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Chapter 2: Analysis of the External Environment: Opportunities and Threats

Multiple Choice Questions

1. Which of the following statements is true about customer needs?
A. Companies that meet the need for communication by manufacturing mobile handsets or mobile ham radios are considered part of the same industry.
B. Understanding them can be very helpful in defining the boundaries of an industry.
C. They should be addressed only when many customers have similar needs that require attention.
D. Two firms cannot be considered part of the same industry even if their products do the same job for customers.

   Answer: B
   Level of Difficulty: Moderate
   Section reference: Determining the Right Landscape: Defining a Firm's Industry
   Learning Objective: 2.1
   Bloom's: Comprehension
   AACSB: Analytical thinking

2. Competition among firms within an industry best defines the term _____.
A. substitute
B. threat
C. rivalry
D. opportunity

   Answer: C
   Level of Difficulty: Easy
   Section reference: Five Forces that Shape Average Profitability Within Industries
   Learning Objective: 2.2
   Bloom's: Knowledge
   AACSB: Analytical thinking

3. The companies LaceThings Inc. and BellePrints Corp. sell the same product. They constantly try to outdo each other in terms of resources, price, and customer satisfaction. The companies try to outperform each other in order to gain customer loyalty and generate more sales. This scenario is an example of _____.
A. integration
B. partnership
C. rivalry
D. switching

   Answer: C
   Level of Difficulty: Hard
   Section reference: Five Forces that Shape Average Profitability Within Industries
   Learning Objective: 2.2
   Bloom's: Application

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AACSB: Application of knowledge

4. A product that is fundamentally different yet serves the same function or purpose as another product best defines the term _____.
A. threat
B. substitute
C. opportunity
D. rivalry

Answer: B
Level of Difficulty: Easy
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Knowledge
AACSB: Analytical thinking

5. _____ can be most accurately defined as conditions in the competitive environment that endanger the profitability of a firm.
A. Integrations
B. Weaknesses
C. Threats
D. Rivalries

Answer: C
Level of Difficulty: Easy
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Knowledge
AACSB: Analytical thinking

6. SevenCloud Inc., a soft drink company, provided service to fair amount of customers for a whole year until a new company called Sparkle Inc. came up. Sparkle provided flavored water as a new product in the beverage market. Customers were eager to try out this new product and purchased it because they believed that it a better substitute for aerated beverages. SevenCloud was afraid that if the trend continued, it would soon run the risk of going out of business. In this scenario, which of the following did SevenCloud Inc. experience?
A. Opportunity
B. Threat
C. Weakness
D. Merger

Answer: B
Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Application

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AACSB: Application of knowledge

7. The ways of taking advantage of conditions in the environment to become more profitable most accurately defines the term _____.
A. opportunities
B. standardization
C. strengths
D. substitution

Answer: A
Level of Difficulty: Easy
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Knowledge
AACSB: Analytical thinking

8. Pancake Platter Inc. opens a new breakfast deli in the small town of Lakeville. It makes a lot of profit during its first year because it is the only deli in the area. Customers choose to have breakfast at this deli because their only other options for availing this type of service would be to travel several miles to the next town. This scenario best illustrates _____.
A. substitution
B. rivalry
C. opportunity
D. integration

Answer: C
Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Application
AACSB: Application of knowledge

9. Which of the following statements is true about rivalry?
A. It is an expensive method that treats other companies amicably.
B. It helps increase losses for an organization to a large extent.
C. It is a force that is best avoided in an industry to increase profits.
D. It is an important driving force to increase profitability.

Answer: D
Level of Difficulty: Moderate
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Comprehension
AACSB: Analytical thinking

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10. Which of the following statements is true of a fragmented industry?
A. It is characterized by rivalry that is typically less intense.
B. It usually has very few competitors and tends to be dominated by a few large firms.
C. It is difficult to keep track of the pricing and competitive moves of multiple players.
D. It involves companies selling the same brand of products that are scattered in different locations.

Answer: B
Level of Difficulty: Moderate
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Comprehension
AACSB: Analytical thinking

11. Bright Inc. is a toothpaste manufacturing company that is facing intense competition from its rivals. In order to encourage higher consumption of its products as well as minimize brand switching among its existing consumers, Bright introduced sweepstakes as a consumer sales promotion strategy. However, its rivals retaliated by introducing deals such as a featured price which is lower than the regular price, buy one, get one free offers, and large package offers that give a percentage more free. This scenario best illustrates a _____.
A. primary industry
B. secondary industry
C. fragmented industry
D. concentrated industry

Answer: C
Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Application
AACSB: Application of knowledge

12. Which of the following statements is true about concentrated industries?
A. These industries have few competitors and rivalry is less intense.
B. Smaller competitors usually respond aggressively to actions taken by large firms.
C. Few large competitors are aware of each other's presence and therefore more likely to create conflict.
D. If firms are approximately the same size, they tend to be able to respond, or retaliate, strongly to moves by rival firms.

