long ponytail hanging down his back, but no one objects because he's the boss.

Diverse interests have, in fact, made Zoghlin into a serial entrepreneur, now working on his fourth new venture. His first enterprise was Internet retailer, Sportsgear LLC. Then, in 1995, he founded Neoglyphics Media Corporation, a Web-site developer whose clients included General Motors, Amazon.com, and Nokia. After selling that company in 1998, Zoghlin, the son of a travel agent, became the number-one employee and chief technology officer of Orbitz.com, the e-ticket-for-consumers site developed by United, Delta, American, Northwest, and Continental Airlines.

While the sale of Orbitz and his earlier ventures have made him a rich man, 36-year-old Zoghlin still appreciates a challenge. His new company, G2 Switchworks, is built on software that makes it easier for travel agents to make travel plans for their customers. Zoghlin claims his product can locate the same information in less than 30 seconds as existing electronic networks like Sabre, Galileo, and Worldspan, which take up to eight minutes and multiple searches. G2 Switchworks has the backing of seven U.S. airlines and two private equity firms.

Zoghlin's opportunity-recognition process is primarily externally driven. He reports that he gets many of his ideas from reading business books. "A lot of people are technically competent, but they don't see how the technology is applied in everyday life or in business. Then you have people who are really good in business and finance, but they don't understand technology. I'm really lucky, I can connect the dots to both."

SOURCE: Adapted from Michael Arndt, "Voices of Innovation, High-Flying Dropout," *Business Week*, March 6, 2006: 22; and "Chicago Dropout Makes Good" Retrieved from the Web May 30, 2006. http://www.businessweek.com/magazine/content/06_10/b3974037.html.

SCHEMATIC OF THE NEW VENTURE'S ENVIRONMENT

WHAT does the world look like to the entrepreneur? What parts of that world are important for making entrepreneurial decisions and finding opportuni-

might appear to an entrepreneur—a series of concentric circles. The innermost circle represents the firm and its resources. This is the core of the entrepreneur's world; it holds the least amount of uncertainty for the entrepreneur. The next circle holds all the elements that are part of the firm's industry, but are not part of the firm itself. There is more uncertainty here. The largest circle represents everything that is not part of the

firm's industry, but is still important for the new venture. This is the **macroenvironment** in which the firm operates. This domain has the most uncertainty. Uncertainty is a barrier to entrepreneurship, but some people are willing to bear this uncertainty.[1]
There are six identifiable, though overlapping, segments within the macroenvironment:

1. Politics and government
2. Stakeholders
3. Macroeconomy
4. Technology
5. Sociodemography
6. Ecology

In this chapter, we will describe the characteristics and segments of the macroenvironment, as well as the characteristics and segments of the industry or competitive environment. The distinction between the two environments is somewhat artificial because, ultimately, institutions and organizations use them interchangeably. Indeed, the organizations and institutions themselves are also exchangeable. They come and go as society, technology, and the rules of law dictate. As new industries are created from new technologies or the desires of consumers, resources from deteriorating industries are converted for their use. The purchasing power of a declining industry's customers can be redirected either to a new industry or to another, more stable industry. Thus, the concentric circles representing the business environment appear as broken lines to depict the

FIGURE 3.1 Schematic of the New Venture's Environment

permeability of environmental boundaries and the possibility, indeed the necessity, of flow and exchange.

In the second half of this chapter, we will examine the competitive environment for entrepreneurship. To do so, we will use the model of competitive industry analysis popularized by Michael Porter of the Harvard Business School.[2] We will conclude the chapter by discussing how to perform a competitor analysis, based on our resource-based model, which can exploit industry opportunities and lessen the threats arising from unfavorable industry conditions.

PROCESSES OF BUSINESS ENVIRONMENT ANALYSIS

Most of the time, we think and analyze very quickly, and we are quite unaware that we are doing so. Sometimes, though, we must be more conscious of our thinking, and do our analyzing in systematic ways. This is the case when we are thinking about the environment for entrepreneurship. We want to make sure we are being comprehensive and analytical. Four separate (although sequentially related) tasks are required for a comprehensive entrepreneurial analysis: scanning, monitoring, forecasting, and assessing.[3]

Scanning

How does this comprehensive process begin? It begins by looking around. **Scanning** the environment is the process by which the entrepreneur first identifies the environment's key elements and their characteristics. It is a surveillance system for early detection. The goal of scanning is to detect change that is already underway. Successful scanning catches important changes early, giving the new venture enough lead time to adapt.

The prospective entrepreneur scans innumerable sources of data. *The Wall Street Journal, Business Week,* and the *Economist* are solid sources for obtaining the broad picture. Television provides a general and continual source of data through Cable News Network (CNN), network news, special reports, and documentaries. More specialized business programming is becoming increasingly popular on cable channels like MSNBC. Surfing the Internet has become an important scanning activity. In addition, through "people-to-people" interactive scanning, like Web logs (blogs), entrepreneurs consult with a variety of professionals and experts outside their fields of expertise. Accountants, lawyers, engineers, consultants, and, yes, even professors are available to the entrepreneur for information and advice. Scanning gives the entrepreneur a sensitivity to environmental conditions that sometimes looks like intuition.

Monitoring

Monitoring is the process of tracking the evolution, development, and sequence of critical events that affect the future business' survival and profitability. Data from the scanning process are used in the monitoring process. Specific trends and events are monitored in real time to confirm or disprove predictions about how they will affect the firm. Monitoring is less general and therefore more focused than scanning. The entrepreneur follows specific periodicals, consults select experts, and even convenes focus groups.[4] The result of the monitoring process is a detailed model of how various elements in the macroenvironment influence and affect the firm. The monitoring model, however, is not reality; rather, it is a workable version of cause and effect.

For example, consider Charlie Ayers, also known as Chef Charlie around Google corporate headquarters. Ayers ran the cafeteria at Google for six years. During that time, he carefully monitored the eating habits and the tastes and preferences of the Google workforce. The folks who worked at Google were the future target market for Ayers' own new venture. They were also potential sources of finance: A lot of Google employees became quite rich when the company went public. Ayers honed his recipes and tried new dishes. "I did most of my research on them," he said.[5] His restaurant, Calafia, in Redwood City, California, is a success and has been featured in the *New York Times*.

Forecasting

Forecasting enables the entrepreneur to develop plausible projections for the future. These can be projections for elements such as price level, the direction of interest rates, or future scenarios for cause and effect. For example, a typical forecast might be: If the money supply grows at above-target rates, inflation will occur. Thus, inputs for forecasts are the data collected from monitoring.

Forecasting includes a series of techniques that provide insight into the future. The specific techniques chosen for a task should correspond to the type of data used as input, and the nature of the desired forecast. When forecasting is used to help search for new business opportunities and to uncover potential macroenvironmental constraints on these opportunities, the following five-step process is suggested.[6]

1. *Choose* the macroenvironmental variables that are critical to the new venture. These will probably relate to the firm's resource base. For example, if a business generally hires low-wage, entry-level people, the minimum-wage costs and payroll taxes are critical variables.
2. *Select* the sources of data for the forecast. These will probably be those the entrepreneur has been monitoring. Data sources can be found in many places, including the local university or library. Internet searches can also produce forecasts.
3. *Evaluate* various forecasting techniques. Forecasters use different techniques and therefore sometimes produce different forecasts. For example, a firm might see a forecast that says the stock market is going up, and therefore conclude that this is a good time to go into business. But just how closely linked are the stock market and the firm? And is the stock market a leading indicator (the economy will be getting better) or a lagging indicator (the economy has already topped and may now be heading down)?
4. *Integrate* forecast results into a plan for the creation of the new venture. These results will probably include resource levels, resource availability, and sales forecasts. If sales are predicted to go up 5 percent to 6 percent, the firm must also plan on increased costs.
5. *Keep track* of the critical aspects of the forecast, meaning compare actual results with forecasted results. If and when a gap appears, it is time for another forecast, beginning at step 1. If the forecasts indicate that the industry can expect 3 percent to 4 percent gains for the coming year (as is frequently predicted in the restaurant indus-

try), it can plan for this level of sales increase. If the industry falls short of the forecast, it may have problems with its customer base and product offerings. If the industry achieves higher-than-forecasted gains, it had a good year and might raise its forecast for the following year.

Table 3.1 summarizes the costs and benefits of six quantitative and judgmental forecasting techniques. The criteria of cost and complexity are used. Cost is a useful criterion because it can be evaluated against the expected benefits to see if the activity is justified. Complexity refers to the difficulty of using the technique. This criterion helps us evaluate the risk involved so that we can weigh the cost/benefit analysis. Levels such as low, medium, and high are subjective, and depend on the venture's familiarity with the technique and overall financial position.

Assessing

Assessing the environment is the most difficult and important of the four environmental analysis tasks. Here the entrepreneur has to answer that most difficult of questions: What does it all mean? Interpretation is an art form, and so is assessment. In a poker game, players can agree on what cards are showing, the previous bets made, and the value of the cards they are holding. Some players hold, some fold, and others raise their bets. Because their assessments are different, their behavior is different. In assessing most entrepreneurial opportunities, there are few facts that people would agree can be generalized.

Although the four-part process described in this chapter seems quite analytical, it actually takes place over time in a mode that is more intuitive than rational. It is sometimes called *entrepreneurial insight* or *vision*. In Street Story 3.1, we see that if one is in the retail sector, one will have to scan, monitor, analyze, and forecast, because each year small changes in the environment bring about large changes in the competition.

Another model for opportunity analysis has been offered by Bhave.[7] New business

TABLE 3.1 Quantitative and Judgmental Forecasting Methods for Emerging Industries, New Ventures, and New Products

Method	Description	Complexity	Cost
1. Sales force estimate	A bottom-up approach that aggregates unit demand	Low	Low
2. Juries of executive opinion	Forecasts jointly prepared by experts in a functional area	Low	Low
3. Customer surveys: market research, focus groups	Intentions of potential customers and final users	Medium	Medium
4. Scenario development	Effects of anticipated conditions imagined by forecasters	Medium	Low
5. Delphi method	Expert guide to consensus	Low	Medium
6. Brainstorming	Idea generation in a noncritical group situation	Low	Medium

SOURCE: Adapted from J. Pearce and R. Robinson, Strategic Management, 4th ed. (Homewood, IL: Irwin, 1991).

