

Threat of Entry

Key Structural Variables Part I.

"New entrants to an industry bring new capacity, the desire to gain market share and other substantial resources. They can bid down prices or inflate costs reducing profitability". Michael Porter



→ Last week we have covered the key Determinants of Buyer's Power

We have finished with all the key determinant factors of competition from the buyers or clients...

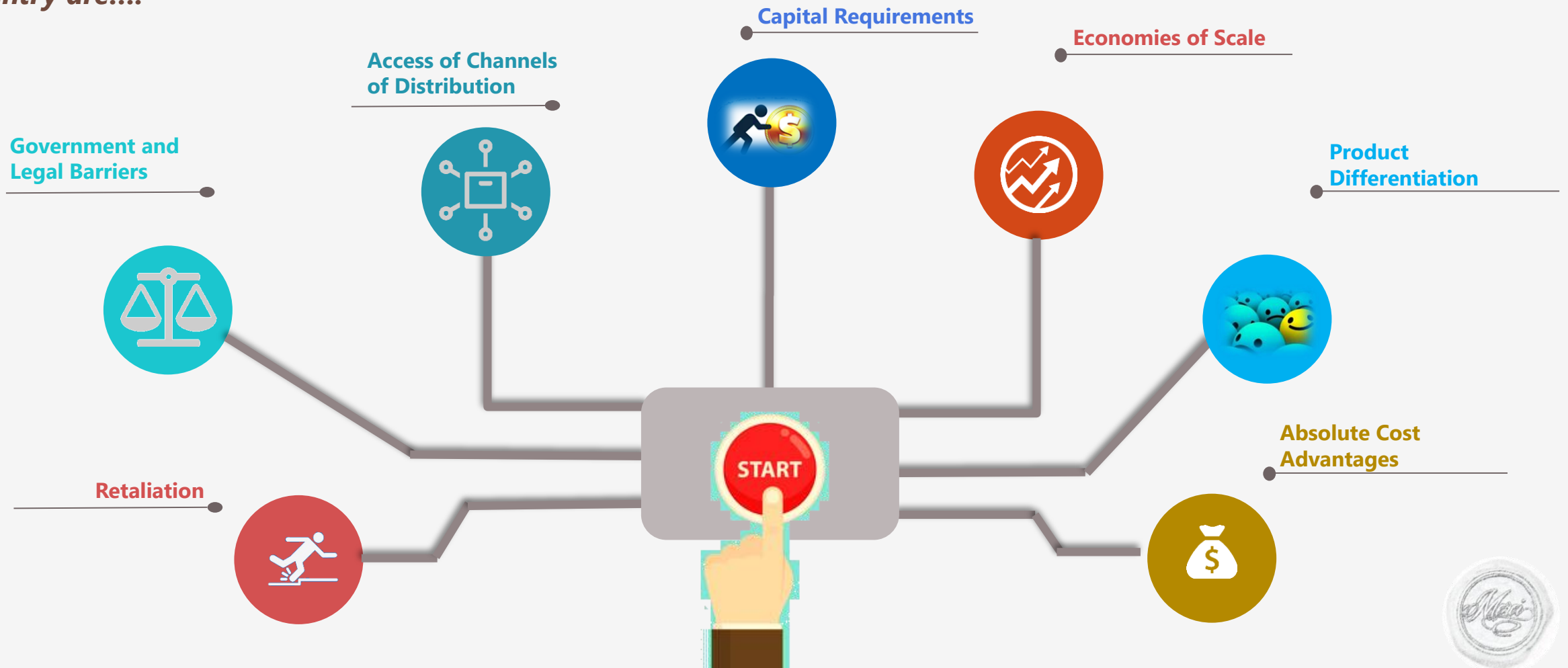


Key Determinants of Buyer's Power	
BARGAINING LEVERAGE or PRICE SENSITIVITY	
1. Differentiation of Products	✓
2. Buyer Switching costs relative to the firm switching costs	✓
3. Presence of Substitute Products	✓
4. Buyer Concentration vs. Firm Concentration	✓
5. Buyer Volume	✓
6. Price/Total Purchases	✓
7. Buyer Information	✓
8. Ability to backward integrate	✓
9. Brand Identity	✓
10. Impact on quality/performance	✓
11. Buyer Profits	✓
12. Decision makers' incentives	✓
13. Pull-Through	✓



→ Threat of Entry. Key Structural Variables

"New entrants cannot enter on equal terms with those of established firms. The principal sources of barriers to entry are...."