Answer: A
Level of Difficulty: Moderate
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Comprehension
AACSB: Analytical thinking

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13. The household appliance industry has few major manufacturers like Nebula Corp., Cook Well Inc., and Mercury Corp. and a few smaller manufacturers. There is not much competition in this industry because the smaller companies cannot afford to compete aggressively with the large firms which do not engage in price wars. This scenario best illustrates a _____.
A. quinary industry
B. fragmented industry
C. quaternary industry
D. concentrated industry

Answer: D
Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Application
AACSB: Application of knowledge

14. Which of the following statements is true of standardization of products?
A. It is easier to convince the customers to switch brands.
B. They meet customer needs in unique ways.
C. It makes buyers more loyal to a particular brand.
D. These products are usually inimitable and of high quality.

Answer: A
Level of Difficulty: Moderate
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Comprehension
AACSB: Analytical thinking

15. The computers of Main Frame Inc., a computer company, are manufactured with in-built operating software. The users of this software have avoided using computers manufactured by other companies because that would entail converting their data to the other software. Also, they would have to get used to working smoothly with the other software. From this scenario, we can infer that:
A. the users of Main Frame Inc. have increased power.
B. the switching cost would be higher for the users of Main Frame Inc.
C. the users of Main Frame Inc. have increased industry rivalry tremendously.
D. it is easy for competitors to poach users of Main Frame Inc.

Answer: B
Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Application
AACSB: Application of knowledge

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16. A popular food company, Crunchez Corp., is finding it difficult to retain its buyers as another food company, MidnightSnax Inc., has started to provide the same product with the same taste for a lesser price. Which of the following is a threat to Crunchez Corp.?
A. Cost push inflation
B. Supplier power
C. Switching cost
D. Unused production capacity

Answer: C
Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Application
AACSB: Application of knowledge

17. Zenith Corp., a bag company, produced a lot of high-end leather bags than could be sold in the market for a year. The leather bags eventually wore out and were not fit to be sold, thus causing huge losses for that year. Which of the following did Zenith Corp. most probably experience during that year?
A. Use of full production capacity
B. Unused production capacity
C. High exit barriers
D. Special sales incentives

Answer: A
Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Application
AACSB: Application of knowledge

18. CharmingBells Inc. has been running into a loss gradually, but the board of directors are reluctant to shut the company down because it has invested millions of dollars' worth of equipment which can only be used in that industry. Moreover, the people in CharmingBells Inc. have become emotionally attached to the company and do not want the company completely shut down. This scenario best illustrates _____.
A. high fixed costs
B. used production capacity
C. high exit barriers
D. unused production capacity

Answer: C
Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2

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Bloom's: Application
AACSB: Application of knowledge

19. Royalz Inc. is an automobile company that requires a lot of raw material to manufacture its cars. Royalz Inc. buys these raw materials from other companies that sell car parts as products. From which of the following does Royalz Inc. source its inputs?
A. Producers
B. Customers
C. Suppliers
D. Employees

Answer: C
Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Application
AACSB: Application of knowledge

20. WillowWorks LLC, a retail clothing store, has been sourcing its raw materials from a supplier named ThreadTym Corp. for the last five years. A change of management at ThreadTym resulted in an increase of the prices of the raw materials. As a result, WillowWorks purchases ThreadTym so that it can produce these products on its own. This scenario best illustrates _____.
A. network effect
B. forward integration
C. backward integration
D. switching cost

Answer: C
Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Application
AACSB: Application of knowledge

21. SliderPage Inc., a furniture company, has been trying hard to keep its profits going. SliderPage asked its suppliers to reduce the cost of the raw materials that would be needed to create its products and also tried to buy supplies that are less expensive. Which of the following buyer price sensitivity factors is best illustrated in this scenario?
A. Product is significant proportion of buyer's costs
B. Buyers struggling financially
C. Buyers purchase in large volumes
D. Product does not affect buyers' performance

Answer: B

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Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
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AACSB: Application of knowledge