STREET STORY 3.1

Tweaking the Retail Environment

It looks more like a store selling fine jewelry instead of women's clothing.

It has small, eye-level display windows with dramatic lighting, and a luxurious interior décor. In the center of the store, there is a circular dressing room—no, *fitting salon*—with three-way mirrors and adjustable lighting where salespeople—no, *style consultants*—offer customers complimentary bottled water, and bring them garments from collections with names like Allegory and Prize. Forth & Towne is the newest offering from the people who brought us Gap, Old Navy, and Banana Republic, and its target market is women over 35 with money.

Scanning the American retail environment has convinced a number of retailers to focus on middle-to-upper-class consumers, or customers who at least want to look upscale. Macy's has widened its aisles, added plush sofas to its department stores, and replaced coupon advertising with image-building commercials. Wal-Mart is running ads in the fashion magazine, *Vogue*. Chains like Gap and Chico's FAS are unveiling concepts tailored to the fashion dreams of specific age groups; Abercrombie & Fitch now has Little A stores for kids, Hollister for high school students, and Ruehl for college students and older shoppers.

Technological monitoring is enabling retailers to target the customers they want with the products they want to pitch to them. The club cards that grocery stores have been using for years are now spreading to noncommodity stores like Borders bookstores, and retailers are using the data they collect with those cards to offer customers customized discounts on the kind of pet food they buy, or to tell them about an upcoming release from their favorite author. Retailers such as the jewelry chain, Zale Corporation, plan to use the information they collect as a guide for future marketing. Some of today's monitoring methods are rather low tech: Clothing retailers are using private-label house brands to evaluate fashion trends, offering expensive garments to customers at relatively low prices.

Forecasting trends have persuaded some retailers to make physical changes to lure well-heeled shoppers. Enclosed shopping malls are being replaced across the country with lifestyle centers where open-air walkways are lined with smaller boutique merchants instead of big-box stores. The most popular lifestyle-center tenants are those that cater to an upscale good life: stores like Williams-Sonoma, Barnes & Noble, Pottery Barn, and Victoria's Secret. The decline of the mall has motivated traditional shopping center anchors like J.C. Penney and Sears, Roebuck & Co. to experiment with stand-alone stores. Some developers are replacing demolished malls with new retail districts where stores are blended into a mix of office and residential tenants, creating an innovative white-collar neighborhood.

Some of these new retailing trends are too new to produce much assessment, but some retailers have obviously decided that size matters. Once independent department stores Macy's, Bloomingdale's, Filene's, Lord & Taylor and Marshall Field's, are now combined under one umbrella, allowing them to increase their advertising clout and leverage with suppliers on their quest to attract well-to-do shoppers.

SOURCE: Adapted from Kris Hudson, "Upscale Experience, Downscale Prices," *The Wall Street Journal*, November 21, 2005. Retrieved from the Web March 4, 2006, http://www.online.wsj.com/article_print?SB113225094874700333.html, and www.forthandtowne.com.

UPDATE: Fourth and Towne announced it would close all its stores in June 2007.

development and entrepreneurship are processes (a series of events and decisions) that lead to a specific outcome (the creation of a new venture). The process begins with opportunity recognition. The sources of opportunities have two points of origin: **internally-stimulated opportunity recognition** and **externally-stimulated opportunity recognition.**

Externally-generated opportunity recognition occurs after the entrepreneur decides to start a business. He or she scans the environment for opportunities, and generates a set of possibilities—but which possibilities should the nascent entrepreneur pursue? The entrepreneur must have some criteria from which to choose. Thus, he or she filters these possibilities, then compares their requirements against his or her skills, resources, experiences, and desires. Usually, but not always, the entrepreneur decides which business opportunity to pursue based on his or her skills, abilities, experiences, and preferences. The exception is when the entrepreneur needs very specialized expertise. Here, he or she may hire outside people.

Once the entrepreneur commits to a suitable idea, he or she refines the idea into a business concept or model. This opportunistic search is the externally driven one. The Chapter 2 profile of the Baker Boys is an example of an externally driven opportunity. The twins looked outward and found ways to make money, regardless of where this path took them.

Internally driven opportunity recognition precedes the decision to start a business. The individual sees a need or a problem related to his or her own experiences at work, a hobby, or some strong belief or value that he or she holds. The individual may be able to solve the problem alone, only afterward realizing that others have the same problem—and are willing to pay to get it solved. Often, the entrepreneur starts to think of the problem and its solution as a business opportunity only after this realization. In other cases, this realization may strike the individual as soon as he or she has identified the problem. In either case, the wish to start a venture comes after the entrepreneur recognizes the problem to be solved, and typically only one "opportunity" is considered. A general advantage of this process is that the entrepreneur will typically do a good job of matching this opportunity with the interests and competencies of the persons pursuing it. Moreover, the entrepreneur will prove at least some level of demand before he or she decides to "go for it." On the downside, we find the fact that people who "stumble" over opportunities related to their personal life in this way may have less motivation and fewer skills needed to successfully start and run a business.

Betty Morris provides an example of internally driven opportunity recognition. The last thing Morris wanted was a career in the toy industry. All she intended that afternoon in her kitchen was to entertain a gaggle of eight-year-old Scouts. She decided that it would be fun and productive to make something, so she found a craft book and studied it for an appropriate activity. She followed the directions on how to make plastic trinkets, and was delighted with the charms she created—Shrinky Dinks. Morris and another mother, Kathryn Bloomberg, decided to invest $1,200 in 1,000 pounds of 8-inch by 10-inch sheets of plastic. The two women formed a partnership, K&B Innovations, and began assembling kits. The toy was introduced at a booth in a mall and received inquiries from 16 different stores. "Companies came out of the woodwork wanting to negotiate some kind of licensing agreement with us," says Morris.[8]

POLITICAL AND GOVERNMENTAL ANALYSIS

Politics is the art of the possible. We could say the same thing about entrepreneurship. Analyzing the political scene will give the entrepreneur a feeling for what is possible, what is probable, and what is unlikely. The political and governmental segment of the business environment is the arena in which different interest groups compete for attention and resources to advance their own interests, establish their own values, and achieve their own goals. It is where particular individuals and groups exercise political power. To a large extent, the individual entrepreneur is forced to accept the current political environment of the new venture. Collectively and over time, however, an organized group of entrepreneurs can influence the political sector. One such group, the National Federation of Independent Business (NFIB), lobbies hard for issues that affect entrepreneurs and small businesses. One can register with the NFIB free of charge, and monitor its Web site at http://www.nfib.com/page/home.

Global and International Issues

Although the entrepreneur may *think* that his or her business is strictly local, this is true of very few businesses. We are all interconnected in a global economy, and events that occur thousands of miles away can influence our businesses. The main global issues are trade barriers, tariffs, political risks, and bilateral and multilateral relationships. All of these issues are interrelated.

Trade Barriers and Tariffs. **Trade barriers** and **tariffs** hinder the free flow of resources across national boundaries. They are the result of economic interest groups within a country attempting to prevent transnational competition. The trend today is to reduce trade barriers worldwide.

Trade Agreements. Since World War II, and especially since the end of the Cold War, the trend has been toward increased trade agreements. These country-to-country and regional agreements have set the economic rules businesses follow when they are interacting with other businesses within the cosigning group of nations.

Political Risk. The potential for instability, corruption, and violence in a country or region is known as political risk. Political risk is an important variable, because in areas where it is high, resources are difficult and costly to procure, protect, and dispose of. Further, the risk of governmental nationalization and the legal appropriation of firms is always present. (Even in a stable democracy, people can vote to take away other people's money.)

National Issues

Political and governmental analysis at the national level refers to taxation, regulation, antitrust legislation, government spending, and patent protection.

Taxation. The primary political factor facing the entrepreneur is taxation. Governments require large amounts of money to promote the public good and carry out the will of the people (stakeholders). However, taxation reduces the cash available to a firm for reinvestment. Thus, the entrepreneur may invest or reinvest not the economically rational amount, but a somewhat lower amount—his or her after-tax earnings. The outside investor too must calculate returns after taxes, which means that required rates of return must be high enough to cover the government's share. Some new ventures are not able to generate outside financing because their after-tax returns to investors will simply be too low to justify the investment.

Taxation affects not only individual businesses, but also the relationships between businesses, giving some firms advantages over others. Special tax breaks for certain industries, such as depreciation and depletion allowances, benefit the firms that receive them. Capital-intensive companies, such as manufacturers, benefit disproportionately from the tax shield that depreciation affords. On the other hand, service businesses with large investments in training and development cannot depreciate their employees. The differential tax treatment given to interest and dividends under the U.S. Tax Code favors firms that can obtain bank loans and other forms of debt over equity-financed firms that pay dividends and whose investors receive capital gains. Because "bankable" businesses—those that usually receive bank loans—are generally older firms with physical assets than can serve as collateral for a loan, new ventures (especially service businesses) are disadvantaged by the current tax code.

Taxation also has a global effect. Different countries treat dividends, interest, and capital gains in different ways. For example, Japanese firms pay very low dividends relative to their German and U.S. counterparts because dividends are more highly taxed in Japan. Thus, the Japanese investor prefers capital gains, which are not taxed at all, thus enabling Japanese firms to keep more cash for reinvestment.[9]

Regulation. Government agencies control the flow of resources to firms and the property rights of business owners through federal regulation. The government creates these agencies in response to a special-interest group or a group of stakeholders to protect its interests, values, and goals. Regulation is not inherently bad; we all belong to one special-interest group or another. For example, we all eat and take medicine at some time. The Food and Drug Administration, with its regulatory function, helps protect our interests in these matters.

The effects of regulation on business, however, are sometimes negative. Regulatory agencies impose significant costs on firms in forms such as paperwork, testing and monitoring, and compliance. These costs may or may not be recoverable through higher prices. If the industry being regulated has good substitutes for its products, and the substitute industry is less regulated, the firms in the more highly regulated industry must absorb the costs, and profitability suffers. These costs result in less reinvestment and an overall lower output in the regulated industry. If the industry can charge higher prices, the public eventually pays for the protection and services conferred by the regulations.