→ Threat of Entry. Key Structural Variables

Capital Requirements



1. Capital Requirements

The higher the initial investments to start up a company in a specific industry



The higher the barrier of entry for new incumbents

Examples Capital Requirements



New Chobani Yogurt Manufacturing plant in Idaho (US\$450M)



The higher capital costs for a greenfield transportation metro train in Dehli



Start up costs of franchised fast-food restaurant are modest

Helpful Tips

“The capital costs of becoming established in an industry can be so large as to discourage all but the largest companies”.



→ Threat of Entry. Key Structural Variables

Economies of Scale



2. Economies of Scale

The higher the capital expenditures and research (R&D) intensive costs



The more important is to produce at a very large scale to be cost efficient and breakeven

Examples Economies of Scale



In automobiles, cost efficiency means to sell three million cars/year. BMW R&D for a new model is \$1.5 Billion



AIRBUS spends at least \$10 Billion in R&D for a new product. It needs to sell at least 500 aircrafts to breakeven



Shipping Largest Companies as Maersk

Helpful Tips

"The main source of scale economies is new product development costs. It can be R&D, labor, technology or capital intensive".



➔ Threat of Entry. Key Structural Variables

Absolute Cost Advantages



3. Absolute Cost Advantages

Established companies have cost advantages over entrants



if these advantages are associated with a good and updated business model: raw materials, patents, digital innovation, etc.



“The IoT and new technology trends can become elements of disruption and competitive advantage for new incumbents.”

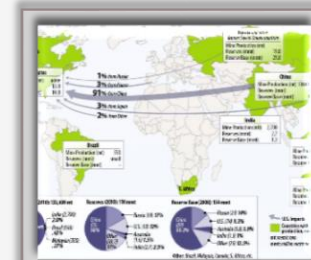
Examples Absolute Cost Advantages



Apple is losing cost advantages vs competitors as Huawei.



Novartis as proprietary of several patents for anticancer drugs

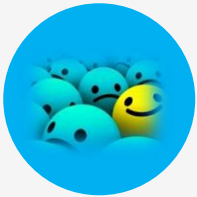


Land Owners of rare materials have higher barriers of entry



→ Threat of Entry. Key Structural Variables

Product Differentiation



“Established firms possess the advantages of brand recognition and customer loyalty”.

**Examples
Product
Differentiation**

4. Product Differentiation

The higher differentiating products of established firms in an industry



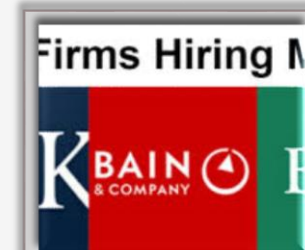
the higher the barrier of entrance for the new incumbents



Johnson & Johnson Baby Care Products



My favorite cosmetic brand: Clarins



The BIG THREE: Boston Consulting Group, Bain and McKinsey

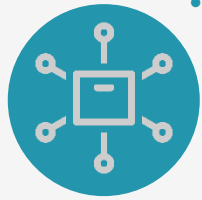
Helpful
Tips

“Product differentiation is perhaps the most important entry barrier in baby care products, over-the-counter drugs, cosmetics, investment banking”.



→ Threat of Entry. Key Structural Variables

Access to Channels of Distribution



- **Internet** ★
- Indirect
- Direct
- Franchising

5. Access to Distribution Channels

The higher the distributors' preferences for established firms' products



The greater the barrier for new entrants to distribution through these channels



"One of the most important competitive impacts of the IoT has been allowing new businesses to circumvent barriers to distribution".