22. Satchels Corp. has been in the retail bag business for 10 years. It has created unique value and attained brand loyalty from its customers. Recently, a new bag company started up in the same area as Satchels. In order to retain the reputation that it has established and avoid competition with the new company, Satchels introduced a new line of fashion bags, conducted a sale, and also increased its advertising. This made it difficult for the new company to gain profits. This scenario best illustrates _____.
A. forward integration
B. barriers to exit
C. barriers to entry
D. backward integration

Answer: C
Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Application
AACSB: Application of knowledge

23. BlockWood Inc. has been providing raw materials to Couches Corp., a furniture company. The management at Couches recently decided to cut the prices it pays for the raw materials. BlockWood Inc. tried to negotiate a price that would be feasible for both companies, but Couches did not agree to pay more than what they had quoted. As BlockWood Inc. was facing similar difficulties with other buyers too, it eventually stopped supplying raw materials and took to manufacturing furniture instead. This scenario best illustrates _____.
A. barriers to entry
B. barriers to exit
C. backward integration
D. forward integration

Answer: D
Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Application
AACSB: Application of knowledge

24. GetYoung Inc., a cosmetic company, recently launched a beauty bar soap that claims to soften the users' skin, giving it a natural glow, and also make them look up to 5 years younger. A lot of women eagerly tried out this soap and received positive results and thus encouraged their friends to try out the soap. GetYoung Inc. gained

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profits very fast through this word-of-mouth advertising. This scenario best illustrates _____.

A. backward integration
B. forward integration
C. barriers to entry
D. network effects

Answer: D
Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Application
AACSB: Application of knowledge

25. Readmore Publishing House, the publisher of a regional daily, has been slowly losing profits as its readers prefer to get news through the television. A recent study on the readers who made the switch stated that it is more accessible and faster to attain up-to-date news through the television rather than to wait for the next day for an update on current events. Which of the following is Readmore Publishing House is facing?
A. Producer power
B. Network effect
C. Substitute
D. New entrant

Answer: C
Level of Difficulty: Hard
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Application
AACSB: Application of knowledge

26. The airline industry is a profitable industry. The firms in this industry create barriers to entry through patents and regulations in order to reduce the threat of new entrants. It also minimizes the threat of substitutes while keeping rivalry to a minimum. The airline industry can be best categorized as a(n):
A. attractive industry.
B. unattractive industry.
C. fragmented industry.
D. concentrated industry.

Answer: A
Level of Difficulty: Hard
Section reference: Overall Industry Attractiveness
Learning Objective: 2.3
Bloom's: Application
AACSB: Application of knowledge

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27. Hercules Inc. is an high performing steel manufacturing company. Chang, a stakeholder of the company, believes that it is important to protect the company from threats. Hercules Inc. has often struggled to overcome rivalry and product substitutes. Chang claims that if the company constantly keeps a check on itself by creating power over buyers, paying heed to customers' requests, and strengthening its resources and manpower, the company can maintain competitive advantage. Which of the following statements strengthens Chang's claim?
A. The employees feel that a change in functions will also cause a change in benefits that they currently are enjoying, such as flexible hours.
B. The company has overcome much rivalry just as the way it is currently functioning and need not change its method.
C. The other members of the management feel that the company would require sufficient funds to create this change in functioning.
D. The company can face first-time conflicts if it is not well prepared with a sound method to retain competitive advantage.

Answer: D
Level of Difficulty: Hard
Section reference: Overall Industry Attractiveness
Learning Objective: 2.3
Bloom's: Analyze
AACSB: Reflective thinking

28. Products that can be used in tandem with those from another industry best define the term _____.
A. standardized products
B. cannibalizing products
C. complementary products
D. supplementary products

Answer: C
Level of Difficulty: Easy
Section reference: How the General Environment Shapes Firm and Industry Profitability
Learning Objective: 2.4
Bloom's: Knowledge
AACSB: Analytical thinking

29. Smart Waves Inc., a company that sells computers, provides an external hard disk along with its high-end professional laptops. Customers can store extra data in these hard disks without having to purchase them. The offer that Smart Waves provides is an example of _____.
A. complementary products
B. network effects
C. buyer power
D. substitutes

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Answer: A
Level of Difficulty: Hard
Section reference: How the General Environment Shapes Firm and Industry Profitability
Learning Objective: 2.4
Bloom's: Application
AACSB: Application of knowledge