Antitrust Legislation. Each national government determines the level of antitrust activity it will enforce. The United States has the toughest antitrust laws in the world. The antitrust division of the United States Justice Department was a driving force in the breakup of AT&T, and in Microsoft's change in strategy, from a passive observer of federal legal policy to an active lobbyist. Other countries, most notably Japan, have a different view of antitrust regulation. In these countries, the zeal of regulatory enforcement may be a function of national economic interests (such as balance of trade or currency exchange). When national interests collide with consumer or entrepreneurial interests, national interests have priority. Generally, new ventures are not in danger of violating antitrust laws; they are more likely to be victims of lax antitrust enforcement.

Patent Protection. National governments grant patents and enforce patent laws. A patent is legal property that enables its holder to prevent others from using a product or service for a specified period of time. There are three types of patents:

1. **Utility patents,** which cover new articles, processes, machines, and techniques
2. **Design patents,** which cover new and original ornamental designs for manufactured products
3. **Plant patents**, which cover various forms of life, and genetically-engineered organisms

A patent is a resource and therefore can be analyzed using our resource-based model. In countries where patent enforcement is lax, a firm may need to weigh the costs of publicly divulging its technology against the benefits of having patent protection before applying for one.. In many cases, small changes to a product or design erode patent protection enough to make the patent worthless. In the United States, patents and trademarks are managed from the U.S. Patent and Trademark Office (http://uspto.gov). Here we can find out how to file a patent or trademark, or do patent and trademark searches to ensure that we are not violating someone else's patent or mark.

Recently, businesses have tended to seek patent protection for the *way* they do business, making minor distinctions in the processes they use. These are known as *business process* patents. For example, J. M. Smucker, the Orrville, Ohio, jam maker, attempted to patent its method for making Uncrustables. Uncrustables are round, sealed, crustless sandwiches. Smucker's already had a patent on the sandwich, but wanted to expand the patent to include how the sandwich was made. They argued that they used a compression method versus the "smushed" method employed in making tarts and ravioli. A federal appeals court judge rejected their application, holding that the patent extension failed the test by being "obvious." A spokesperson for Smucker's said, "It wouldn't be fair to let another company simply copy the product and benefit from the hard work our people invested."[10]

Government Spending. In most countries, the national government is the largest purchaser and consumer of goods and services. The government is therefore a large market, and it displays preferences for certain products, services, and suppliers. These preferences are influenced by pressures from the various interest groups, stakeholders, and political organizations that constantly lobby the government. At times, the political winds seem to favor defense spending and new entrants into defense and related industries. At other times, government priorities may work to the benefit of building infrastructure or developing social programs. In the latter case, the beneficiaries would include construction contractors, consultants, and related service industries.

State, Regional, and Local Issues

State, regional, or local tax policies can create opportunities or disadvantages for the entrepreneur. At the state level, three other areas affect business: licensing, securities and incorporation laws, and economic development and incentives.

Licensing. Licenses are economic privileges granted to individuals and firms that enable them to legally conduct a business. Not all businesses require licenses, but many do. At one time, licenses were valuable franchises and a way of limiting entry and raising quality within a particular industry. Today, however, state and local authorities often consider licenses a revenue source and do little to monitor the performance level of the licensees. The entrepreneur must remain watchful of current licensing regulations and potential changes to upgrade enforcement that could affect the new venture.

Securities and Incorporation Laws. Many security regulations and incorporation laws are written and enforced by the states. Because the U.S. Constitution does not specifically grant the federal government the power to regulate business incorporation, this is one of the major regulatory roles left to the states. Although the federal government does have an important regulatory role under the Securities Act of 1934, which created the Securities and Exchange Commission, new incorporations are granted and monitored at the state level. Most early financing that the firm receives is covered by state securities regulations. Entrepreneurs need to employ lawyers and accountants to ensure that the firm complies with all state regulations.

Incentives. State and local authorities control the granting of economic-development incentives and tax abatements to new or old businesses relocating within their jurisdiction. These incentives can be a powerful stimulus for new firms. They may include subsidized job-training programs, real estate improvements and favorable real estate tax treatment, and improved infrastructure (e.g., roads and interchanges, sidewalks, water and sewer improvements). Local governments also control zoning ordinances and laws, which determine how property can be used and developed. Every firm has a local component. Entrepreneurs can scan and monitor these developments, especially when considering where to locate.

State and local agencies also can pose serious barriers and disincentives. For example, in the Philippines, the local government can require that an entrepreneur conduct 11 different procedures to set up a new venture. In the Organization for Economic Cooperation and Development (OECD), the average number of procedures is six. Pablo Planas invented a fuel-savings device for cars and motorbikes. Unfortunately, he invented the device in the Philippines 30 years before he could put it into production. He hassled with the lack of infrastructure and bureaucracy for the longest time, but eventually, he made the device and founded Khaos Super Gas Saver. “I was one of the lucky ones,” he said.[11]

At the municipal level, taxation again erodes the firm’s ability to finance itself and reward its investors. Local taxes include income and property, sewer, water, and waste disposal. If local taxes can be allocated to particular services that the local government provides for business use, they are not really taxes but fees for service.

In summary, the entrepreneur must be knowledgeable about a variety of political issues, particularly those related to securing, protecting, and disposing of resources. The effect of political power on property rights is of primary concern. Table 3.2 presents the four levels at which political and governmental analysis should be performed.

STAKEHOLDER ANALYSIS

How many different individuals, groups, and interests can influence the survival, development, and profitability of the new venture? Quite a few. In this section, we will discuss **stakeholders** and stakeholder analysis.

Stakeholder analysis helps the entrepreneur identify which groups and interests are friendly to the new venture and which are hostile. It enables the entrepreneur to see whether any groups have an immediate affinity for the product or service, and whether this affinity can be translated into a market. The analysis also reveals trends regarding consumer attitudes and behavior for the new venture's products, competing products, and complementary goods.

Seven Dimensions

Stakeholders' influences can be both positive and negative. Not all stakeholders are alike. Stakeholders may vary along the following seven dimensions[12]:

Resource capability: The degree to which stakeholders have access to resources that help influence businesses or agencies that can be categorized in the same way as described in Chapter 2 (financial, physical, technical, reputational, human, and organizational; rare, valuable, hard to copy, and nonsubstitutable).

Extent of influence: The degree to which the interest group is able to promote its agenda. Some stakeholders are organized as lobbying groups and have enormous influence—for example, the National Rifle Association or Mothers against Drunk Driving.

Degree of organization: The extent to which stakeholders are organized for collective action locally, regionally, and nationally. Some stakeholders are very well organized

TABLE 3.2 Political and Governmental Concerns

Global	National	State and Region al	Local
Trade barriers	Taxation	Taxation	Taxation
Trade agreements	Regulation	Securities law	Zoning
Tariffs and duties	Antitrust legislation	Licensing	
Political risk	Patent protection	Incentives	
	Government spending		

and influential. Others are disorganized or incompetently managed organizations. They do not represent a significant threat to existing firms.

Nature of interest: The type of agenda the interest group has: a specific agenda (e.g., cleaning up toxic waste sites) or a general agenda (e.g., making business responsive to people's needs).

Duration: The length of time the interest group has been active and its potential staying power. Sometimes stakeholders are interested in issues that prove to be fads or of passing interest. This is especially true in areas such as consumer goods, travel, and leisure industries.

Degree of manifestation: The ability of the interest group to take its case directly to the public or to the media.

Bases of influence: The extent to which an interest group can gain support from other interest groups that share an affinity for similar causes.

Kauffman Foundation

The Kauffman Foundation is one of the most important nongovernmental organizations (NGO) to become a stakeholder for entrepreneurs. It is formally known as The Ewing Marion Kauffman Foundation of Kansas City, Missouri (http://www.kauffman.org/). The Kauffman Foundation supports education, research, and community-based action to help promote new venture creation and entrepreneurship. For example, when the foundation became aware of a study showing that minority-owned businesses were growing rapidly but were faced with financial problems, it established a coalition with the National Urban League and other organizations to address the issue. When Hurricane Katrina devastated the Gulf Coast of the United States and New Orleans, the foundation drew up plans to offer entrepreneurs intensive help and free advice.[13]

MACROECONOMIC ANALYSIS

The macroeconomy is the total of all goods and services produced, distributed, sold, and consumed. Where does all of this activity take place? It happens at the global, national, and local levels. Each level has its own macroeconomy, and the sum of all the lower levels is the global economy. These geographic distinctions are important to policy makers because policy makers' power and influence are usually constrained by geographic limits. These geographic distinctions are also important to the entrepreneur because, to a greater or lesser degree, every business is entwined in all three macroeconomies. The entrepreneur should analyze all three macroeconomies, but the time he or she spends on any one of them should be proportional to the potential impact on the firm's performance. Macroeconomic change can occur at any of the three geographic levels discussed previously.[14] There are two types of macroeconomic change: structural change and cyclical change.

Structural Change

Structural changes in the macroeconomy are major, permanent shifts of resources and customers from one sector of the economy to another. As these shifts occur, the financial capital, physical resources, and employees diminish in an industry that is fading, and flow to the emerging industry. An example of recent structural change can be found in the newspaper industry. News-gathering capability, advertising dollars, financial resources, and technological innovation have been transferred from the printed newspaper industry to the Internet and the electronic news and information industry. Some newspapers were able to make the adjustment, such as *The Wall Street Journal*, which has the largest paid Internet subscription base in the United States. Other newspapers have lost business, gone out of business, or been bought by investors looking to milk these cash cows. Without new investment and innovative strategies, this industry may become a dinosaur.[15]

Cyclical Change

The second type of macroeconomic change is **cyclical change**. The macroeconomy enjoys periods of growth followed by periods of contraction. These alternating time periods form what is called the **business cycle**. Business cyclicality is the degree to which the new firm follows the trend of the business cycle. A venture that grows and contracts as the economy does is **procyclical**. An example is the automobile industry and its suppliers. People buy more cars when their wages are high and rising and they feel their jobs are secure. Thus, when the economy is good, car sales are good, and when it is poor, car sales are slow.