**Examples
Access to
Channels of
Distribution**



Supermarkets have limited shelf space for new products



Subway sandwich shops utilizes franchising



Amazon.com vs
Alibaba.com

→ Threat of Entry. Key Structural Variables

Government and Legal Barriers



6. Government and Legal Barriers

If the business require a government permit to operate



The higher the barrier to entry for new incumbents

Examples Government and Legal Barriers



Telecommunication and TV broadcasting



Banking: New banks are confronted to high barriers of entry through regulators



Pfizer top pharma products are protected by regulatory patents

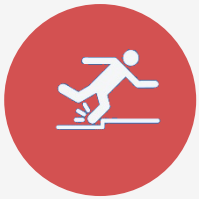


"Firms which require a license by a public authority, patents, copyrights, trade secrets, etc."



→ Threat of Entry. Key Structural Variables

Retaliation



7. Retaliation: Revenge, doing harm on purpose as a barrier of entry

The higher the retaliation barriers in impeding the entry of a new company



The more difficult for the new incumbent to enter the industry and operate

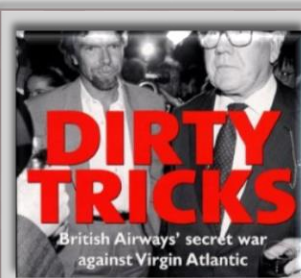


"Retaliation against a new entrant may take the form of aggressive price cutting, increased advertising, sales promotion, blocking a distribution channel or litigation".

Examples Retaliation



Chilean Salmon Dumping prices



Dirty tricks and sabotage to Virgin Airlines operations in the 1990s

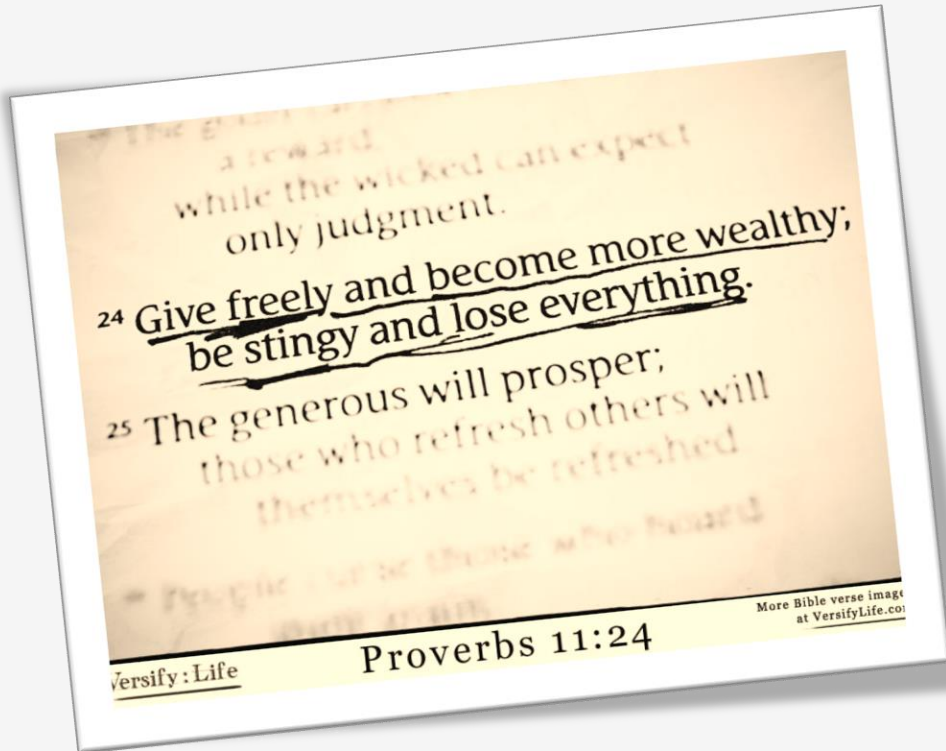


Attacking a new consultant reputation in order to diminish her potential success





Threat of Entry. Key Structural Variables



Thank you for reading me.

Next week I will dig deeper in each of these key structural variables because it is crucial for new incumbents or start-ups to consider effective actions to surpass these barriers. Some hints and tips will be shared.

***Blessings and Thanks again.
Eleonora***