30. MouseTag Inc. has incorporated a new type of technology that has increased the potential of the company by two fold. Its machinery can now work faster and produce more products in a day than any of its previous machines ever could. This has also helped increase the profits of the company. Which of the following trends does this scenario best illustrate?
A. Complementary products
B. Demographic change
C. Technology change
D. Global competitive forces

Answer: C
Level of Difficulty: Hard
Section reference: How the General Environment Shapes Firm and Industry Profitability
Learning Objective: 2.4
Bloom's: Application
AACSB: Application of knowledge

31. Jupiter Bank was one of the first banks to adopt intelligent imaging that helps in classifying, storing, and retrieval of data. It was also among the first to practice virtual banking and transfer data electronically. As such, Jupiter Bank was an early adopter of these new and faster techniques of banking. This helped the bank to gain a large market share which consequently enabled it to generate huge profits. Jupiter Bank yielded such profits because it paid importance to _____.
A. technology changes
B. population demographics
C. legal and regulatory forces
D. general economic conditions

Answer: A
Level of Difficulty: Hard
Section reference: How the General Environment Shapes Firm and Industry Profitability
Learning Objective: 2.4
Bloom's: Application
AACSB: Application of knowledge

32. Summer Corp., a retailer of consumer electronics, has been experiencing high profits because an increasing percentage of the customers have sufficient disposable income

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to afford its products. Similar companies have also experienced a boom in customer demand. Which of the following macroeconomic forces is Summer Corp. experiencing?
A. Currency exchange rate
B. Economic growth
C. Interest rate
D. Inflation

Answer: B
Level of Difficulty: Hard
Section reference: How the General Environment Shapes Firm and Industry Profitability
Learning Objective: 2.4
Bloom's: Application
AACSB: Application of knowledge

33. Leo Corp., an automobile company, experienced an increase in growth rate this year as the company sold its products at a lesser rate due to the economic conditions that the industry recently went through. This has helped the company to attain more investments than before and consequently to invest in new assets, research and development, and new product development. Which of the following macroeconomic forces does this scenario best illustrate?
A. Currency exchange rate
B. Economic growth
C. Inflation
D. Interest rate

Answer: D
Level of Difficulty: Hard
Section reference: How the General Environment Shapes Firm and Industry Profitability
Learning Objective: 2.4
Bloom's: Application
AACSB: Application of knowledge

34. A hardware company named Ace Works Corp. has been going through financial problems because the entire industry experienced a drastic rise in prices. This has made it hard for the company to plan any future investments as it cannot risk the chance of losing more funds. Rather than development, most of the companies in this industry are experiencing an increase in price competition because all of them are competing with each other to gain more market share. Which of the following general economic conditions is Ace Works Corp. experiencing?
A. Inflation
B. Low interest rate
C. Low currency exchange rate
D. Economic growth

Answer: A

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Level of Difficulty: Hard
Section reference: How the General Environment Shapes Firm and Industry Profitability
Learning Objective: 2.4
Bloom's: Application
AACSB: Application of knowledge

35. OneTick Shop Inc. experienced a loss of finances in the small town of Brightland as a lot of people from the town moved to bigger cities in search of jobs. This resulted in a loss of both returning as well as new customers. This scenario primarily reflects _____.
A. regulatory forces
B. global forces
C. environmental forces
D. demographic forces

Answer: D
Level of Difficulty: Hard
Section reference: How the General Environment Shapes Firm and Industry Profitability
Learning Objective: 2.4
Bloom's: Application
AACSB: Application of knowledge

36. The management of GNH Corp., a chemical plant in the city of Werkshore, has promised to take care of its surroundings. It assured to dispose its factory wastes in a way that does not affect the habitat. In order to do so, the company had to go through renovations that allow the plant to take up green initiatives. Which of the following is the source of change for GNH Corp.?
A. Complimentary services
B. Global forces
C. Regulatory forces
D. Natural environment

Answer: D
Level of Difficulty: Hard
Section reference: How the General Environment Shapes Firm and Industry Profitability
Learning Objective: 2.4
Bloom's: Application

AACSB: Application of knowledge

37. CoolDrink Inc., a beverage company, had to change its medical insurance policies because of a new federal law. The new law required all companies with over 50 full-time employees to provide health insurance for their employees. In case these companies are unable to do so, they would have to face penalty. CoolDrink Inc. had to implement changes due to _____.