A **countercyclical** industry has just the opposite pattern. Sales are better when the economy is poor and wages are down. To a large extent, the fast-food industry is countercyclical because, when people are economizing on eating out, they tend to choose lower-cost restaurants. A venture that is unaffected by the business cycle is **acyclical**. For example, consumer staple industries are frequently acyclical because people need soap and soup, shampoo, and light bulbs regardless of how the economy is performing.

Understanding the new venture's relationship to the business cycle is crucial to the entrepreneur because it is difficult, if not impossible, for the new business to run counter to its natural cyclicality. Thus, if the firm is in a procyclical industry and the current trend in the business cycle is downward, the firm will have a difficult time ignoring this trend by expanding. Clearly, the entrepreneur needs to scan and monitor the economic variables that indicate the direction of economic trends.

TECHNOLOGICAL ANALYSIS

What is technology? **Technology** can be defined as "the branch of knowledge that deals with industrial arts, applied science, and engineering," and "a process, an invention, or a method." The first part of the definition tells us that technological analysis is concerned with the "what" of science. Technological analysis, then, requires scanning and monitoring from the time of basic research through product development and commercialization. The second part of the definition implies that technology is also concerned with the "how" of science. Therefore, a complete technological analysis also includes scanning of operations and manufacturing techniques. Technological change takes place in two ways: (1) through pure invention (and scientific discovery), and (2) through process innovation.

Pure Invention

Pure invention is the creation of something that is radically different from existing technologies or products. Because pure invention is different, it has certain characteristics that are economically interesting. An invention may have no competitors at its birth, thereby giving a monopoly to the individuals who hold its legal rights. The disadvantage at this time is that the invention also has no market. Further, there may never be a market for the commercial version of the invention. The combination of the monopolist upside with the no-ready-market downside makes the economic aspect of invention risky because the outcomes are potentially so variable.

New inventions can create new industries. The invention of the semiconductor created the computer industry in all its forms. The scientific discoveries made by geneticists created the biotech industry with all of its niches and segments. In the initial phase of such technologies and discoveries—the creation of products and markets— entrepreneurs play the most important role. Over the product's life cycle, large organizational units develop to exploit these products and markets as they mature.

Process Innovation

After an invention has been successfully commercialized, the second type of technological change, **process innovation**, becomes dominant. Whereas pure invention is radical and revolutionary, carrying with it the potential to create new industries, process innovation is incremental and evolutionary. Its purpose is to make existing industries more efficient. Process innovation refers to the small changes in design, product formulation and manufacturing, materials, and service delivery that firms make to keep their product up-to-date and their costs down. Table 3.3 presents the ways in which technology and key related variables change over the course of the product life cycle. The table headings show the product life-cycle stages: introduction, shakeout, growth, and maturity. The left-hand column gives the important dimensions for product innovation, such as who is in charge and how the innovation process is organized. For example, we can see that major innovations are most likely in the introduction and shakeout stages, while incremental innovation is more prevalent in the growth and maturity stages. We will discuss the table's bottom line, Organization Structure, in more detail in Chapter 9.

Frequently, process innovation improvements are made by people working for large companies. If these companies are not the best place to fully exploit these improvements, the people who make them may decide to become entrepreneurs. They literally spin themselves and their new product into a new venture.

The critical question for the entrepreneur should be: Which innovations have the best chance of success? An academic study of these factors reported the results of 197 product innovations (111 successes and 86 failures). The researchers found that the successful innovations had some or all of the following characteristics:

1. They were moderately new to the market.
2. They were based on established technology.
3. They saved customers money.
4. They met customer expectations.
5. They supported existing processes and procedures.

TABLE 3.3 Forms of Technological Change Over the Product Life Cycle Stages

	Product Life-Cycle Stage			
	Introduction	*Shakeout*	*Growth*	*Maturity*
Type of innovation	Major product innovation or invention	→ Major product innovation or invention	→ Incremental product or major process innovation	→ Incremental product or process innovation
Location of innovation	Entrepreneur	→ Marketing and R&D	→ Marketing and production	→ Production
Bases of competition	Product, performance, or novelty	→ Product, performance, or novelty	→ Product differentiation or price	→ Price, image, minor differences
Production process	Job shop	→ Batch	→ Islands of automation	→ Assembly line or continuous flow
Dominant function	Entrepreneur	→ Marketing/R&D	→ Marketing/production	→ Production/sales and promotion
Management role	Entrepreneur	→ Sophisticated market manager	→ Administrator and integrator	→ Steward
Modes of integration	Informal communication	→ Informal communication, task forces and teams	→ Informal communication, teams, project manager	→ Formal communication, senior management, committees
Organization structure	Free form	→ Functional organic	→ Project/matrix	→ Functional bureaucratic

SOURCE: Adapted from W. Moore, and M. Tushman, "Managing Innovation over the Product Life Cycle." In Tushman and Moore (eds.), ***Readings in the Management of Innovation*** (Boston: Pitman Press, 1982): 143.

The study concluded that the failures were either too cutting edge or too "me-too"; there were no suggestions for how to improve them. The study also looked at the sources for the innovation and found six of them: need spotting, market research, solution spotting, trend following, mental inventions, and taking advantage of random events. Of these, the greatest number of failures derived from trend following and mental inventions (no basis in the market). Need spotting accounted for twice as many successes as failures, market research four times the successes, and solution spotting seven times the number of successes. What was the best source of ideas? Taking advantage of random events! This process accounted for 13 times more successes than failures. Why? Only the most flexible organization with the best resources can take advantage of serendipity. It is the hardest thing to copy.[16]

SOCIODEMOGRAPHIC ANALYSIS

The sociodemographic phase of business environment analysis has two closely-related aspects: demographics and social trends (sometimes referred to as *lifestyle trends*). The interaction that results when these elements combine is known as *popular culture*. Enormous business opportunities in consumer and durable goods, retailing and services, leisure and entertainment, and housing and construction are found in a society's popular culture.

Demographics

Demographic changes are a major source of long-term social change. **Demography** is the study of trends in human populations: the size of the population and its various subgroups; the population's age structure, geographic distribution, and ethnic and racial mix; and the distribution of income and wealth within the population. Demographic change refers to changes in any of these variables as well as changes in the relationships between them. Demography is destiny, because all of these factors form the essence of consumer demand, industrial capacities, and purchasing power. Markets are created from demographic analysis.

We obtain some of the best demographic data from the census. In the United States, a census is taken every 10 years; the results for the most recent 10-year period (1990–1999) are available at http://www.census.gov. A number of important trends emerged from comparing the last 10-year period with the first 10-year period of the twentieth century.[17]

First, it is clear that we are living longer. The most significant increases in life expectancy are found among older people. During the second half of the twentieth century, life expectancy for people in their 70s grew by an additional 5 years, to age 82. Seniors today are living substantially longer and healthier lives. One of the most studied and targeted demographic segments is the baby boomers. Baby boomers are those born between 1946 and 1960; they represent over 76 million consumers—almost 27 percent of the total population. Table 3.4 provides some key statistics on this group.

We can learn more about the "mature" market and how to target it from Street Story 3.2.

Immigrants are once again an important demographic in the United States. The major new groups of immigrants come from Korea, Haiti, Vietnam, and Mexico. In fact, Hispanics constitute the second-largest ethnic group in the United States (after people of European descent). The Census Bureau considers a Hispanic any person whose national origins are Latin America or Spain (e.g., Cubans, Mexicans, Puerto Ricans, Dominicans).

Entrepreneurs have emerged to serve this market. For example, Bill Kulik started his own radio network to broadcast Boston Red Sox baseball games in Spanish. His company, Spanish Beisbol Network Incorporated, was incorporated in 2002. He is commentator, engineer, and chief marketing person. As the Hispanic market is growing at more than 8 percent per year, and because approximately 30 percent of all major league baseball players speak Spanish, Kulik figured that his network would offer a great way to reach his target market. But he had problems, mostly financial. "Every newspaper article I saw said that the Latin market was booming. But I never expected it to be this hard," he noted. Nevertheless, Kulik seems to have become a cult figure and is working toward becoming a successful entrepreneur.[18]

Third, the population of the United States is moving south and west. California is our largest state, with over 34 million people. Twenty-two percent of Americans live in the West; that percentage would be higher if the Census Bureau counted Texas as a southern state. The South, then, is the largest region, with 36 percent of the total population, which may make the air conditioner the most important invention in the history of U.S. demographics.

The total population of the United States is growing, too. It is now slightly over 300 million people. Only China and India have larger populations,[19] which explains why companies want to sell to these markets.

Social Trends and Values

Social trends refer to the modes and manners in which people live their lives. Lifestyles reflect people's tastes and preferences from an economic standpoint. Lifestyle-related

TABLE 3.4 Targeting the Baby Boomers

Descriptor Variable	Numerical Value
Percentage women	51%
Percentage minorities	16.9%
Number already 50+	32 million
Average annual spending	$45,654
Divorce rate	14.2%
Percentage who never married	12.6%
Percentage who voted in 2000	59%
Percentage who finished high school	88.8%
Percentage with bachelor's degree or higher	28.5%

SOURCE: "Boomers by the Numbers," The Wall Street Journal, September 26, 2005: R4. Adapted from Metlife Mature Market Institute data. (http://www.metlife.com).

STREET STORY 3.2

Moving from Boom to Zoom

A senior vice president at Home Depot, Inc. calls them "a really sweet spot." That's why his company recently announced plans to install information kiosks in 80 of its Florida stores to specifically help that sweet spot—50-year-old-plus baby boomers—get advice on making changes to the kitchens, bathrooms, entryways, and hallways of their homes in preparation for postretirement life.

Seniors have become the hot prospect in marketing today, and the hottest of them all are the *zoomers*, meaning those baby boomers born between 1946 and 1955. "They're in high-income years and are still young at heart," says Lois Huff, an executive with the Ohio consulting and research firm, Retail Forward, Inc.

