

Introduction

This video is the second in a two-part series on industry analysis. The first video introduced the framework, this video shows you how to generate insight from the framework.

Once we understand the six competitive forces that shape industry profitability, we can then use the industry analysis framework to generate strategic insights. In other words, we shift from knowing something about the industry to knowing what to do about it.

The airline industry

Let's use the example of the airline industry. Buyers are business and personal travel passengers who need to travel from point A to point B as quickly as possible. Buyers hire airlines to fly them where they need to go quickly and safely.

Rivalry among existing airlines is quite high and keeps profits low. There are numerous airlines that compete for each route, so customers typically have multiple options. Additionally, there are few differentiators between airlines, so customers are more likely to focus on price differences. Fixed costs are also very high for each flight, giving airlines incentive to fill every seat, even if that means dropping prices on certain routes. Thus, rivalry keeps strong downward pressure on industry profits.

There is also a reasonably high threat of new entrants into the airline industry. It is relatively easy for a new airline to get gate space at some airports, acquire planes and financing for their planes, and capture market share in their specific routes. The industry has seen many new airline entrants over the last few decades including JetBlue, Frontier, and so forth. New entrants keep downward pressure on fares because if airlines keep fares high on any particular routes then new entrants have incentive to enter those routes and try to capture market share with lower prices. Thus, the threat of new entrants keeps downward pressure on industry profits.

We generally expect buyers to have a great deal of power in this industry, keeping a strong downward pressure on industry profits. In general, there is not much brand loyalty in the industry, and there are few switching costs for customers between airlines. Additionally, customers tend to have many options for air travel, meaning that they can shop for the best price for the route they need. While any individual customer cannot negotiate for lower fares, customers collectively can vote with their dollars by going to the airline with the best fares. This keeps strong downward pressure on airfares and industry profits.

We also generally expect suppliers to have a great deal of power. Suppliers include airplane manufacturers, engine manufacturers, airports, fuel suppliers and employees (pilots and flight attendants). The airplane manufacturers are extremely concentrated (really only two viable manufacturers for large commercial airlines in 2019), and only a few engine suppliers. Given airlines' reliance on particular airplane models they have reasonably high switching costs when trying to change suppliers. Airports have local monopolies because there is often only one airport in a particular

geographical area - airports can effectively charge whatever prices they want for access to their geography. And, as of 2019 there is a significant pilot shortage in the airline industry, giving pilots significant bargaining power relative to the airlines. Supplier power, then, also keeps strong upward pressure on industry costs and downward pressure on industry profits.

Fortunately, the threat of substitutes is generally low. There is currently no effective substitute for air travel, especially for very long hauls. Customers could drive, take a train, take a bus, or a boat, but these alternative forms of travel are often slower and may be less cost effective. For business travelers who travel for face-to-face interactions the increased availability of high-quality video conferencing may provide a substitute for travel, but this does not seem to yet provide a great threat to the airline industry. Thus, substitutes do not seem to limit industry profitability.

Compliments for air travel include major sporting events, conferences, concerts, festivals, and so forth. These are activities that require physical presence to fully appreciate and as customers desire to attend these activities, they will also need to purchase airfare. It is not clear whether the prevalence of complements overcomes the other threats to industry profits.

All in all, this seems like a very unprofitable industry. But, what does this mean for actual strategic decisions?

Use industry analysis to make decisions

Well, let's first think about what our analysis means for us if we are a current airline, or a *current competitor* in this industry. If we are currently in the industry, then we have a high fixed cost investment and it is very costly to exit. Thus, we are likely to make investments geared towards sticking it out and trying to be successful. Our analysis reveals many key weaknesses in the industry, so we may consider what we can do to counter some of these weaknesses.

For example, buyers tend to have very high power. So, we may explore whether there are ways to shift the power dynamic in our relationships with our customers. Are there ways to enhance the extent to which customers prefer us over our competitors? If we simply add features like better Wi-Fi, better screens or more comfortable seats then our competitors can match our moves and negate their benefit. But a frequent flier program may help. If airlines reward passengers for repeat purchases and cumulative travel on their airline, then they can potentially lock customers into their offerings when they travel.

Delta, for example, offers seat upgrades for frequent fliers who have achieved certain status levels in their program along with other perks and benefits such as free entry into airline clubs, memberships to TSA Pre, CLEAR and Global Entry, and access to premium snacks and services. Once frequent fliers achieve certain status levels then the benefits of flying on Delta are much greater than flying on a rival airline where they do not have the same status. In many cases these frequent fliers are even willing to

pay more to fly on Delta both because they get the benefits of their status when they fly AND because more flying on Delta increases their status in the program. Thus, creating a well-designed frequent flier program may be one way for airlines to reduce the extent of direct price-based competition in ways that all airlines can win while simultaneously creating more value for these frequent fliers.

To summarize, if we did an industry analysis and found that buyers have a lot of power, we might record this as a key insight. Then, as a current airline, we might consider various recommendations for how we, as a company, might shift that power more in our favor.

But if we are a potential *entrant* to the industry our approach may be a bit different. Typically, if the industry analysis suggests a very profitable industry it also means that the industry is going to be VERY hard to get into as an entrant. Thus, the best-looking industries on paper are also often the hardest industries to enter. If we want to enter really attractive industries, then we might look for back doors or secret passages.

For example, are there any customers that are under-served by the current industry, or are there small subsets of customers whose needs seem to be distinct from the broader set of customers? Maybe we can enter and target these customers with a niche offering that helps us get an initial foothold in an otherwise difficult industry to enter. Alternatively, we may have some new technology that allows us to offer a superior product, or we may have some new business model that allows us to do a similar job for customers in a different way. The key point here is that an entrant may do an industry analysis to understand the barriers to entry in an attractive industry and then systematically search for weaknesses in those barriers.

In contrast, the least profitable industries are often much easier to enter, but a lot less attractive. Who wants to spend a lot of money to enter an unprofitable industry? This certainly seems to be the case in the airline industry. So, if we are thinking about entering this relatively unprofitable industry, we may use the industry analysis to reveal opportunities to enter without the same industry pressures. So, for example, we may examine airline routes that are under-served by existing airlines, and that they are unlikely to want to occupy. This is precisely how Southwest Airlines initially entered the market. When every major airline was using a hub-and-spoke model, Southwest did point-to-point routes for small regional airports to give a small subset of passengers direct flights between these small locations. Thus, they entered a whitespace in the industry where they did not have any head-to-head competition.

Or, we may identify a subset of customers that may be willing to pay a premium for some unique service. Airlines in 2018 started significantly reducing passenger abilities to bring pets with them on planes, but significant growth in the pet industry in years preceding 2018 suggests that individuals are less and less price sensitive on products and services for their pets. Maybe there is a small subset of customers who would be willing to pay premium prices for an airline that accommodates their pet travel. This is likely a space where traditional airlines do not want to compete, so a potential whitespace

in the airline industry where a new entrant could enter with unique value that does not require a low-price offering. Entering in this way might bypass one of the key weaknesses of the existing industry.

Conclusion

Hopefully this video helps you see some ways that you can use industry analysis to generate key insights that can drive strategic decisions both for existing competitors in an industry as well as potential entrants to an industry. There are certainly many other ways that you may use industry analysis to generate insights, this is only one illustrative example to show you how you can think carefully about finding insights from industry analysis.