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A. global forces
B. regulatory forces
C. demographic forces
D. natural forces

Answer: B
Level of Difficulty: Hard
Section reference: How the General Environment Shapes Firm and Industry Profitability
Learning Objective: 2.4
Bloom's: Application
AACSB: Application of knowledge

38. A federal act was passed in the country of Arahonia which changed the way many of the Arahonian industries worked. Most of the firms in Arahonia had to restructure their strategic plans accordingly. This resulted in the larger firms acquiring the smaller ones which did not exit the market altogether. This scenario best illustrates a(n) _____.
A. technology change
B. regulatory force
C. economic change
D. cultural force

Answer: B
Level of Difficulty: Hard
Section reference: How the General Environment Shapes Firm and Industry Profitability
Learning Objective: 2.4
Bloom's: Application
AACSB: Application of knowledge

39. The board of directors of August Inc., a company that provides legal services, has been debating over whether to provide its 99 full-time employees with health insurance. The managers of the firm, however, are considering dropping employee health insurance as a benefit. Which of the following statements strengthens the managers' consideration?
A. The fine that August Inc. would face would be cheaper than the current premiums for health insurance.
B. The Affordable Health Care Act requires firms with over 50 employees to provide health insurance for their workers, or face fines.
C. The federal Affordable Health Care Act, enacted in 2009, mandates that health insurers cover even those with preexisting conditions.
D. The revised policy would help August Inc. erect entry barriers in its industry and change the nature of rivalry in the industry with most of the small firms.

Answer: A
Level of Difficulty: Hard

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Section reference: How the General Environment Shapes Firm and Industry Profitability
Learning Objective: 2.4
Bloom's: Analyze
AACSB: Reflective thinking

40. The residents of the town of Segonon have initiated a campaign to stop the production of aerated beverages by Sip Drink Inc. The community members of Segonon stated that these beverages are causing loss of memory, nausea, and tiredness among the children who consume them regularly, and thus, have urged that the company should be shut down. The community's reaction to Sip Drink's beverages illustrates a _____.
A. regulatory force
B. social force
C. legal force
D. global force

Answer: B
Level of Difficulty: Hard
Section reference: How the General Environment Shapes Firm and Industry Profitability
Learning Objective: 2.4
Bloom's: Application
AACSB: Application of knowledge

Fill in the blanks

41. Barriers that help keep firms using the same supplier or buyer by imposing extra costs for substituting suppliers or buyers are known as _____.

Answer: switching costs
Level of Difficulty: Easy
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Knowledge
AACSB: Analytical thinking

42. A firm that provides products that are inputs to another firm's production process is known as a(n) _____.

Answer: supplier
Level of Difficulty: Easy
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Knowledge
AACSB: Analytical thinking

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Short Answers

43. How do switching costs affect industry rivalry?

    Answer: The lower the switching costs, the easier it is for competitors to poach customers, thereby increasing industry rivalry.
    Level of Difficulty: Moderate
    Section reference: Five Forces that Shape Average Profitability Within Industries
    Learning Objective: 2.2
    Bloom's: Comprehension
    AACSB: Analytical thinking

44. How is buying power related to switching costs?

    Answer: If customers, or buyers, can easily switch firms, then buyers have increased power.
    Level of Difficulty: Moderate
    Section reference: Five Forces that Shape Average Profitability Within Industries
    Learning Objective: 2.2
    Bloom's: Comprehension
    AACSB: Analytical thinking

45. In what way are switching costs a fundamental part of not just rivalry but also the force of new entrants?

    Answer: If buyers can easily switch to new companies attempting to enter the industry, there is a greater threat of new entrants.
    Level of Difficulty: Moderate
    Section reference: Five Forces that Shape Average Profitability Within Industries
    Learning Objective: 2.2
    Bloom's: Comprehension
    AACSB: Analytical thinking

Essay Questions

46. Identify the five forces that shape the profit-making potential of an average firm in an industry. Discuss the basic steps involved in using the five forces analysis tool.

    Answer: Michael Porter, a well-known strategy professor at Harvard, identified five forces that shape the profit-making potential of the average firm in an industry. Those five forces are: (1) rivalry, (2) buyer power, (3) supplier power, (4) threat of new entrants, and (5) threat of substitute products.
    There are three basic steps involved in using the five forces analysis tool:
    • Step 1: Identify the specific factors relevant to each of the five major forces.