By 2010, about one-third of the U. S. population will be at least 50 years old. The boomers already control an estimated 67 percent of the country's wealth. "They are a big consumer group with a lot of buying power," notes Mitch Rhodes, president and CEO of Safeway.com, an online service for grocery and pharmacy deliveries.

Convenience is one of the keys to attracting this demographic group. Because older shoppers have historically dominated catalog shopping, five years ago a company called Newgistics, Inc. developed a prepaid, preaddressed, bar-coded label for mail-order companies like Lands' End. Customers can use the catalog to return merchandise without standing in line at the post office. "Baby boomers were in mind as a large part of the direct-shopper crowd when the company was born," says a company spokesperson. A 2004 Harris poll found that a convenient return policy was important or very important to shoppers between the ages of 55 and 64, and that more than 90 percent of this group said ease of return was likely to affect their decision to shop with that retailer again.

Novelty items like kayaks and Segway people movers have helped to draw 50-plus vacationers to resorts like Amelia Island Plantation. "It's a gadget," comments Richard Goldman, marketing vice president, on the appeal of the stand-up scooters that older vacationers use for ecology tours. "Baby boomers are big on trying something new." Safeway.com has discovered that upscale goods are important to zoomers, too. The company now has its butchers custom-cut meat orders for its delivery service instead of having the orders picked from the packaged-meat selection. Safeway has also added party goods like deli trays to their offerings, and has provided its order pickers with additional training to make them more responsive to older shoppers' discerning tastes.

The one thing that doesn't seem to attract this affluent group is the word *senior*. "We're very sensitive about using the 's' word," says Amelia Island's Goldman. To avoid using this word, the resort decided to christen a skin treatment for menopausal women *The Baby Boomer Facial*. "We can use the term because there's a certain amount of affection in it," Goldman says. He reports that the treatment has now become the third most popular facial at the resort.

SOURCE: Adapted from Jeanette Borzo, "Follow the Money," *The Wall Street Journal*, September 26, 2005. Retrieved from the Web February 23, 2006. http://online.wsj.com/article_print/SB112724418267446432.html.

variables that affect new venture creation include household formation, work modes and labor-force participation rates, education levels and attainments, patterns of consumption, and patterns of leisure.

Scanning and monitoring lifestyle changes are relatively easy because many diverse sources of data are available. Much of this data is aggregated and therefore suggests trends. There are both public and private sources for demographic data. The national government, through its agencies, bureaus, and regulatory bodies, collects vast amounts of data. Trade publications and specialist magazines and newspapers contribute demographic analysis. Consumer reports and the annual reports of corporations furnish additional details. One publication, *American Demographics,* is specifically designed to ferret out unusual and important trends.

Social values and social change together form an important component of sociodemographic analysis. "A **value** is a conception, explicit or implicit, distinctive of an individual or characteristic of a group, of the desirable, which influences the selection of available means and ends of action."[20] Simply stated, this statement means that the choices we make reflect our values. The values that individuals and groups hold cluster around the dimensions of the macroenvironment discussed earlier in this chapter. People hold political values relating to the role of government, political participation, and distributive justice.[21] They hold regulatory values concerning issues such as consumerism and energy policy. Their social values reflect their beliefs about work, the relationship between races, and the significance of gender. Their economic values are reflected in the choices they make about growth and taxation. Some of these values are at the core of an individual's belief systems, and others are on the periphery.

Of course, people within the same country may have diametrically opposite values. For example, the United States is one of the largest church-going countries in the world. We could make the case that Americans are a religious and pious people, devoted to serving a higher power. But then what do we make of the mass media, which occasionally borders on the libertine, our vast consumption of tobacco and alcohol, and our high divorce rate? To avoid wrongly characterizing a value held by a group, an analyst must be sure that he or she is investigating the right subgroup.

ECOLOGICAL ANALYSIS

Ecological analysis is the study of the current state of the ecology. The **ecology** pertains to such issues as pollution and waste disposal, recycling of usable materials, protection of wildlife and wilderness preserve areas, workplace safety and hazards, and overall quality of life. Ecological analysis cuts across all the other areas already discussed: politics and government, the macroeconomy, technology, and lifestyle. Ecological issues are bottom-line concerns; the entrepreneur must be as accountable for them as any other businessperson or citizen . Ecological awareness goes beyond simply addressing the manufacturing issues of pollution and waste.

The entrepreneur is part of the world movement toward **sustainable development**, that is, meeting the needs of the current generation without compromising the needs of future generations.[22] Future economic progress must be guided by ecological conservation. The ecosystem and its protection enter into all major entrepreneurial and business-development decisions. For example, product development and design issues take into account the rate of usage and transformation of natural resources and the disposal of waste products. Entrepreneurs should make decisions about these matters in the planning stage of a business, not at the crisis stage. In addition, financial calculations should fully value natural resources for their current worth and their potential value to future generations. Undervaluation of natural resources causes waste and overdemand. The time at which entrepreneurs could run the earth like a business in liquidation has long since passed.[23]

General Electric (GE), one of the largest companies in the world, has an initiative called *ecomagination*. As part of this initiative, GE teams with Dow Jones & Company to promote a competition for the best business plan for an innovative, environmentally friendly venture. The prize is $50,000. The winner in 2006 was Mr. Robert R. Wright. His idea was for potable water, and his plan fit the prize criteria: (1) innovative and beneficial to the environment, (2) a clear path to profitability, and (3) a persuasive and logical presentation. Wright has spent his entire career, over 40 years, working in the field of water management and wastewater. He is an author, consultant, and a partner in his own firm. He cares deeply about the environment, and he knows water.[24]

COMPETITIVE ANALYSIS

The tools of competitive analysis are derived from economics, the so-called dismal science. Jokes are sometimes told to illustrate how deflating economics can be to entrepreneurs. So let us begin with a joke.[25] A student and her economics professor, while walking together across campus, were engaged in a serious discussion concerning the price elasticity of demand for a college education. As they walked, the student's eyes fell on a piece of paper on the pavement ahead of them. As they drew closer, the student could see that the paper was a $20 bill. When they were upon the bill, the student bent down to pick it up. "What are you doing?" asked the economics professor. "There's a $20 bill on the walk," replied the student. "Nonsense," said the professor. "If there were a $20 bill on the ground, someone would have picked it up by now."

This joke demonstrates that a strong belief in the all-powerful, efficient-market model of economics can prevent a person from seeing an opportunity, even when that opportunity is right under his or her nose. The economics professor cannot believe that a $20 bill (an opportunity) would be lying on the walk, because, with the assumptions of the efficient market theory, opportunities disappear instantly.[26] However, current reality and economic history show that there are truly many opportunities for individuals who follow their instincts and act on them intelligently.

Industry Analysis

The purpose of industry analysis is to determine what makes an industry attractive and to decide which segments of that industry are the most attractive. This analysis reveals the appropriate strategies and resources to procure or develop. Industry attractiveness is generally indicated either by above-normal profits or high growth, depending on the resources and cost positions of the firms in the industry. For example, hard-to-replicate efficiency levels (resources) lead to high industry profitability, but also make the industry less attractive for inefficient firms. On the other hand, high-growth industries are generally more attractive for less-efficient firms than for efficient firms.[27] Research has shown that some industries are more profitable over the long run than others. Each year, *Fortune* surveys all major industry groups and publishes the data. The results have been remarkably stable over time: One-year results for an industry might be spectacularly bad or good, but overall profitability within that industry is constrained by the industry's characteristics.

The firm's ultimate objective is to earn above-normal profits. It does this in one of two ways: (1) by developing a product that is so distinctive the customer will be willing to pay a price high enough to produce attractive margins, or (2) with a product identical to the competition's that can be produced at a cost low enough to result in attractive margins and profitability. These two strategies are broadly referred to as **differentiation strategy** and **low-cost strategy**, respectively. When a firm pursues either the differentiation or the low-cost strategy for a subsegment of a market (as opposed to the general market), it is using a **focus strategy**.[28]

A comprehensive analytical tool for determining the attractiveness of an industry is the *model of competitive analysis.*[29] This model describes five forces that determine the price/cost relationships within an industry and therefore define the industry's margins. These forces are:

1. The **bargaining power of buyers**
2. The **bargaining power of suppliers**
3. The **threat of** relevant **substitutes**
4. The threat of new entrants into the industry (presence and height of **entry barriers**)
5. The **rivalry** among existing firms (influenced by the other four factors)

Figure 3.2 is a schematic of the five forces at work. The industry under analysis is referred to as the **focal industry** to distinguish it from the buyer, supplier, and substitute industries that exert pressure on it.

Buyer Power

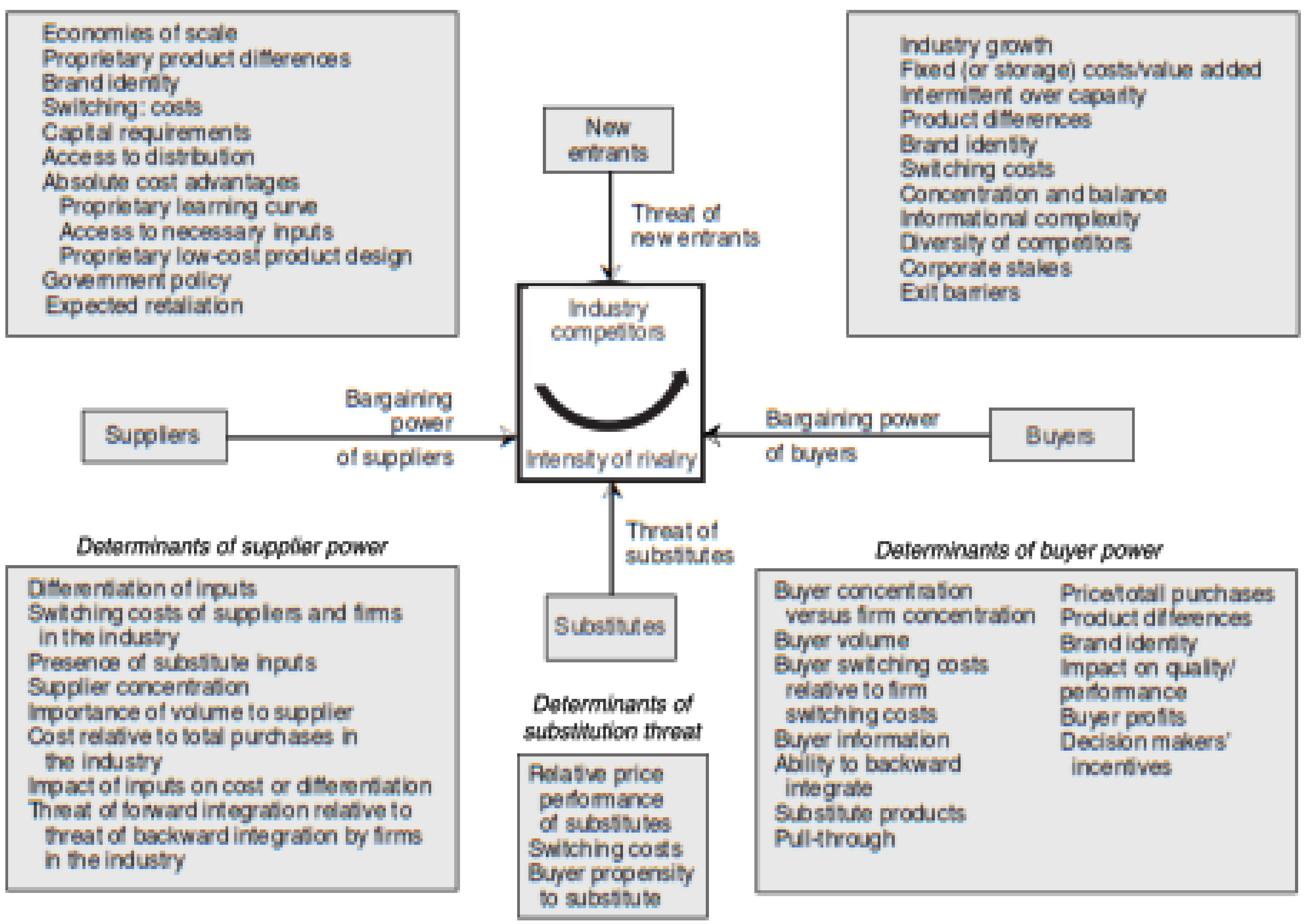
In perfectly competitive markets, buyers or customers have no power other than to accept or reject the product offered. All products are the same, so there is no shopping around for quality, service, or other characteristics. All have the same price, so no haggling is possible. When we relax this condition, we find that in a number of scenarios the buyer has a great deal of bargaining power. The two issues that are dearest to the buyer in bargaining situations are: (1) decreases in price for the product, and (2) increases in the product's quality.

Both of these buyer bargaining positions decrease the producer firm's margins. Price concessions squeeze margins from the revenue side; increases in quality squeeze margins by increasing the seller's costs.[30]

Once the conditions for perfect competition are relaxed, a buyer group can become powerful in several circumstances.

1. *Buyer Group Concentration.* If there are more sellers selling than buyers buying, the natural tendency is for the sellers to reduce prices to make a sale. Even if they do not reduce prices, they offer additional services to make quality improvements to their products, both of which have the effect of squeezing margins. If the buying group makes large purchases, in an absolute as well as a relative sense, it will bargain for volume dis-

FIGURE 3.2 Elements of Industry Structure



SOURCE: Adapted from The Free Press, A Division of Simon & Schuster, from *Competitive Advantage: Creating and Sustaining Superior Performance* by Michael E. Porter. Copyright ©1985 by Michael E. Porter.

counts. The bases for these discounts are: (1) the threat to withhold the order and disrupt production, (2) the lower per-unit costs of billing and shipping large orders, and (3) the lower production costs resulting from long production runs.

2. *Buyer's Costs.* If the products represent a significant share of the buyer's total costs or total income, the buyer becomes extremely price sensitive. When purchases are large, small concessions in price produce large benefits for the buyer. Most consumers are familiar with this situation, because bargaining over the price of cars and homes is the primary consumer bargaining experience. The automobile and residential real estate industries allow people to bargain over the prices of these items because they know their customers are price sensitive owing to the size of the purchase. Consumers bargain a little, but they still pay enough to salvage the sellers' margins.[31]

3. *Similar Products.* If the buyer is indifferent among sellers because the products available for purchase are basically alike, the buyer has power. If buyers can procure alternatives, they naturally look for a reason to buy from a particular seller, and one good reason is a lower price. The implication here is that the selling firm may believe it has a product that should command a premium price because of its high quality and special features. If these features are unimportant or not communicated to the buyer, the buyer will still shop on price.

4. *Switching Costs.* If the buyer faces few switching costs and can shop for price or quality without incurring high transaction costs, the buyer is powerful. Switching costs are costs that lock the buyer into an ongoing relationship with the seller. An example is frequent-flyer miles. Travelers will fly higher-priced, less-convenient air routes to accumulate these miles. The cost of switching airlines is the loss of frequent-flyer miles.[32] Sometimes, high transaction costs also result from switching vendors or searching for information. Faced with these costs, the buyer remains in the current relationship, enabling the seller to maintain profitable margins.

5. *Buyer Income.* The buyer whose profits are low or who has a low income is price sensitive. Price sensitivity increases when the buyer is short of funds, either personal income (for consumers) or profits from operations (for industrial buyers). Rich people sometimes haggle over a price, and purchasing agents of profitable companies search for a penny-saving agreement. More often, though, for the buyer with enough funds, the cost of negotiating a tough deal outweighs the minor savings derived from haggling over price.

6. *Threat of Integration.* If the buyer firm chooses not to purchase in the open market and can make a credible threat to fabricate a product or provide a service itself, it increases its power by gaining bargaining leverage over the sellers in the industry. This factor brings into play the classic make-or-buy decision, and it does so on a strategic level. If the buyer firm can provide the entire product itself, that firm then constitutes a credible threat for full **backward integration**. If it can provide some of the input, the process is known as **tapered integration**. The reasons for increased buyer power are as follows: (1) The buyer can make a take-it-or-leave-it offer to the seller with the full knowledge that if the seller "leaves it," the firm can still supply itself; (2) the buyer knows the actual costs of producing the product or delivering the service and can thus negotiate more effectively down to the seller's reservation price. The major offsetting factor for the sell-

er is the credibility of its threat of **forward integration**.

7. *Indifference to Quality.* If the products or services in an industry are not distinguished by quality, cost becomes a determining factor in consumer choice. In the presence of indifference to quality, the major reason buyers distinguish between sellers is price. Increased price sensitivity causes buyers to shop around and negatively affects the industry's margins.

8. *Full Information.* The more information the buyer group has about product prices, manufacturing costs, comparative product attributes, and the negotiating strategies of sellers, the more bargaining leverage it has. In young industries, where buyers and sellers are new at dealing with one another, certain cost and price data can be kept secret, which makes firms in young industries less likely to face pressure on margins. In mature industries, as firms build up long records and files of information on each other, they are more likely to have full information, causing downward pressure on prices.

Seldom do an industry's products have only one type of buyer. Certainly, for consumer products, market segmentation analysis demonstrates that there are many types of buyers. Each segment possesses its own utility functions and is therefore subject to strategic product-positioning tactics. The same is true in industrial marketing, making **buyer selection strategy** a key decision. Firms strive to hold a portfolio of buyers, each with a different degree of bargaining power. If a firm has only weak buyers, its short-term margins may be good, but the firm is not producing high-quality products and is probably not investing enough in the kind of product improvements and innovation that more powerful buyers demand. These deficiencies make the venture potentially vulnerable to an innovative competitor that produces high-quality products or services. If the venture has only strong buyers in its portfolio, it will have low margins and will always be a captive of its customers. Such a firm is vulnerable to the whims of its customers and to their desire to increase their own profits.

Strategies to manage buyer power are particularly critical to new ventures in the retailing industry. Street Story 3.3 reports on the efforts of a pair of entrepreneurs attempting to reach the pinnacle of retailing—successful placement of their product in Wal-Mart.

Supplier Power

Like buyers, suppliers exert bargaining power over an industry in two ways. Suppliers seek to (1) increase the prices they charge for the products and services they sell, or (2) lower the quality of those products and services to current market-clearing prices. Either of these bargaining objectives has the net effect of squeezing the margins in the focal industry and, other things being equal, making the industry less attractive. If the supplier industry is successful in the use of these tactics, it shifts profits from the focal industry to its own industry, capturing the economic power that the focal industry may have with its own buyers and appropriating the gains. Entrepreneurs who concentrate all their energy and analysis on their buyers and none on the supplier industry may well find that profits are quickly eroded by cost-squeeze pressures.

Supplier power is basically the other side of the buyer-power coin. The same prin-

STREET STORY 3.3

The Write Stuff

For many vendors it represents nirvana: access to 138 million customers every week in 5,300 stores. "They see Wal-Mart and see dollar signs and think they can sell us anything," says Excell La Fayette, Jr., the retailer's director of supplier development. In 2004, 10,000 vendors applied to become new Wal-Mart suppliers, but only 2 percent, or around 200, were selected for trial runs. Approximately one-quarter of those ultimately became official suppliers.

Colin Roche and Bobby Ronsse were two of the lucky ones. In 2001, the former fraternity brothers used $10,000 to found Pacific Writing Instruments, a company that manufactures an ergonomic pen that Roche created when he was in high school. Unlike padded "stick" pens, the PenAgain's wishbone design is powered by the user's index finger, allowing a writer to rest the entire weight of his or her hand between its two prongs. Roche created the pen to combat writer's cramp, but many occupational therapists and physicians now recommend it for patients with arthritis and carpal tunnel syndrome.

Roche and Ronsse have a Web site (www.penagain.com), and have been selling the pen to more than 5,000 independent retailers and to Amazon.com. Their company chalked up sales of $2 million in 2005. But the two entrepreneurs longed to break into national, mass-market distribution, and their attempt to do so provides an interesting illustration of buyer and supplier power—and its pitfalls.