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• Step 2: Analyze the strength of each force. To what extent is it shaping the industry's attractiveness?
• Step 3: Estimate the overall strength of the combined five forces to determine the general attractiveness of the industry, the expectation that an average firm in the industry can earn good profits.
Level of Difficulty: Easy
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Knowledge
AACSB: Analytical thinking

47. Define switching costs and the forces that it takes into consideration.

Answer: Switching costs are barriers that help keep firms using the same supplier or buyer by imposing extra costs for switching suppliers or buyers. It includes any cost to the customer for changing brands. Switching costs for buyers are related to the degree of product standardization. Switching costs are a fundamental part of not just rivalry but also the other four forces:
1. Buyer power. If customers, or buyers, can easily switch firms, then buyers have increased power.
2. Supplier power. If firms cannot switch suppliers easily, then suppliers have increased power.
3. New entrants. If buyers can easily switch to new companies attempting to enter the industry, there is a greater threat of new entrants.
4. Substitutes. If buyers can switch to substitute products without much difficulty, firms face an increased threat from those substitutes.
Level of Difficulty: Easy
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Knowledge
AACSB: Analytical thinking

48. Define barriers to entry and briefly mention its characteristics.

Answer: Not all industries are created equal. Industries in which the average firm is making good profits can often be targets, enticing firms from outside those industries to enter. Likewise, quickly growing industries are often attractive, which increases the incentive for outside firms to enter those industries. One of the important tasks for strategists is to identify firms that might enter their industries. New entrants pose a double hazard. First, they typically are anxious to gain market share. Unless the industry is growing quickly, that market share must come at the expense of existing firms. Second, new entrants bring new production capacity, which tends to drive prices down unless demand is growing faster than the increase in supply.
New entrants mean greater rivalry, so existing firms often try to discourage new entrants by building barriers to entry. Barriers to entry means the way organizations make it more difficult for potential entrants to get a foothold in the industry. The higher the barriers to entry, the more difficult it is for potential entrants to get a foothold in the industry, and the more likely that they are to quit or choose to not enter

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in the first place. Likewise, incumbent firms, those already in the industry, often signal new entrants that they are likely to retaliate by slashing prices, increasing advertising, or other competitive moves that help the established firms hold on to their market share. If the threats of retaliation are perceived as credible, potential entrants might decide to stay away.
Level of Difficulty: Moderate
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Comprehension
AACSB: Analytical thinking

49. Explain the reason why substitute products are taken as a threat by firms.

Answer: A substitute is a product that is fundamentally different yet serves the same basic function or purpose as another product. One of the primary problems for the strategist in assessing substitutes is determining what a substitute is and what isn't. It involves determining the boundary of an industry. Generally, something can be considered a substitute if it serves the same function, such as quenching thirst, but does so with a different set of characteristics. If the product has the same basic characteristics and is made using the same general set of inputs, it would be considered part of rivalry, rather than a substitute. In general, substitutes put downward pressure on the price that firms in an industry can charge. The factors that determine the intensity of a threat of substitutes include the awareness and availability of substitutes and their price and performance compared to an industry's products.
Level of Difficulty: Moderate
Section reference: Five Forces that Shape Average Profitability Within Industries
Learning Objective: 2.2
Bloom's: Comprehension
AACSB: Analytical thinking

50. Mention the general environmental factors that can affect the profit potential of a firm. Briefly explain the factors of technological change and social/cultural forces.

Answer: The eight categories that help shape the general environment are:
• Complementary products or services
• Technological change
• General economic conditions
• Population demographics
• Ecological/natural environment
• Global competitive forces
• Political, legal, and regulatory forces
• Social/cultural forces
Technological change within an industry has the potential to radically reshape a firm's landscape, and sometimes society with it. Technological changes can include new products, such as smart phones; new processes, such as hydraulic fracturing (fracking), which has dramatically increased the output of the natural gas industry; or new materials, such as lithium batteries, which make electric automobiles possible. In many industries, the pace of technological change has accelerated over the last couple

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of decades. Managers find it increasingly important to consistently scan the environment to locate potential new technologies that might affect their industries. Not only can technology change the nature of rivalry in an industry by giving some firms an upper hand in gaining market share, but it also can often lower barriers to entry.
Social forces refer to society's cultural values and norms, or attitudes. Values and attitudes are so fundamental that they often affect the other six general environmental forces, shaping the overall landscape in which firms compete. Like the other environmental forces, however, social forces can create opportunities if a firm happens to be among the first to act on changes in values and attitudes. Social forces are different, sometimes radically so, in different countries. Firms that compete in a global industry must understand differences among consumers in each country they serve.
Level of Difficulty: Moderate
Section reference: How the General Environment Shapes Firm and Industry Profitability
Learning Objective: 2.4
Bloom's: Comprehension
AACSB: Analytical thinking

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