Unfortunately for Pacific Writing Instruments, most of the power during their buyer-supplier negotiations rested with the buyer. Wal-Mart's sheer size provided the group concentration needed to negotiate lower costs. While the PenAgain sells for as much as $12 in some stores, Wal-Mart wanted their almost identical model to retail for $3.76. To produce a product at that price, the supplier had to move production to China. Wal-Mart also required Pacific Writing Instruments to follow specific packaging and labeling guides to help the chain minimize its sorting and display costs.

Wal-Mart, of course, already sells lots of pens, and had previously rejected an instrument similar to the PenAgain. But Roche and Ronsse convinced their chain contact that their pen already had a proven track record, and that they were well on their way to building a brand with name recognition and different versions.

Buyer Wal-Mart kept lowering its costs by granting Pacific Writing Instruments a trial period in which the PenAgain would be stocked in 500 stores, primarily in easy-to-change displays at the ends of aisles, for a period of six weeks. The retailer placed an initial order for 48,000 pens. Even though sales fell short of the 85 percent of stock goal, after 30 days Wal-Mart ordered additional pens for the 150 stores where they sold best.

As a supplier, most of Pacific Writing Instruments' power rests with the fact that their product is relatively unique, and that they have a cadre of users and people who recommend the product who have already purchased 1 million pens during the lifetime of the company. Roche and Ronsse appealed to their e-mail list of 10,000 names to help make their Wal-Mart test successful, and contacted all 150 chapters of their Lambda Chi Alpha fraternity. They also hired a merchant service company to call each of the 500 Wal-Mart department managers and ensure that PenAgain was actually displayed in the aisles. In addition, each day they downloaded sales data for each store from the Wal-Mart vendor site. Roche and Ronsse even personally visited 50 stores. Wal-Mart's La Fayette says they went "probably above and beyond" the retailer's expectations.

The two entrepreneurs are somewhat concerned about backlash from their existing outlets, and have developed a line of special versions of the PenAgain to sell through those vendors, but their chance to more than double their revenue with the Wal-Mart trial makes this risk worthwhile.

You can follow PenAgain's progress by checking its Web site, and by going to www.Walmart.com.

SOURCE: Adapted from Jeanette Borzo, "Follow the Money," *The Wall Street Journal*, September 26, 2005. Retrieved from the Web February 23, 2006, http://www.online.wsj.com/article_print.SB112724418267446432.html, and from Gwendolyn Bounds, "Pen Maker's Trial by Wal-Mart, Part III," *The Wall Street Journal*, July 18, 2006, and www.aipfl.com.

ciples apply, only here the focal industry is the buyer. Suppliers can exert pressure on margins under several conditions.

1. *Supplier Concentration.* When the supplying industry is dominated by a few companies and is more concentrated than the focal industry, suppliers have power.
2. *Role of Substitutes.* Suppliers are powerful when there are few good substitutes for supplying the industry's products. Even large, powerful suppliers cannot maintain high prices and low quality if good substitutes for their products are available.
3. *Purchasing Power.* If the focal industry is not an important customer for the suppliers, the suppliers have power. If the total dollars spent by the focal industry are small relative to the supplying industry's total sales, it will be difficult for the focal industry to obtain price concessions, quality improvements, or extra services such as delivery, warranties, and on-site repair.
4. *Importance of Quality.* When the product or service being purchased is crucial to the success of the industry's product or service, it must be of high quality. Focal industry firms often pay dearly for this high quality. Without substitutes of similar quality, the focal industry can expect cost increases for the product or service, which could severely diminish its profitability.
5. *Switching Costs.* Switching costs prevent buyers from playing suppliers off against each other in an attempt to bargain for price concessions or improvements in quality. These costs are, of course, analogous to the buyer-power conditions mentioned in the preceding section.
6. *Threat of Integration.* Again, the analogy to the buyer-power situation is apparent. If suppliers can do for themselves what the focal industry does, the focal industry cannot expect to exert much bargaining power. For suppliers, this is a use-or-sell decision. They have the option to either sell their input to another firm or use that input themselves to produce a final product. Also, tapered integration, where the supplier uses only some of the input internally, can be used to generate data on costs, which enhances the supplier's bargaining power.

Although there is a tendency to think of suppliers as firms that only sell the entrepreneur goods and services, other supplier industries may require analysis. For example, labor, capital, land, information, and business services are all suppliers. Each can be analyzed using the framework described previously. Every new venture has a portfolio of suppliers—some can be influenced by strategy and some are too powerful to be influenced. **Supplier selection strategy** minimizes the possibility that profits made in output markets will be lost in input decisions.

The Threat of Substitutes

Every industry competes against other industries for customers. Sometimes the competition is fairly direct, as in the case of fiberglass insulation versus rock wool, cellulose, or plastic foam.[33] At other times, the substitute-product rivalry is indirect, though still real. For example, the "eat-at-home" food-processing industry and its distribution chain—grocery stores and supermarkets—compete with the "meals away from home" restaurant industry and all its many segments. At times, it is difficult to tell whether another industry is a factor in determining the pricing power of the company. For exam- ple, does the motor home industry compete with the car, truck, and boat industries, or does it compete with motels located along interstate highways and near campgrounds and parks? Clearly, the substitute product is defined by its function, not by the way it looks, how it is produced, or even what it costs.

It is important for the entrepreneur to understand the nature of substitute products for three reasons. First, when entrepreneurs are the first to market a new product or product type, they sometimes believe they have no competition because "we're the first ones doing this." However, competition often exists in function, and a competitive challenge from a substitute industry is likely to surface. Second, substitutes can limit the potential returns to the focal industry by placing a price ceiling on what the industry can charge. A price may be so high that it will force customers to switch from one industry's product to another's. The more attractive the value of the substitute (its price/performance relationship), the lower the price ceiling will be.

Last, existing firms often disparage the threat of substitutes because of psychological factors that block quick action. For the entrepreneur, this can be an advantage. The entrepreneur usually has a period of time in which to maneuver before established firms recognize a threat.

Entry Barriers

Why is the professor of economics so certain that the $20 bill is not there? Because nothing prevents someone else from picking it up first. There are no entry barriers to the "found $20 opportunity." Entry barriers are a crucial factor for entrepreneurs in analyzing industry structure.[34] The entrepreneur must overcome entry barriers as they currently exist, and later attempt to create entry barriers to prevent others from following and diminishing the found opportunity.

This is again the second **paradox of entrepreneurship** (see Chapter 1). If the entrepreneur can find an industry that is easy to enter, it may be similarly easy for others to enter. The second paradox of entrepreneurship sets what may appear to be a lucrative opportunity against the characteristic low profitability of low-entry barrier businesses. If the entrepreneur finds an industry that is difficult to enter (and by implication profitable), all its profit potential might have to be expended in high initial start-up costs to overcome the barriers.[35] The paradoxical conclusion might therefore be: No profit can be made in an industry with low-entry barriers, and no profit can be made in an industry with high-entry barriers (the conclusion is the same for intermediate situations). Therefore no new firms can make profits. The answer to the paradox is that the new entrant's resources and the strategic differences between new firms and existing firms allow entry and success despite high barriers.

Table 3.5 presents the major entry barriers that face a new venture entering an existing industry. There are two general types: (1) **structural barriers**, which result from the industry's history, technology, and macroenvironment, and (2) **retaliatory barriers**, which are a function of current competitors' anticipated reactions to the new entry.

Structural Barriers to Entry. Structural barriers prevent the entrepreneur from getting started; they represent a lost opportunity. For example, capital investment may be high and out of the reach of most entrepreneurs. Or scientific knowledge may be needed and difficult for entrepreneurs to procure. But retaliatory barriers are even more dangerous to the entrepreneur because they can destroy the entrepreneur's chances of success after a large investment of time, money, and resources.

Retaliatory Barriers to Entry. Usually, when a new firm, especially one that is relatively small, enters an industry, there is little response from that firm's large, well-established competitors. Sometimes, however, entry by a new venture provokes a strong response from larger and more powerful firms. Because retaliation becomes an immediate threat to the survival of the new venture, the owners of new firms should understand when they may provoke retaliation. Large, established firms retaliate primarily under the following three conditions:

1. *When they have a reputation to uphold and a history of retaliation.* Firms that are historically known as aggressive competitors do not want to lose that reputation, even if the competition is a new venture of small size. This is the case because that reputation is an asset (rare, valuable, imperfectly imitable, and nonsubstitutable) that helps protect the competitor from other aggressive strategies and tactics. If the reputation is tarnished, other firms may decide to attack. Microsoft is a company with this type of aggressive position.

2. *If the attack is at the core business.* When a newcomer attacks the core business of an established firm, the attacked firm feels the greatest threat and will most likely retaliate. When the Dr. Pepper soft drink threatened Coke's cola business, Coke developed Mr. Pibb, a Dr. Pepper taste-alike that it could promote (a fighting brand) if need be.

3. *If the entry occurs in a slow-growth industry.* When an industry is growing slowly, in terms of total sales dollars and unit volume, each new entrant takes away a small percentage of sales that an established firm was counting on. The slow-growth industry has the elements of a zero-sum game: Sales garnered by one firm are forever lost to all other firms. Segments of the liquor industry are slow growth, and new entrants are targeted. The tobacco industry would be the same if a new entrant emerged.

Price Cutting. Retaliation can be expected in two additional situations: when the product is commodity-like and when the industry has high fixed costs. Both are likely to cause price-cutting retaliation in an attempt to force the new firm out of business. The

TABLE 3.5 Entry Barriers

Structural Barriers	Retaliatory Barriers
Economies of scale	Competitors' reputation
Excess capacity	Industry history
Product differentiation	Attack on competitors' business
Specific assets	Slow industry growth rate
Capital requirements	Competitors with substantial resources
Switching costs	Price cutting
Access to distribution channels	Legal challenges
Cost disadvantages unrelated to size	

presence of either of these conditions drives the industry price level down to the entry-deterring price, the hypothetical price that will just balance the rewards and cost of entry. In other words, it is the product or service price that makes the entrepreneur forecast zero profits for the proposed new venture. When an industry's prices are below the entry-deterring level, no rational entrepreneur would start a new business in that industry. The existing firms will allow prices to rise again when the threat of entry has subsided. If the threat is persistent, these firms will have to use other methods or concede that their industry imposes low-entry barriers and, therefore, other things being equal, is not an attractive industry in which to be.

In some situations, the small, new venture is protected from entry-deterring price cuts. Table 3.6 lists the factors that both encourage and inhibit the use of price cutting as a competitive tactic. The table illustrates that when price cutting is not likely to work—when it is likely to cause major losses for the price cutter and probably provoke large, existing competitors to follow suit—the new firm can operate under the **price umbrella** of the existing competition without fear of price retaliation.

Legal Challenges to New Ventures. New firms can expect retaliation to take forms other than price cutting, especially when larger firms do not see price cutting as an option. Legal attacks have become a common method of retaliation. The basis for a court battle could be patent, copyright, or trademark infringement, violation of a former-employee noncompete clause, claims of defective products, violation of environmental laws, or, in the case of a foreign new venture entrant, claims of dumping and unfair competition. If we try to start a business called Squids "?" Us, we will see legal retaliation. Toys "R" Us™ owns the property rights to all such names; its policy on this subject appears on its own Web site.

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TABLE 3.6 Factors Affecting Retaliatory Pricing

Encouraging Factors	Discouraging Factors
Elastic demand	Inelastic demand
Cost advantages	No cost advantages
Excess capacity	Tight capacity
Small competitors	Large competitors
New competitors	Long-time rivalry
Single-product markets	Market interdependency

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Rivalry between Firms

An industry with strong buyer power, strong supplier power, good substitutes, and low entry barriers is more competitive than an industry without these forces. Each force, by itself, can cause costs to rise, prices to fall, or both. This cost push or price squeeze reduces the operating margins of the firms in the industry. Reduced margins force less-efficient firms to go out of business (if exit barriers are low),[37] modestly efficient firms to break even, and the most efficient firms to endure low profitability until industry conditions are altered.

The rivalry and competitiveness between firms increase when the other four forces in the model are negative. However, additional conditions lead to rivalry and low industry attractiveness. These conditions focus on the status of the existing firms. Rivalry among firms increases (and, other things being equal, margins and profitability decrease) when the following conditions prevail.

1. *Numerous and Balanced Competitors.* The more competitors there are, the more likely that some of them will "misbehave" by slashing prices and quality. This misbehavior causes problems for everyone. When competitors are balanced and all are about the same size, there is no clear leader in the industry to whom the others can look for direction. An industry leader helps maintain price discipline, and keeps the industry from engaging in destructive price wars.
2. *Slow Industry Growth.* When an industry is growing, there are enough customers to go around and fill most firms' capacity. Slow growth causes firms to compete for customers, either with price decreases or quality increases. Also, as growth slows, the need for advertising may increase, adding an additional expense and hurting margins.
3. *High Fixed Costs.* Firms with high fixed costs have high operating leverage. This means that they need high volumes to break even, but after the break-even point has been reached, each unit they sell adds significantly to their bottom line. Therefore, industries with high fixed costs have strong incentives to fill capacity any way they can. Filling capacity may lead to price cutting. Examples here are the recent histories of the airline and automobile industries.

4. *Commodity-Type Products.* When the product is a commodity, or is perceived by the public as a commodity because the industry cannot differentiate products, pressures for intense price and service competition grow. The absence of switching costs and increased buyer power are related to this condition.[38] It is time to address the *all things being equal* assumption interspersed in our discussion. All things being equal refers to the firm's resource-based strategies. That is, industries are attractive or unattractive for entry without considering the resources the new entrant may bring to the table. The type of resources and the extent to which they possess the four attributes of competitive advantage do make a difference. An unattractive industry might be a profitable opportunity for a firm with a winning configuration of resources. An attractive industry might produce mediocre results for a firm without any resource advantages.

COMPETITOR ANALYSIS

What is the new entrepreneur to do with all of this analysis? The new entrant in an industry must perform a detailed analysis of its competition. The industry analysis, discussed previously, precedes the competitor analysis and is more general. The data required for the industry analysis are aggregated; in their disaggregated (firm-level) form, these data provide the raw material needed to assess the strategy and resource base of the competition. The competitor analysis will be used in the next chapter to develop the strategy for the new venture.

Identifying the Competition

The first step the firm must take in identifying the competition is to determine who the competition is. This step is the equivalent of asking, What business am I in? and What needs does my product or service fulfill for the customer? The competition consists of firms that fill the same customer needs as the new venture, or have the potential to serve those customers. How can the presence of these competitors be determined?

Current competitors can be identified in a number of ways. A direct method is to ask customers (of existing firms) or potential customers (of new ventures) where else they would consider procuring the product or service. Indirect methods include scanning trade and business directories, reading the *Yellow Pages,* and searching the Internet. To discover the larger competitors, the entrepreneur should check *Value Line*, *Standard & Poor's* classifications, and the *Disclosure* database that identifies firms by the U.S. government's four-digit Standard Industrial Classification code http://www.sec.gov/info/edgar/siccodes.htm).[39]

Ranking Competitors

The next step is to evaluate a set of relevant current and potential competitors based on the qualities of their resources. This analysis will give a picture of the competitors' relative strengths and weaknesses and will present a comparative framework, enabling the entrepreneur to position the new venture. Weaker competitors may be attacked head-on. Competitors with characteristics similar to those of the new entrant may be candidates for alliances that would strengthen both firms. Or the entrepreneur may be required to position the new venture around powerful competitors to avoid head-to-head conflict.

A useful tool for competitor analysis is the resource-based grid in Figure 3.3. The grid presents the six types of resources by attribute for each relevant competitor, and requires the entrepreneur to assign a score for each dimension.[40] The entrepreneur's own venture is included in the analysis. In later chapters, we will also use a competitor grid to look at strategies, products, and services.

The initial information derived from the competitor analysis will rank the competitors on each type of resource, producing a grand ranking of all competitors. The next step is to examine how the competitors use their resource bases to confront industry forces. That is, how do the competitors' strategies influence buyer power, supplier power, threats of substitutes, entry barriers, and rivalry among firms? The competitors' strategies are revealed by studying their deployment of resources.[41] This examination enables the entrepreneur to answer the second question posed earlier in the chapter: What is the best way to compete in the industry for the highest profitability? The answer is: *Look for ways to employ one's resource base that reduce the forces threatening firm profitability, and position one's firm for leadership in that area.*

SUMMARY

The business environment can be viewed as a stock of resources: financial, physical, technological, reputational, human, and organizational. The entrepreneur with an effective strategy for acquiring resources can control some of these resources, with others being controlled by competitors and potential competitors. No single entrepreneur can control all the resources. Larger forces are at work, and it is unlikely that the trends in the macroenvironment will be influenced by any single firm.

The entrepreneur must understand the macroenvironment, for it establishes the political, economic, technological, sociodemographic, and ecological rules under which the new firm is created and must operate. The entrepreneur must be able to scan and monitor the macroenvironment and to recognize the contingencies and constraints the macroenvironment imposes. This analysis, however, is not enough for the firm's success.

The entrepreneur must be able to forecast and assess development, using as a knowledge resource the four attributes required for competitive advantage. Also required is the ability to marshal the resources necessary to overcome the constraints or effectively deal with the contingencies.

Understanding the elements and the processes of the competitive market enables us to discover the forces that make an industry attractive to the entrepreneur. These forces are the power of buyers, the power of suppliers, the threat of substitutes, the height of the entry barriers, and the nature of the rivalry between competitors. When buyers and suppliers are powerful, when good substitutes exist for the firm's products, and when entry barriers are low and rivalry is intense, the industry is not attractive because profits are likely to be low.

However, the entrepreneur's resource configuration occasionally enables entry into an unattractive industry. If an entrepreneur can configure his or her resource base and

FIGURE 3.3 Resource-based Competitive Analysis Grid

Instructions: On a scale of 1 through 7, evaluate the competition's resource base. A value of 1 indicates that the firm has absolutely no advantage in the resource area; a value of 4 indicates that the firm possesses about the same resource capabilities as other industry participants. A value of 7 indicates that the firm possesses an absolute advantage in the resource category.

Competitive Analysis Grid

Resource Types and Attributes	Own firm	*Competitors* #1	#2	#3	#4	#5
Physical resources Rare Valuable Hard to copy Nonsubstitutable						
Reputational resources Rare Valuable Hard to copy Nonsubstitutable						
Organizational resources Rare Valuable Hard to copy Nonsubstitutable						
Financial resources Rare Valuable Hard to copy Nonsubstitutable						
Intellectual/human resources Rare Valuable Hard to copy Nonsubstitutable						
Technical resources Rare Valuable Hard to copy Nonsubstitutable						
Total scores						

design a strategy that offsets the profit-reducing forces within an industry, the new venture can achieve a sustainable competitive advantage.

Attractive industries provide opportunities for profitability. The forces that determine rivalry in attractive industries are not strong forces, and the rivalry is not cutthroat. Firms compete on the level of product innovations, advertising, brand loyalty, and distribution channels, a level that enables them to differentiate and position their products. There is little pressure on prices, and increased costs are passed along to the customer as increased value. Operating margins are generous and sufficient for reinvestment and shareholder distributions. An industry characterized by high profitability and good returns to investors is attractive for entry, all things being equal.

KEY TERMS

Assessing
Acyclical
Backward integration
Bargaining power of buyers
Bargaining power of suppliers
Business cycle
Buyer selection strategy
Countercyclical
Cyclical change
Demography
Design patents
Differentiation strategy
Ecology
Entry barrier
Externally stimulated opportunity
Focal industry
Focus strategy
Forecasting
Forward integration
Internally stimulated opportunity
Low-cost strategy
Macroenvironment
Monitoring
Paradox of entrepreneurship
Plant patents
Political risk
Price umbrella
Process innovation
Procyclical
Recognition
Retaliatory barriers to entry
Rivalry
Scanning
Stakeholders
Structural barriers to entry
Structural change
Supplier selection strategy
Sustainable development
Tapered integration
Tariffs
Threat of substitutes
Utility patents
Values